

Surging energy prices further catalysed by OPEC+

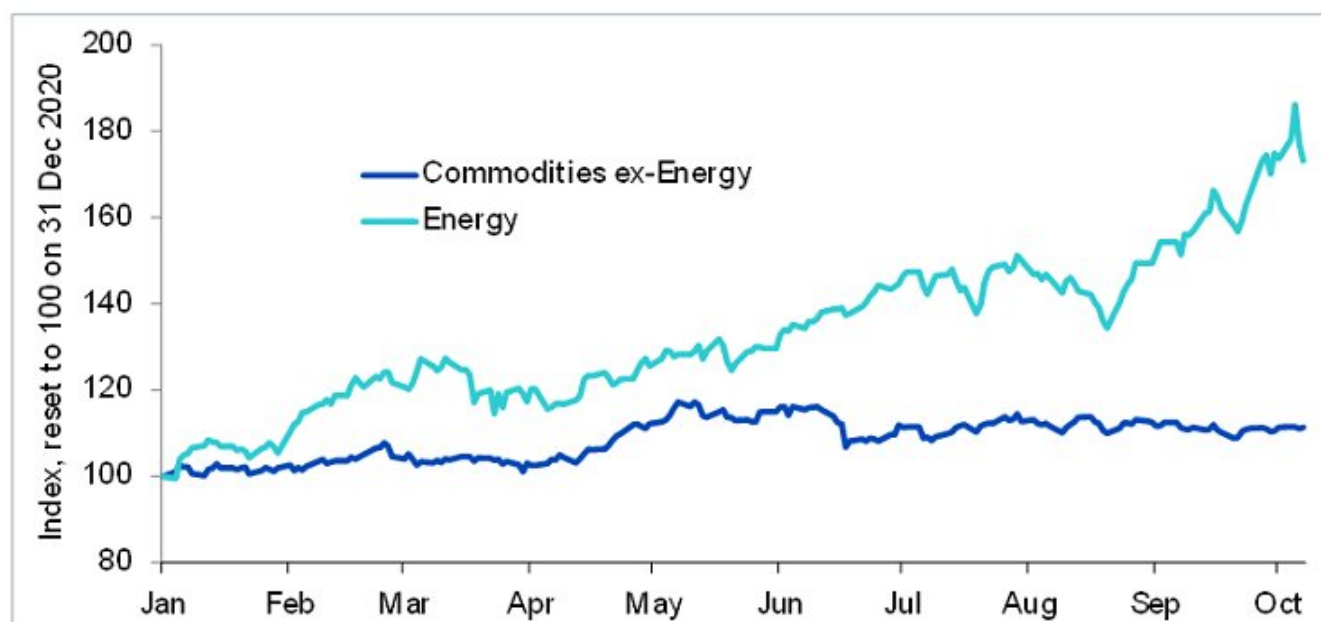
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Energy markets are creating headlines. As of 07 October, the Bloomberg Energy Subindex is up around 73% year to date¹ (see figure below), with contributions from across the basket. What's driving the individual commodities, how are their stories intertwined, and what might be the risks on the horizon?

Figure 1: Energy prices have diverged meaningfully from other commodities this year



Source: WisdomTree, Bloomberg. Data as of 07 October 2021. Energy is the Bloomberg Energy Subindex, and Commodities ex-Energy is the Bloomberg exEnergy Subindex. Total Return Indices in USD used.

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Following their meeting on 04 October, the Organisation of the Petroleum Exporting Countries and its partners (OPEC+) have decided against increasing the rate of supply additions. Earlier in the summer, the group agreed to increase production by 400,000 barrels per day (b/d) each month between August 2021 through 2022 – the aim being to bring production back to pre-pandemic levels by the end. The initial reaction in oil markets was that Brent surged past \$80/barrel – its highest level since October 2018, while WTI also came close to \$80/barrel, its highest level since 2014.

OPEC+ do not see a clear case for increasing the rate of supply given the risk of Covid derailing demand recovery over the winter. If this risk does not manifest, however, and demand growth is faster than the current rate of supply growth, oil prices may gain further momentum. The initial reaction of oil prices to the group's decision suggests a broad expectation for the supply rate to be increased. Additional supply would not only have served to plug the gap created by Hurricane Ida, which took 1.9 million barrels per day (mb/d) offline from US supply in August² but would also have helped quench the higher fossil fuel demand given lower output from wind and solar in many parts of the world, including Europe.

What about natural gas? Prices have been on a tear this year. It started with high electricity demand from fossil fuels over the summer. This is because renewables have not received optimal conditions, particularly in Europe and China this year. As a result, the two regions have competed for liquefied natural gas in international markets. When Hurricane Ida struck the US in August, more than 90% of natural gas production in the Federal Offshore Gulf of Mexico (GOM) went offline³. And while European natural gas prices have retreated since President Putin's suggestion that Russia could solve Europe's gas problem, a very cold winter could create further upside risk for natural gas prices.

Key developments to look out for in the energy space would be:

1. Will Russia alleviate Europe's gas shortages;
2. Might the OPEC+ meet before their next scheduled meeting in November and increase supply to control prices; and
3. Will we see more extreme weather conditions leading up to and during winter?

It would, therefore, not be unreasonable to expect more volatility in energy prices in the coming weeks.

1 Bloomberg. Based on USD total return.

2 International Energy Agency

3 US Energy Information Administration

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