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# PRE-OPEC MEETING NOTE: OPEC TO RESTORE BRENT BACKWARDATION?

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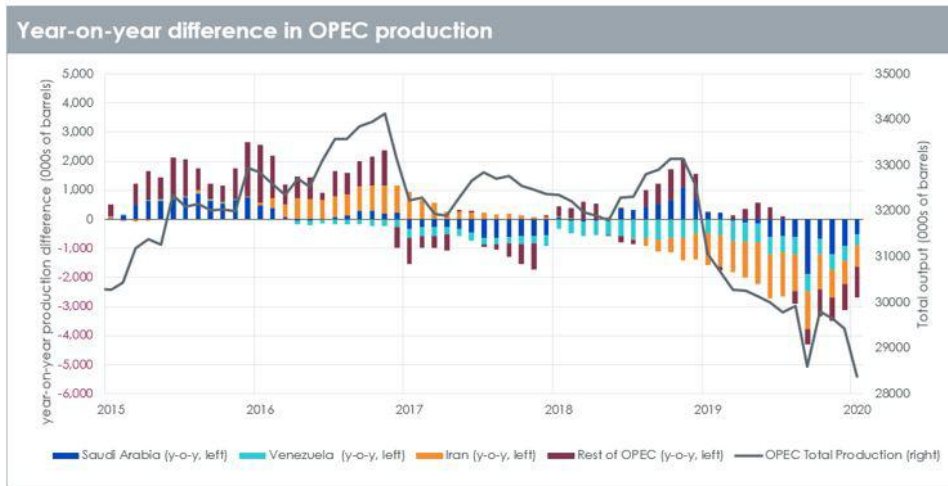
## Coronavirus is hurting global oil demand

With close to half the population of China facing various forms of lock-down due to the coronavirus<sup>1</sup> and many other parts of the world becoming affected (notably, Korea and Italy, where cases are growing at a rate that has taken many by surprise), the market is understandably scared that demand for crude oil will fall hard this year. Brent oil prices have fallen from a peak of US\$68/barrel in the first week of January to US\$56/barrel currently (24/02/2020).

Getting clear data on how much demand has already declined is difficult as data is already clouded by the lunar New Year (seasonally adjusting this data is fraught with difficulty). But we know that a sharp decline in flights, road journeys and factory activity (which can all be anecdotally monitored using satellites and thermal imagery) are likely to dent the demand for fuel. In the 3rd February release of the Caixin China Manufacturing Purchasing Managers' Index (PMI) press release, there wasn't even a mention of the word 'virus'. The PMI level was above the 50 demarcations between expansion and contraction. We expect the March 3rd release for February to be very different. We would be surprised if manufacturing is able to expand in current circumstances.

## OPEC stands ready to act

The Organization of Petroleum Exporting Countries and its allies (OPEC+), which collectively controls around 60% of global oil production recognises the issue. The Joint Technical Committee has already recommended to the group to cut 600k barrels of oil per day<sup>2</sup>. That's on top of the 2.1 million barrel cut (relative to October 2018) that is already in place. OPEC policy ministers are due to meet on 5th March and the larger group on 6th March. We expect them to not only endorse this recommendation, but cut deeper. In part, that is because more data on the grim situation now will be available than when the technical committee met a few weeks ago. Saudi Arabia has historically taken on voluntary cuts that go beyond what they formally sign up to do. In the last policy meeting - the first for the new Saudi Energy Minister, Prince Abdulaziz bin Salman - Saudi Arabia announced the value of the intended voluntary cuts. As long as other countries sign up to cut a little, Saudi Arabia stands ready to cut enough to balance markets.

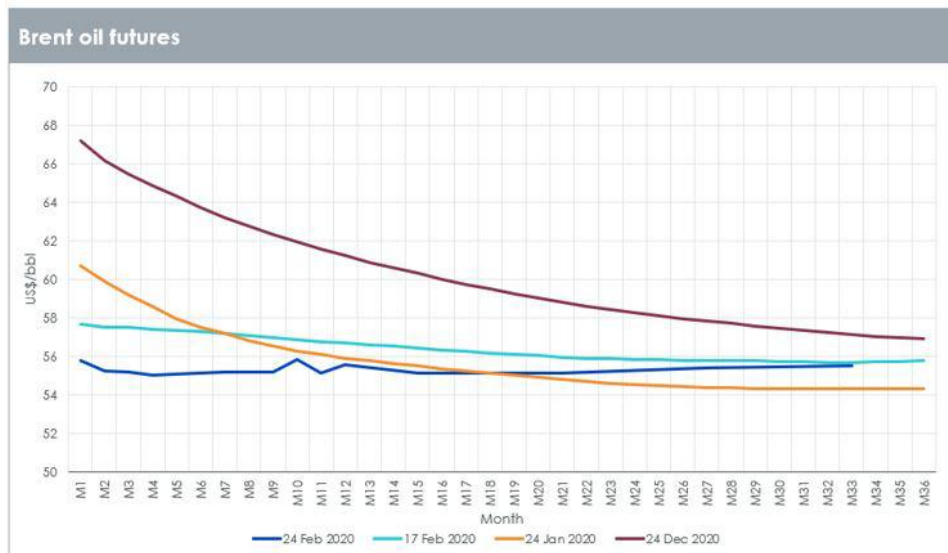


Source: Bloomberg, WisdomTree, data available as of close 24 February 2020. OPEC = Organization of Petroleum Exporting Countries

**Historical performance is not an indication of future performance and any investments may go down in value.**

**Brent futures curve only just in backwardation<sup>3</sup>**

We believe that the backwardation in the Brent oil futures curve is generated by the fact that OPEC is ready to intervene. However, at the time of writing, that backwardation is close to evaporating. If OPEC cuts deeper than 600k barrels per day, we believe that stronger backwardation can be restored. Rolls yields can be an important component of returns for investors. For example, we estimate that out of the +34% return on the Bloomberg Brent Commodity Subindex (totalreturn series), +8% came from roll yield<sup>4</sup> (WisdomTree calculation from 31/12/2018 to 31/12/2019).



Source: Bloomberg, WisdomTree, data available as of close 24 February 2020

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It's rare to see an OPEC meeting without drama, intrigue and suspense. Meetings often don't end on time (or even on the scheduled day). So, it goes without question that we will send an update after the event to say what happened and the market's reaction.

<sup>1</sup> New York Times, 17 February 2020: "At least 760 million people – slightly over half the country's population – are under various kinds of lockdown."

<sup>2</sup> 6th February 2020.

<sup>3</sup> Backwardation refers to a situation in which the spot or cash price of a commodity is higher than the forward price.

<sup>4</sup> As there is no spot series, we estimate this using the roll method applied by Bloomberg.

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