
OPEC PROVIDES MARKETS AN UPSIDE SURPRISE

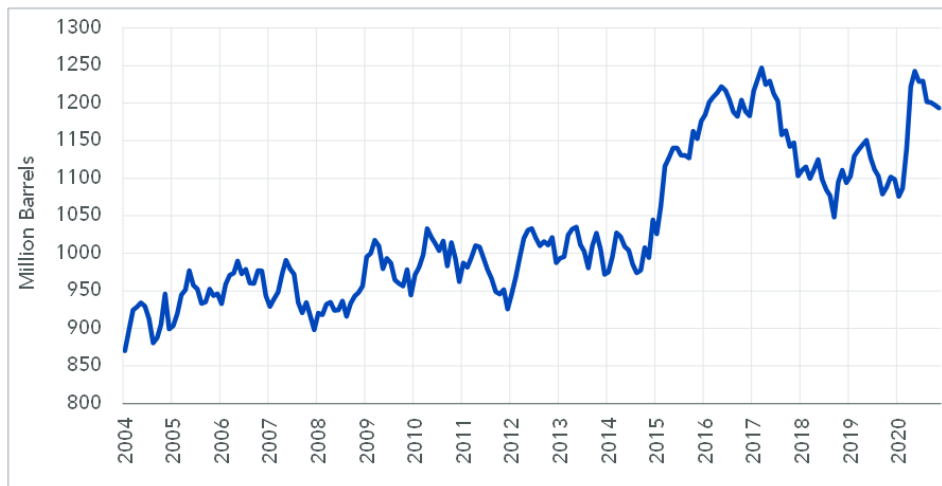
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- OPEC+'s surprise policy outcome has been a boost for WTI and Brent, with both crude oil benchmarks rising over 5% on 4th March 2021¹ after the meeting.
- If they maintain such production tightness, oil prices could rise further, as global oil inventory could decline further.
- The key question is whether OPEC+ will maintain such a tight policy in the coming months as the group is continually giving away market share.
- For now, oil markets remain in backwardation, providing oil investors with a positive roll yield in addition to rising spot prices.

Oil inventory to continue to decline

Against market expectations, the Organisation of Petroleum Exporting Countries (OPEC) and its partner countries (combined together as OPEC+) decided to keep production flat going into April 2021, instead of beginning to taper down its 7.1 million barrels per day production restraint. The fact that OPEC ministers come out of their policy meeting with a firm resolve to keep the markets tight contrast sharply with where they were this time last year. In March 2020, OPEC+ failed to reach any agreement and flooded the market with excess supply when demand was falling sharply. Today, demand is recovering. In fact, OPEC's overall discipline in maintaining its quotas leaves the market in a supply deficit (i.e. we are consuming more we are producing each month). Therefore, the Organisation for Economic Co-operation and Development (OECD) oil inventory is declining. The OECD oil inventory may not be back at average levels yet, but if OPEC maintains this degree of tightness, we could get back to 2019 inventory levels during this year.

Figure 1: OECD Oil Inventory



Source: Bloomberg, data as of 04 March 2021.

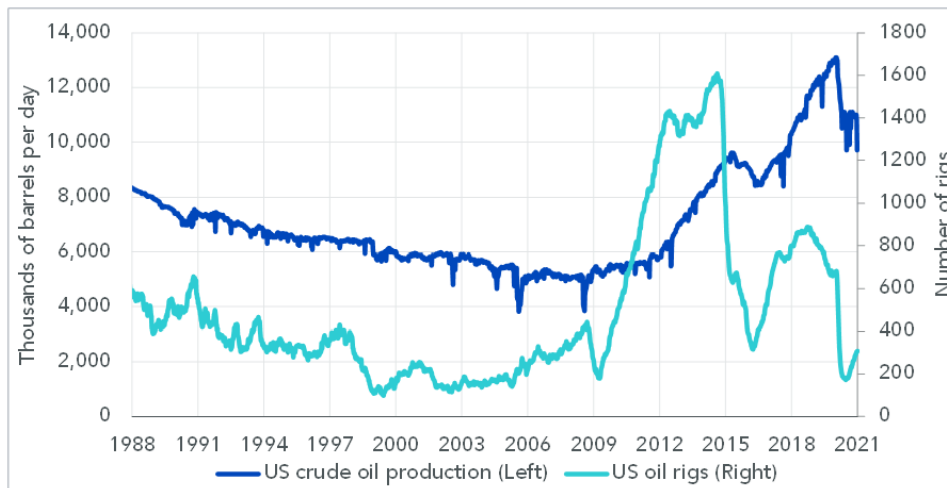
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An increase in US market share will test OPEC+'s resolve

We, and the market, had expected OPEC+ to reap some of the fruits of its labour from prior months and raise production a little to improve their revenue generation from oil production and stop giving away market share to countries like the US. In fact, Russia's position going into this meeting was just that: it wanted higher production levels. However, Saudi Arabia wanted to remain more conservative. It looks like Saudi Arabia has won this time. Without any increase in production, we believe global markets will remain tight, and oil prices could rise further. Now there are several caveats: (1) OPEC+ now undertake monthly production decisions, and so in their next meeting, they could raise production by a higher degree; (2) the incentive to 'cheat' is that much higher today. On this latter point, Russia had been producing over its quota and relied on Saudi Arabia to cut more than its fair share to compensate. It's questionable whether we can rely on this mechanism forever.

Oil drilling rig counts in the US had been increasing in recent months, and so had production and exports (barring the big freeze disruption). If OPEC maintains such tight restraint, US production could continue to rise further.

Figure 2: US oil production and rig count



Source: Bloomberg, WisdomTree. Data from February 1988 to February 2021

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Crude oil in backwardation provides a further tailwind for oil investors

Both Brent and WTI futures are in sharp backwardation², providing a positive roll yield for investors. For example, the May WTI contract is priced almost \$0.50 higher than the June WTI contract (up from \$0.40 a month ago), and the May Brent contract is priced almost \$0.60 higher than the June Brent contract (up from \$0.63 a month ago)³. If OPEC maintains this tight policy, we could see this curve structure maintained.

Sources

¹ WisdomTree, Bloomberg. From 3rd March 2021 to 4th March 2021. In US Dollars using the front month contract for WTI (WTI CRUDE FUTURE Apr21) and Brent Crude Oil (BRENT CRUDE FUTURE May21).

² For more information on contango and backwardation please see [Commodity ETPs Are Exposed To Futures Contracts Not The Physical Spot. Why Does It Matter?](#), May 2020

³ Bloomberg data 4 March 2021

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