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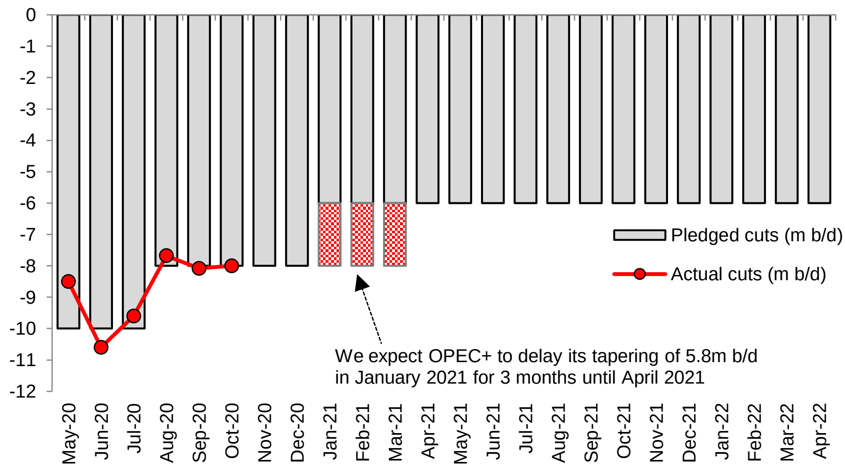
OPEC+ meeting preview – base case: 3 months delayed tapering of existing cuts

- MUFG's base case for the OPEC+ 30 November/1 December meeting: a delay of the planned 1.9m b/d January output increase by 3 months to April. OPEC+ is in a spot of bother. Navigating the wedge between the push-and-pull stemming from rising virus cases on both sides of the Atlantic on the one hand, and vaccine efficacy news as well as the phoenix-like return of Libyan crude to global oil markets on the other hand, is a tall order. Taking this into consideration, we believe the group will err on the side of caution and heed the market's anxieties stemming from the virus resurgence. As such, on balance, a 3 month delay to April provides the group breathing space to adjust its reaction function to market conditions once the COVID-19 winter speed bump is behind us.
- Despite OPEC's technical panel recommending a fairly plain vanilla freeze in cuts for 3-6 months, we view emerging robust vaccine efficacy developments, alongside diverging Saudi and Russian oil strategies, will soften the need for an extension north of 3 months. Saudi Arabia has been a stern advocate and "hawk" in propping up prices by sticking to the prevailing OPEC+ agreement given its fiscal budgetary requirements (breakeven oil prices are north of USD70/b). Meanwhile, the encouraging vaccine developments may convince Russia – which prefers a "wait-and-see" approach being able to stomach lower prices with its fiscal breakeven ~USD45/b – that a long extension of the current cuts may not be warranted. On net, these considerations gives us conviction that the compromise of a 3 month rollover will be the most agreeable outcome.
- Oil price implications. We do not anticipate much price action post-meeting given that a 3 months extension is baked in. Beyond the decision, the group's communication strategy will be central in determining the near-term direction of oil prices. The more united, coherent and coordinated (and less fudge and ambiguity) the group's messaging will be, the greater the prospects of markets being wowed (and vice versa).

OPEC+ COMPLIANCE WITH ITS PLEDGED CUTS HAVE BEEN IMPRESSIVE

OPEC+ AGREED 3 PHASES OF PRODUCTION CUTS AND ACTUAL CUTS (M B/D)



Source: Bloomberg, OPEC, S&P Global, MUFG Research

OPEC+ meeting preview – base case: 3 months delayed tapering of existing cuts

OPEC+ expected to delay its tapering cuts for 3 months until April 2021

OPEC+ meets on 30 November and 1 December with a host of uncertainties in its in-tray. Virus uncertainty, lockdown headlines, low trading volumes, a still high level of inventories and the aftermath of the US election are all confronting the group when it meets. Taking this into consideration, we believe the group will err on the side of caution and heed the market's anxieties stemming from the virus resurgence. As such, our base case is that the group will a delay the planned 1.9m b/d January output increase by 3 months to April. We believe this will provide the group breathing space to adjust its reaction function to market conditions once the COVID-19 winter speed bump is behind us.

Demand picture still bleak

Oil markets have stabilised since the start of November, with Brent crude trading near its two month upper trading limit of ~USD43-44/b spurred by the encouraging vaccine efficacy news from Pfizer and its partners as well as from Moderna, and increasingly amid expectations that OPEC+ will respond to pressure and delay its next phase of production cuts for 3 months. With COVID-19 cases still reaching new records almost every day, many countries, particularly on both sides of the Atlantic, have ordered new lockdowns, hampering global oil demand.

Oil markets to pivot to a surplus in December before return back to a deficit in early 2021

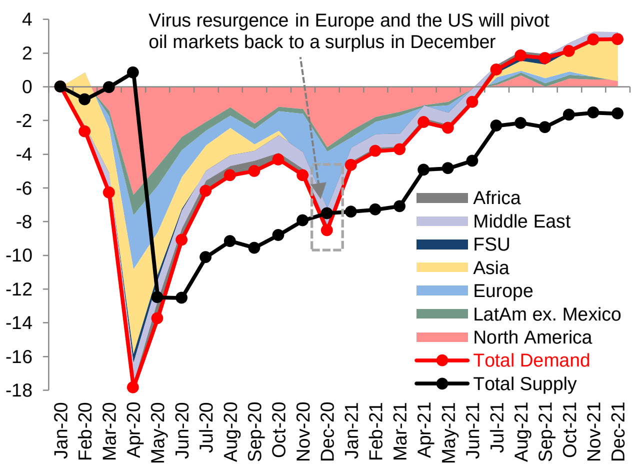
The initial design of the OPEC+ deal signed in April set up a 3 stage process of production cuts set to last until April 2022. The commitment to rebalance the market and significantly draw down global inventories remains impressively robust. The supply cuts led by OPEC+ have been successful in supporting Brent crude oil prices north of USD40/b despite the steepest demand shock in the industry's history. However, given the expected 0.7m b/d year-end oil market surplus (see here) and prevailing elevated demand uncertainty stemming from the virus, we expect that OPEC+ will delay its cuts for 3 months until April which will help bring the market back to a narrow 0.9m b/d market deficit in Q1 2021, when we forecast Brent prices to rise to USD49/b by March 2021.

Diverging Saudi-Russian oil strategies back in focus

Despite OPEC's technical panel recommending a fairly plain vanilla freeze in cuts for 3-6 months, we view emerging robust vaccine efficacy developments, alongside diverging Saudi and Russian oil strategies, will soften the need for an extension north

OIL MARKETS ARE EXPECTED TO PIVOT BACK TO A SURPLUS IN DECEMBER …

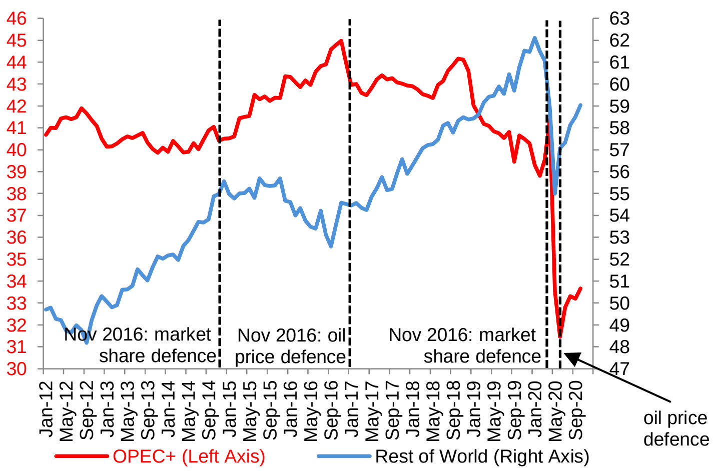
GLOBAL OIL DEMAND AND SUPPLY, CHANGE VS. JANUARY 2020 (M B/D)



Source: Bloomberg, EIA, IEA, OPEC, MUFG Research

… AND THE OPEC+ STRATEGY COULD STILL SIGNAL A TEMPORARY TRUCE RATHER THAN A PERMANENT DEAL

OIL PRODUCTION (M B/D) – OPEC+ AND THE REST OF THE WORLD



Source: Bloomberg, OPEC, MUFG Research

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of 3 months. Notwithstanding the resurgence in virus cases across both sides of the Atlantic sparking fears of a double-dip recession, the sheer velocity of the upward move across the entire oil price curve stemming from recent promising vaccine news will offer comfort to OPEC+'s calculus heading into the meeting at the end of this month. Meanwhile, despite their close coordination in the existing historic OPEC+ production cuts, the dynamics between Saudi Arabia and Russia will also be pivotal heading into the meeting. Whilst a Biden presidency is likely to solidify the Saudi-Russian relationship from an geopolitical perspective, the two countries have deviating approaches for oil market management (see here). Saudi Arabia has been a stern advocate of propping up prices by sticking to the prevailing OPEC+ agreement given its fiscal budgetary requirements (breakeven oil prices are north of USD70/b). Meanwhile, the encouraging vaccine developments may convince Russia – which can stomach lower oil prices with its fiscal breakeven ~USD45/b – that a long extension of the current cuts may not be warranted (Russia is also still lagging behind in its pledged commitments). On net, these considerations gives us conviction that the compromise of a 3 month rollover will be the most agreeable outcome.

A longer extension of 6 months is possible

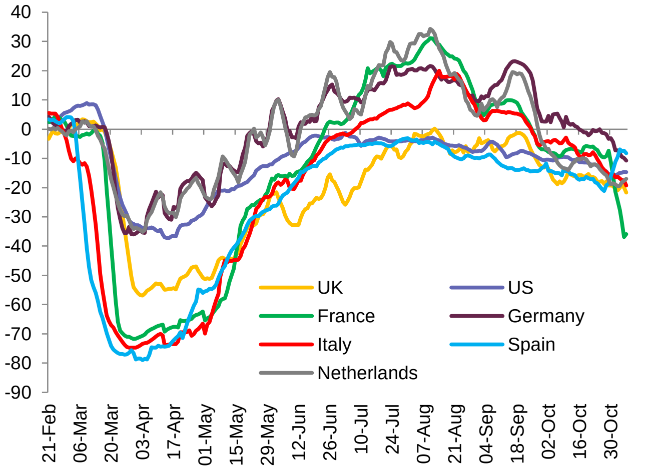
It is conceivable, albeit unlikely, that a 6 months (or longer) delay materialises during the OPEC+ deliberations at the end of the month, offering strong stability to markets. The most important consideration for the group would be the impact on global oil demand stemming from the mobility restrictions across both sides of the Atlantic. It would appear that, at face value, OPEC+ is not materially troubled by the resurgence of the virus, given that the recovery in Asia continues to garner momentum (indeed Chinese crude processing rates rose by 2.6% y/y in October, equivalent to 14.1m b/d – a record fuelled by strong gasoline consumption). However, the recent complications on the US side are more important for OPEC+ given the rising potential for new soft lockdowns being imposed to ensure the healthcare system is not overwhelmed. Though, debate on lockdowns in the US is polarised and the ability of governors to proceed with stringent European style lockdowns is limited – any level of restrictions that impacts oil demand in the US will be monitored closely by OPEC+ in the coming days ahead in the lead up to the meeting.

Other supply constraints are looming

Beyond the OPEC+ decision, supply constraints have been hampering the current oil market deficit. The phoenix-like return of Libyan production has staged an unprecedented bounce back to reach 1.2m b/d, rebounding more than 2x our expectations and previous rebounds witnessed in 2014 and 2016. Granted, there remains considerable uncertainties surrounding the fragile state of affairs given the delicate political agreement in place, we prudently price in that output will continue to

EUROPEAN AND US MOBILITY INDICATORS HAVE WANED OWING TO LOCKDOWN REIMPOSITIONS …

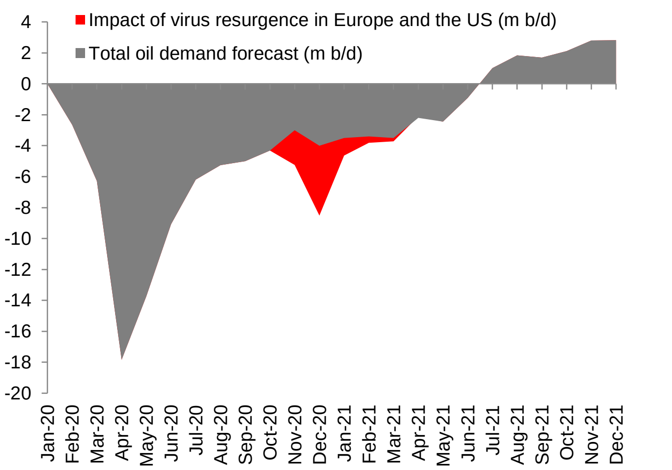
GOOGLE MOBILITY INDEX (7 DAY MOVING AVG OF CORE COMPONENTS)



Source: Google, MUFG Research

… WHICH WILL SHAVE 2.4M B/D IN GLOBAL OIL DEMAND BETWEEN NOVEMBER AND DECEMBER

GLOBAL OIL DEMAND, CHANGE VS. JANUARY 2020 (M B/D)



Source: Bloomberg, IEA, MUFG Research

recover, averaging ~1.0m b/d until the potential next OPEC+ meeting in April – note that communications from the Saudi Energy Minister stated on 17 November that OPEC+ was not discussing output quotas for Libya at the current juncture. Beyond Libya, hurricanes have materially interrupted US offshore production (~0.4m b/d since July). With OPEC+ compliance coming in at 101% in October, we forecast global oil supply increasing from 91.5m b/d in October to reach 92.3m b/d in November and 92.9m b/d in December.

A 3 months extension is baked in

Given the recent articulation from various OPEC+ ministers, on top of OPEC's technical panel recommendation on 17 November of a postponement on putting an additional 1.9m b/d crude back on the market, the odds are overwhelming that the group will concur to delay their tapering, with markets having all but priced in a 3 months extension.

As such, we do not anticipate much price action post-meeting given that a 3 months extension is baked in, with the group continuing its modus operandi strategy of supporting prices over defending market share through its active oil market intervention policy to effectively carve out an OPEC+ floor in oil prices. Beyond the decision, the group's communication strategy will be central in determining the near-term direction of oil prices. The more united, coherent and coordinated (and less fudge and ambiguity) the group's messaging will be, the greater the prospects of markets being wowed (and vice versa). Given the fragile state of current in global markets, investors are searching for credible assurance from OPEC+ that it will stand ready to take a flexible and adaptable approach in its oil supply management policies. Heading into the last few weeks of 2020 – absent any unforeseen event risk – our constructive oil price conviction remains intact (see here and here) and we continue to forecast Brent and WTI to end-2020 at USD48/b and USD45/b, respectively. For 2021, we project Brent and WTI averaging USD57/b and USD53/b, respectively, with a large inflection higher from Q3 2021, as oil markets transition from the cyclical tightening phase to the structural repricing stage which by then we are likely to see oil demand breaching the pre-virus run rate of 100m b/d and the requirement for higher upstream capex investment (see here).

OPEC+ unlikely to support free riders any longer

On the whole, the OPEC+ agreement to curb output and support prices, marks the second time since 2014 that OPEC+ endeavours to pursue a strategy of defending market share through ramping up production has buckled. Once COVID-19 slowly ebbs away and with it oil demand begins to recover, prices will recover further. Herein lies the OPEC+ dilemma that has been ongoing since 2014 – while cuts can support oil prices above shale marginal costs initially, this can only be sustained at the expense of ever diminishing volumes and revenues. This is at the core of the new oil order, which could derail the very existence of such coordinated cuts, with OPEC+ unlikely to be willing to support prices for "free riders" in the oil industry any longer. Thus, this existing OPEC+ agreement could inevitably signal a temporary truce rather than a permanent deal.

Ranges and outlook for the week ahead

BRENT – BULLISH BIAS – (41.00-48.00)

WTI – BULLISH BIAS – (38.00-46.00)

Quarter End	Spot close 19.11.20	Q4 2020	Q1 2021	Q2 2021	Q3 2021
Brent	44.17	48.40	49.20	54.60	57.80
NYMEX	41.50	44.70	45.20	50.30	53.60
		Range	Range	Range	Range
Brent		33.90-59.10	41.70-64.20	43.10-66.10	45.30-66.30
NYMEX		31.20-55.60	38.60-61.80	40.80-63.80	42.10-64.10

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