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MUFG Bank, Ltd.
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01 April 2021

OPEC+ to take no risks

Oil market focus
OPEC+ to take no risks

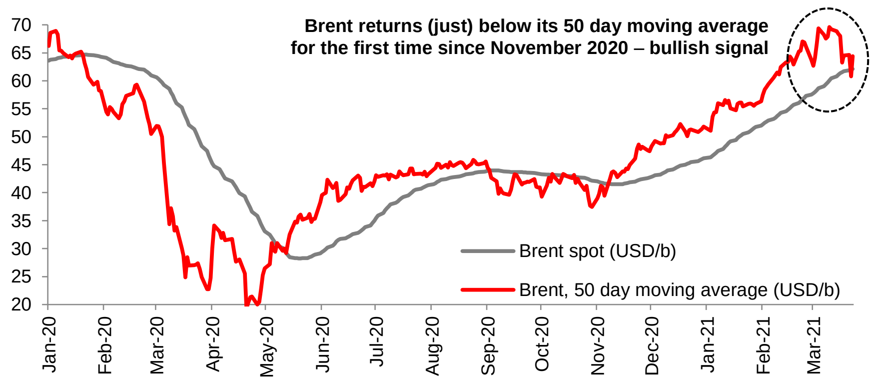
Week in review, week ahead, oil price call and quarterly price forecasts
Week in review and week ahead
Quarterly oil price spot forecasts, ranges and oil price thesis

Core indicators
Prices and market positioning
Timespreads and futures
Inventories, storage and products

Executive summary

All eyes are on the OPEC+ ministering meeting today (1 April). Our base case is for OPEC+ to keep its production unchanged for May and for Saudi Arabia to extend its unilateral 1m b/d cut for another month. Divisions and old wounds amongst OPEC+ members are reappearing but we expect the group to heed to recent apprehensions on the demand-side of the oil equation given the recent COVID-19 resurgence and slow pace of vaccinations, as well as a softening technical oil market – factors which have been exacerbated by US dollar strength. Whilst the oil price rally has taken a breather, this will prove transitory in our view, and we maintain a strong conviction (see here) that a vaccine-led, spring accelerated, global recovery will spur oil prices "overshooting" in the second quarter (Brent USD77/b; WTI USD74/b), buoyed also by accommodative monetary and fiscal policy, pent-up savings and limited scarring effects from the virus. We continue to see rapid rebalancing as the market remains in a large deficit with the normalisation in inventories ongoing and OPEC+ is likely to keep targeting a tight market. From the expected Q2 peak, we see prices gradually regressing back in H2 2021 towards the equilibrium price for the oil industry, which we view as being centred on the current anchor near the long-term marginal cost of production and support of ~USD55-65/b for Brent and ~USD50-60/b for WTI.

CHART OF THE WEEK: OIL IS NOW ABOVE ITS 50 DAY MOVING AVERAGE
BRENT SPOT AND BRENT 50 DAY MOVING AVERAGE, (USD/B)



Source: Bloomberg, MUFG Research

Oil market focus

OPEC+ to take no risks

OPEC+ to rollover production cuts for one more month and Saudi to extend its unilateral cut as well

The last OPEC+ meeting delivered no increase in oil supplies for April and our base case is for OPEC+ to keep its production unchanged for May and for Saudi Arabia to extend its unilateral 1m b/d cut for another month, when it meets today (1 April). Divisions and old wounds amongst OPEC+ members are reappearing but we expect the group to heed to recent apprehensions on the demand-side of the oil equation given the latest COVID-19 resurgence and slow pace of vaccinations, as well as a softening technical oil market – factors which have been exacerbated by US dollar strength. Adding to the delicate state of affairs, the OPEC+ Joint Technical Committee (JTC) revised down demand growth estimates for 2021 (to 5.6m b/d from 5.9m b/d) earlier this week, which follows a recommendation from OPEC Secretary General Barkindo that the coalition should remain "very cautious and attentive to changing market conditions".

OPEC+ to cautiously taper

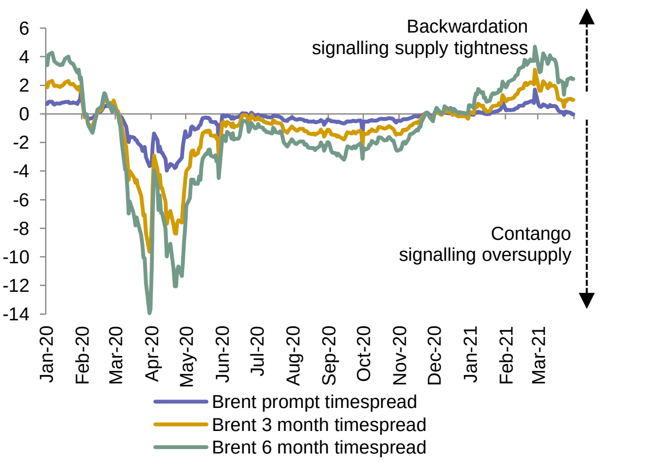
One of our key concerns for oil markets in 2021 has been the potential disunity of OPEC+ cohesion as conditions improve, especially given the sheer magnitude of how much OPEC+ crude remains off the market. Front and centre for OPEC+ policy appears to be the demand-side at the current juncture, and the group will seek stronger signals that the robust reopenings that are likely to appear across the world in the second quarter is feeding through into higher demand growth before it commences tapering its production cuts. According to our estimates, absent any unforeseen surprises in global inventory data or a slowdown in global reopenings, the second quarter will likely include increases in production. However, it will come in small incremental additions given in particular that Saudi Arabia would prefer to see tangible signs of demand growth before committing to bringing more barrels onto the market.

OPEC+ strategy is working

The OPEC+ supply strategy has been working because of its unexpectedness and suddenness. Year-to-date, oil prices are up ~25% and excess inventories continuing its sharp drawn down, meanwhile OPEC+ production is flat (excluding the Saudi 1m b/d voluntary cut) and the US oil rig count up only 23% and still 30% below the level needed to stabilise output (without drilled but uncompleted wells [DUCs]). This stands in sharp contrast to the strategy prior to 2020, when OPEC+ viewed itself as

BRENT TIMESPREADS SHOW MARKET IS REBALANCING SWIFTLY GIVEN BACKWARDATION LEVELS …

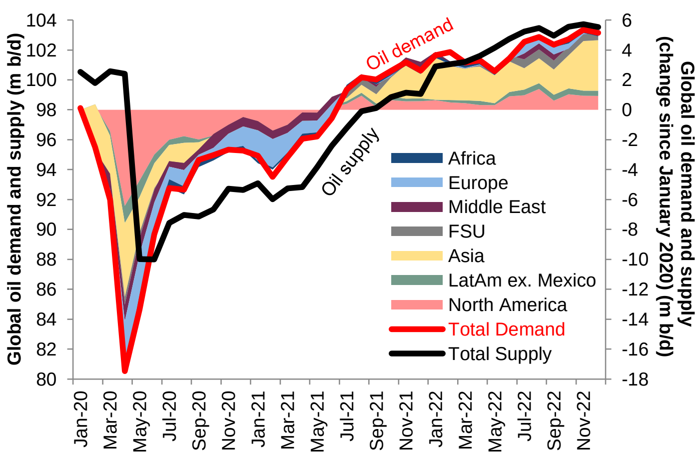
BRENT TIMESPREADS – FRONT, 3 AND 6 MONTHS (USD/B)



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

… WITH THE WINTER VIRUS RESURGENCE NOT IMPACTING DEMAND AS MUCH AS WE THOUGHT

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



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

the central bank of the oil market, reassuring too much with predictable but never large enough cuts. The key will be the potential shale supply response, although the latest earnings season suggests investors are still a long way away from rewarding growth, with the few producers who hinted at higher capex underperforming the rally in oil equity share prices.

OPEC+ optimisation is for backwardation – and it has been successful

The clearer trajectory in a tightening in fundamentals through a swifter draw of inventories, is prompting sharper levels of backwardation – bullish structure where nearer-dated contracts trade at a premium to later-dated ones – is signalling supply tightness. This is favoured by OPEC+, given its ability to lock-in forward prices near spot levels. This strikes at the heart of the OPEC+ optimisation strategy in achieving fiscal stability through higher revenues and market share. In other words, backwardation favours OPEC+ as it eliminates the financial incentive to store oil over time and discourages US shale oil competition from locking-in prices for future production (as low "deferred" prices through the backwardation structure restrains shale's access to capital). In many respects, OPEC+ is borrowing from the playbooks of the global central banks, where policymakers often focus on the interplay between long and short-term interest rates (with low cost OPEC+ producers selling all their production at a higher spot price).

Saudi Arabia has large spare capacity leverage

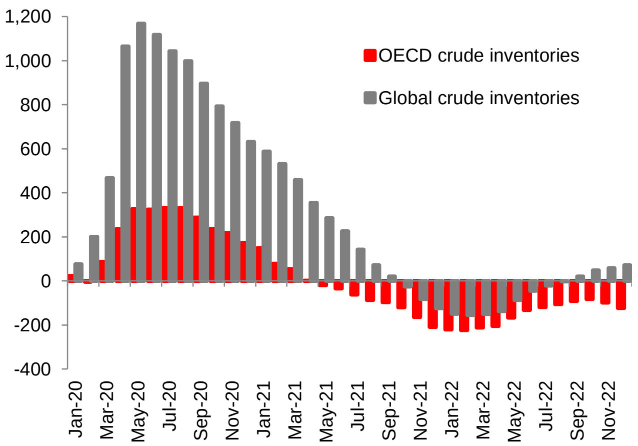
In recent months, OPEC+ discipline has been surprisingly good (even at recent prices) driven largely by a cautious Saudi Arabian approach and the strong leverage the Kingdom has by virtue of its immense spare capacity of ~3.5m b/d at present. Ever since the current OPEC+ agreement was first reached (April 2020), Saudi Arabia has pushed for a far more conservative approach to bringing back supply than many other participants, and at times the differences in viewpoint have been abundantly clear, both in public statements and in weak compliance with cuts. While the "stick" of Saudi Arabia's spare capacity has always been there in the background, we have since also seen the "carrot" in the form of its 1m b/d voluntary extra cut in July last year, and again this year in February, March and now April too. Based on this, we are of the view that Saudi Arabia has leverage in its large spare capacity when entering OPEC+ negotiations, given its demonstrated willingness both to add and restrict large volumes of oil output.

Oil prices are set for a strong leg up and peak in Q2 2021 and thereafter revert back to equilibrium

Whilst the oil price rally has taken a breather, this will prove transitory in our view, and we maintain a strong conviction (see here) that a vaccine-led, spring accelerated, global recovery will spur oil prices "overshooting" in Q2 (Brent USD77/b; WTI USD74/b), buoyed also by accommodative monetary and fiscal policy, pent-up

WORKING OFF IN CRUDE INVENTORY LEVELS HAS BEEN SPURRED BY ROBUST OPEC+ SUPPLY RESTRAINT

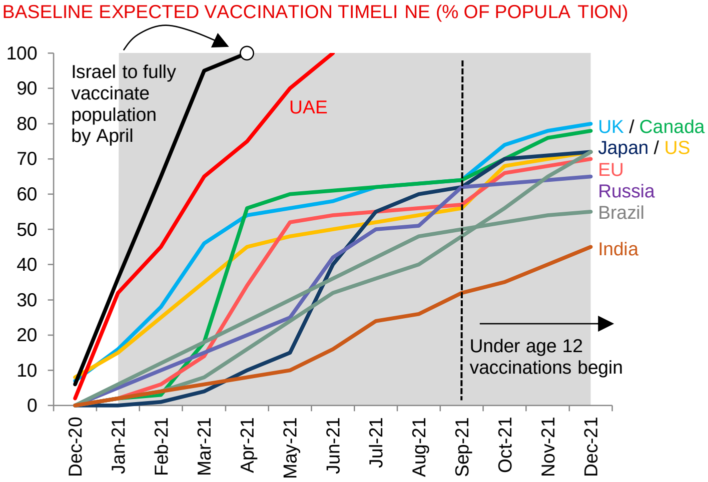
GLOBAL LAND AND FLOATING INVENTORIES (M BARRELS)



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

MOST DEVELOPED MARKETS TO VACCINATE 50% BY Q2, WHILST EMERGING MARKETS TO FOLLOW BY Q4

BASELINE EXPECTED VACCINATION TIMELINE (% OF POPULATION)



Source: National Sources, Our World In Data, MUFG Research savings and limited scarring effects from the virus. From a fundamentals perspective, we continue to see still rapid rebalancing as the market remains in a large deficit with the normalisation in inventories ongoing and OPEC+ is likely to continue targeting a tight market in the months ahead. From the expected second quarter peak, we see oil prices gradually regressing back in H2 2021 towards the equilibrium price for the oil industry, which we view as being centred on the current anchor near the long-term marginal cost of production and support of ~USD55-65/b for Brent and ~USD50-60/b for WTI. For 2021 as a whole, we now forecast Brent averaging USD68/b (from USD58/b previously) and WTI averaging USD65/b. For 2022, we continue to forecast Brent averaging USD58/b (WTI averaging USD55/b), with lower prices next year being driven by (i) a lower carbon future accelerating the decline in oil intensity of GDP growth and (ii) an ongoing falling cost structure of the oil industry. Succinctly put, we are cyclically positive an expect an “overshoot” over the near-term prospects but the medium-term outlook for oil is not rosy.

Week in review and week ahead

Demand-side woes

In the last week of Q1 2021, uncertainty surrounding the demand-side of the oil equation remained elevated. An increase in global COVID-19 case numbers caused by the spread of more infectious virus strains has triggered new, extended mobility restrictions. In Europe, ongoing lockdowns will prevent the traditional increase in fuel demand over the Easter holiday period in early April. In Asia, increases in local and regional infections are delaying plans to gradually reopen international borders to business and leisure travellers. Combined with an slow vaccine rollout across much of the Asia-Pacific region, it seems likely that jet fuel demand will be hindered for the foreseeable future. The US remains a bright spot for regional fuel demand given a relatively prompt inoculation rollout, more businesses staying open even amid ongoing high infection rates, and President Biden's substantial stimulus packages. While this public spending spree could spur inflation in the longer run and erode future growth, its near-term impact will almost certainly be a rise in US fuel consumption as people buy purchase more vehicle and become more confident about travel because of high vaccination rates.

Continued profit taking is likely in the week ahead

Looking ahead, oil markets are heading towards Q2 2021 with confidence amid hopes that a broad vaccine rollout will accelerate demand and that big government stimulus, especially in the US, will boost markets. Meanwhile, ongoing supply restraint by producer club OPEC and some of its non-affiliated allies means inventories are being drawn down, providing further price support for crude. China's strong pandemic recovery from mid-2020 onward lifted Brent crude oil spot prices from multi-year lows and comfortably back to USD 60/b by early 2021. However, the recent demand push has come from the US where a strong vaccine programme and government stimulus spending have instilled confidence that the world's biggest economy is heading for a strong recovery by mid-2021. Against a backdrop of widespread immunisation and a higher public tolerance for COVID-19 infection rates than elsewhere, especially Asia, US airlines have been advocating that domestic aviation is already improving.

Ranges and outlook for the week ahead

BRENT – BULLISH BIAS – (59.00-69.00)

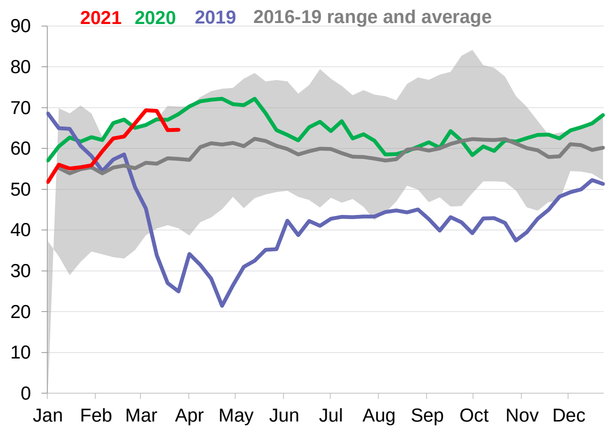
WTI – BULLISH BIAS – (55.00-65.00)

Quarter End (USD/b)	Spot close 31.03.21	Q2 2021	Q3 2021	Q4 2021	Q1 2022
Brent	63.05	77.10	69.40	64.20	58.40
NYMEX	59.47	74.20	66.10	60.90	55.10
		Range	Range	Range	Range
Brent		66.60-87.60	55.90-82.90	50.45-79.95	42.65-74.15
NYMEX		63.70-84.70	52.60-79.60	47.22-76.65	39.35-70.85

Core indicators – prices and market positioning

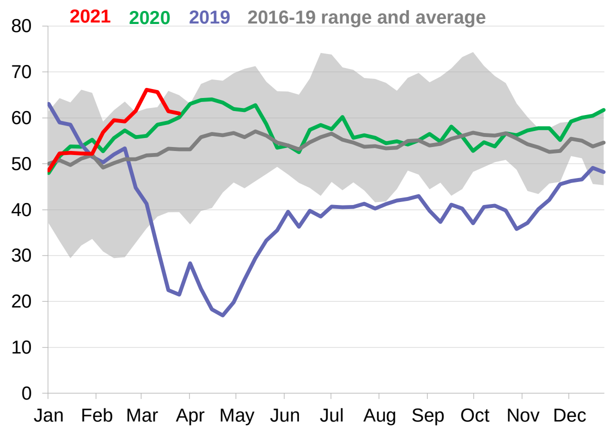
BRENT SPOT

USD/B



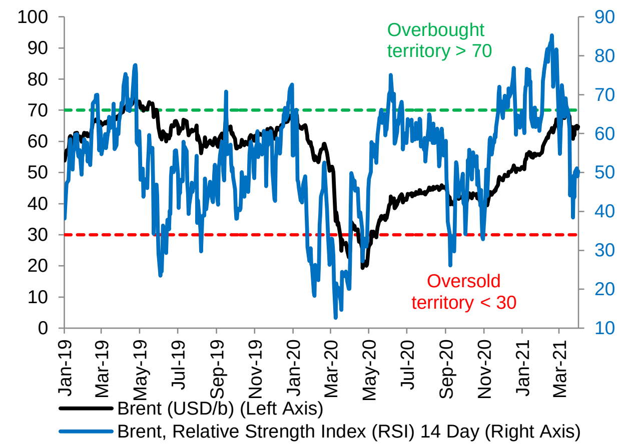
NYMEX WTI SPOT

USD/B



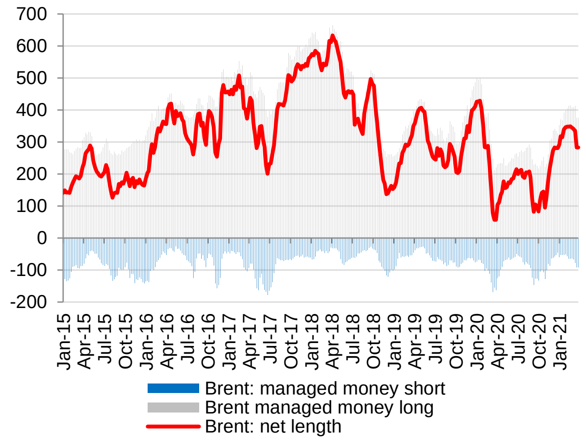
14 DAY RELATIVE STRENGTH INDEX (RSI) AND WTI

USD/B AND 0-100 INDEX (<30 = OVERSOLD; >70 = OVERBOUGHT)



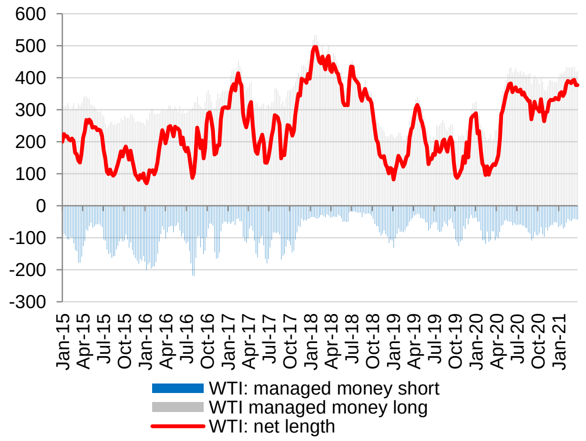
BRENT NET LENGTH MANAGED MONEY

CONTRACTS (THOUSANDS)



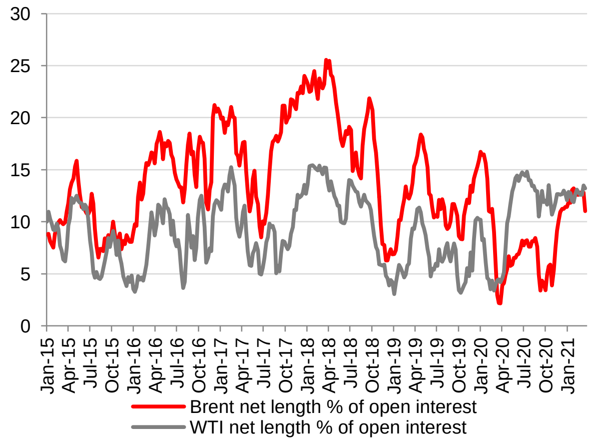
WTI NET LENGTH MANAGED MONEY

CONTRACTS (THOUSANDS)



NET LENGTH MANAGED MONEY / OPEN INTEREST

%

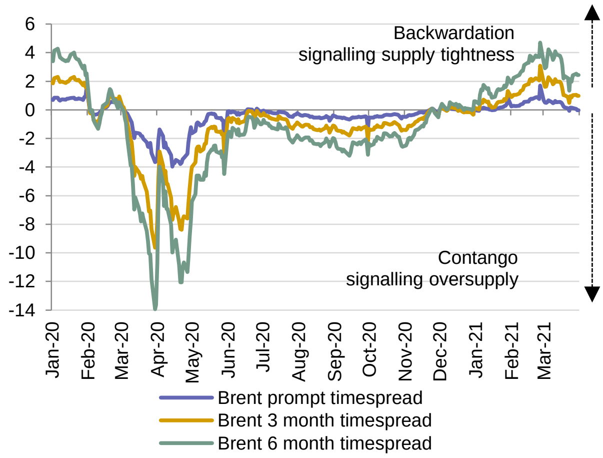


Source: Bloomberg, EIA, IEA, OPEC, MUFG Research

Core indicators – timespreads and futures

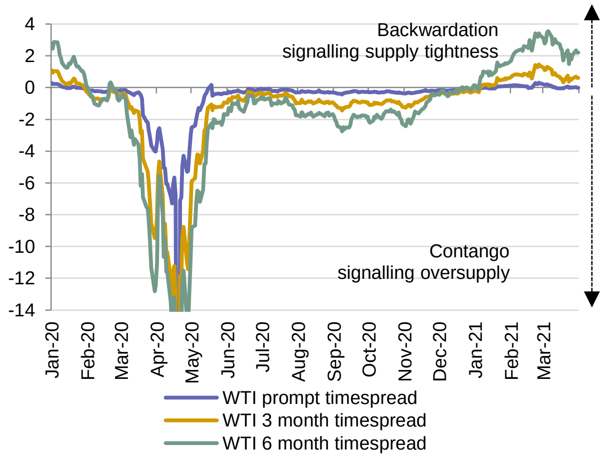
BRENT TIMESPREADS – FRONT, 3 AND 6 MONTHS

USD/B



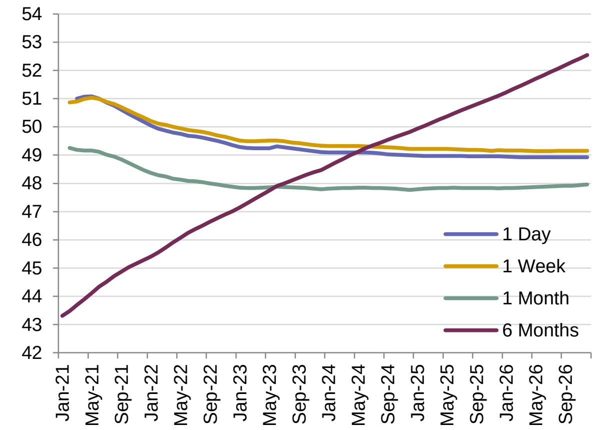
WTI TIMESPREADS – FRONT, 3 AND 6 MONTHS

USD/B



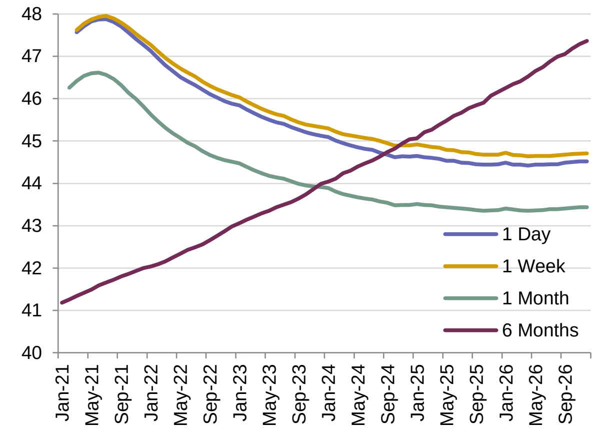
BRENT FUTURES CURVE

USD/B



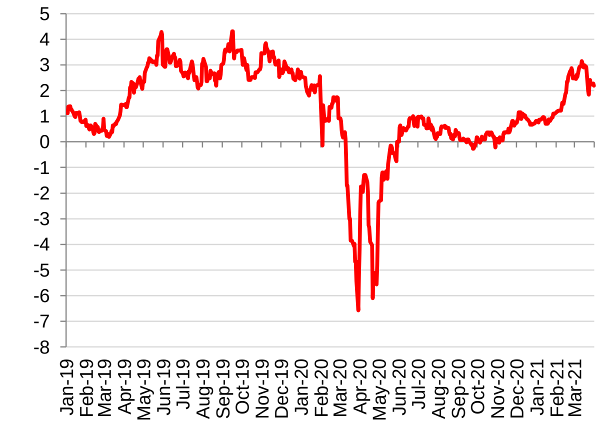
WTI FUTURES CURVE

USD/B



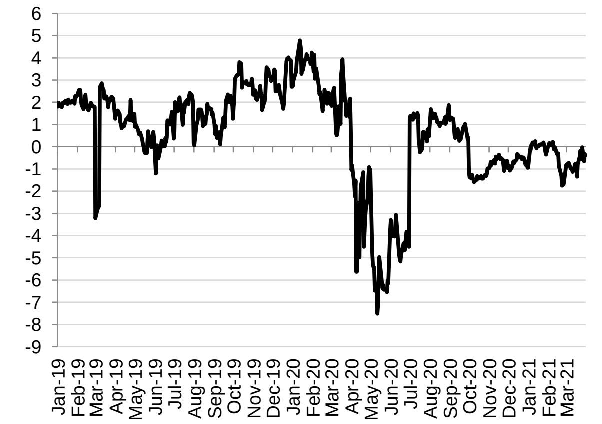
BRENT-DUBAI SPREAD

USD/B



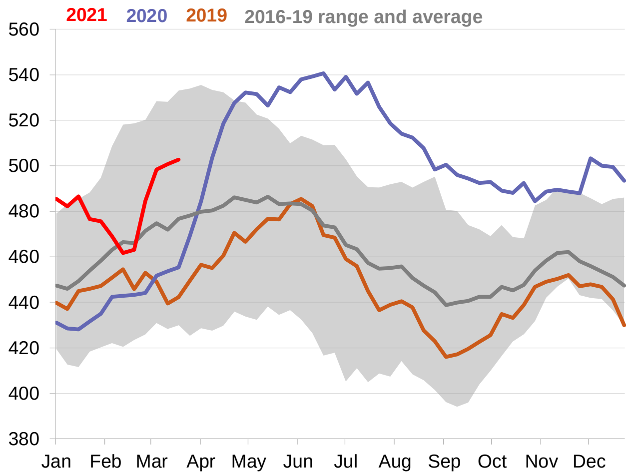
BRENT-MURBAN SPREAD

USD/B

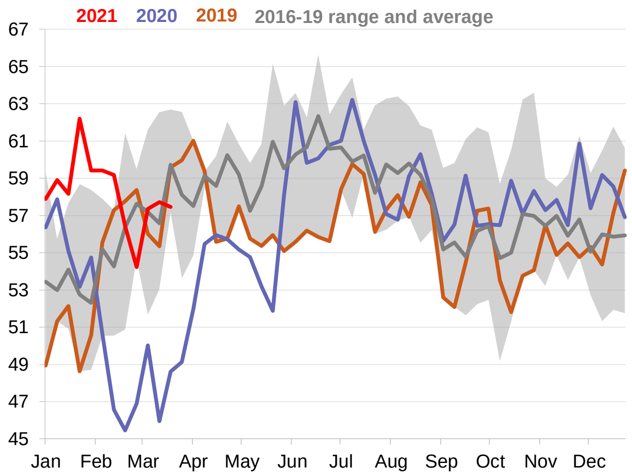


Source: Bloomberg, EIA, IEA, OPEC, MUFG Research

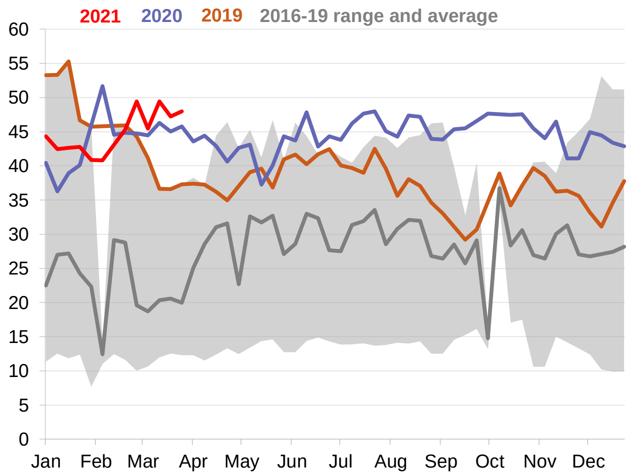
US CRUDE INVENTORIES
MILLION BARRELS



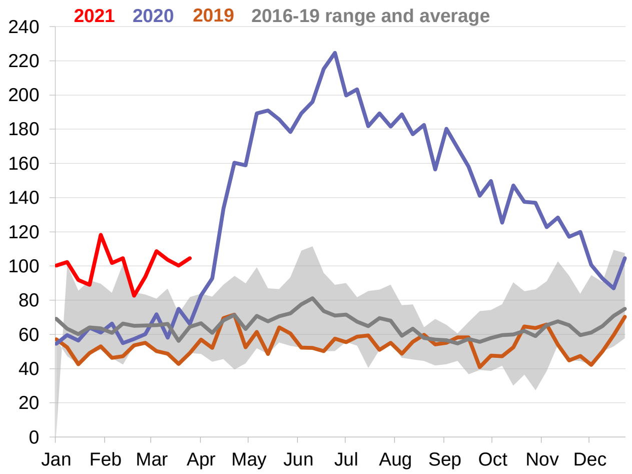
ARA CRUDE INVENTORIES
MILLION BARRELS



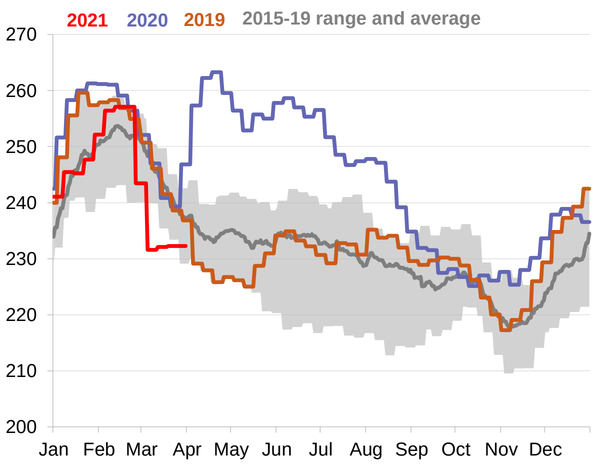
CHINA SHANDONG CRUDE INVENTORIES
MILLION BARRELS



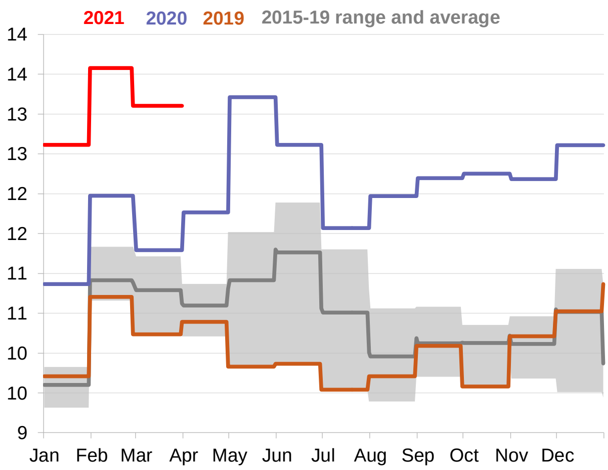
GLOBAL CRUDE FLOATING STORAGE
MILLION BARRELS



US GASOLINE INVENTORIES
MILLION BARRELS



JAPAN GASOLINE INVENTORIES
MILLION BARRELS



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

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