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# The proposed US SPR release will not be oil price bearish – differentiating between stocks and flows

**Oil market focus:** The US administration has been reviewing its policy options, particularly the release of crude from the US Strategic Petroleum Reserve (SPR), to reduce the sensitive price of gasoline (now at the highest level since 2014). Whilst politically, crude releases from the SPR would demonstrate the US administration's apprehensions surrounding elevated energy prices to the electorate, practically we view that such a decision would do little to stymie the price rises. The SPR reserves are stocks whilst OPEC+ production policy affects a flow – the SPR holds 613m barrels of crude while OPEC+ accounts for more than 40m barrels per day (b/d). Thus if US president Biden authorises the release of 30m barrels from the SPR (maximum under his authority), it would be equivalent to increasing global supply by only 82k b/d on a full-year basis. As such, using stocks to counter flows is unlikely to be sustained and will hardly dent the colossal 1.8m b/d deficit we model in Q4 2021.

**Week in review and week ahead:**

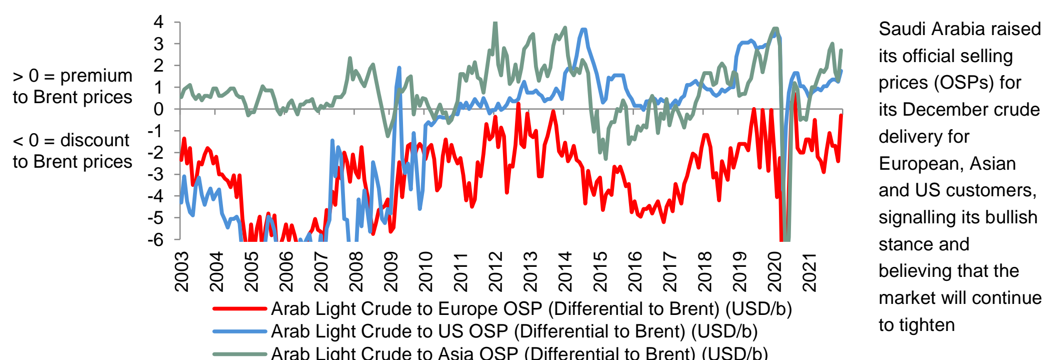
Oil prices are in a delicate balance and in wait-and-see mode to gauge the US reaction function after OPEC+ did not heed to market screams to accelerate its production hikes by more than its monthly 0.4m b/d pledges (see here). We continue to remain tactically bullish for the week ahead, though the now open disagreement between OPEC+ and the US administration, the prospect of an SPR release and the lingering US-Iran potential rapprochement will increase the volatility in oil prices, particularly as trading liquidity recedes into year-end.

**Oil price forecast:** We continue to believe that the setup for oil could not be more favourable throughout the autumn and winter months. Our modelling estimates signal that the prevailing market deficit which started in June 2020, will not pivot into oversupply until Q2 2022 (see here). Given the tight oil market, we forecast Brent ending Q4 2021 and Q1 2022 at USD85/b and USD82/b, respectively – widening the strong backwardation embedded into the oil futures curves and generating positive carry for oil investors. Thereafter, with the market expected to return to a mild surplus, leads us to be tactically bearish with a leg lower to USD74/b, USD72/b, and USD66/b in Q2, Q3 and Q4 2022, respectively.

**Core indicators:** Prices, market positioning, timespreads, futures, inventories, storage and products performance over the previous week are covered below.

CHART OF THE WEEK: SAUDI HIKES ITS MONTHLY OSP'S – BULLISH SIGNAL

OFFICIAL SELLING PRICES (OSP) OF SAUDI CRUDE TO EUROPE, ASIA AND THE US* (USD/B)




*Source: Bloomberg, MUFG Research; * differential to Brent crude (USD/b)*



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# Oil market focus

**The proposed US SPR release will not be oil price bearish – differentiating between stocks and flows**

Push-and-pull between the US and OPEC+ intensifies in global oil markets

With OPEC+ not heeding to market screams to accelerate its production hikes by more than its monthly 0.4m b/d pledges (see here), the US administration has been formally reviewing its policy options, particularly the release of crude from the US Strategic Petroleum Reserve (SPR), to reduce the sensitive price of gasoline (now at the highest level since 2014). The US administration officials, particularly US energy secretary Granholm, have recurrently placed responsibility on OPEC+ for the rise in energy prices, which they believe is increasing inflation and threatening the global economic recovery. "Gas prices of course are based on a global oil market. That oil market is controlled by a cartel. That cartel is OPEC, so that cartel has more say about what is going on", declared Granholm. Whilst politically, crude releases from the SPR would demonstrate the US administration's apprehensions surrounding elevated energy prices on the electorate, practically we view that such a decision would do little to stymie the price rises.

US SPR is part of the wider IEA network of emergency crude reserves

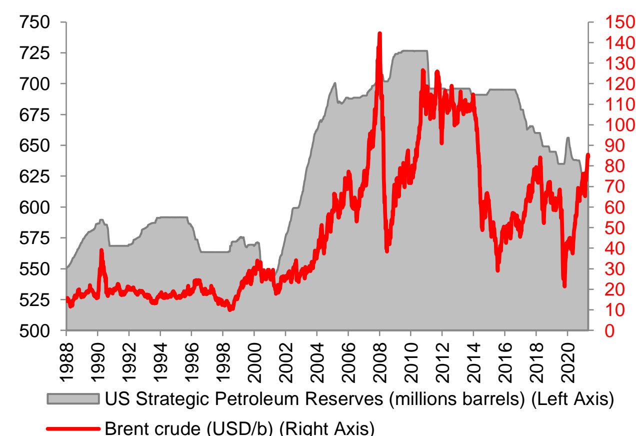
The SPR was established by the US Energy Policy and Conservation Act of 1975 to hold up to 1 billion barrels of petroleum in response to the Arab oil embargo of 1973-74. The SPR is part of a wider network of emergency crude reserves maintained by the International Energy Agency (IEA) member countries. IEA members have agreed to hold emergency stocks equivalent to at least 90 days of net imports as part of their response to the 1973 oil shock.

Details and purpose are key in comprehending the US SPR and IEA emergency crude stockpiles

In the US, the President is only legalised to order a drawdown from the SPR if he/she has determined it is required by "a severe energy supply interruption" or by international obligations under the IEA system. The President must also determine that a severe increase in the price of petroleum products has resulted from such emergency situation and that such price increase is likely to cause a major adverse impact on the economy. Fundamentally, In the circumstances which do not reach threshold of a severe energy supply interruption, the President may order a more limited release of up to 30m barrels spread over no more than 60 days. At international level, the IEA's emergency reserves and programmes for reducing demand can be activated "whenever the group as a whole or any participating

US SPR HAVE MATERIALLY DIMINISHED SINCE THE PEAK IN 2008 BUT REMAIN AT AMPLE LEVELS (613M BARRELS)

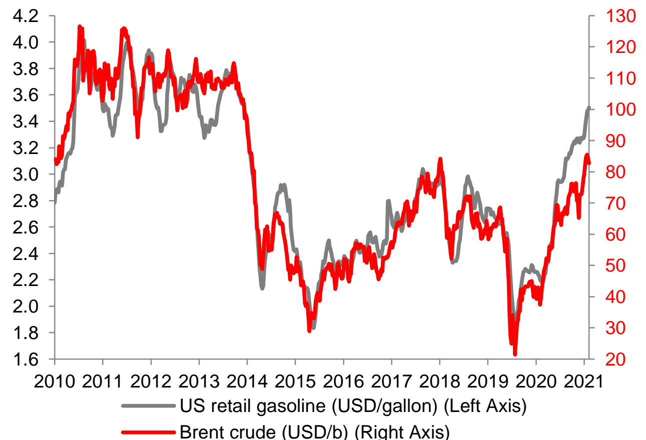
US STRATEGIC PETROLEUM RES. (SPR) (M BARRELS) VS BRENT (USD/B)




*Source: Bloomberg, OPEC, MUFG Research*

SPR RELEASE BRINGS FORWARD US EXPORTS CURBS - IRONICALLY BULLISH GASOLINE (PRICE OFF BRENT)

US RETAIL GASOLINE (USD/GALLON) VS BRENT CRUDE (USD/B)




*Source: Bloomberg, EIA, MUFG Research*

country sustains or can reasonably be expected to sustain a reduction in its oil supplies". Therefore, the legislative context for both the SPR and IEA emergency reserves systems signals that the purpose is to manage energy shortages rather than tackle higher energy prices.

US SPR stocks vs OPEC+ production flows

As such, given no sudden and significant supply disruption, it is challenging to foresee the US or the IEA release crude from emergency supplies. Critically, the SPR reserves are stocks whilst OPEC+ production policy affects a flow – the SPR holds 613m barrels of crude while OPEC+ accounts for more than 40m barrels per day (b/d) – and thus if US president Biden authorises the release of 30m barrels from the SPR (maximum under his authority), it would be equivalent to increasing global supply by only 82k b/d, which is not significant. Should the US and IEA members take a more coordinated effort to release a sizable volume of crude and products from stocks, then the legal basis to do so for levels in excess of 30m barrels by the US and the same by IEA members is ambiguous. On net, using stocks to counter flows is unlikely to be sustained and will hardly dent the colossal 1.8m b/d oil market deficit we estimate in Q4 2021.

OPEC+ may in fact raise production by more than pledged in the months ahead

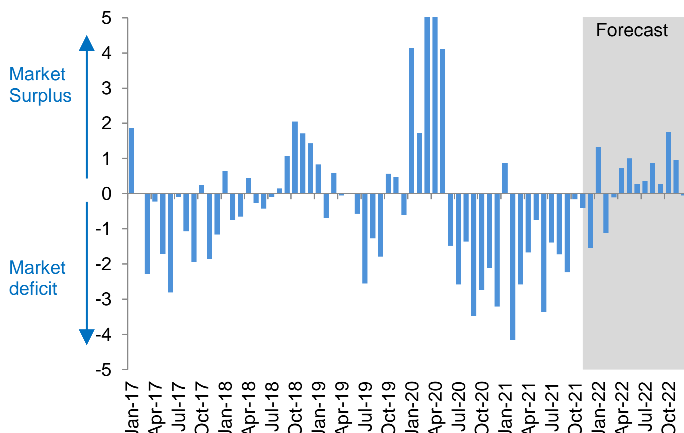
Moreover, the candidness of OPEC+ to hike output by more than their articulated 0.4m b/d monthly increases could temper demands from the US as well as other oil importing countries such as China, India and Japan. Indeed, during the 4 November OPEC+ meeting, OPEC+ ministers stated during the press conference the already agreed upon plan to ramp-up production further in coming months and the potential to ramp-up more aggressively quickly given the monthly frequency of OPEC+ meetings. This adds an additional lever for restraining emergency crude releases from the US SPR or indeed a coordinated IEA emergency crude supply release onto global markets.

Dovish EIA's STEO report eases the need to make an imminent need to release any level of US SPR onto global oil markets

The latest pulse on the potential SPR release has been squarely focused on the US Energy Information Administration's (EIA) Short Term Energy Outlook (STEO), which the US administration stated that it will assess before making any decision, as it had been suggested that President Biden may make an announcement this week regarding high oil and gasoline prices. The STEO signalled that the global oil markets will in fact become oversupplied in 2022 – in line with our previously held forecasts (see here and here) – and prices will fall by early next year. Specifically, the EIA estimates that the oil market will be oversupplied by 0.5m b/d in 2022, which compares to an undersupply of 1.6m b/d in 2021. As a result, the EIA expects Brent to average USD72/b next year, compared to USD82/b in Q4 2021. As for US crude

EIA'S STEO ESTIMATES POINTS TO STOCK BUILDS IN 2022 FOLLOWING A MARKET DEFICIT IN 2021

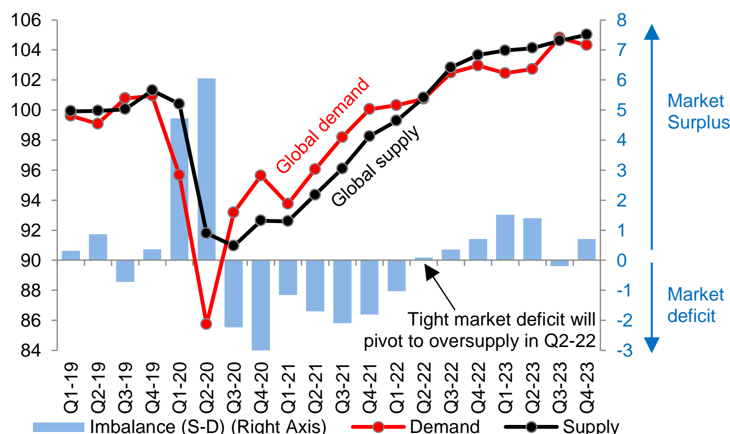
EIA GLOBAL OIL MARKET DEFICIT/SURPLUS (M B/D)




*Source: Bloomberg, EIA, MUFG Research*

MUFG'S MODELLING ESTIMATES SIGNAL A SIMILAR PROFILE WITH A PIVOT TO OVERSUPPLY FROM Q2 2022

MUFG'S GLOBAL OIL DEMAND, SUPPLY AND OVERALL BALANCE (M B/D)




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



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oil supply, the EIA estimates that oil output will average 11.9m b/d in 2022, up 0.8m b/d from 2021. On net, the STEO's dovish stance cools some of the pressure off the US administration to act in order to bring oil prices lower in the near term. However, we would still not rule out an SPR release, particularly if Brent crude stays comfortably north of USD80/b.

We remain resolute in our bullish oil conviction over the autumn and winter months with firm backwardation in motion

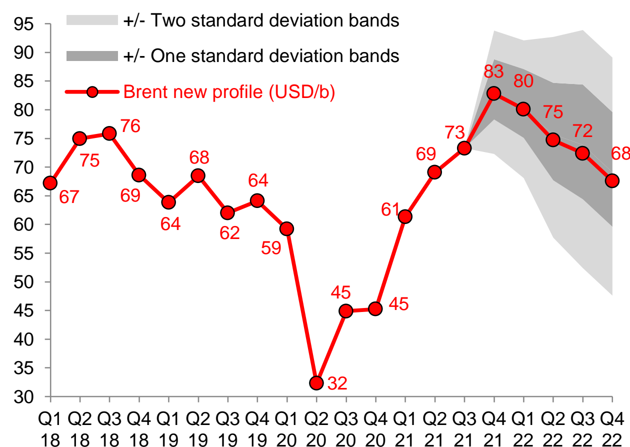
Looking ahead, our constructive bullish view remains intact, though the now open disagreement between OPEC+ and the US administration, the prospect of an SPR release and the lingering US-Iran potential rapprochement will increase the volatility in oil prices in coming weeks, particularly as trading liquidity falls into year-end. On the whole, the sheer magnitude of oil market deficit remains unresolved with the prevailing potency in global oil demand a near-term tailwind, juxtaposed against inelastic production outside of OPEC+ capping global oil supply. As such, we do not envisage the current acute oil market deficit to dissipate any time soon. We recently marked-to-market our quarterly profile higher wherein our modelling estimates now signal that the prevailing market deficit which started in June 2020 (see here), will not pivot into oversupply until Q2 2022 (from our initial estimates of Q1 2022). This is driven by winter demand risks which is now squarely skewed to the upside as the global gas crunch is increasing gas-to-oil substitution (see here), and thus lead to an even tighter for longer physical oil market pushing oil inventories to lower levels. This will generate further price appreciation. In terms of levels, we forecast Brent ending Q4 2021 and Q1 2022 at USD85/b and USD82/b, respectively – widening the strong backwardation embedded into the oil futures curves and generating positive carry for oil investors. Thereafter, with the market expected to return to a mild surplus, leads us to be tactically bearish with a leg lower to USD74/b, USD72/b, and USD66/b in Q2, Q3 and Q4 2022, respectively.

Firm backwardation will continue

All signs point to the current physical supply constraints increasingly garnering traction over the winter and presenting a tightening influence on the oil (and broader energy) market. This is increasingly being shown up in futures markets wherein prompt timespreads, which are one of the best indicators of market tightness given they price fundamentals and not expectations – corroborate with this market tightening, remaining in firm backwardation – which are bullish structures where near-dated contracts trade at a premium to later-dated ones. Indeed, in physical markets like oil (and other energy commodities), investors cannot borrow from the future like in financial markets such as equities and bonds, which forms the basis of backwardation (in effect, the technical term for a scarcity premium).

MUFG'S OIL PROFILE SIGNALS A PEAK IN Q4 2021 WITH A BEARISH 2022 BIAS GIVEN THE EXPECTED SURPLUS

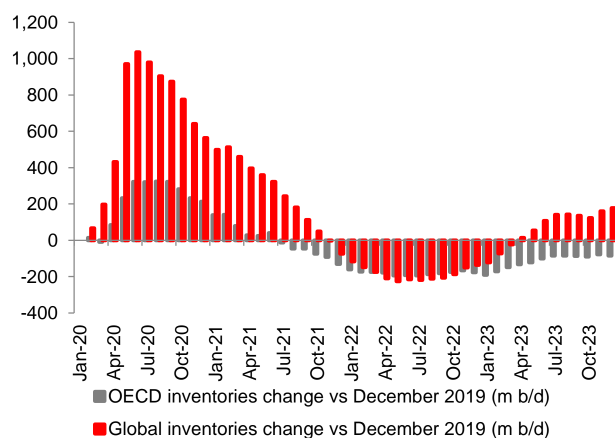
AVERAGE BRENT (USD/B) WITH ONE AND TWO STANDARD DEV. BANDS




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

OIL INVENTORY DRAWS HAVE ACCELERATED, WITH THE MARKET STILL IN A LARGE DEFICIT

GLOBAL AND OECD OIL INVENTORIES VS DECEMBER 2019 (M B/D)




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



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Risks are skewed to the upside

Absent (i) the stagflationary winds blowing through the global economy taking a firmer hold; (ii) a potentially new COVID-19 variant that renders vaccines less effective; (iii) a swift return of Iranian barrels should a rapprochement with the US materialise; and/or (iv) a rapid pivot of US shale supply away from their current "value over volume" strategy, all the near-term risks have shifted to the upside. Moreover, diminishing OPEC spare capacity as well as oil service and carbon cost inflation skew risks upwards. Critically, our bullish near-term call on oil would not be derailed by either a faster Fed taper nor the rising rates environment given that oil is a spot (anchored) asset which is not vulnerable to only depend on the prevailing "level" of demand and supply, and thus are not vulnerable to rising rates which only slow down the "growth" rate of demand (see here).

Whilst oil prices may not follow a linear line up, we remain structurally bullish on oil over the long-term

Longer-term, we expect the market to return to a structural deficit by 2023 as the forces of ESG gain traction. Indeed, if policymakers' objectives of a large-scale buildout in green infrastructure are to be met, oil (and broader energy commodity) prices will need to significantly overshoot to the upside to provide the incentive for renewable investments to considerably rise. This is needed to compensate for the growing risks involved in long-cycle capex projects and the inherent complexities surrounding the energy transition. With this context in mind, our conviction is squarely centred on the premise that the less popular oil (and broader fossil fuels) become, the more they will cost, as crimping supply without tackling demand (which will unlikely peak until the 2030s) will only cause oil prices to rise. However, we do not believe that oil prices will follow a linear line up, but instead occur in a series of ever-increasing spikes in the coming decade, given the push-and-pull dynamics between demand and supply.

## Week in review and week ahead

Oil prices are in a delicate balance but we continue to remain tactically bullish for the year ahead

Oil prices are in a delicate balance and in wait-and-see mode to gauge the US reaction function after OPEC+ did not heed to market screams to accelerate its production hikes by more than its monthly 0.4m b/d pledges (see here). We continue to remain tactically bullish for the week ahead, though the now open disagreement between OPEC+ and the US administration, the prospect of an SPR release and the lingering US-Iran potential rapprochement will increase the volatility in oil prices, particularly as trading liquidity recedes into year-end.

We turn tactically bearish in Q2 2022 but until then all the risks are skewed to the upside

With pandemic inventory buffers exhausted, supply shortages that spur such high price shocks will be negated by demand elastic destruction as the only option to rebalance markets (that is, the cure for high prices is high prices – a self-correcting mechanism). It is at this point, in conjunction with the looming constructive supply impulses (weaker OPEC+ compliance, more Iranian barrels, an increase in US shale supply and a steady build-up of oil inventories) that we turn tactically bearish from Q2 2022 until the end of 2022 given our expectations that oil markets will likely remain in surplus during this period. However until then, all the risks are skewed to the upside.

# Oil price forecasts and ranges

MUFG AVERAGE OIL PRICE FORECASTS (USD PER BARREL), AS OF 10 NOVEMBER 2021

| USD/b | | | Average quarterly forecasts | | | | | Average annual forecasts | |
|---|---|---|---|---|---|---|---|---|---|
| | Spot | Q3 2021 | Q4 2021 | Q1 2022 | Q2 2022 | Q3 2022 | Q4 2022 | 2021 | 2022 |
| Brent | 82.6 | 73.3 | 82.8 | 80.1 | 74.7 | 72.4 | 67.6 | 71.6 | 73.7 |
| NYMEX WTI | 81.3 | 70.7 | 79.8 | 76.8 | 71.0 | 68.9 | 64.2 | 68.7 | 70.2 |
| Brent ranges | --- | --- | 68.6 – 95.9 | 64.4 – 92.3 | 56.3 – 85.6 | 54.0 – 82.5 | 49.2 – 78.9 | --- | --- |
| WTI ranges | --- | --- | 65.6 – 88.3 | 60.3 – 87.7 | 53.0 – 79.5 | 51.9 – 76.8 | 46.7 – 72.4 | --- | --- |

*Source: MUFG Research*

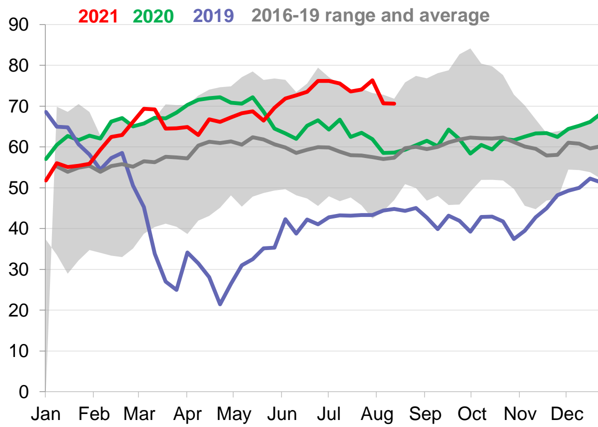
MUFG QUARTER-END OIL PRICE FORECASTS (USD PER BARREL), AS OF 10 NOVEMBER 2021

| USD/b | | | Quarter end forecasts | | | | | Average annual forecasts | |
|---|---|---|---|---|---|---|---|---|---|
| | Spot | Q3 2021 | Q4 2021 | Q1 2022 | Q2 2022 | Q3 2022 | Q4 2022 | 2021 | 2022 |
| Brent | 82.6 | 78.4 | 85.2 | 82.4 | 74.3 | 71.9 | 65.6 | 71.6 | 73.7 |
| NYMEX WTI | 81.3 | 74.7 | 81.9 | 79.2 | 70.8 | 68.2 | 61.8 | 68.7 | 70.2 |
| Brent ranges | --- | --- | 71.6 – 98.5 | 67.8 – 95.3 | 56.2 – 85.4 | 53.5 – 81.3 | 47.8– 76.5 | --- | --- |
| WTI ranges | --- | --- | 68.5 – 90.3 | 61.5 – 88.7 | 52.4 – 79.0 | 50.9 – 76.0 | 44.5 – 70.5 | --- | --- |

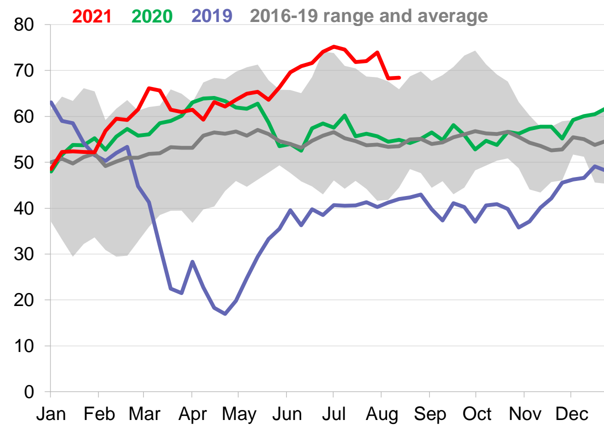
*Source: MUFG Research*

# Core indicators – prices and market positioning

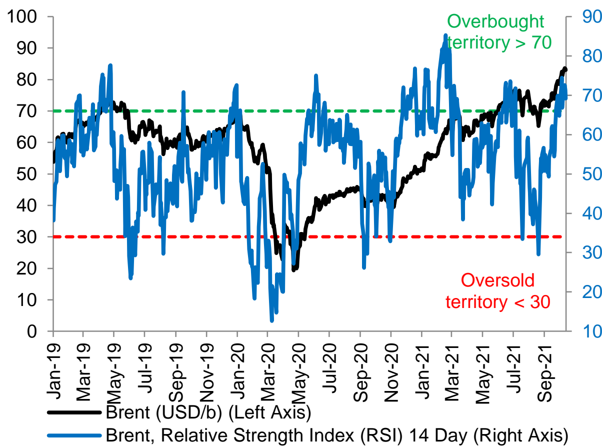
## BRENT SPOT
USD/B



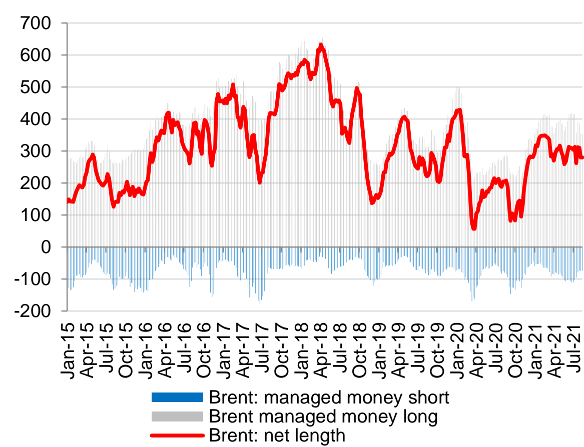

## NYMEX WTI SPOT
USD/B



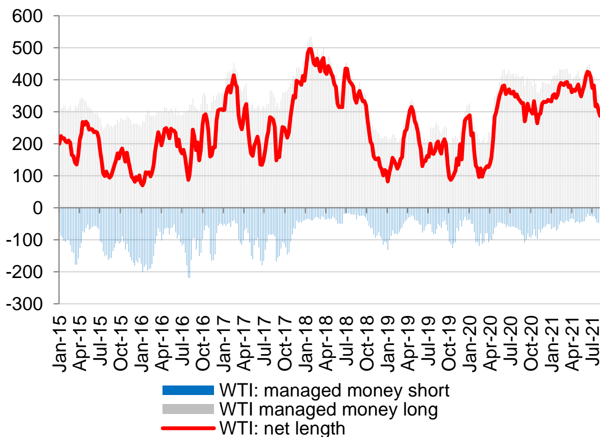

## 14 DAY RELATIVE STRENGTH INDEX (RSI) AND WTI
USD/B AND 0-100 INDEX (<30 = OVERSOLD; >70 = OVERBOUGHT)



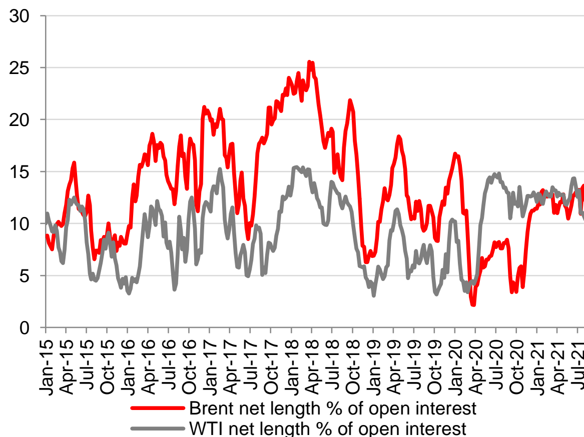

## BRENT NET LENGTH MANAGED MONEY
CONTRACTS (THOUSANDS)




## WTI NET LENGTH MANAGED MONEY
CONTRACTS (THOUSANDS)




## NET LENGTH MANAGED MONEY / OPEN INTEREST
%




*Source: Bloomberg, EIA, IEA, OPEC, MUFG Research*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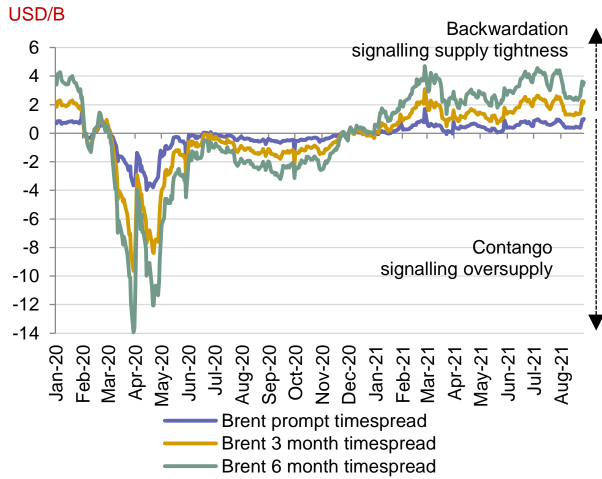
## Core indicators – timespreads and futures

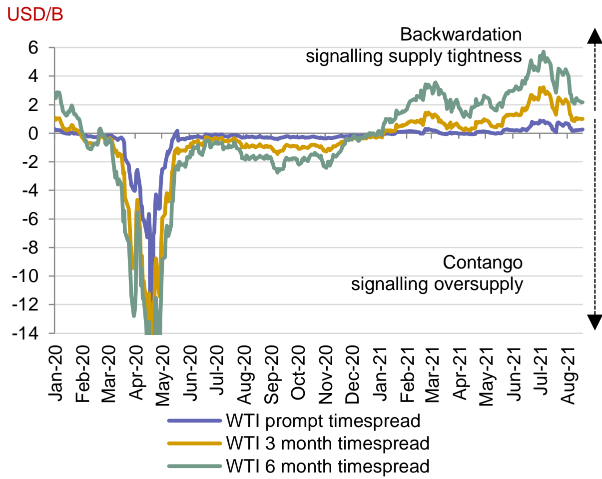
### BRENT TIMESPREADS – FRONT, 3 A ND 6 MONTHS

USD/B



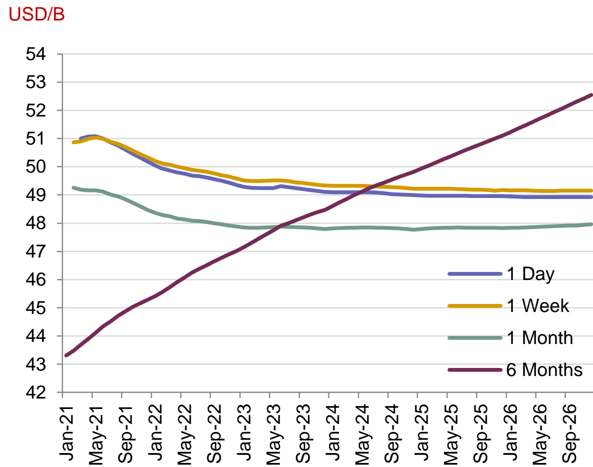

### WTI TIMESPREADS – FRONT, 3 AND 6 MONTHS

USD/B



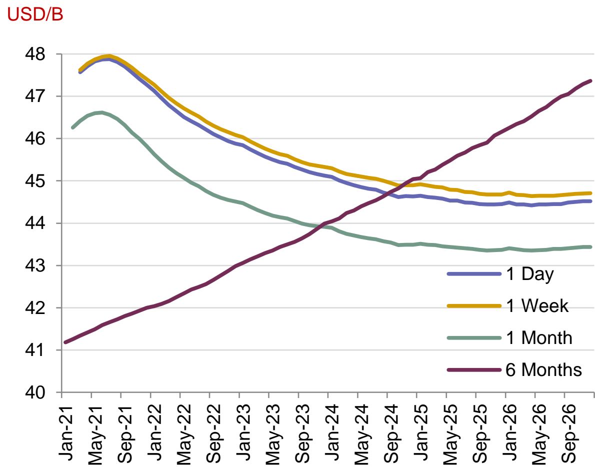

### BRENT FUTURES CURVE

USD/B



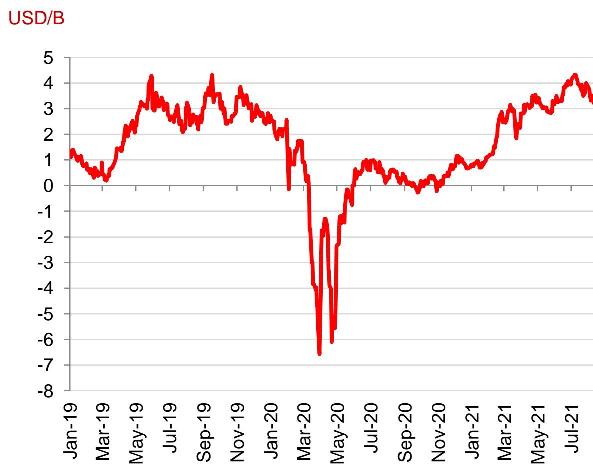

### WTI FUTURES CURVE

USD/B




### BRENT-DUBAI SPREAD

USD/B



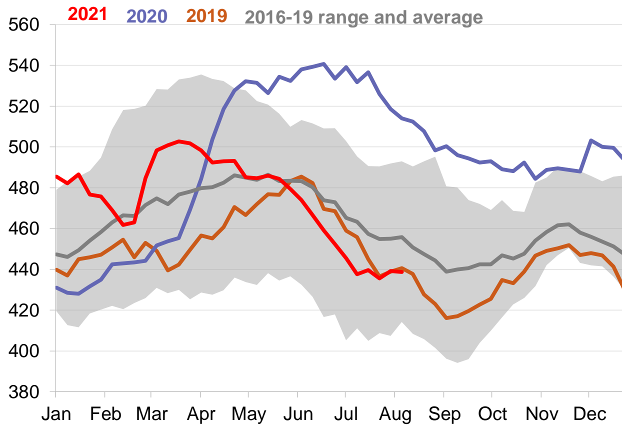

### BRENT-MURBAN SPREAD

USD/B

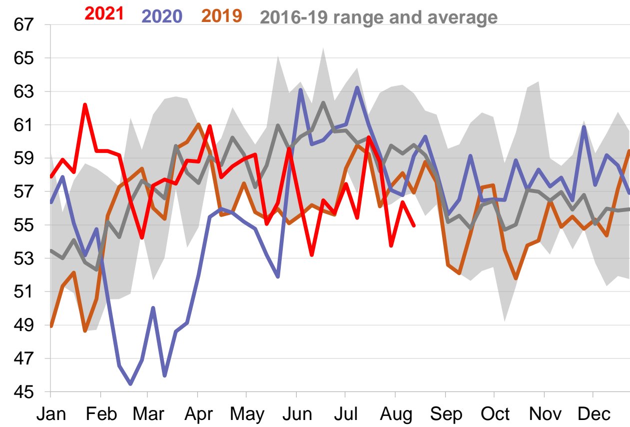
*Source: Bloomberg, EIA, IEA, OPEC, MUFG Research*

# Core indicators – inventories, storage and products

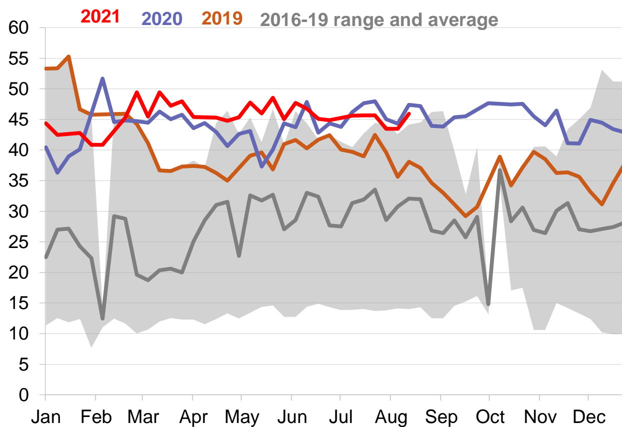
## US CRUDE INVENTORIES
MILLION BARRELS



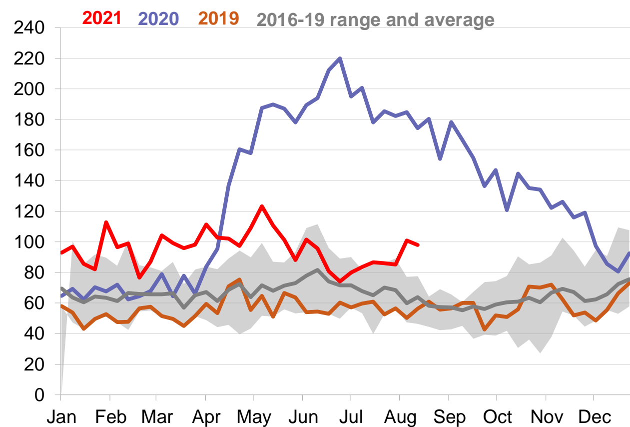

## ARA CRUDE INVENTORIES
MILLION BARRELS



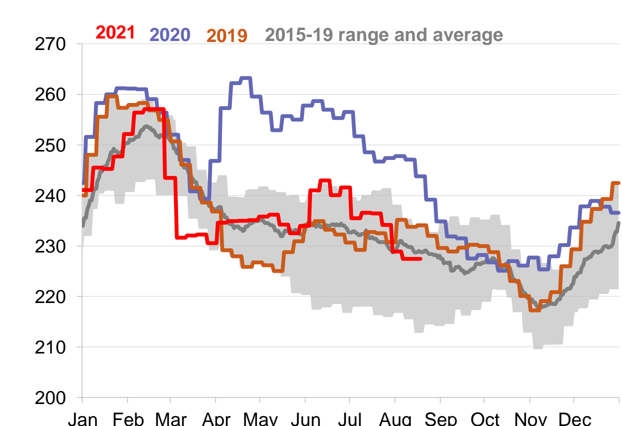

## CHINA SHANDONG CRUDE INVENTORIES
MILLION BARRELS



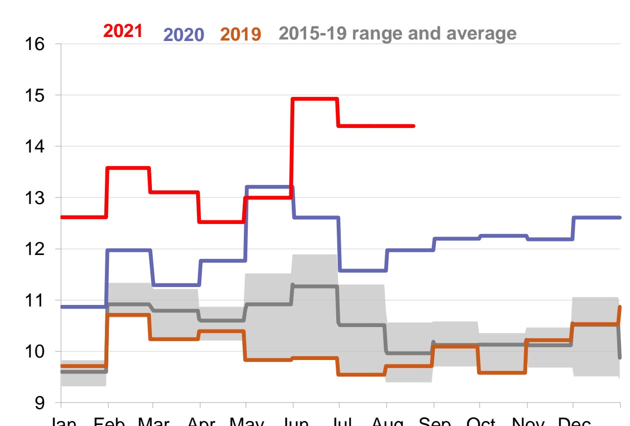

## GLOBAL CRUDE FLOATING STORAGE
MILLION BARRELS




## US GASOLINE INVENTORIES
MILLION BARRELS




## JAPAN GASOLINE INVENTORIES
MILLION BARRELS




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

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