Oil

Short-term defensive cut sets the stage for a tight oil market

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The first monthly OPEC+ meeting to decide on the group's production ended with an unexpected two-month agreement: (1) Saudi announced an unexpected and unilateral production cut of 1 mb/d in February and March, (2) Russia and Kazakhstan will instead increase output modestly to meet seasonal needs while (3) other producers will remain at their January levels. Despite this bullish supply agreement, we believe Saudi's decision likely reflects signs of weakening demand as lockdowns return, with our updated 1Q21 balance actually weaker than previously. Saudi's action and the prospect for a tight market in 2Q21, as the rebound in demand stresses the ability to restart production, will likely support prices in coming weeks, leading us to reiterate our bullish oil view. We continue to recommend a long Dec-21 Brent trade (currently trading at $52/bbl vs. our $65/bbl forecast) and expect sustained backwardation and lower implied volatility. Fundamentals do matter, but we see the recent recovery in refining margins and product cracks as premature and the best way to express the expected weakness in near-term oil demand.

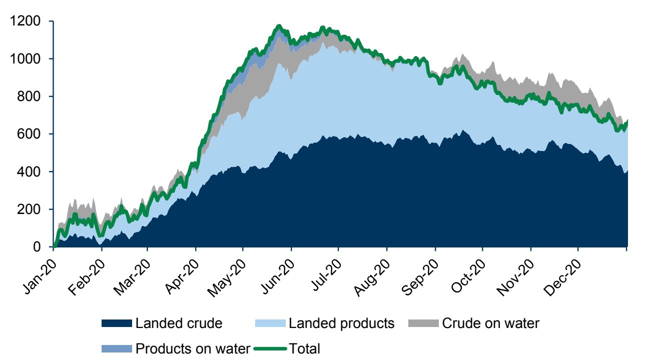
- The most significant decision was Saudi's pre-emptive measure to reduce output in the face of renewed lockdowns with OPEC+ production now expected below our prior forecast by 1.45 mb/d in February and 1.85 mb/d in March. Saudi's decision surprised as global demand beat expectations in December on shallower and shorter EU lockdowns and resilient jet demand. Further, by allowing Russia to increase production, Saudi undermined its efforts since April to have every producer implement similar cuts, with the Kingdom solely taking a fiscal hit. Finally, by lifting prices to their highest levels since last March, it risks extending the ongoing recovery in shale production, as WTI spot prices now at $50/bbl can allow for higher activity and positive free cash flows (although such a response would likely take time to materialize with producers cautious of further OPEC surprises).
- This leaves a large expected slowdown in global oil demand as the most rational explanation for Saudi's cut, likely signaled through its term contract to Asian consumers where infections are rising quickly (Korea, Japan, South-East Asia). Our high-frequency of oil demand suggests indeed that the return of more aggressive lockdowns is already weighing on demand (although the seasonal drop in oil demand early each year makes for a difficult assessment of daily data). We are reflecting these headwinds in our balance, taking down January and February oil demand to 92.5 mb/d from an upward revised December

demand level of 93.5 mb/d. From a geopolitical perspective, the transition to a likely less supportive US administration may also have led Saudi to adopt a more supportive stance towards other Middle East producers, as illustrated in both today's unilateral cut and restoration of ties with Qatar.

- Our updated 1Q21 balance is weaker than previously although with prospects for a tighter market in 2Q21. This new OPEC+ path and our demand downgrade lead us forecast a 1Q21 0.25 mb/d surplus vs. a commensurate deficit previously (only half offset by a tighter December). Importantly, OPEC+ March production level will still be low just as global demand starts rebounding sharply driven by warmer weather and rising vaccinations. This points to the group potentially struggling to ramp-up output quickly enough, with our balance currently reflecting a 1.3 mb/d deficit in April-July despite OPEC+ increasing production by 4 mb/d, a historically tall order. Net, we believe today's outcome will help support prices in the face of demand risks given Saudi's commitment to balance the market, the potential for them to cut more than demand actually disappoints, risks of a tighter 2Q21 balance and a growing consensus (Bloomberg) bullish outlook for crude fundamentals later this year. Our own year-end Brent forecast of $65/bbl is still well above market forwards and consensus expectations.

Exhibit 1: Despite lockdowns, stock draws continued through all of 4Q20

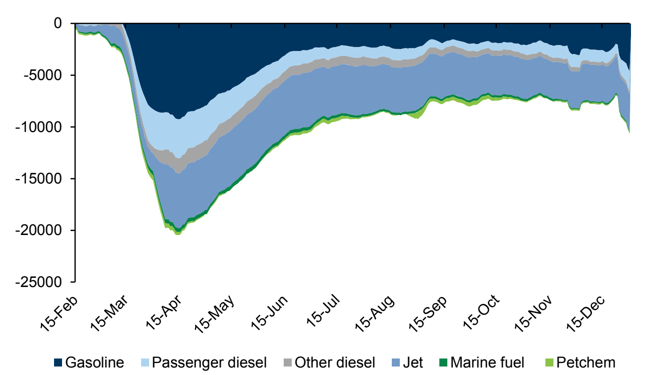
Global oil stocks vs 31-Dec-19 levels (mb)



Source: Kpler, Kayrros, EIA, PJK ARA, PAJ, IE Singapore, Goldman Sachs Global Investment Research

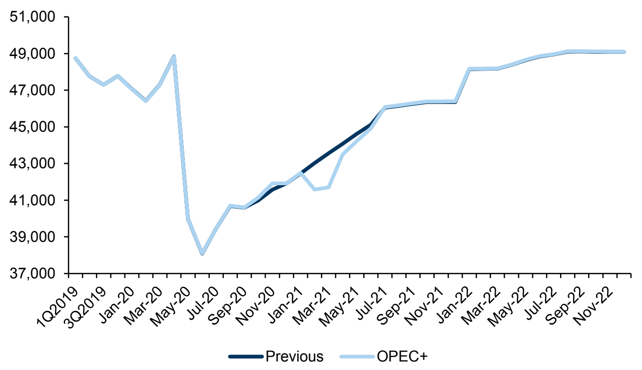
Exhibit 2: More severe mobility restrictions are weakening demand in January

Demand impact of COVID-19 relative to counterfactual path (kb/d)



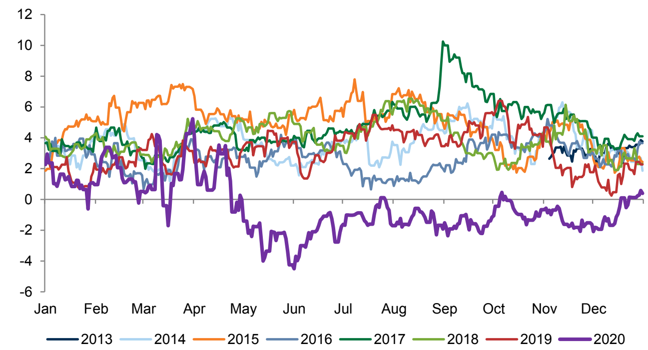
Source: Google COVID-19 Community Mobility Reports, Reuters, OAG, Kpler, IIR, Goldman Sachs Global Investment Research

Exhibit 3: We expect OPEC+ to reach similar production 3Q21 levels but with a much larger and challenging ramp-up needed in 2Q21
OPEC+ production (kb/d)



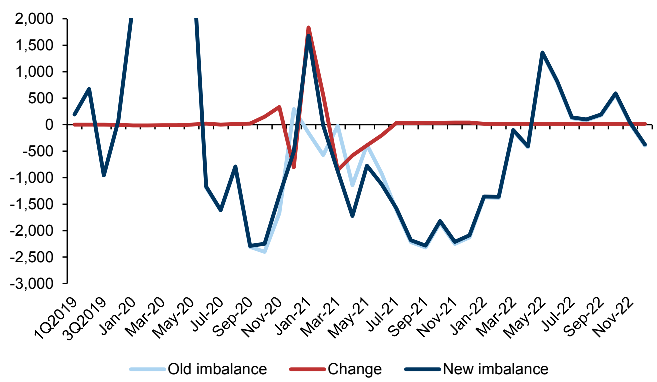
Source: IEA, OPEC, Reuters, OPEC, Goldman Sachs Global Investment Research

Exhibit 4: Refining margins have rebounded despite worsening demand
NW European cracking refining margins adjusted for yields, slate, and freight (USD/bbl)



Source: Reuters, ICE, Platts, IEA, Goldman Sachs Global Investment Research

Exhibit 5: Prolonged OPEC cuts will offset the weaker 1Q21 demand
GS global oil imbalance (kb/d)



Source: IEA, Woodmac, Kpler, Google COVID-19 Community Mobility Reports, Apple, National sources, JODI, Goldman Sachs Global Investment Research

Exhibit 6: GS Summary oil balance
kb/d

	1Q2019	2Q2019	3Q2019	4Q2019	Jan-20	Feb-20	Mar-20	Apr-20	May-20	Jun-20	Jul-20
Old supply	100,016	100,022	100,078	101,422	100,573	99,819	100,544	100,422	88,086	88,046	90,467
OPEC+ ex Saudi	0	0	0	-3	-13	-14	-11	-11	0	19	0
Saudi	0	0	0	0	0	0	0	0	0	0	0
Net change	0	0	0	-3	-13	-14	-11	-11	0	19	0
New supply	100,016	100,022	100,078	101,419	100,560	99,805	100,533	100,411	88,086	88,065	90,467
Old demand	99,822	99,349	101,036	101,343	98,273	95,628	91,991	80,432	84,541	89,235	92,083
Change											
New demand	99,822	99,349	101,036	101,343	98,273	95,628	91,991	80,432	84,541	89,235	92,083
Old imbalance	194	672	-958	79	2,299	4,191	8,553	19,990	3,545	-1,189	-1,616
Change	0	0	0	-3	-13	-14	-11	-11	0	19	0
New imbalance	194	672	-958	76	2,286	4,177	8,542	19,979	3,545	-1,170	-1,616

	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	Jun-21
Old supply	91,298	90,827	91,367	92,117	92,968	93,648	94,275	94,928	95,439	96,035	97,018
OPEC+ ex Saudi	12	18	148	370	5	36	-302	-587	-414	-275	-137
Saudi	0	2	4	-37	-9	0	-1,143	-1,272	-168	-116	-65
Net change	12	20	152	333	-4	36	-1,445	-1,859	-583	-392	-201
New supply	91,310	90,847	91,518	92,449	92,964	93,683	92,830	93,068	94,856	95,643	96,816
Old demand	92,099	93,135	93,767	93,789	92,672	93,803	94,847	94,948	96,578	96,416	97,941
Change					800	-1800	-2000	-1000			
New demand	92,099	93,135	93,767	93,789	93,472	92,003	92,847	93,948	96,578	96,416	97,941
Old imbalance	-801	-2,308	-2,401	-1,672	296	-156	-572	-21	-1,139	-381	-923
Change	12	20	152	333	-804	1,836	555	-859	-583	-392	-201
New imbalance	-789	-2,288	-2,249	-1,340	-508	1,680	-17	-880	-1,722	-773	-1,125

	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22
Old supply	98,261	98,396	98,050	98,785	99,024	98,970	100,766	100,936	101,084
OPEC+ ex Saudi	31	33	35	37	39	40	17	18	18
Saudi	0	0	0	0	0	0	0	0	0
Net change	31	33	35	37	39	40	17	18	18
New supply	98,292	98,430	98,085	98,822	99,062	99,010	100,783	100,955	101,102
Old demand	99,870	100,613	100,368	100,640	101,275	101,096	102,138	102,316	101,201
Change									
New demand	99,870	100,613	100,368	100,640	101,275	101,096	102,138	102,316	101,201
Old imbalance	-1,609	-2,216	-2,319	-1,855	-2,251	-2,126	-1,372	-1,380	-118
Change	31	33	35	37	39	40	17	18	18
New imbalance	-1,578	-2,183	-2,283	-1,818	-2,213	-2,086	-1,355	-1,362	-99

	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22
Old supply	101,508	102,059	102,658	103,080	103,366	102,933	103,432	103,557	103,457
OPEC+ ex Saudi	18	18	18	15	15	15	18	18	18
Saudi	0	0	0	0	0	0	0	0	0
Net change	18	18	18	15	15	15	18	18	18
New supply	101,526	102,077	102,676	103,095	103,381	102,948	103,450	103,575	103,475
Old demand	101,935	100,714	101,854	102,957	103,282	102,755	102,859	103,543	103,850
Change									
New demand	101,935	100,714	101,854	102,957	103,282	102,755	102,859	103,543	103,850
Old imbalance	-427	1,346	804	123	84	178	573	14	-393
Change	18	18	18	15	15	15	18	18	18
New imbalance	-409	1,364	822	138	99	193	591	32	-375

Source: Goldman Sachs Global Investment Research

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