Daily Macro Insights: Oil optionality

26/05/2021

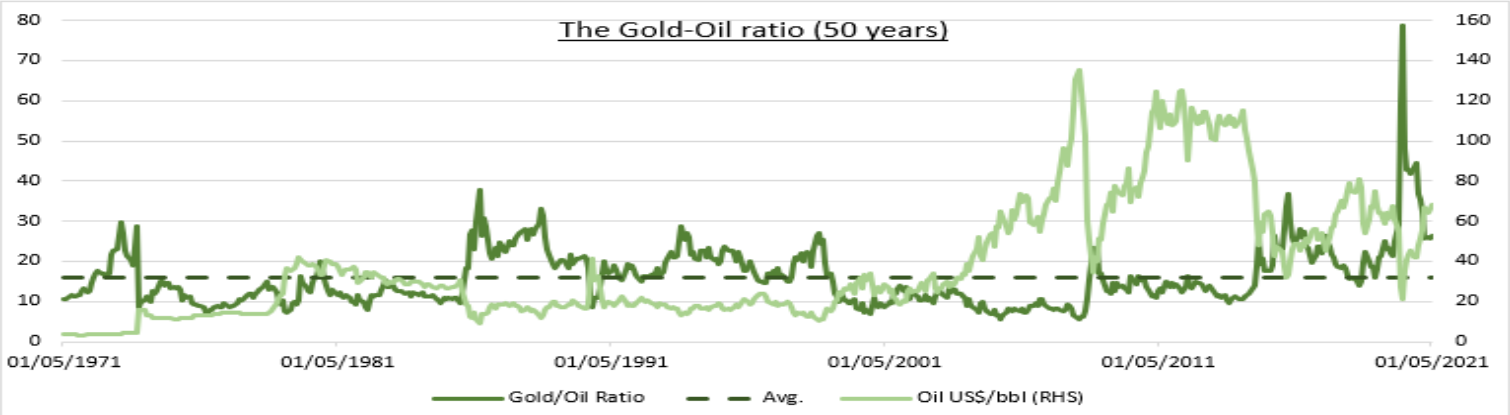
WELL-SUPPORTED: Oil prices (OIL, USO) and energy equities (XLE, @OilWorldWide) are up a third YTD, leading commodity and equity performance. Prices are well supported by stronger physical and inflation-hedging demand, and weaker USD, with upside to low US$64-5/bbl consensus forecasts this year and next. But much higher prices are limited by surplus OPEC capacity and political sensitivities. We prefer more capacity constrained industrial metals.

DEMAND: It is forecast up 6% this year and near pre-pandemic 99 million barrels a day (mb/d), led by China's quick rebound and US's re-opening, but is uneven as no. 3 importer India, for example, see's new virus cases, and jet fuel is still weak. Recovery has also helped bring high inventories back down to average. But longer term demand is hurt by de-carbonisation efforts, with renewables 90% of new power capacity and oil capital expenditures -30% last year.

SUPPLY: Is rising with 1) OPEC (c40% global supply) cautiously easing its crisis cuts, and Saudi Arabia its extra voluntary reductions, with no change seen at June 1st meeting. OPEC spare capacity is around 8% of global demand. 2) Ninth largest producer Iran is nearing a deal to lift US sanctions and boost its exports. 3) US shale output will keep growing at these prices. But longer-term supply is pressured by shareholder 'green transition' and dividend demands.

GOLD-OIL RATIO: The number of barrels of oil needed to buy an ounce of gold (see chart) is a proxy for health of the global economy, and relative value between the two commodities. This ratio spiked to all-time highs last year as gold surged, and oil plunged, and still shows relative value in energy. Energy equities (XLE) also seem good value, at 25% P/E valuation discount to the market, with twice the dividend yield (4.2%) and higher earnings growth (2022e +20%). More levered segments to higher oil include services (OIH), explorers (XOP), and big producers like Russia (RSX).

TODAY: We look to leading chipmaker Nvidia (NVDA) Q1 report, with estimates for 80% yoy earnings growth, amidst surging demand and broader chip shortages. Overnight we also see China YTD industrial profits (est. +50% yoy) as earnings forecasts have been easing as China's GDP rebound has softened, and equity market underperforming.



Source: Refinitiv. *Brent Crude

Ben Laidler, Global Markets Strategist. Email: benla@etoro.com