



Daily Macro Insights: Markets say oil to slump

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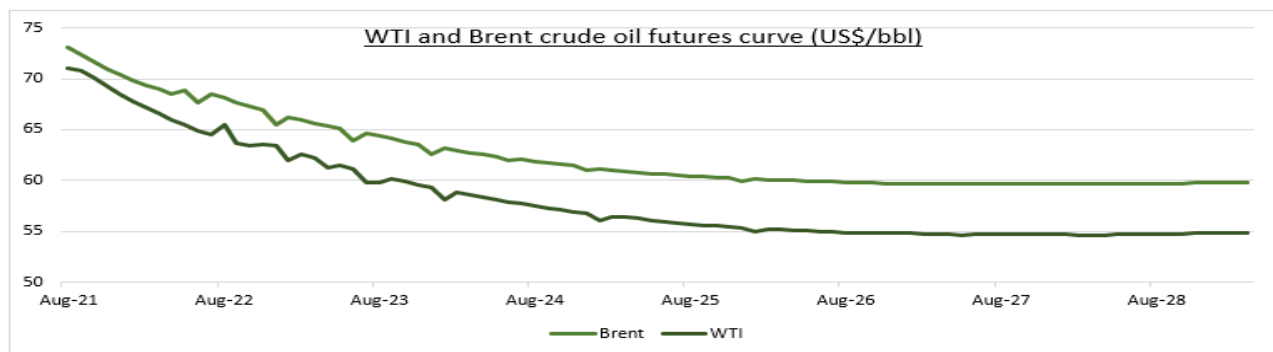
THE RALLY: Oil (OIL) has rallied sharply and futures are in sharp 'backwardation', signalling a slump ahead (see chart). This is in line with truism that 'the cure for high prices is high prices' that drives more capex and production. But this time may be different as: 1) carbon transition and ESG (environmental, social, governance) drivers limit oil capex, and 2) investors demand a cash return focus, such as dividends, not more capex. The Baker Hughes rig count, a proxy for drilling, is under half 2018-19 levels despite oil back at those levels. Also, as oil backwardation signals lower prices, investors are cautious funding new capex. This is positive for oil now.

FUTURE CURVE: Both Brent and WTI futures are in backwardation as investors expect lower prices. This can be counter-intuitively positive. 1) High prices today encourage inventory selling, supporting future prices. 2) Incentivizes production today, not investing in future production. 3) Traders can buy more oil for same cost by rolling into lower future contracts, supporting futures.

THE EXPLAINER: Contango and backwardation describe the futures curve structure. Contango is the norm, when the forward price of a futures contract is higher than the spot price, usually due to the cost of carry – storage, insurance, wastage. Rarer is backwardation, when the futures contract is lower than spot, due to short term shortages (such as now) or a lower price outlook.

THE VIEW: Oil strength raises likelihood OPEC+ raises production at its July 1 meeting. Even after its 2.1MMbbls/d May-July supply increase they still have 6MMbbls/d (6% supply) to bring back to market, to offset the demand recovery ahead. But any oil weakness would be temporary as demand recovers strongly and as the rising risk of less longer-term supply feeds talk of US\$100/bbl, benefitting long-dated futures and listed producers like @OilWorldWide or XLE.

TODAY: See global growth pulse with forward-looking purchasing managers indices (PMI). US and UK lead, Europe catch up led by services, Japan lags. To help EPS upgrades and cyclicals.



Source: Refinitiv

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