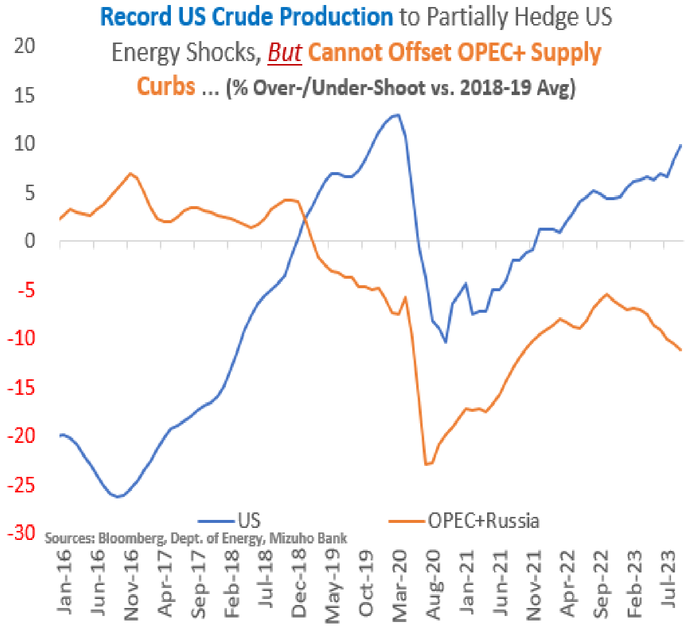
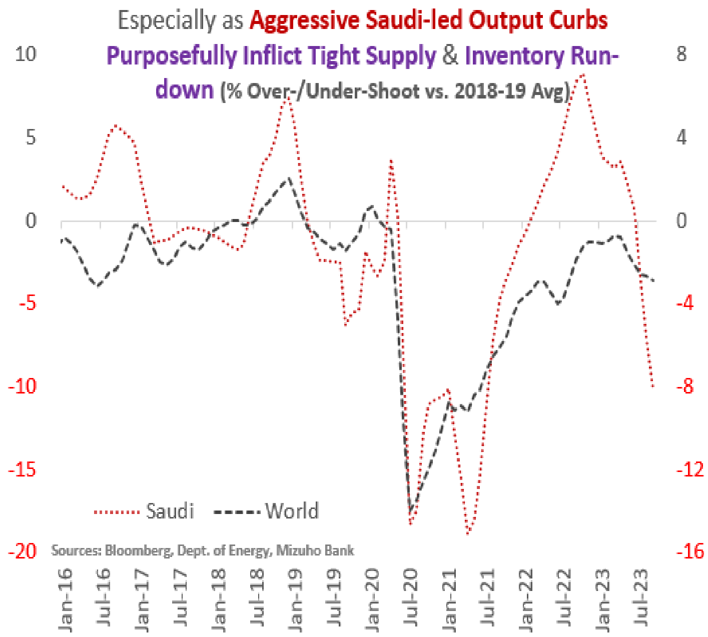
Mizuho Chart Speak: Oil

Economics & Strategy | Asia ex-Japan

3 October, 2023 | Vishnu Varathan | Head, Economics & Strategy

Oil: US Pain Relief, Not Panacea





"Strength is irrelevant. Resistance is futile." – ***The Borg, Star Trek***

- Admittedly, the **extremely strong pick-up in US crude output**, close to record highs, *ought to help dampen potential energy* shocks from resurgent global crude prices. But US response to OPEC+ supply curbs is **at best pain relief, not panacea**.

- To misappropriate a phrase from Star Trek, the ***strength*** (of US output ramp-up) ***is irrelevant and resistance*** (to brutal OPEC+ supply cut) ***is futile***; as **US supply response will inevitably be overwhelmed by OPEC+ will to impose tight supplies**.

- **Not merely because OPEC+ is over three times US output**, but more importantly as OPEC+ accounts for a disproportionately larger exports share and marginal supply. In effect, the ability of OPEC+ to influence a shortfall in effective global supply is far greater than that of the US.

- Especially as **aggressive Saudi-led OPEC+ methodically maintains tight global supply**; further **accentuated by a significant drawdown of inventories*** this year, which has been engineered by the purposeful supply cuts (with Saudi leaning in with additional "voluntary cuts).

- What's more, **Saudi's incentive are aligned to ensuring tight supplies** *that keep crude prices*, to steal a phrase from global central banks, *"higher for longer"* (well over $90). **Especially given the Kingdom has very recently downgraded its fiscal outlook** to reveal deficits through 2026 (from projected surplus earlier), and conspicuously benefits from higher oil revenues.

- **In contrast** to the purposeful spare capacity for Saudi, **US oil production** is likely already **straining at the seams**, with Shale limited by falling efficiencies/profitability constraints. In turn, **US' ability to sway oil markets** is **diminished**. Unlike OPEC+ grip further strengthened by geo-politics.

- The upshot is that **US' ability to overturn higher oil prices imposed by** brutal **OPEC+** supply curbs is **severely constrained**. *At best*, US derives *pain relief* from partial domestic supply offset. But this is *certainly not a panacea* **for related energy shock/inflation risks**. Much less on the global stage.

- Oddly, **despite this frustrating inability to override OPEC+ constraints**, *US exceptionalism is underpinned, not undermined*. For one, **dis-inflation in the US may be less impeded** by energy shocks, and arguably the attendant growth drag less severe too (relative to elsewhere).

- And insofar as consumer demand does not collapse, a "*higher for longer*" **Fed will be unfettered**. In turn this could **buoy real UST yields and the USD** *even as Oil remains elevated*.

- For now, **OPEC+ retains the upper hand**. And the Borg's words, "*strength is irrelevant … resistance is futile*" **resonates in favour of the current agenda of OPEC+ producers**.

- But those same words from ("*strength is irrelevant … resistance is futile*") may come back to haunt OPEC+ if **painfully elevated oil prices persisting too long** ironically seed its own downfall. Specifically, as **oil prices will plunge, following demand collapse** from a *double whammy of consumption dent and* prolonged state of *exceptionally elevated global policy rates*.

* Please see Mizuho Chart Speak – Oil: The OPEC Squeeze, 13th Sep 2023