Mizuho Chart Speak: Oil

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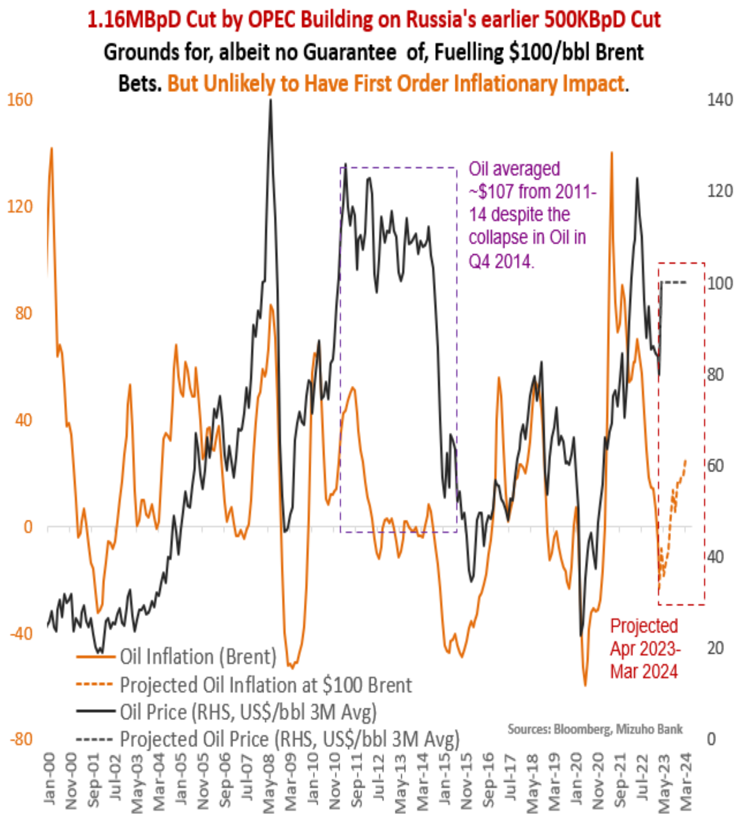
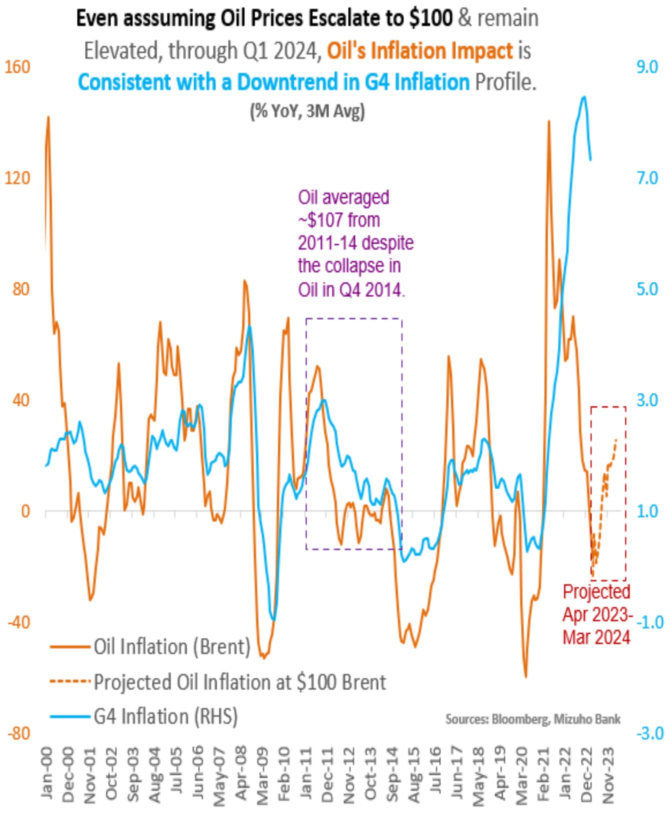
OPEC+ Cuts: Shock or Shrug?





In a Nutshell: **OPEC's surprise 1.16MBpD crude output cut**, building on earlier Russian cut (in retaliation of Western sanctions) of 500KBpD, admittedly **poses significant upside price risks**; given that in concert the cuts comprise nearly 4% of end-2022 OPEC+ output. In which case it is **not inconceivable that** (Brent) **crude prices may very well be lifted to $100/bbl**; as some traders have suggested. **Especially if geo-political risks remain elevated and supply elsewhere is inelastic**. Nonetheless, **first-order inflation risks are overblown**. Fact is, even assuming $100 oil, crude will be mostly dis-inflationary and consistent with broader dis-inflation. *Nonetheless*, **second-round inflation impact** and the **geo-political risks accentuate threat of a hard-landing from policy mis-calculations**; rendering *Oil a victim of its own tyranny*.

Surprise OPEC Output Cuts Trigger Economic & Geo-political Worries: **OPEC blindsiding markets with a 1.16MBpD crude output cut** *just a day before the scheduled OPEC+ meeting on 3rd April*, where the widely expected (and signalled) view was for a status quo, **has understandably invoked unwelcome economic anxiety** (about inflation and attendant policy tightening) and **inflamed geo-political abrasions**.

Jury Out on Impact: Looking past the resultant and sustained 6-8% reflex jump in crude oil prices, the question is **whether the OPEC's offensive curve ball** will turn out to be a **sustained shock** to the system *or* **fleeting bump confined mostly to the Oil markets** and is poised to be **shrugged off** thereafter. While it is too early to tell one way or another, examining

Obvious Inflation & Policy Risks: Ostensibly, the **first order economic risk** is that the **consequent surge in crude oil prices**, from OPEC (and earlier Russia) cuts, touted by some traders to send crude prices to $100/barrel, may **potentially unleash renewed** *inflation shocks* and *attendant monetary policy response.*

$100 Barrel Not Inconceivable: For the record, insofar that the OPEC's *1.16MBpD cut by OPEC** is *over and above earlier 500KBpD cut by Russia* (in retaliation of to Western sanctions), the **combined 1.66MBpD reduction in OPEC+ output is significant**; at ~3.9% of the cartel's end-2022 41.856MBpD output. Admittedly, r*ule of thumb*, *approximations of 5-times price change relative to supply disruptions* square with $100/bbl, assuming some 20% premium over pre-SVB $80-85/bbl Brent price. Especially insofar that assessments of less price elastic oil supply outside of OPEC+ (e.g. US Shale) to compensate for the cuts.

Not an Inflation Disaster: Psychologically, triple-digit crude oil is of course unsettling. But to be sure, the **inflation impact** even assuming **$100/bbl** is **neither a disaster for CPI optics nor a deal-breaker for central banks retaining a narrative of peaking inflation**. In fact, our analysis suggests outright dis-inflation impact from crude deflation (at $100) through July before gradual but measured inflation that is consistent with declining G4 inflation through Q1 2024.

First-Pass Inconvenience: Sure, the **diminished dis-inflation impact** from higher crude prices as a result of OPEC production cuts may **render inflation stickier** than initially thought. **But the first-pass inflation effect** of crude is essentially **an economic inconvenience** that *may defer*, *but not derail pipeline policy pivot.* In any case, the **first-pass effect of crude** should **not** present **an enduring core inflation shock**.

But Notoriously Consequential Second-Round Effects: **Nevertheless**, **notoriously pervasive second-round effects means that sanguine first-pass inflation effect**s of crude oil inflation are **insufficient grounds to shrug off output cuts as inconsequential**. Fact is, a **conspiracy of second-round forces** from; i) oil's *sway on more generalized inflation expectations*; ii) the *long-memory effect on, and from, longer-term energy contracts,* and; ii) groomed *expectations of OPEC intervention* to arrest/reverse rapid decline to/below $75; are likely to **infuse considerable uncertainty around the wider inflation impact and outcomes**. Especially in the current climate of elevated and sticky inflation.

Sharpening Policy Trade-Offs: Consequently, **pre-existing policy trade-off** (between inflation and mounting growth headwinds, further accentuated by financial stability risks) **are sharpened** further; as the **bar for central banks to back down from tightening is raised**. Not only due to downside risks to growth or fat-tail risks from the banking/financial sector, but also **because of Oil's inherent duality** – as *both a source of inflation risks and adverse demand shock* (that is ultimately deflationary).

Geo-Politics Complicates Calculus: Moreover, the **obvious dimension of geo-political risks** revealed in the assumed (even if inadvertent) alignment of Saudi/OPEC with Russia teetering on rebuffing the US only **amplifies the underlying risks of policy mis-calculation** and **resultant economic pain**; all around.

For one, **elevated geo-political tensions may** result in stockpiling amid diminished confidence, **resulting in undesirable stagflation-type outcomes** that **accentuate rather than alleviate central bank dilemma**. In any case, **higher oil** (and ultimately inflation) amid pre-existing economic fragilities may **invoke extended global monetary policy tightening inadvertently triggering a hard-landing**; by which time *crashing Oil will belatedly reflect gloom* (driven by recession fears) *rather than pre-emptively provide cushion.*

Saudi (500KBpD), Iraq (211KBpD), UAE (144KBpD), Kuwait (128KBpD) account for 85% of the cuts, with Kazakhstan (78KBpD), Algeria (48KBpD), Oman (410KBpD) and Gabon (8KBpD) making up the rest. These cuts take effect from May, and exacerbate earlier (March) 500KBpD production cut by Russia, which has warned of cuts being maintained rest of 2023.