Mizuho Chart Speak: Oil

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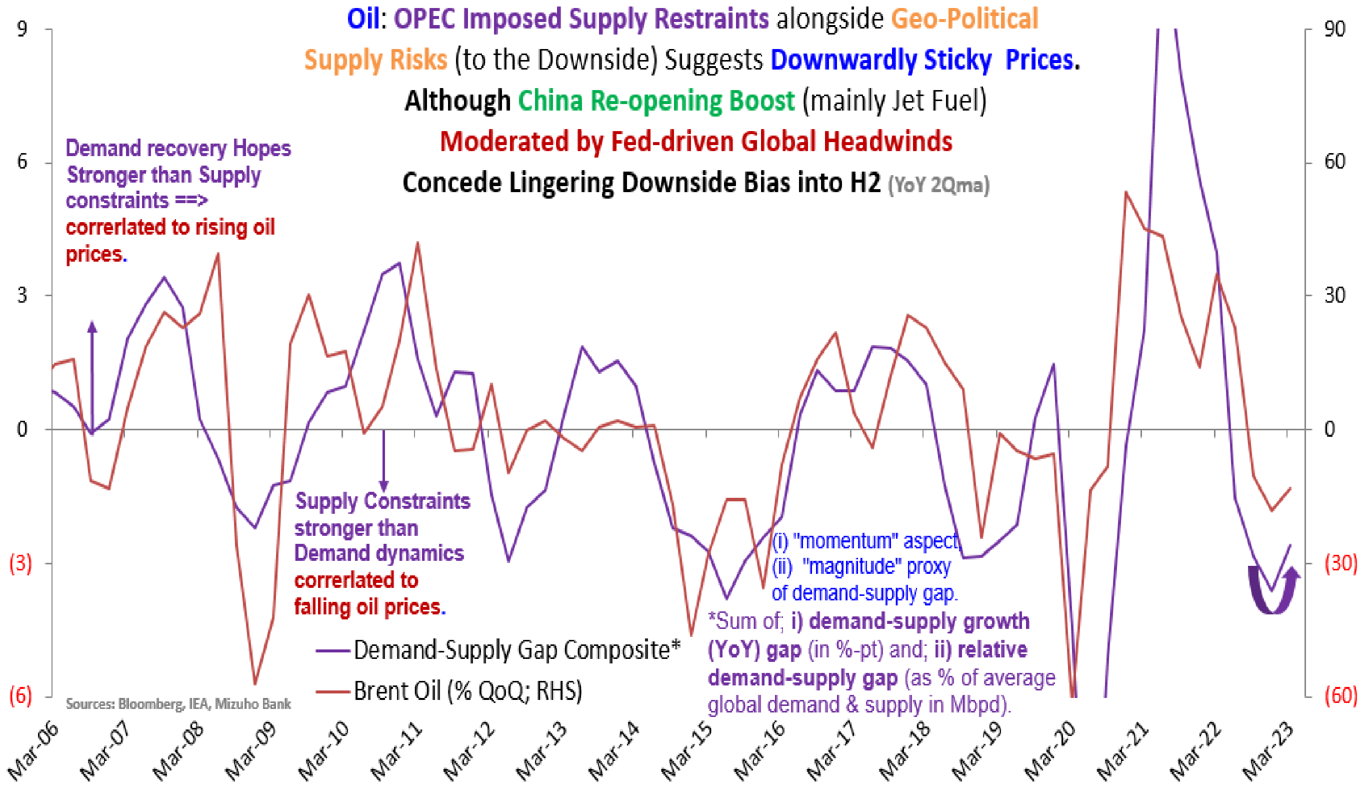
Why Oil is Softer, Yet Sticky



"The test of a first-rate intelligence is the ability to hold two opposed ideas in the mind at the same time and still retain the ability to function." – F. Scott Fitzgerald

In a Nutshell: **Softer Oil prices defy upgrades to the demand outlook** (by OPEC and IEA), predominantly driven by China re-opening demand. This **partly reflects risks of a more aggressive Fed,** *triggered by inconveniently elevated inflation*, **inadvertently dampening demand**. In turn, **underlining negative feedback –loop between oil and inflation**. What's more, demand exuberance derived from **China re-opening are justifiably reined** in on account of *US-China geo-political tensions*.

Nonetheless, oil is likely to be sticky on the way down for now, **despite the downside bias into H2**. Fact is, *geo-political backstops* (security stock-piling demand offset to larger drag from uncertainty), if not blowout risks (episodes of price spikes on disruption) and *OPEC+ supply restraints*. Especially **as supply-side price sensitivities appear to be more pronounced for supply shortfall** (triggering price surges) and the **bar for negative demand shocks may be tipped a tad higher**.

Softer Oil Snubs Demand Upgrade

Oil prices have softened, **despite the OPEC+** and **the IEA** (International Energy Agency) **turning marginally less downbeat, if not outright upbeat.** For the record, OPEC has raised 2023 *global demand growth* by 100KBpd to 2.3MBpD while the IEA has revised *global demand level* higher by 1.9MBpD to a record 101.7MBpD; **both premised on China re-opening demand**.

As Inflation-Policy Feedback Dampens …

The **pullback in Oil prices defying more upbeat demand** outlook led by China is ostensibly **attributable to higher/stickier US inflation** *setting off more elevated US rate/Fed tightening expectations;* which in turn **check demand-end Oil price boost -** partly via "negative feed-back loops".

> Negative Oil-Inflation Feed-back Loop: The tantalizingly odd thing is that oil and inflation have what biologists will call a negative feedback loop*; essentially a chain reaction that counteract the change that first triggered the loop. That is to say, oil going higher drives inflation higher. But in turn, higher inflation spurring *fears of more hawkish Fed* and *attendant not-so-soft landing risks* tempers the rise oil price. So, the checking mechanism is built-in.

… & China Cheer Tempered

Moreover, **China "re-opening" cheer cited by OPEC+ have since been tempered** *by the realities of geo-political-turned-economic headwinds*. As a result of which, **more exuberant expectations of broad-based demand resurgence** (be it directly from China or wider spill-over of optimism) **have been reined in**.

But Oil Not Traumatized

Alongside *measured supply restoration* and *nascent inventory build-up*, crude's **softening bias appears to be reinforced**. **Nonetheless, oil is merely tempered, not traumatized**. Point being, partial *offset from demand buffer* and *relatively tight supply* **render Oil "sticky" despite underlying downside bias**.

Geo-political Backstop: For one, **US-China geo-political risks**, *while initially a* **demand suppressant from the uncertainty factor**, **nonetheless has a partial offset in the form of energy security/stock-piling**. And so, that creates the **"stickiness" around oil price pullback**.

Tail-risk of Blowout: What's more, if **underlying geo-politics descends into conflict, oil will not merely be "sticky", but be prone to abrupt outbursts of price spikes**; at least briefly. Particularly if resultant disruptions to production/ shipping trigger **more acute adverse supply shocks** that send prices soaring.

OPEC+ Restraints: Crucially, **markets are acutely aware that the OPEC+ has neither the instantaneous capacity nor the inclination to bump up output on demand upside**. On the contrary, **OPEC+ is keeping a tight grip on output**. Consequently, fairly restrained OPEC+ supply is consistent with *price stickiness*.

Softer, But Supply-Sensitivity Biased to Price Upside

To be sure, the **direction of travel in Oil prices into H2 is downwardly inclined**; given **gathering headwinds to global demand accentuated by hawkish Fed risks**, beyond the initial China re-opening demand boost. *But* **asymmetric supply-side sensitivity** - specifically, greater sensitivity to supply shortfall - is **consistent more pronounced Oil price rebound/backstop**. And this sets the stage for price dynamics.

High Bar for Bearish Demand Shocks

And on the demand-end, a **large bearish shocks to oil price may require the wheel coming off** demand. Point being, **despite concerns of a more hawkish Fed** *and US-China geo-politics*, watering down demand boost for oil, the general consensus that **a hard-landing will be averted**. And so, arguably there is **a fairly high bar for adverse demand shocks to set-off brutal oil bears**.

* Not to be mistaken for an adverse spiral which amplifies the (negative/adverse) effects.