Commodity Week

08 March 2021

OPEC's Pricing Power Underlines Supply/Demand Fragility

Just as the rally in oil prices appeared to be petering out, driven in part by the fact that OPEC was expected to raise production rates, Saudi Arabia, the largest producer in OPEC, announced that it would maintain production at current levels until at least the next meeting propelling the oil price towards $70/bbl (Table 1).

Nevertheless, pricing power is unlikely to remain in the ascendancy when the US' Permian Basin starts to come back on stream, which will either need to be accounted for by a rate cut from OPEC, or, as is more likely, the additional volumes in the market will provide a headwind to current pricing.

Given the transient nature of the reduction in the Permian volumes, and the expectation that as the polar vortex recedes that production will be restored, it is somewhat curious that OPEC's decision to maintain production should have such a strongly positive impact on the price.

While the world returning to "normal" demand levels post Covid-19 is a key element of the market psyche, what this week's price movement tells us is that despite Permian volumes returning that: (i) the supply/demand balance is currently finely weighted; and (ii) supply security is already perceived to be acute.

The key question is whether the proposed pullback in upstream investment and the imposition of exploration and development restrictions in the United States and Europe has already been factored in, or whether this is yet to be fully played out.

Irrespective of the extent to which this has been priced in, these factors will have a greater impact as time progresses. At that point, we would expect to see contango events being more prevalent, and signs of an increase in the extent of concavity, or mores the point, a reduction in forward curve convexity.

In this Week's Edition

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Fingertip Figures

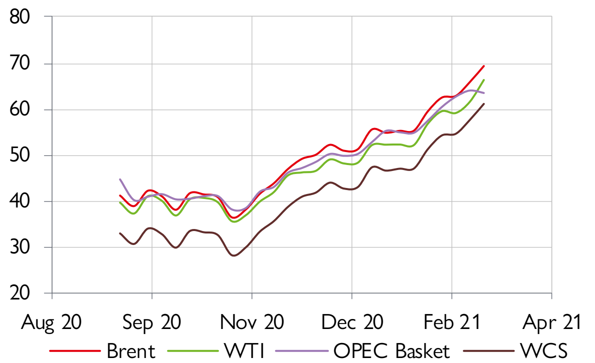
Table 1 – Commodity Prices

Item	Price	1 Week Change (Net)	1 Week Change (%)
Crude			
Brent ($/bbl)	69.36	3.50	5.31%
WTI ($/bbl)	66.09	4.59	7.46%
OPEC ($/bbl)	64.26	(0.11)	(0.17%)
WCS ($/bbl)	57.74	4.59	8.64%
Natural Gas			
Henry Hub ($/mm btu)	2.87	(0.07)	(2.35%)
NBP (p/therm)	41.40	1.61	4.05%
JKM ($/mm btu)	6.00	(0.20)	(3.15%)
Dutch-TTF (€/MWh)	16.37	0.65	4.11%
PSV (€/MWh)	17.10	0.47	2.80%
De Gas Pool (€/MWh)	16.75	0.75	4.71%
Currencies			
GBP ($/£)	1.382	(0.016)	(1.15%)
EUR (€/$)	1.191	(0.023)	(1.89%)
JPY (¥/$)	108.3	1.715	1.61%
NOK (N₭/$)	8.579	(0.033)	(0.39%)
RUB (₽/$)	74.45	(0.093)	(0.12%)

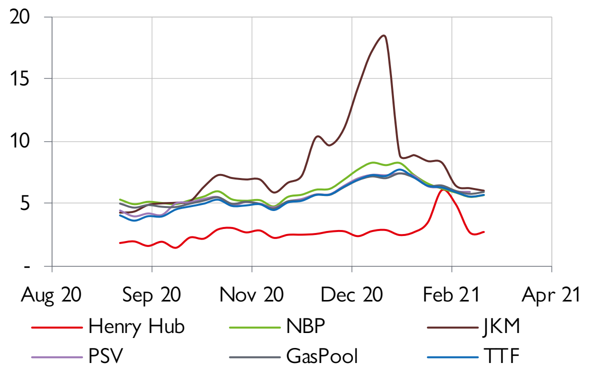
Source: FactSet & OGA data

Figure 1 – Commodity Charts

Oil ($/bbl)



Gas ($/mm btu)



Source: FactSet & OGA data

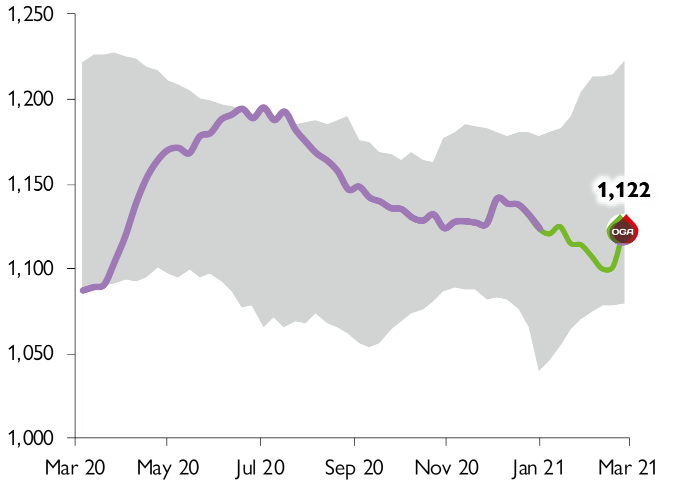
Oil Market

Commentary

Given the fact that the oil and gas markets are both deep and liquid, it should hardly be a surprise that the price is a correlation of the relative balance between supply and demand, or at least the perception of the relative balance between supply and demand.

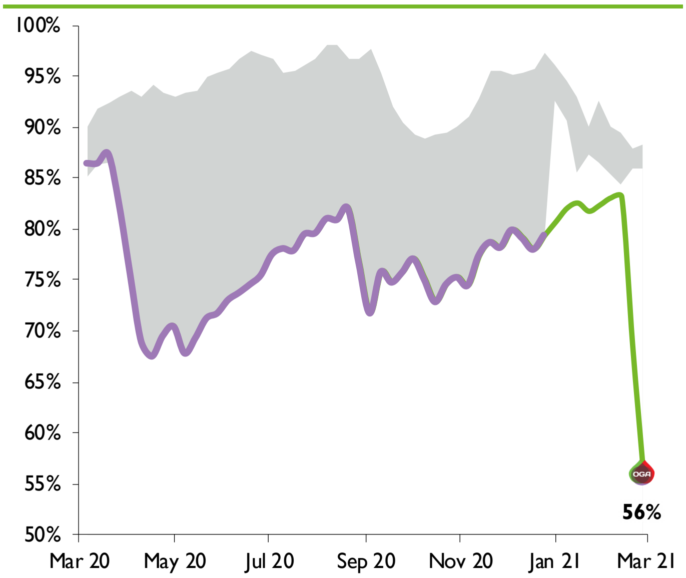
This week's oil price performance comes despite a significant build in inventories (Figure 2), which must be placed in the proper context, as it comes on the back of significant historically low refinery charge rates (Figure 3).

Figure 2 – US Crude Oil Inventories
m bbl



Source: FactSet & OGA data

Figure 3 – US Refining Utilisation
Charged as percentage of Nameplate Capacity



Source: FactSet & OGA data

This week has seen OPEC+, or rather Saudi Arabia, effectively fix the supply side until the next meeting, which given that there is a strong belief that demand is going to bounce back strongly, has resulted in a surge in prices, albeit mostly at the short end of the forward curve.

The coming week will be interesting as relative "normality" starts to return to the Gulf Coast, as refining starts to spool up and production from the Permian Basin begins to restart.

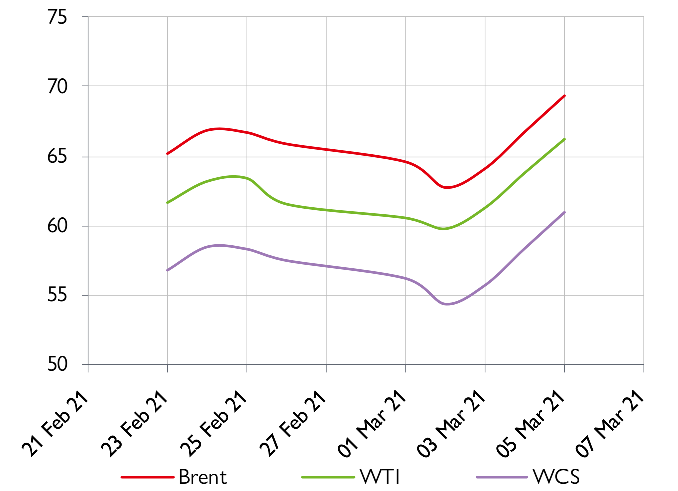
As the Permian Basin production starts to come on stream, this will place downward pressure on the price, which in conjunction with further action from OPEC+, could see prices trend towards $50/bbl.

This does not mean that the Supercycle is any less likely. On the contrary, such is the extent of investment is required between now and 2025, given that we are already behind the curve, and falling away further with each passing month, these modest fluctuations in oil price, demand and supply have no impact whatsoever.

While we expect the oil price to ease over the coming week, in time this will be seen as a "sawtooth" on the way to what we believe will be a Supercycle high in excess of $150/bbl.

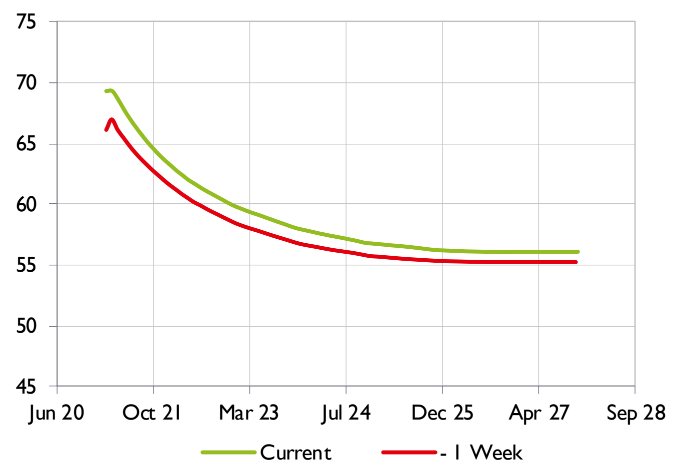
Recent Pricing & Forwards

Figure 4 – International Benchmark Prices – Last 7 Days
$/bbl



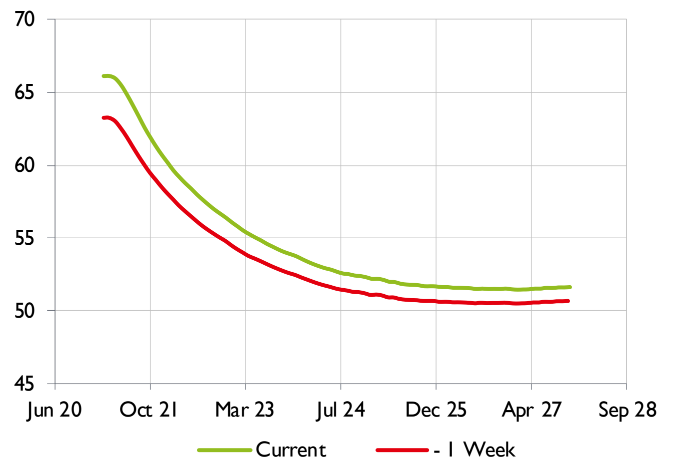
Source: FactSet & OGA data

Figure 5 – Brent Forwards
$/bbl



Source: FactSet & OGA data

Figure 6 – WTI Forwards
$/bbl



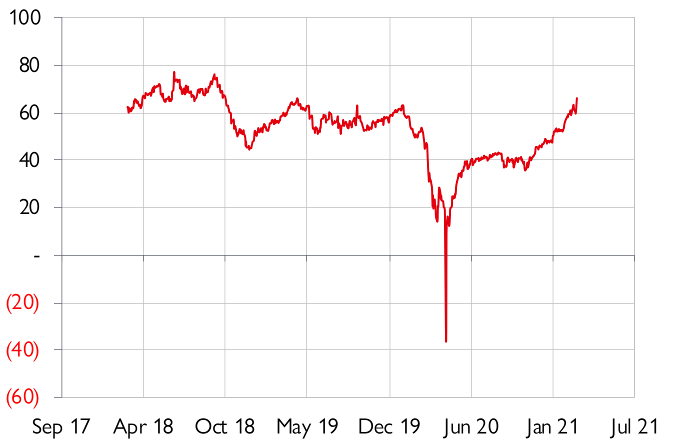
Source: FactSet & OGA data

Historic Pricing

Figure 7 – Brent
$/bbl

Source: FactSet & OGA data

Figure 8 – WTI
$/bbl



Source: FactSet & OGA data

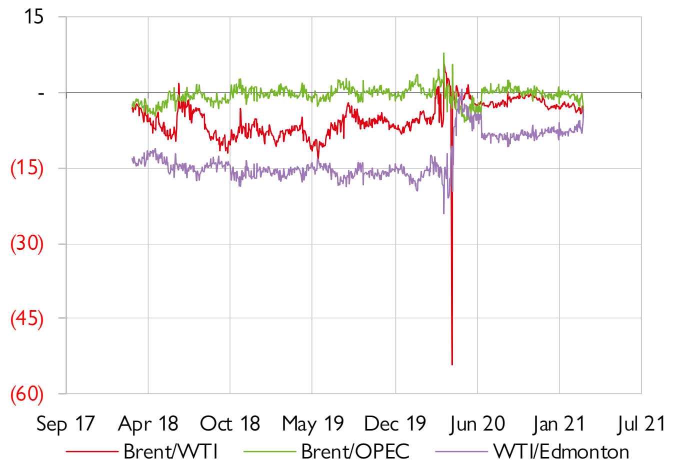
Figure 9 – OPEC
$/bbl

Source: FactSet & OGA data

Figure 10 – WCS
$/bbl

Source: FactSet & OGA data

Figure 11 – Differentials
$/bbl



Source: FactSet & OGA data

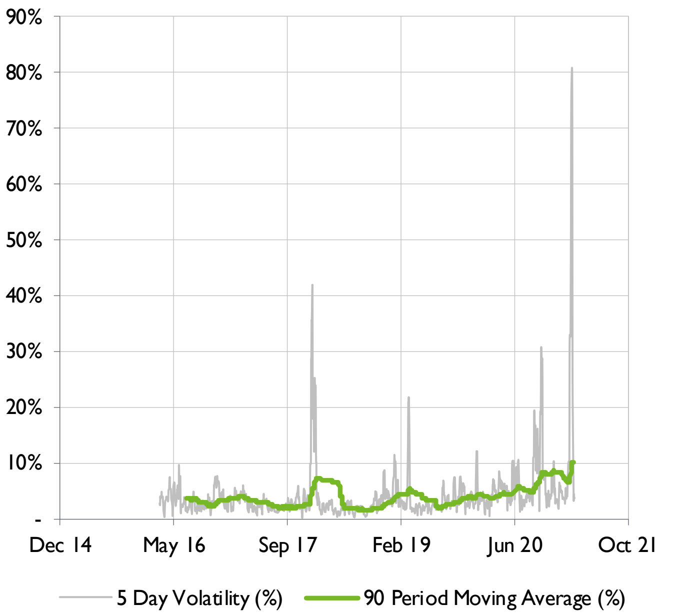
Gas Market

Commentary

after what was an exceptionally high price, in excess of $25/mm Btu, Henry Hub has once again returned to its more "normal" ~$3.0/mm Btu level (Figure 13).

There is little doubt that the recent price spike had a significant impact on volatility (Figure 12), but as Figure 12 also shows, Henry Hub volatility has been increasing, and the recent Covid imposed decline in demand, has not had any appreciable impact.

Figure 12 – Henry Hub Volatility
%



Source: FactSet & OGA data

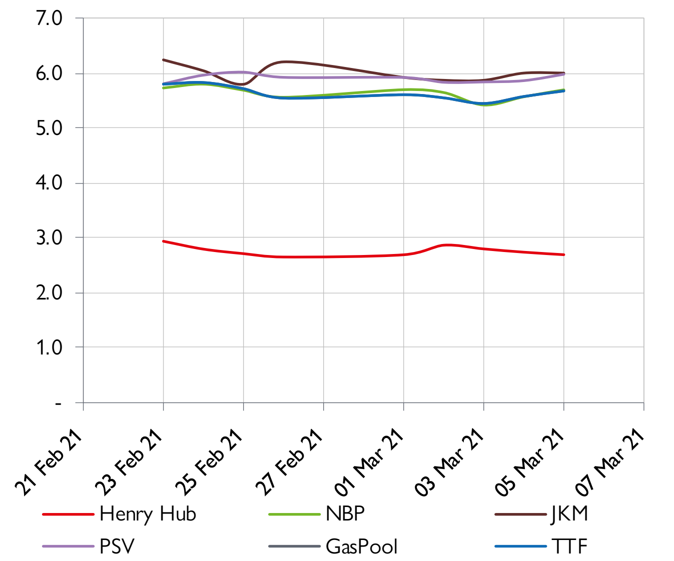
As we highlighted numerous times recently, this is predominantly due to a lack of investment in gas, with preferential investment being given to liquids.

While ultimately the lack of investment will create a higher environment, the real concern is that if the Democrat party continues to restrict the growth in oil and gas the way that they have been, and have mooted may happen in the future, then when that point arrives it will be too late and gas prices are likely to surge.

In that scenario, we would expect to see the LNG facilities which are currently set up for export, rededicated to handle imports.

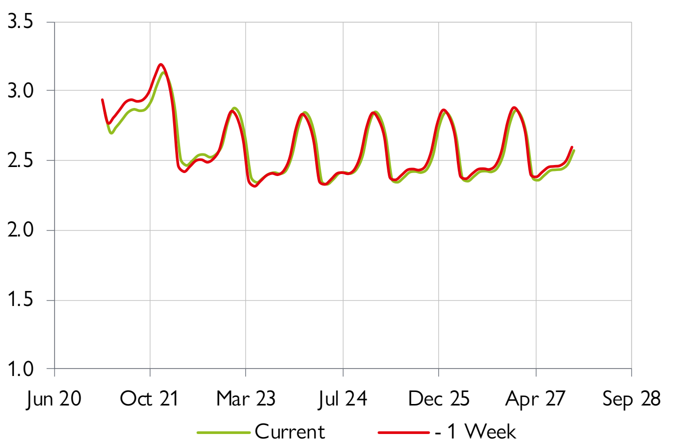
Recent Pricing & Forwards

Figure 13 – International Benchmark Prices – Last 7 Days
$/mm btu



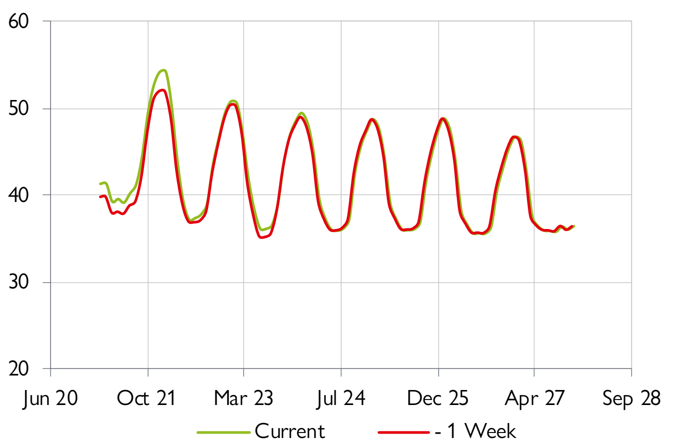
Source: FactSet & OGA data

Figure 14 – Henry Hub Forward
$/mm btu



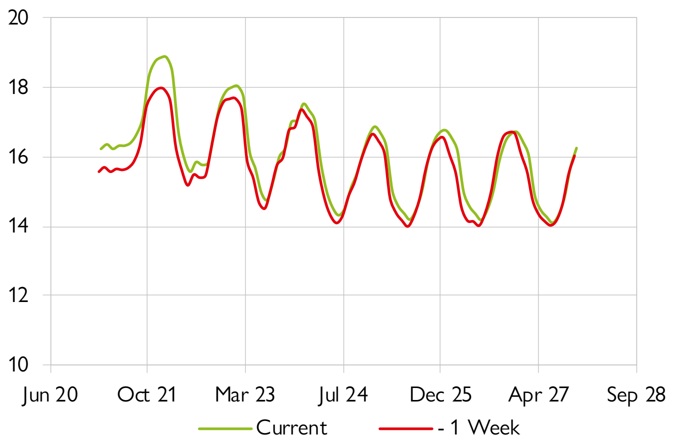
Source: FactSet & OGA data

Figure 15 – NBP Forward
p/therm



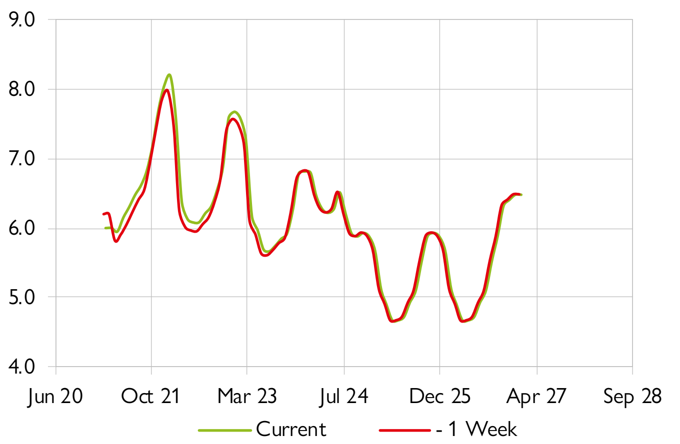
Source: FactSet & OGA data

Figure 16 – Dutch-TTF Forward
€/MWh



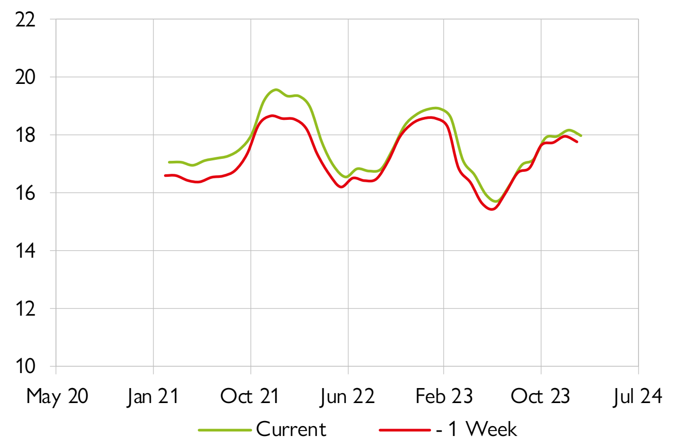
Source: FactSet & OGA data

Figure 17 – JKM Forward
$/mm btu



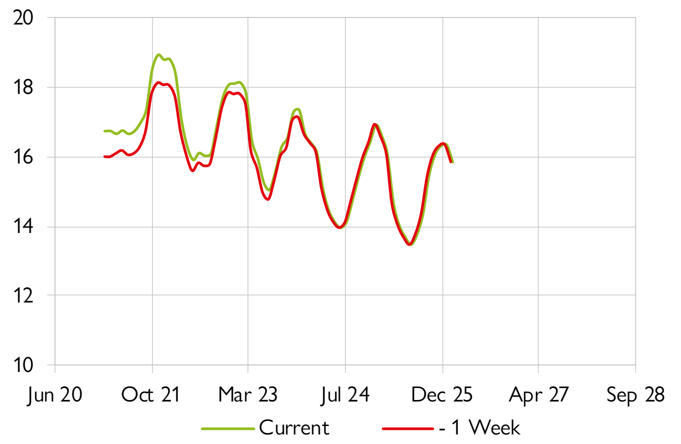
Source: FactSet & OGA data

Figure 18 – PSV Forwards
€/MWh



Source: FactSet & OGA data

Figure 19 – German Gaspool Forward
€/MWh



Source: FactSet & OGA data

Historic Pricing

Figure 20 – Henry Hub
$/mm btu

Source: FactSet & OGA data

Figure 21 – NBP
p/therm

Source: FactSet & OGA data

Figure 22 – Dutch TTF
€/MWh

Source: FactSet & OGA data

Figure 23 – JKM
$/mm btu

Source: FactSet & OGA data

Figure 24 – PSV
€/MWh

Source: FactSet & OGA data

Figure 25 – De Gaspool
€/MWh

Source: FactSet & OGA data

Rig Update

Commentary

Rig utilisation rates have flatlined (Table 2), but this doesn't necessarily mean that the market is softening, just as we commented for the opposite.

Table 2 – Rotary Rig Data

Item	Latest (δ %)	-1 Week (δ %)	-6 Months (δ%)
USA	403	402	256
	0.2%	57.0%	-
Canada	141	163	52
	(13.5%)	213.5%	-
North America	544	565	308
	(3.7%)	83.4%	-
Rest of the World	701	701	747
	-	(6.2%)	-
Total	1,245	1,266	1,055
	(1.7%)	20.0%	-

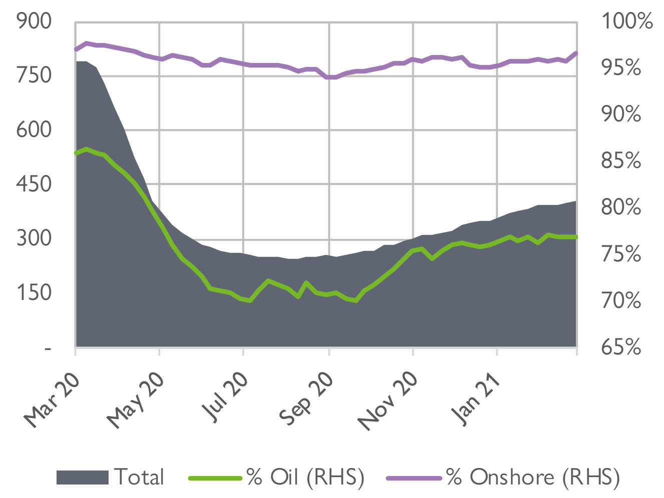
Source: FactSet & OGA data

what is interesting to note, however, is that despite the recovery in the rig utilisation rates, the majority of this recovery has been focused on land rigs (Figure 26), and that the proportion of offshore rigs has fallen.

Obviously, we have to factor in the longer lead times associated with offshore rigs, but offshore waters are deemed to be federal lands, so this may just be the start of the impact of the Democrats drilling moratorium.

Whether this will ultimately prove to be the case, or not, only time will tell. Given that lead times for offshore drilling are rarely below 4 months, even in a liquid market like the Gulf Coast, we would expect to see some evidence, one way or another, as we approach 2021's Hurricane season.

Figure 26 – Rolling 12-Month Rig US Rates Count



Source: Baker-Hughes, FactSet & OGA data

About Us

Oil & Gas Advisors assists its clients in achieving their goals and objectives. We advise our clients on asset level acquisition and disposals (A&D), farmins and farmouts, corporate-level mergers and acquisitions (M&A), equity, debt, corporate and asset restructuring, and strategic matters.

We also assist our clients in gaining access to the capital markets, whether it is for debt via the issuance of corporate bonds, Reserves Based Lending (RBL), or structured credit instruments such as PrePay structures, or the equity markets, whether the seed, IPO or secondary markets.

OGA has worked with a wide range of oil & gas companies, from start-ups and independent E&P companies, to BP and Chevron, Gulf Oil. OGA has also worked with a range of specialist financiers, from boutique investment and merchant banks, to Bank of America Merrill Lynch, HSBC and ING Barings.

OGA's extensive experience with sovereign wealth funds also, such as Dubai World, where OGA formed part of the management team with responsibility for the economic, financial and legal management of Dubai World's oil & gas business, investments and subsidiary companies.

OGA's project and transaction value exceeds $65bn, experience which has been gained in all the hydrocarbon provinces. As a company, we understand that the areas in which it operates are often sensitive and key to the health and successful development of our clients.

We understand that honesty and integrity are of paramount importance. We are committed to developing an environment where our clients' needs are met, and expectations exceeded, which is reflected in our approach, core values, people and affiliations.

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