# OCBC TREASURY RESEARCH

## Crude Oil

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# Quick take: Saudi Arabia flexes its muscles, unilaterally cuts output by 1mbpd

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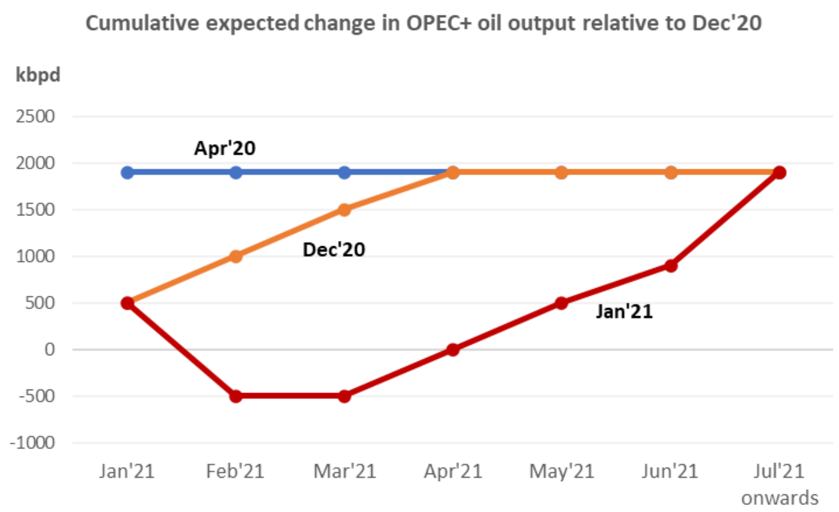
- **Saudi's unexpected oil output cut of 1mbpd is no small quantity and is likely to flip the market back into supply deficit this quarter.**
- **The kingdom is supporting prices with regular intervention and could result in an implicit floor on how low oil prices could correct.**
- **We see Brent trading mostly in the mid-50's through this year, although the upper end of our estimates sees Brent trading in the low-60's.**

- **Saudi Arabia has unilaterally reduced its crude oil output by 1mbpd for Feb'21 and Mar'21.** This more than offsets the 500kbpd crude oil increase from OPEC+ beginning Jan'21 and the marginal increase of 75kbpd from Russia and Kazakhstan beginning Feb'21.

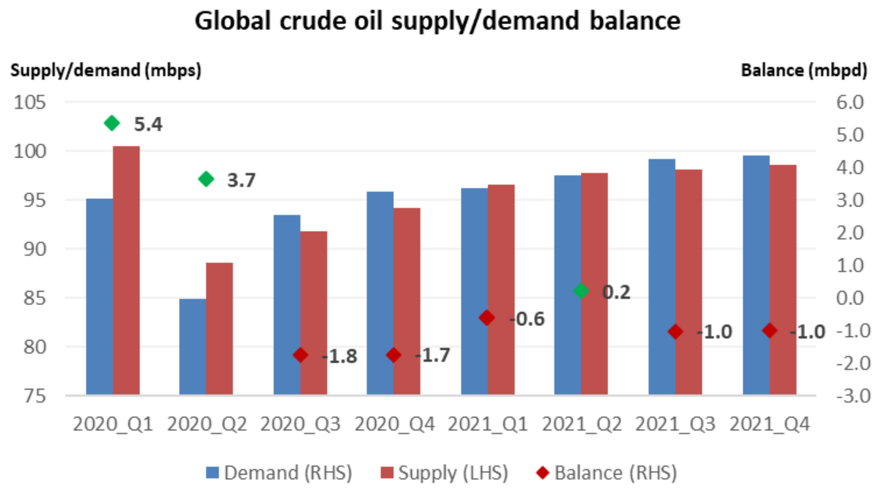
- **The reduction of 1mbpd from Saudi Arabia is highly unexpected and is a considerably steep supply curb.** The oil market reacted strongly, with Brent rising 4.9% to $53.60/bbl and WTI trading above $50/bbl for the first time in almost a year.

- **Recall that OPEC+ was supposed to increase output by 2mbpd in Jan'21, according to its initial plan laid out in Apr'20.** The fragile global economic recovery, however, led the group to just increasing output by 500kbpd in Jan'21, with monthly reviews to be conducted each month to assess the suitability of increasing output. We had expected a consistent increase of 500kbpd each month for the next four months, beginning Jan'21.




*Source: OPEC, Bloomberg, various, OCBC estimates*

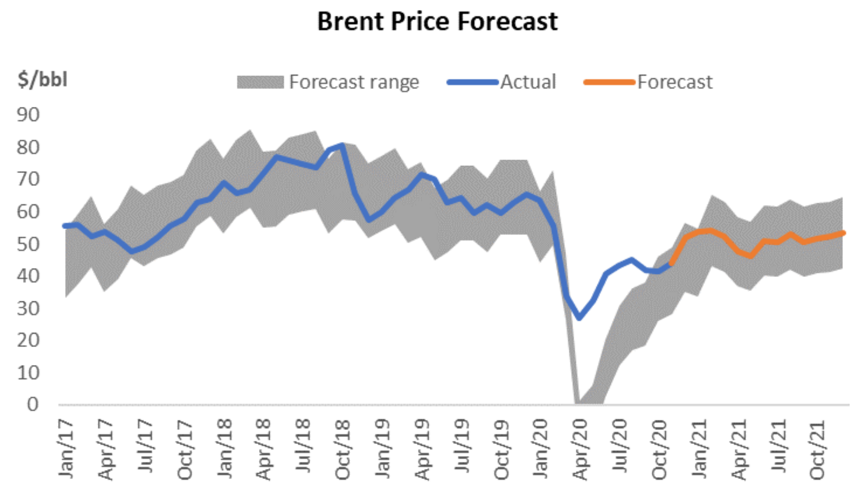
- **With Saudi Arabia's decision to cut its output by 1mbpd, the market in Q1 is likely to flip back into supply deficit of 600kbpd from our initial estimate of a 300kbpd surplus,** even with expectations of a dip in demand arising from the new coronavirus variant.




*Source: US EIA, STEO, OPEC, Bloomberg, OCBC Estimates*

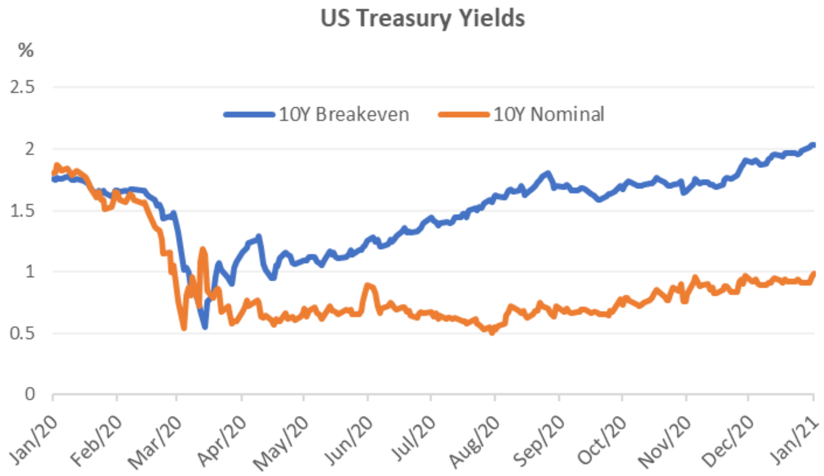
- **The message is now loud and clear.** 1mbpd reduction is nothing to scoff at and this is pure flexing of muscles by Saudi Arabia. Saudi Arabia is there to guard the fragile market equilibrium and it will take a lot of guts to bet against this rally. More importantly, Saudi's actions could set a floor on how low prices can correct, as the market is going to anticipate intervention from the kingdom each time prices fall too low.

- **With this output cut and assuming no major hiccups in vaccine availability,** we see Brent mostly trading in the mid-50's through 2021. The upper bound of our estimates, however, do suggests Brent may potentially trade in the low-60's occasionally.



*Source: US EIA, STEO, OPEC, Bloomberg, OCBC Estimates*

- **Keep a lookout for increasing inflation expectations,** especially with the oil market's bullish stance firmly supported. 10Y breakeven yields have traded above 2.0% since the start of 2021, even if 10Y nominal yields have stayed almost largely stable.




*Source: Bloomberg, OCBC Bank*

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