Mizuho Brief: Oil

Economics & Strategy | Asia ex-Japan

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MIZUHO

Oil Stifled as OPEC+ Pursues Market Share

"Mad Hatter: Would you like a little more tea?

Alice: Well, I haven't had any yet, so I can't very well take more.

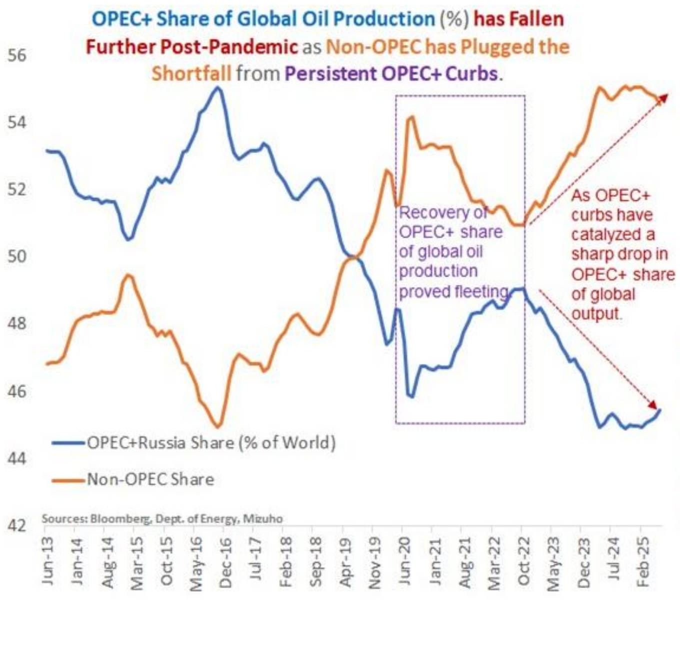
March Hare: Ah, you mean you can't very well take less.

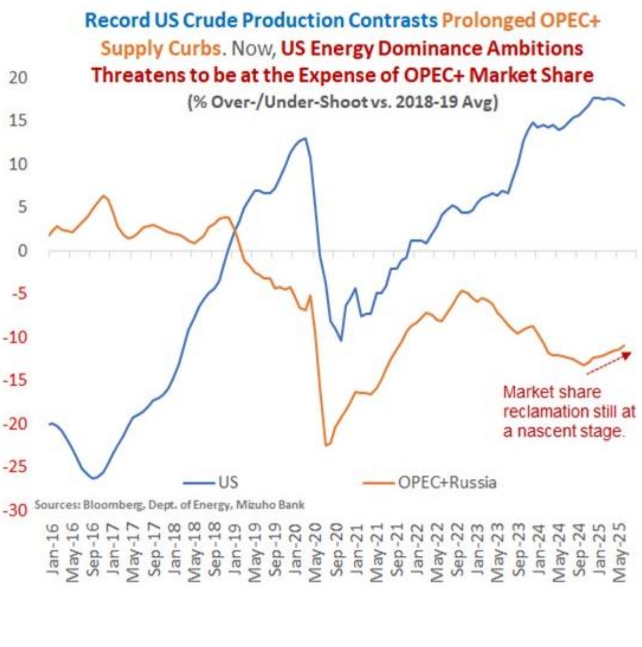
Mad Hatter: Yes. You can always take more than nothing."

- **Lewis Carroll, Alice in Wonderland**

In a Nutshell:

- Another **larger than expected bump-up** (restoration) in crude output by ***548KBp***D by OPEC+ **sets the stage for tamer summer oil price volatility** and softer crude/energy further out.
- Fact is, the OPEC+ is bent on restoring the 2.2MBpD that it voluntarily removed from markets earlier, and likely sooner rather than later.
- A **key catalyst** at work, as we highlighted back in April, is the **Saudi-led resolve to reclaim markets share lost**, as it races *to ensure energy market dominance not lost irredeemably.*
- Admittedly, higher prices were desired earlier (post-pandemic), and $90/bbl required to balance the budget, and avert sharply higher deficits.
- Nonetheless, **softer oil prices is the lesser evil** (and **accepted trade-off**), that helps strategic reclamation of share, acquiesce Trump's demand (for softer oil) and to asset intra-cartel and Middle East dominance (vs. Iran).
- **Resultant energy dis-inflation** could **validate global central bank's easing** and **Fed's catch-down rate cuts**.
- **Softer yields** are thus **par for the course**, although a **more distinct term premium** could *weaken oil's transmission to long-end yields.*





- Yet another **larger-than-expected bump up in crude output** (of 548KBpD) **by the OPEC+** (to take effect from August) **further softened Brent prices** to sub-$68/bbl.
- Admittedly, the **ceasefire brokered between Israel and Iran has stolen the thunder** for Oil's bearish outburst ((from ~$78 to ~$68 since 23rd June).
- Nonetheless, the **aggressive OPEC+ supply restoration** *led by Saudi* **underwrites a bearish backdrop for Oil** as it;

i. *buffers demand strains from summer driving season,* thereby dampening potential upside spikes, and;
i. *tips the global balance* of supply-demand dynamics *to* a more *durable abundance of supply* further out.

- In the absence of a reversal of outsized restoration of output, the **stage may well be set for a surplus of oil**, which **drag soften crude prices further**, heading **into year-end**. And ***perhaps even more durably***.
- Ostensibly, the **aggressive approach to supply restoration** is **counter-intuitive to OPEC+'s profit-maximizing** goals (as is often the case with most cartels).
- **Especially given** that **wider OPEC budgets are increasingly reliant on richly priced oil** for financing. Saudi itself would require $90/bbl crude to balance its budget.
- *But* as established in our earlier note* on oil, **softer oil prices may be the "lesser evil" for Saudi**, OPEC+, and arguably for the global economy, all things considered.
- For one, as we highlighted in April, Saudi (and OPEC+) are proactively posturing **to reclaim markets share**, given fears of irredeemable loss of share and sway.
- To that end, softer prices in the interim is *a palatable enough* (albeit a tad bitter) *trade-off,* that id facilitated by **inherent advantage of comparatively lower cost of production**.
- What's more, **Saudi also gets the political benefit of acquiescing Trump's demands** *for lower oil prices* as a **means to lower inflation**, which then sets the **stage for rate cuts to soften yields**.
- In addition, upping production **imaginably also accentuates Saudi's regional dominance**/**clout**.

1. First by checking Iran, which may get waivers to export oil, if Trump's off-hand remarks about allowing Iranian oil to flow to China are taken at face value.
2. Second, by inflicting intra-cartel discipline (and pain) on OPEC+ members that have flouted curbs

- All said, the **OPEC+ is on track to fully unwind supply curbs** much earlier than projected, *with another similar sized (548KBpD) restoration set to fully reverse the 2.2MBpD curbs* from earlier.
- The upshot is that a **reclamation of market share by Saudi appears to still be in the nascent stages**. So, the **bar may be higher for OPEC+ to back down from restoration** of output
- Which in turn **squares with softer crude prices trending to ~$60/bbl** (see Table below for our forecasts), mostly contained in the wider ~$55 to sub-$70 range, barring another flare in Middle East conflict.

    - Underpins Fed's Catch-Down Rate Cuts: The resultant dis-inflationary impact of softer oil should **dovetail with emphatic**, even if ***belated*** **Fed rate cuts that catch down with other global central banks**.
    - Softening Yields: In turn, **softer UST yields** (*led by the front-end*) are par for the course.

- Steeper Curve & Yields: But a steeper yield curve goes beyond just the cyclical Fed rate cut trigger.
- Amid Fiscal/"Sell America" Risks: Instead, **US fiscal risks** amid **"Sell America" dynamics** may **add more distinctly to term premium**, which could *weaken correlation between Brent crude* and *10Y yields.*

	Q2 2025	Q3 2025	Q4 2025	Q1 2026	Q2 2026	Q3 2026
Brent Crude	67.6	65.5	61.5	65.5	62.5	61.0
(US$/bbl)	58.4-74.7	58.55-72.5	56.5-68.8	56.5-72.5	54.5-68.8	54.5-68.5

*Please refer to the earlier discussion in Oil from 4th April 2025 attached in the box below.

OPEC+ & Oil: Lesser Evils & Lower Yields? (4th April 2025)

"The probability lies in that direction." – **Sherlock Holmes, The Hound of Baskervilles**

In a Nutshell:

- A **surprisingly large bump up in OPEC+ supply restoration**, dragging crude prices, is **ostensibly at odds with OPEC+'s desire for price support**. ***But*** it is **consistent with the broader interests of the OPEC+**.
- Most prominently, **averting further and irrevocable loss of market share to non-OPEC** competition, led by *aggressive US energy dominance ambitions (looking to pump 3MBpD more).*
- Moreover, the **strategic importance of aligning with Trump's call for a "cut in Oil prices"** also features conspicuously.
- Furthermore, **geo-political calculus** that involves compensating for Iran's output, to **facilitate a policy of "maximum pressure"/sanctions on Iran**.
- Finally, higher output is **a warning to non-compliant members** (e.g. Kazakhstan and Iraq), who have more to lose against low-cost producers such as Saudi and Russia.
- Upshot being **lower crude prices are the lesser evil** compared to *hard-to-recover loss of share, geo-political pitfalls* or *inadvertent loss of cartel discipline.* Especially considering the overhanging risk of geo-economic shocks.
- Admittedly, ***OPEC further supply ramp-up is highly contingent***. Nonetheless, **rising risks of adverse demands shocks** suggest **softer oil price on balance**.
- This **squares with underlying anchor for, if not drag on, inflation expectations**, in turn ***supports further*** *(even if not imminent)* ***global easing***.
- **More durably lower yields** could be supported by Fed cuts on well-anchored inflation expectations.

- OPEC Surprises with Upsized Output Bump-Up: In a **dovish** (bearish for Oil) surprise, **OPEC+ announced a 411KBpD addition for May**, *three times the earlier guidance for a calibrated 138KBpM monthly increment.*
- Crude Prices Sink: Markets took heed, **sinking crude prices some 7-8%** (Brent from \$75+ to \$sub-\$70 | WTI from \$72 to \$66-67).
- Contrary to OPEC Preferences …: The **price action is ostensibly the opposite of what the OPEC+ would have desired.** Afterall, the OPEC+ is known for its inclination to protect, if not buoy, prices.
- … & Fiscal Support: In fact, *Saudi's implied preference for (Brent) crude price is closer to \$90,* as backed out of its fiscal breakeven.

- Uncharacteristic At face value, this admittedly appears like **diametrically opposed to OPEC+'s usual caution and conservatism in adding crude supplies** (to the detriment of price support).
- But Not Misaligned: ***But*** it is **not a departure from the OPEC+'s fierce defense of self-interest**.
- Lesser Evil on Greater Considerations: In fact, **lower prices are the lesser evil** when **accounting for a wider array of risks**, *including risks to market dominance, geo-political posturing, (intra-cartel) game-theory and overarching geo-economic risks augmenting pure profit motives.*
- 1. To Avert Irrevocable Loss of Share: For one, **OPEC+ is acutely aware of irrevocably losing even more market share**, (to non-OPEC output led by US, Canada, etc.) ***if it does not increase output***.
- Especially on US Energy Dominance Ambitions" : **A risk accentuated by US' aggressive energy dominance ambitions**. **US' world-leading, record 13MBpD US production**, **with sights on an additional 3MBpd** is ***a serious threat to the cartel***.
- Price Support Too Expensive: Fact is, **price support by OPEC+ benefits the competition *at the expense of its market share*.** In other words, **OPEC+ simply cannot afford stubbornly** support **prices**, (with output) curbs at the cost of market share.
- 2. Trump's Pressure to "Cut Oil Price": Second, and the elephant in the room, is **Trump's persistent pressures to "cut oil prices"**. Imaginably, *both Saudi and Russia want to oblige, given the geo-political stakes involved.*
- 3. Pressuring Iran: What' more, it **is in Saudi's geo-political interest to displace Iran's exports share** *so as to lower US hurdles for "maximum pressures" sanctions on Iran.*
- 4. Intra-OPEC Discipline: Finally, **increasing output may be a "Prisoner's Dilemma" type warning for non-compliant members** (notably Kazakhstan and Iraq). Especially given flouters have more to lose on falling prices than low-cost producers such as Saudi and Russia.
- Opportune Timing of Tariff Turmoil Cover: Notably, the **cover of tariff turmoil to up output** *may partly piggy-back on dominant bearish demand factors,* **potentially blunting price pain** from the supply bump-up.
- Non-Linear & Contingent: To be sure, this a **linear projection of May's upsized output restoration is far from guaranteed**. Instead, **OPEC+ supply response will fluidly respond to** *evolving demand risks* and *geo-political contingencies.*
- Albeit Tilted to Softer Oil: Nonetheless, **softer oil prices* are likely to prevail on balance**, *as competition for share checks the temptation to fully offset price declines* in an environment of adverse demand shocks.
- Dampening Inflation Expectations: Consequently, this **squares with inflation expectations being materially dampened** as **follow-through demand-pull risks from potential tariff price shocks** are **more than offset**.
- & Dovish Monetary Policy Impetus: In turn, tis **lowers the hurdle of global central banks to ease further**, as they are ***no longer unduly hobbled by opposing price and income shocks***.
- Lower Yields Hastened by OPEC+: The upshot is that **OPEC+'s distinct shift from price support to market share**, **prioritizing geo-political considerations**, **hastens a path to a more dovish Fed and durably lower UST yields**.

*$60-$75 (compared to 2024 average of $80/bbl)