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Opec+ supply cut sends oil price up

OIL AND GAS

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PETALING JAYA: As investors globally are beginning to feel the easing of the Federal Reserve's (Fed) hawkish stance, underpinned by relief on banking concerns, a potential curveball has appeared in the form of an announcement from the Organisation of the Petroleum Exporting Countries and its allies (Opec+) declaring an unanticipated voluntary supply cut beginning next month.

The organisation, made up of 13 Opec members plus an additional 11 countries including Malaysia, will cut oil supply by up to 1.16 million barrels per day (bpd), taking the total of supply cuts by the group to 3.66 million bpd for 2023.

The obvious questions to be asked then would be how would this affect Malaysia's revenue, as well as inflationary prospects both locally and internationally moving forward, if this latest cut produces sustained effects.

Coface Services South Asia-Pacific Pte Ltd Bernard Aw and Eve Barre pointed out that higher oil prices had in the recent past affected Malaysia's public finances both positively and negatively.

Aw and Barre told *StarBiz* that on one hand, a rise in oil prices increases government revenues, notably through a larger export duty as well as higher profits for Petroliam Nasional Bhd – the oil and gas state-owned group – while on the flip side, it expands public expenditure by leading to greater subsidies for fuel retail prices.

"Last year, global oil prices increased, with the Dubai spot – the reference for the crude oil price in Asia – climbing by 40% on average from 2021. The net impact of the increase was slightly negative for public finances, with fuel subsidies increasing by RM39.8bil while petroleum-related revenue expanded by RM39.4bil," the duo pointed out.

Therefore, they believe that even if higher oil prices arising from the Opec+ supply cut are sustained, it could have a slight negative impact on Malaysia's public finances and could put the idea of targeted fuel subsidies on the table again.

Economist and chief executive of Centre for Market Education (CME) Carmelo Ferlito, looking at matters from the government's perspective, agreed that the supply cut could be a double-edged sword for its coffers.

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>
> Carmelo Ferlito

He told *StarBiz*, "While higher oil prices would improve revenues, they will also increase the subsidy bill, given that the government has not implemented any targeted subsidy plans that were mentioned last year."

Glancing at the broader economic picture from the inflationary angle, especially in light of the uptick in oil prices from approximately US$78 (RM344) per barrel to over US$84 (RM371) since the Opec+ announcement at the weekend, Ferlito said that interest rates, being a key indicator of economic activity, should be the result of market forces and not of policy decisions.

"Bank Negara's policies have always been traditionally more moderate, which is good in that they do not blindly follow the Fed. Bank Negara has also always mentioned that it will decide according to the evolution of the situation," he noted.

Malaysia University of Science and Technology economist Geoffrey Williams said with oil prices expected to be in the US$80 (RM353) range in the immediate context, it is still significantly lower than this time last year, a factor which would reduce year-on-year inflation.

"But it will keep transportation and supply costs elevated and so higher inflation will persist, but hopefully, will be lower than last year.

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Higher prices bode well for exploration and production activities

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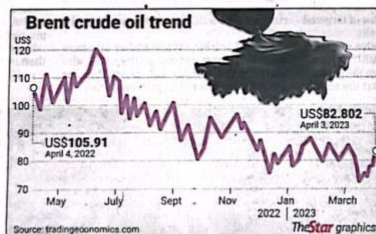
"We are still in the 2.8% to 3.8% range Bank Negara is forecasting, but now with more upside risk," he added.

Williams perceives the real risk would be in whether this supply cut will lead to an escalation in geopolitical issues because it looks coordinated among a number of countries keen on changing the global balance of power.

"Hopefully, it is just a market realignment as the Saudi Arabia government says," he added.

From a bigger-picture standpoint, Coface's Aw and Barre said the current knee-jerk price reaction to the supply cut will likely be limited, as the global oil market has been in surplus for three straight quarters.

They reported that global observed inventories hit an 18-month high in January at 7.8 billion barrels, with February likely to see a further build-up, although the International Energy Agency expects the oversupply conditions to fade in the second half of the year as seasonal trends, air travel recovery and China's rebound are set to push global oil demand to a record 102 million bpd.



"The additional (and unexpected) supply cuts from Opec+ may widen the projected supply deficit in the second half of 2023, but ample stocks should help to ease tensions in the oil markets," they said.

Meanwhile, oil and gas analysts are largely viewing the surprise supply reduction positively for the sector, with RHB Research saying in its notes that it had anticipated price-supportive measures to only appear in the latter part of this year.

Its analysts Sean Lim and Athipu Visavaveja said the latest supply cut is also seen as a pre-emptive step to accommodate any potential demand weakness, and that not all Opec+ members are participating in the decision, as some are already producing lower supply than expected.

The Biden administration is making a case against the latest cut, calling the move "not advisable" as low oil prices are needed at present to support global economic recovery, while accusing Russia, an Opec+ member, of trying to increase its funding for the skirmish with Ukraine.

In spite of that, Lim and Visavaveja said based on the Energy Information Administration's disclosure, with the US' strategic petroleum reserve's (SPR) stock level at 372 million barrels as of mid-March 2022, its lowest mark since 1984, the United States has very few options to curb energy prices, as a further draining of the reserves could heighten national security risks and make the country vulnerable to another major supply disruption.

They expect oil prices to hover around US$87 (RM384) per barrel in the latter half of 2023.

MIDF Research is also optimistic about the supply reduction, saying that while the higher oil prices will be a possible headwind for the sector's mid-stream refineries and downstream in relation to sales of refined products, it bodes well for the upstream companies in terms of exploration and production activities.

"In consideration that Malaysia has over 1,300 oil and gas services and equipment companies, we believe the upstream will be a major beneficiary to the increase in the crude oil price in the near term," it said.

The research unit opined that the Opec+ decision would move to stabilise oil prices, aiding the recovery of under-invested local upstream operations, while also revealing Dialog Group Bhd as its top buy with a target price of RM3.28.