Economic Update

NBK Economic Research Department I 8 May 2019

Oil markets

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Oil prices gain as US cancels Iran sanctions waivers

Highlights

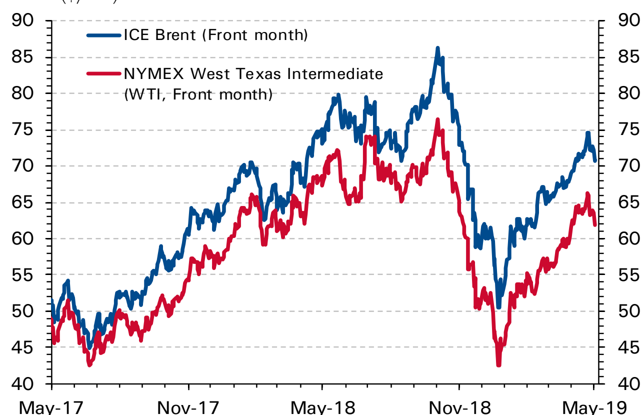
- **Oil prices up by at least 32% in 2019, with Brent ($70.9/bbl) and WTI ($61.9/bbl) buoyed by the US's decision to terminate the 180-day Iran sanctions wavers in pursuit of a 'zero' Iran exports policy.**
- **But markets largely unfazed as President Trump presses OPEC to increase output to offset potential Iran losses.**
- **OPEC+ tops 100% compliance for the first time in March (125%), thanks largely to Saudi, Kuwaiti and UAE over-compliance.**
- **Projections for global oil demand growth in 2019 remain unchanged at 1.4 mb/d, up from 1.3 mb/d in 2018.**
- **Balance of oil price risks marginally to the upside due to risk of further supply losses and still healthy global oil demand.**

Oil prices reach 6-month highs before retreating

Oil prices posted a fourth consecutive month of gains in April, rising to 6-month highs amid continued market tightness and the Trump administration's recent decision to end the Iran sanctions waivers. Major crude benchmarks Brent and West Texas Intermediate (WTI) reached as high as $74.6/bbl and $66.3/bbl, respectively, around 23 April—levels last recorded in late October 2018—though both markers have retreated a little since then as the US attempts to press the Saudis and OPEC to pump more crude to offset further supply losses from Iran. (Chart 1.) Oil prices are up 31-37% so far in 2019, one of the best starts in years.

Chart 1: Crude oil prices

($/bbl)



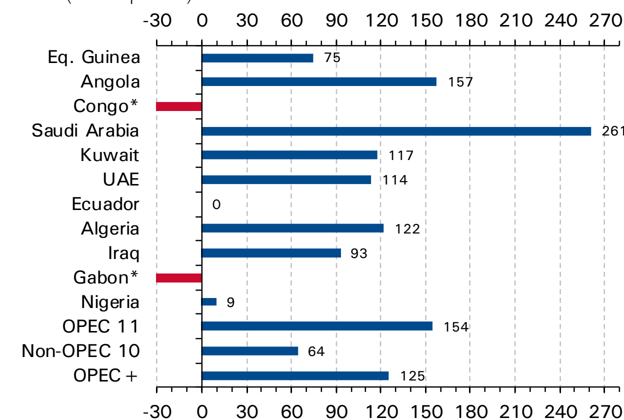
Source: Thomson Reuters Datastream

Speculators and investors continue to view the prospects for oil prices favourably. In the crude futures markets, hedge funds have piled into Brent and WTI futures, increasing wagers on oil prices rising (net length), for seven and nine weeks in a row, respectively, by the week ending 23 April. In WTI's case, this is the longest bull run in 13 years.

While much of the market tightness can be attributed to the crude production cuts of Saudi Arabia and the OPEC+ group, where overall compliance reached 125% (Chart 2.), in recent weeks, oil prices have also benefitted from a higher geopolitical risk premium related to actual or potential supply outages. From Libya, where General Haftar has launched an assault on the capital, Tripoli, to the continuing crisis in Venezuela, where opposition leader Juan Guaido is attempting to force President Maduro to relinquish power amid power shortages, food rationing, civil unrest, and plummeting crude production. The latest OPEC data (secondary source) shows that Venezuelan crude output fell to 732,000 b/d in March—a 50% drop y/y and the lowest level in 75 years.

Chart 2: OPEC and non-OPEC compliance in March 2019

(% compliance)



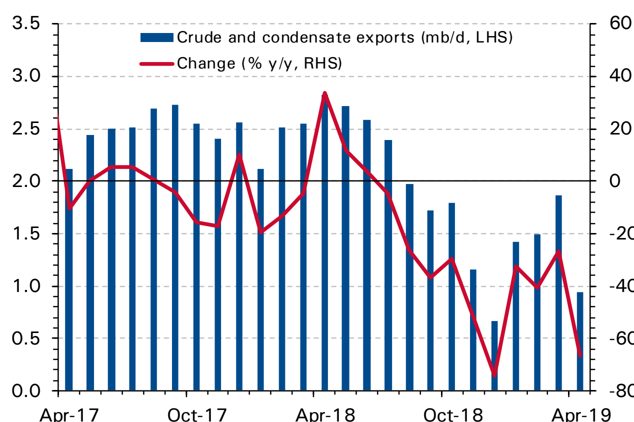
Source: OPEC, IEA; *Gabon and Congo at -450% and -190%, respectively.

Aiming for zero

Despite its billing as the key geopolitical moment of the first half of the year, markets largely took the announcement of the

termination of the 180-day Iran sanctions waivers, which took effect on 2 May, in their stride. Brent's rise of almost 3% to $74 was mostly reversed in the same week as President Trump moved to pressure Saudia Arabia, the UAE and OPEC more broadly to open the taps to keep prices from rising. However, having been blindsided by President Tump's decision last November to grant sanctions waivers to some of Iran's largest crude importers at a time when the US administration was intent on pursuing a 'zero exports' policy on Iran, the Saudis are unlikely to be as receptive to US pressure this time around. Indeed, the Saudi energy minister, Khaled Al-Falih, recently suggested that OPEC+ may opt to extend the production cuts beyond June when they were due to end. The Saudis, having cut production by more than 500,000 b/d over and above what was mandated by the OPEC+ Agreement (to 9.79 mb/d in March with compliance at 261%), are determined to reduce the global stock overhang and establish a new demand-supply equilibrium. Oil prices in the high $70-80/bbl range would appear to be satisfactory to the kingdom.

Chart 3: Iran crude and condensate exports



Source: Bloomberg, from tanker tracking data

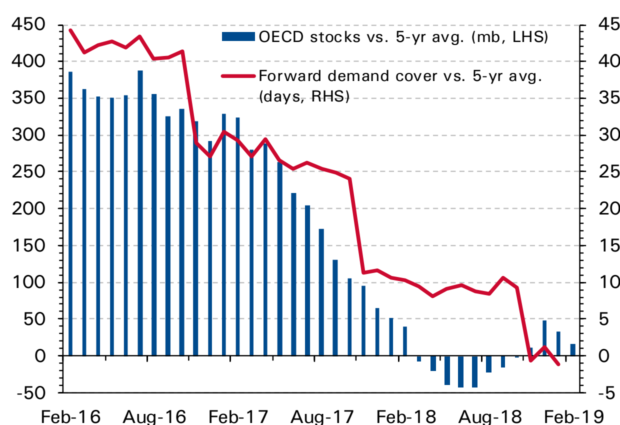
The prospect of further supply losses in Iran appears not to have fazed the markets. Sustained price spikes have yet to materialize. This is likely due to several reasons, including a belief that Iran's crude and condensate exports, which have already declined significantly (-1.9 mb/d, or -67% y/y, to 0.94 mb/d in April) as its customers curtailed purchases ahead of tighter sanctions, are unlikely to ever fall to zero due to low-level purchases by its customers in defiance of US sanctions (by bartering oil for goods, for example, thereby circumventing the US dollar financial system). (Chart 3.)

We estimate that exports could decline by another 200,000 kb/d at most. Markets are also confident that sufficient global spare capacity exists among Saudi Arabia, OPEC and Russia especially to mitigate further supply losses. And then there is US shale, which continues its unremitting increase; production reached a record 12.3 mb/d in the week ending 26 April, up a staggering 1.7 mb/d (16%) in one year.

Global stock drawdowns point to market tightening

Preliminary estimates of OECD commercials crude and petroleum product stocks by the International Energy Agency (IEA) would tend to confirm the tightening market narrative. By February, monthly stock levels (2,871 million barrels) vs. the 5-year average—one of the key metrics used by OPEC+ to gauge the state of market oversupply—had posted three consecutive monthly declines to just 16 million barrels above the 5-year avg. While this is still 'oversupply' according to the OPEC+ definition, the volume of oil stocks needed to meet oil demand (forward oil demand cover basis) was below the five year average (by 1.1 days). The Saudis would call this progress, but a job still far from complete. (Chart 4.)

Chart 4: OECD stocks and forward demand vs. 5-yr average



Source: IEA

Meanwhile, in terms of global oil demand, the IEA has maintained its global demand growth estimate of 1.4 mb/d in 2019, a slight improvement on last year's figure of 1.3 mb/d. This is despite weaker-than-expected demand data from the US and Canada in 1Q19 and despite the recent downward revision to economic growth in 2019 of 0.3% (to 3.3%) by the International Monetary Fund (IMF) in its April update. The IEA expects robust oil demand in major non-OECD economies such as China and India to continue into 2019, helping to offset any weakness from advanced economies. In China's case, demand has been propped up by government stimulus, particularly on infrastructure. But global growth more broadly is likely to benefit from the prospect of a more accommodative US monetary policy stance, which is looking more likely after the US Federal Reserve refrained from raising interest rates in its first two meetings in 2019 and while US inflation remains subdued.

The backdrop of healthy economic growth will therefore be supportive of oil prices. At this juncture, with OPEC+ proceeding as planned with its production cut and the likelihood of some further drops in oil supply from Iran and Venezuela especially, upside risks to oil prices are currently in the ascendancy.

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