Commodities: Crude Oil

OCBC Bank

Crude Oil: Expect a volatile Q2 ahead

Friday, April 05, 2019

House View				
	1 Week	**1 Month**	**3 Months**	**12 Months**
Latest	Bullish	Neutral	Neutral	Neutral

OCBC COMMODITY FORECAST 2019							
	3Y AVG	Spot	Q1	Q2	Q3	Q4	Annual
Energy							
WTI ($/bbl)	53	56	55	55	60	65	59
Brent ($/bbl)	57	67	65	65	67	70	67

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At A Glance:

- Expect higher crude price volatility in Q2 on uncertainties surrounding Iranian sanction waivers, OPEC cuts, macro environment.
- OPEC cuts are expected to have run its course in the short-term as Saudi's output likely to have reached its Feb commitment of 9.8m bpd
- Trump administration reportedly undecided on the magnitude of renewal of Iranian oil sanction waivers, due to expire in early May.
- OPEC+ to only clarify on whether they may extend its supply cuts further in June, leaving markets on a knife-edge.
- Any unexpected reduction of Iranian sanction waivers is likely to send the market higher, but if OPEC chooses not to extend supply curbs the market may head south.

After an astonishing Q1 bull run of almost 30%, crude prices have likely hit a brick wall in their rally. Reduction of Iranian oil sanction waivers and a formal agreement in US-China trade talks may still push the market higher, but if OPEC+ chooses not to renew its supply curbs the market may similarly head south. We expect crude oil prices to be volatile in Q2 and trade in a large sideway range.

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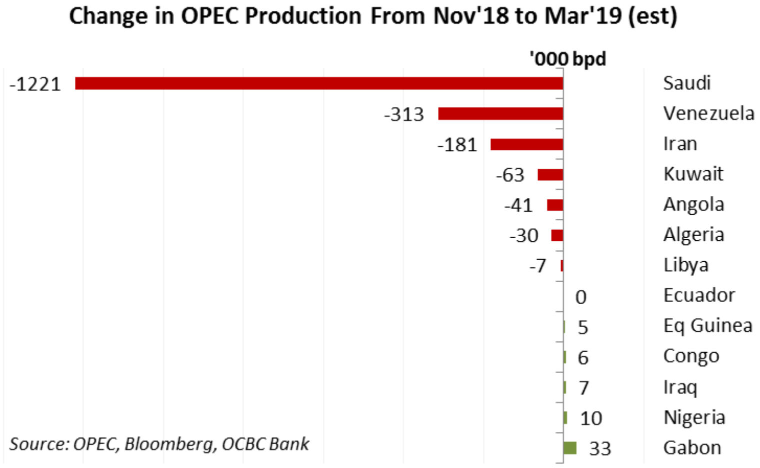
OPEC supply cuts hit a wall

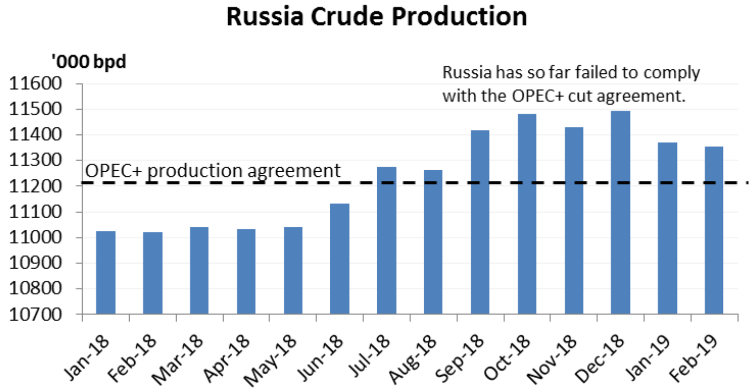
According to private estimates, Saudi Arabia would have hit its target of reducing output in 9.8m bpd in March from 11m bpd in November 2018. This target was set in February and production data out of Saudi appears to suggest that the country is likely to hit this target by end March.

We estimate OPEC production in March at 30.33m bpd, down almost -2m bpd from November's level of 32.31m bpd. Of the 2m bpd reduction, 1.2m bpd of supply curbs were driven by Saudi Arabia, while another 300k bpd loss were a result of the Venezuelan crisis. With Saudi not expected to restrict supplies further from here and Venezuela already producing below 1m bpd, further OPEC cuts are unlikely at this stage. **The crude market, therefore, may likely have to turn to other avenues other than further OPEC cuts if it wishes to sustain its rally.**



Uncertain if OPEC+ will keep supply cuts in 2H 2019

OPEC+ members were due to decide in April on extending their supply cuts beyond the earlier stipulated deadline of June. Russia, which so far has yet to fully comply with the OPEC+ cuts (as we have previously expected), deemed it too early to decide on the extension and pushed the meeting to June. This potentially sets the oil market on a knife-edge cliff – if OPEC+ members choose not to extend the supply cuts, the market will have to react to potentially a glut of oil supply flooding the market in a matter of weeks between the June meeting to 1 July. Prices from now till June, therefore, are likely to keep a broad range as the June meeting sets itself up as an abrupt market mover.



Source: Bloomberg, OCBC Bank

Extension of Iranian oil sanction waivers still unknown

Eight countries were granted 6-month waivers in November over sanctions on Iranian oil – China, India, Turkey, Japan, South Korea, Taiwan, Greece and Italy. With the waivers expiring on 2 May, top US officials are reportedly deeply divided on the extension of waivers, according to a Bloomberg report. The division is primarily between John Bolton's National Security Council and Michael Pompeo's State Department, with Bolton's team preferring a tougher tack on Iran.

With the US presidential elections next year and falling production in Venezuela, we expect Trump's hands to be tied on this regard. A compromise is expected to be made in which only the existing importers of Iranian crude may receive the extension waivers on a reduced quota – notably China, India, Turkey and Japan. Any lesser exemptions in terms of permissible countries or lower-than-expected import quotas may drive the crude market higher.

Imports of Iranian oil

'000 bpd	1Q2018	2Q2018	3Q2018	4Q2018	1Q2019
China	1809	2043	1983	1701	1635
India	1452	2097	1683	993	843
Turkey	594	495	390	225	300
Japan	294	375	333	0	498
South Korea	282	292	0	0	0
Taiwan	0	133	65	0	0
Greece	233	163	98	32	0
Italy	498	511	49	65	0

Source: Bloomberg, OCBC Bank

US-China trade talk agreement to boost oil prices

The US and China appear closer to a deal. At time of writing, Chinese Vice Premier Liu He is due to meet President Trump at the White House as speculation mounts that a trade deal is near between the two global superpowers. Despite the optimism, the key issue of monitoring and compliance remain; White House economic adviser Larry Kudlow has cautioned “We’re not there yet” but also remarked that the two sides “hope this week to get closer.”

If President Trump and President Xi can officially put pen-to-paper a core agreement in principle, oil prices are likely to see a rally. Much of the optimism, however, appears priced-in at this stage and a rally on this front may eventually turn out to be brief and short-lived, especially given the soft economic underbelly globally.

Conclusion: expect a volatile Q2 ahead

The core issues of the extension of Iranian oil sanction waivers and OPEC+’s pending decision to extend the supply cuts beyond Q2 weigh heavily on the market. With most of the optimism from a nearing US-China trade deal already priced into current levels, any further positive developments from that front may eventually result in a brief rally. The oil market is being pulled by many uncertain factors at the moment. Expect oil prices to trade in a large range bound and to experience high volatility in the coming quarter.

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