Commodities: Crude Oil

OCBC Bank

Crude Oil: No extension of Iranian crude waivers

Tuesday, April 23, 2019

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

OCBC COMMODITY FORECAST 2019							
	3Y AVG	Spot	Q1	Q2	Q3	Q4	Annual
Energy							
WTI ($/bbl)	53	66	55	65	68	70	65
Brent ($/bbl)	57	74	65	73	76	78	73

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At A Glance:

- The Trump administration has pulled off a shocker by choosing not to renew any waiver on Iranian oil sanctions
- Most market observers expected 5 of 8 countries to receive a new lease of waivers after the current deal expires on 2 May
- Iran exported 1.3m bpd in March – the onus is now on the likes of Saudi Arabia and Russia to pick up the slack
- Iran, Venezuela and Libya are experiencing larger production outages than expected, leading to an increasingly tight supply flow
- Given the latest development, the odds of OPEC+ continuing its supply curtailing programme into 2H2019 looks very slim

The US pulled off a shocker by not extending any waivers on Iranian crude sanctions. There is little reason now for OPEC+ to continue their supply curbs, especially now with Iran and Venezuela suffering from sanctions and the loss of Libyan production still up in the air.

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1. US chooses not to renew any Iranian sanction oil waivers

With the current set of Iranian oil waivers due to expire on 2 May, many expected 5 of the existing 8 countries – China, India, Turkey, Japan and South Korea – **to receive an extension of the waivers, albeit on a reduced quota allocation.** The idea was to gradually ease the crude market into shifting imports of Iranian oil to other sources, thereby not introducing a rude upward shock to prices.

The other 3 countries – Italy, Greece and Taiwan – were already importing zero Iranian crude in Q1; leaving them out of the expected renewal is not likely to have impacted crude prices materially.

Iranian Crude Imports

'000 bpd	1Q2018	2Q2018	3Q2018	4Q2018	1Q2019	Quota
China	603	681	662	567	599	360
India	484	699	561	332	281	300
Turkey	198	165	130	76	101	60
Japan	98	125	111	0	165	Unknown
Korea*	238	141	0	10	289	200
Taiwan	0	44	22	0	0	Unknown
Greece	78	54	33	11	0	Unknown
Italy	166	170	163	22	0	Unknown

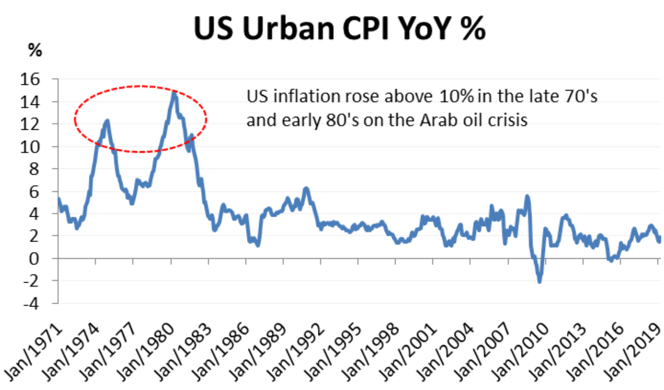
*condensates

Source: Bloomberg, OCBC

2. Trump prioritises "Maximum Pressure" campaign over gasoline prices

President Trump's team was reportedly divided over the decision on renewing waivers for Iranian crude exports way back in March. John Bolton's National Security Council wanted to turn the screw fully on Iran as part of Trump's "Maximum Pressure" campaign on countries deemed a threat to US national security. Michael Pompeo, however, favoured a more conservative approach on concerns of oil price volatility.

The US has chosen to apply maximum pressure on Iran at the risk of a spike in gasoline prices back in the US, much to our surprise. This is a highly risky political move from Trump, with the US presidential elections due next year and campaigning to begin before the end of 2019. Gasoline prices have the largest impact on consumer prices, which in turn has a large bearing on US politics throughout history. With Venezuela and Libya also facing oil production outages, Trump's team may find that attempting to drive a hard policy on Iran while balancing oil prices below its allergy of $70/bbl a very tall order.

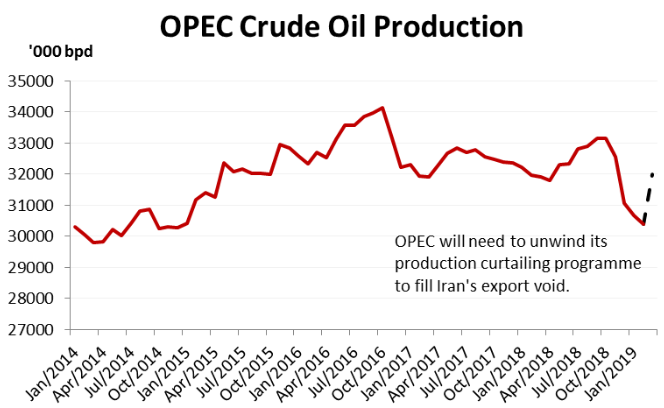


Source: Bloomberg, OCBC Bank

3. **OPEC+ deal now highly unlikely to extend into 2H 2019**

OPEC+ banded together in November in an attempt to rescue collapsing crude prices, which worked to a large extent in stabilizing the market. Since November, OPEC has reduced its production from 33.2m bpd to 30.3m bpd in March – a decline of -2.8m bpd across 4 months. Without even considering the sanctions on Venezuela's 730k bpd oil production, the market is already estimated to be in a supply deficit of -900k bpd. Put Venezuela, Libya and the full sanction on Iranian oil into the picture, and **the supply market is much tighter than it looks**.

The -2.8m bpd supply curb from OPEC+ now seems unlikely to continue into 2H 2019 – there is no economic incentive at current price levels for members to comply, on top of the pressing need to fill Iran's export gap of 1.3m bpd.

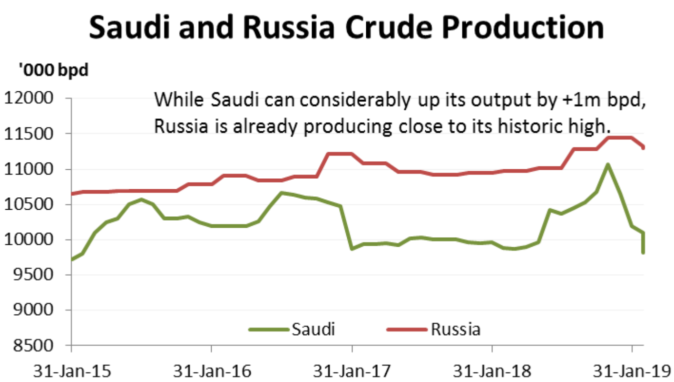


Source: Bloomberg, OPEC, OCBC Bank

4. **Saudi and Russia alone may find it hard to pick up Iran's export slack**

Assuming an export-proportionate split of Iran's 1.3m bpd exports between these Saudi and Russia, by our estimates Saudi would need to produce 700k-1m bpd more, while Russia will need to up its supply by 600k-1m bpd. This means that Saudi and Russia will need to produce 10.5m bpd and 11.9m bpd at least to fill the export-void left by Iran.

Saudi ought to easily produce 10.5m bpd, given that it produced 11m bpd at its peak. Whether Russia, however, can produce 11.9m bpd is a larger question, given it ever only produced 11.5m bpd at its highest. It is highly likely that the rest of OPEC+ members will have to produce more to fill the void left by Iran – not withstanding further supply outages from Venezuela and Libya.



Source: Bloomberg, OPEC, OCBC Bank

5. Prices likely to inch higher from here

At the end of Q1, we mentioned two key factors will likely influence oil prices this quarter: the decision on extending Iranian crude sanction waivers, as well as OPEC+ decision on whether to extend the supply-curb deal into 2H.

With Iranian waivers not extended, the crude market looks highly imbalanced at this point. Just to fill the gap left behind by Iran, the OPEC+ deal would likely have to discontinue on expiry in June, while the likes of Saudi and Russia are expected to produce close to their historic production highs. This is not taking into account the continued Venezuelan crisis and more importantly, the uncertainty of production loss from Libya. At the same time, economic green shoots are resurfacing from China and that may lead to higher demand for oil. **Prices are likely to drift higher from here, with $78-80/bbl for Brent a potential target level.**

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