VANDA insights

Energy markets & beyond.

BULLS & BEARS

Sentiment on Oil

29 July 2022

Near-term: Neutral

BULLISH

Financial markets relief rally

Risk appetite in the broader financial markets, the main driver of crude prices since early-Jul, bounced up this week. Consensus view among investors from Fed Chairman Powell's comments on Wed and a worse-than-expected 0.9% contraction in US Q2 GDP is reduced pressure on the US central bank to continue chasing aggressive tightening. While most of the relief is baked into crude prices, it could sustain some buoyancy.

BULLISH

Russia sanctions, EU energy crisis

Russian crude and products exports to global markets remain crimped. But the shortage is far milder than initially feared and likely to remain this way. However, the EU is in a serious gas crunch due to reduced Russian exports and some of the coping measures may result in incremental demand for oil as replacement fuel.

SUPPORTIVE

OPEC+ restraint

We don't expect any major change when OPEC+ meets on Aug 3 to decide production policy for Sep. All output cuts will have ended as of Sep 1 but the "quotas" may remain frozen till year-end. The alliance was about 2.74 mil b/d short of its target output in Jun.

NEUTRAL

China's Covid curbs

China is expected to stick with its Zero-Covid policy, under which rolling lockdowns and curbs dampen travel and economic activity. But this is a neutral factor for now, as the oil market has baked in a status quo.

MILDLY BEARISH

Libya pumping full-tilt again

Libyan crude output had rebounded to 1.1 mil b/d as of end-Jul, doubling from Jun, and exports were back to normal after a government deal with protesters who had been blockading oil facilities for weeks. But the conflict between political factions persists and the market won't fully factor in the new normalcy unless it is sustained.

BEARISH

Economic activity, spending slowdown

Major central banks are raising interest rates right through an economic slowdown. Macro-economic data from around the world is showing a sustained decline in manufacturing. As consumers grow weary and wary of inflation and recession, retail spending is starting to fall.

BEARISH

Weakening oil demand

Consumer spending has pivoted from goods to services this year. But the strong early-summer bump in travel, tourism and leisure has begun to flatten mid-season. Global airline flights are only at around 85% of corresponding 2019 levels. US gasoline has been below year-ago levels since Apr. Current 4-week average demand is 7% below corresponding 2019 levels. Chinese oil demand is flat to slightly lower YoY. Global gasoline prices have slid since around mid-Jul and stocks in key hubs across the globe have risen, crashing refiners' margins – an indicator of softening demand.

Mid-Aug to mid-Sep: Mildly Bullish

BULLISH

OPEC+ restraint, shortfall

Though OPEC+ cuts end on Aug 31 and US President Biden has requested Saudi Arabia to boost output, we don't expect much change in production levels from Sep. Caution will prevail in view of demand uncertainty for the coming months. The alliance's shortfall vs its target may narrow, albeit marginally, if Saudi Arabia and UAE crank up output slightly and if Russia continues to expand crude exports to Asia.

BULLISH

Peak Atlantic hurricane season

The Atlantic hurricane season is predicted to be "above normal" this year. It typically peaks over Aug-Sep. Strong hurricanes in the US Gulf of Mexico could force preventive shut-downs or longer outages in the event of damage capable of impacting 1.7 mil b/d of oil output and 8 mil b/d of refining capacity.

SUPPORTIVE

Possible calm in financial markets

Since Jun, volatility and panicky sell-offs in risk assets has typically peaked around the monthly US inflation data and Fed policy meetings. The latter will get a break, with the next Fed meeting not due until late-Sep. That may restore some calm to the markets temporarily.

SUPPORTIVE

EU energy crisis

The EU's energy crisis is likely to fester as Moscow seems intent on curbing gas exports to retaliate as the Ukraine war grinds on. This could buoy oil sentiment on an expected rise in diesel/FO use as replacement fuel.

NEUTRAL

Potential Chinese recovery

This one is hard to predict, but we are in the camp that expects a gradual and modest recovery in Chinese economic activity as Beijing tries to avoid more draconian lockdowns and even reopen its borders cautiously. But it won't be a bullish factor unless there is a clear rebound in Chinese oil demand.

BEARISH

Gradual normalisation of Russian supply

This was a "mildly bearish" factor in our last report, but we now have higher confidence that Russia will continue placing most of its crude and products displaced out of Europe into other markets. The EU, struggling with gas shortages, has little appetite right now to try and lock out more Russian oil from the world markets. The US has given itself until year-end to impose a price cap on Russian crude exports and does not seem to be making much progress on the plan.

BEARISH

Recession/stagflation will begin to bite

Recessionary winds are starting to gather strength and we expect the erosion in consumer spending on goods as well as services to start accelerating too. The easing of inflationary pressures is likely to be gradual and won't inject confidence in consumers contemplating a full-blown recession with weakening job markets and uncertain career prospects.