VANDA insights

Energy markets & beyond.

BULLS & BEARS

Sentiment on Oil

30 May 2022

Near-term: Moderately Bullish

BULLISH

EU continues to pursue Russia oil embargo

The European Union is now looking to phase out all seaborne Russian oil imports by early 2023. About 700kb/d of Russian crude imports through the Druzhba pipeline will not be affected. But an additional 1-1.5 mil b/d of Russian crude and products supply could be hit. US-EU sanctions and boycotts have already removed around 1.5 mil b/d of Russian oil from the market. Russia could divert some more crude to Asia but India will face high freight and insurance costs, while Chinese appetite has been crimped by its Covid curbs. Russia is facing difficulty finding buyers for its diesel, naphtha and fuel oil exports that are being rejected by the West.

BULLISH

Major Kazakh, Libyan production outages

Output from the 410kb/d Kashagan oil field in Kazakhstan has dropped due to maintenance planned for May 19-Aug 3. The field will be fully shut through Jun. Around 500kb/d or 42% of Libyan crude output remains shut in due to partial blockades, a situation that may fester, given the country's political impasse.

SUPPORTIVE

Tanker seizures reignite Iran tensions

Iran seized two Greek-flagged oil tankers in the Strait of Hormuz on May 27. It was in retaliation for Greece transferring an Iranian crude cargo from a tanker it had confiscated in Apr to another ship on May 26, saying it violated sanctions. Israel appears to have stepped up attacks on Iran, bolstering the Mideast geopolitical fear premium. However, this premium would typically wane gradually, unless more confrontations occur.

SUPPORTIVE

China eases Covid curbs, unleashes stimulus

Shanghai and Beijing began to gradually relax Covid curbs this week, as new cases eased. However, both still need a negative virus test for residents to enter public areas and a patchwork of other restrictions remain in place. The central government and Shanghai authorities have adopted a raft of measures to support businesses, but it remains to be seen whether they will do the trick.

NEUTRAL

OPEC+ sticks to playbook, undershoots target

OPEC/non-OPEC energy ministers are expected to rubber-stamp another 432kb/d hike in monthly output target when they meet on Jun 2 to decide Jul production policy. OPEC+ fell short of its Apr output target by a whopping 2.7 mil b/d, with Russia alone accounting for a 1.3 mil b/d shortfall. All of this is baked into current crude prices.

BEARISH

Decelerating economy

The world's economy is undoubtedly slowing down, whether or not the US enters a recession. A combination of decades-high inflation worsened by the Ukraine war, synchronised monetary tightening by central banks and worsening supply chain chaos is crimping growth. The impact of falling oil demand will be felt on prices only when the drop equals or exceeds supply losses.

Mid-Jun to mid-Jul: Mildly Bearish

BULLISH

Festering Ukraine war

The Ukraine war is expected to drag on, possibly for months. The EU is under growing pressure to punish Moscow harder, especially by curtailing its oil revenues. It may keep trying variations of the original embargo plan until a consensus is reached. If it manages to agree a phase-out of Russian oil imports, Moscow could retaliate by curbing gas supplies or in other ways, worsening global energy shortages. Russia-Ukraine negotiations remain out of the picture. All in, the Ukraine factor puts a firm floor around $100 for Brent, as long as there are no major countering bearish forces.

SUPPORTIVE

Lower Kazakh, Libyan output

The Kashagan oil field maintenance will deprive the market of a sizeable cumulative volume of crude just when Russian supply is also tightening. Libyan production is clouded by high uncertainty but as of now, a return to sustained normalcy looks highly unlikely, as the political impasse is hard to resolve.

SUPPORTIVE

Summer demand bump

The northern hemisphere summer season typically brings a rise in demand for air and road transportation fuels in the US and Europe. The bounce may be a bit muted this year. US fuel demand rebound has been losing steam in recent months; the latest 4-week average of 19.51 mil b/d was 2% above year-ago levels but 2% below 2019. In Europe, continuing momentum from the post-Covid release of pent-up demand for services will face the headwinds of economic slowdown and waning consumer confidence.

MILDLY BEARISH

China's zero-Covid quicksand

China's zero-tolerance policy towards Covid means its economic and oil demand recovery is predicated on the virus' trajectory in the country. The latest stimulus measures are directed at businesses. We are not optimistic about a quick or strong rebound in oil demand as we expect a very cautious rollback of curbs.

MILDLY BEARISH

More SPR releases likely

Brent is at a two-month high, trading around $120/bbl on May 30. Pump prices in the US are at historic peaks, a sensitive issue ahead of the mid-term elections. The US administration will have to look at tapping more emergency oil reserves if prices sustain at current levels or rise further and other IEA members may also join in, though this may not address refined product shortages.

BEARISH

Demand downturn awaits

The Ukraine war is causing oil supply fears to dominate but a global demand pullback due to high prices and slowing economic growth could come into view by mid-year. Russia and Europe face the biggest risks of recession from the Ukraine war. As the economic pain worsens, the EU may be incentivised to facilitate Moscow and Kiev returning to the negotiating table.

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