FINANCIAL REVIEW

Oil exposed to price spikes as storage shock absorber disappears: RBC

RBC Capital Markets' Michael Tran is confident about the oil price outlook at least until the end of 2018.

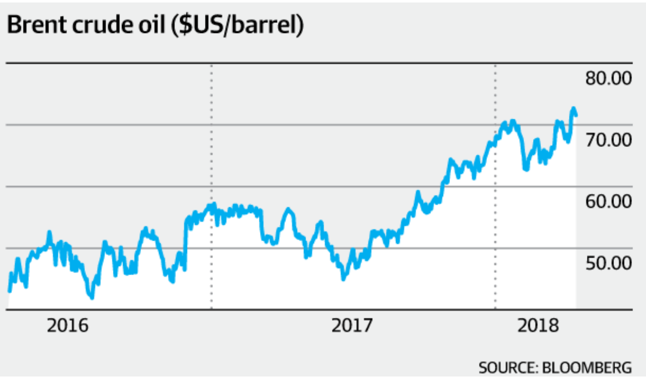
by Angela Macdonald-Smith
www.afr.com/business/energy/oil/oil-exposed-to-price-spikes-as-storage-shock-absorber-disappears-rbc-20180416-h0yt9l#

Brent oil prices are in little danger of dipping below $US70 a barrel for the rest of the year and could leap higher given the rapid fading of the stock overhang that has been plaguing the market, which will leave it exposed to resurgent geopolitical risks, according to RBC Capital Markets global energy strategist Michael Tran.

Mr Tran said that US shale is also no longer a threat to prices for the rest of 2018 because pipeline bottlenecks in the prolific Permian basin region means US production will "hit the wall" until new infrastructure comes online next year.

"The market is racing towards equilibrium right now from a storage perspective," New York-based Mr Tran said in an interview in Sydney.

"The US production growth story has been and continues to be the biggest fear for the market but what we've realised over the past several weeks is ...these pricing differentials [between US benchmark WTI and Midland grade] signal you're hitting the proverbial wall with pipeline capacity."



RBC Capital Markets

Mr Tran said the overhang in oil stockpiles, which has weighed on prices over the past years, looks set to be "completely eradicated" by mid-summer as demand steadily expands at an expected 1.6 million barrels a day this year and OPEC and its allies continue to put the brakes on production.

That removes the buffer that has been protecting the market from geopolitical shocks just as those risks are increasing with the Trump administration's more hawkish stance on foreign policy under new national security adviser John Bolton and Secretary of State Mike Pompeo, and increased friction in the Middle East with US-led strikes on Syria and attacks by Iranian-backed Houthi rebels on Saudi Arabia.

Strong floor

Brent oil was trading just shy of $US72 a barrel on Monday, near highs not seen since late 2014, amid the heightened Middle East tensions.

Mr Tran said the run-down in oil stockpiles had the effect of setting a "floor" for prices that has been absent for a few years.

Figure 26: Global Oil Supply & Demand Balance and Price Forecasts (Commodity Strategy)

Oil balance (mb/d)	Q1 18 E	Q2 18 F	Q3 18 F	Q4 18 F	2018 F	Q1 19 F	Q2 19 F	Q3 19 F	Q4 19 F	2019 F
Total Supply	98.3	98.7	99.3	99.5	99.0	99.4	100.2	101.2	101.3	100.5
Total Demand	98.0	98.9	99.7	100.1	99.2	99.3	100.4	101.3	101.6	100.7
Stock Change	0.3	-0.2	-0.4	-0.5		0.1	-0.3	-0.2	-0.3	
Call on OPEC	32.1	32.5	32.9	32.6	32.5	31.9	32.3	32.4	32.2	32.2
WTI ($/bbl)	**63**	**66**	**68**	**67**	**66**	**61**	**63**	**65**	**66**	**64**
Brent ($/bbl)	**67**	**70**	**72**	**72**	**70**	**67**	**68**	**68**	**70**	**68**

RBC expects Brent prices to average $US72 a barrel in the December half. RBC Capital Markets

"We think that Brent prices will be extremely well supported at the $US70 mark over the course of the balance of this year," he said.

"The way we look at the fundamentals is, they've improved so much that it warrants a very strong floor in this market. That's very different to what we've seen over the past couple of years."

Mr Tran described RBC's overall view on the oil market outlook as one of "measured optimism with the expectation that there is potential for significant gap risk in this market" because of the geopolitical threats.

The bank believes that a structural cycle of higher oil prices has kicked off, with the market likely to ebb and flow between periods of equilibrium and deficit, rather than the varying degrees of oversupply that have been typical recently. It is forecasting Brent prices will average about $US70 a barrel this quarter, then $US72 for the rest of the year.

Figure 5: OPEC Watch List

	Oil production (mb/d)		Geopolitical risk		
Country	2017 avg	Last month	Past year	This year	Comment
Saudi Arabia	9.97	9.87	6	7	Hawkish foreign policy raises confrontation risks
Iraq	4.44	4.43	9	9	Upcoming elections represent a potential destabilizing factor
Iran	3.79	3.81	6	7	The lightning rod for regional grievances
UAE	2.91	2.86	2	3	Best in class in OPEC but high military expenditures
Kuwait	2.71	2.70	1	1	Financially flush but the population does not want austerity
Venezuela	1.94	1.51	10	10	With few economic options left, oil production is at risk and falling
Nigeria	1.71	1.85	10	9	Does face a number of challenges including political ones
Angola	1.66	1.57	6	6	Angola is facing strong economic headwinds amid a transition
Algeria	1.04	1.00	8	7	While Algeria's risk rating is lower y/y, it remains elevated
Libya	0.83	0.99	9	9	Being the IS fallback option could push it back up on our watch list
Qatar	0.61	0.61	3	7	Faces a current crisis and a longer term LNG challenge
Ecuador	0.53	0.52	5	5	Amid a political transition but middle of our risk spectrum
Gabon	0.20	0.19	6	6	Low production but rising political risk over the course of the year
Scale:			High -> Low	High -> Low	

Source: Bloomberg (production date), RBC Capital Markets

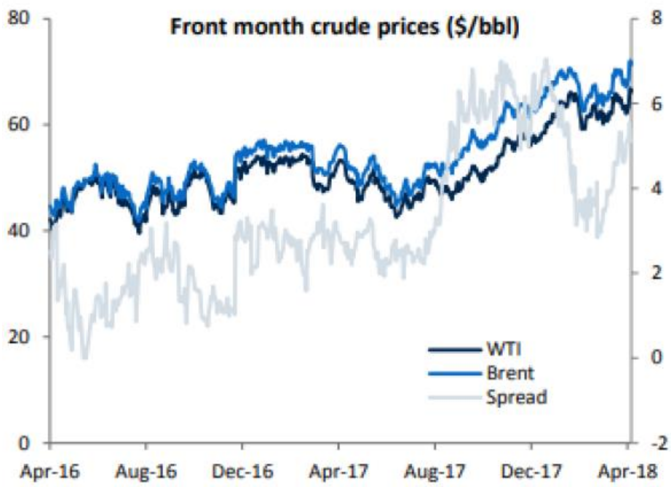
Geopolitical risks have increased in several OPEC nations. RBC Capital Markets

Demand looks "pretty good" overall, though continues to be significantly concentrated in emerging markets, notably China and India, both of which look "extremely strong", Mr Tran said.

Trade war

As bearish risks to oil prices, Mr Tran pointed to the possibility of a full-blown trade war developing from the US-China tariff battle and, in the longer term, that China's surge in the deployment of electrified bus and taxi fleets could undermine expected growth in private car sales and hence gasoline demand.

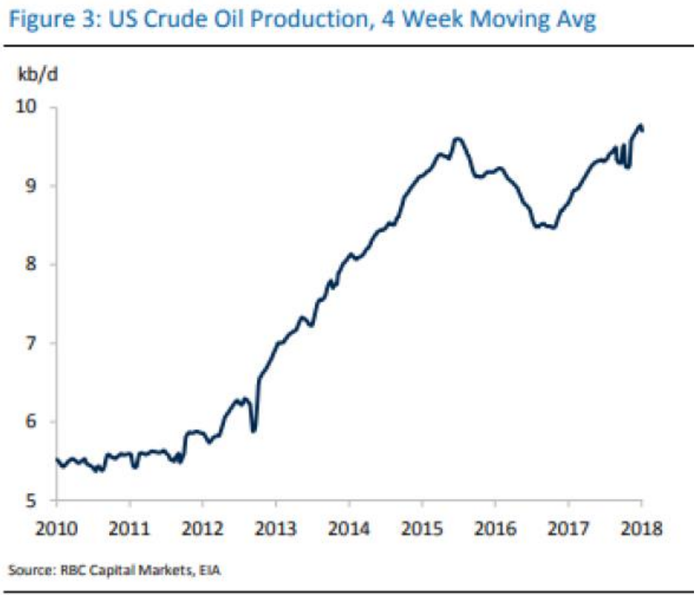
Still uncertain is the position that OPEC and its allies will take on whether to extend the output constraints beyond the end of 2018, although Mr Tran said the rhetoric from the group signalled a bias toward over-tightening the market than the opposite, which would just have the effect of wiping out the work done since the restrictions had been in place.



Oil prices are near their highest since late 2014. RBC Capital Markets

"The worst case scenario that could lay out for OPEC is if you close out the deal and several months later US production just overwhelms the market again," he said.

On US shale, Mr Tran said that just in the last 4-6 weeks, US shale producers had become "a victim of their own success" in that Permian production was starting to overwhelm pipeline capacity. That puts a limit on how much US shale could influence prices until new pipelines are brought into operation, mostly from mid-2019.



US output in the Permian is restricted by pipeline capacity. RBC Capital Markets