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MACROCOSM

The Perfect Moment to Take Out Iran

Tuesday, April 23, 2019

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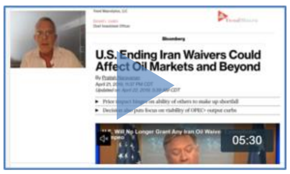
A "Saudi call" and a million more barrels/day from the Permian mean little upside risk for oil.

Click to watch short video on the sanctions

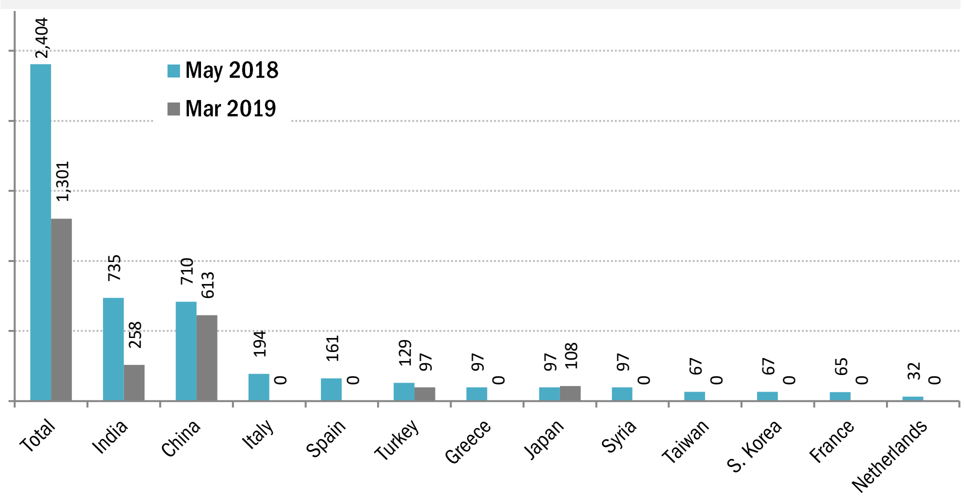


[All videos]

On Monday the Trump administration announced an end next week to waivers from US sanctions on oil purchases from Iran that had been granted six months ago to China, India, Japan, South Korea, Italy, Greece, Turkey and Taiwan. The action is "intended to bring Iran's oil exports to zero and deny the regime its principal source of revenue."

- *Oil prices are having a knee-jerk upside reaction to the announcement as though it were a surprise, but we don't see how it could be.* Half the target nations – Italy, S. Korea, Greece and Taiwan – have already cut their imports from Iran to zero, despite the waivers. India, the largest importer, has already cut its purchases by about two-thirds (please see the chart below).
- Officially at least, China, India, Japan and Turkey are Iran's only remaining customers. *Assuming their full compliance with US sanctions, their boycott would reduce Iran's exports by 1.3 million barrels per day from present levels – which effectively reduces global supply by the same amount.*

Iran crude oil exports, million barrels/day



Source: Bloomberg, TrendMacro calculations

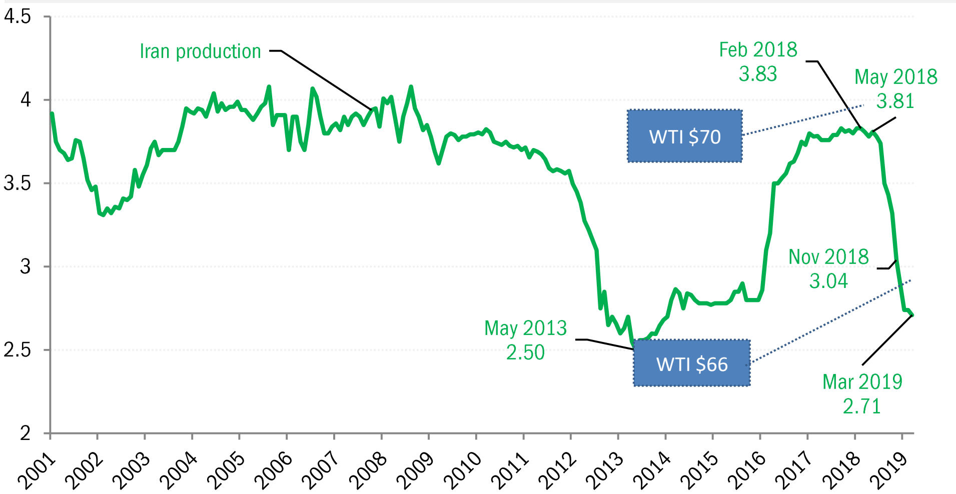
Update to strategic view

OIL: Trump announced the end to waivers from US sanctions granted six months ago to eight nations that are large importers of Iran's oil. Four have already ceased oil purchases from Iran, with China being the largest remaining importer. Assuming perfect compliance, 1.3 million barrels per day would be removed from global supply, but at historical levels of compliance, only 210,000. Trump has recently been supportive of Saudi initiatives in the Middle East, and the Kingdom has announced it will make up for any Iran shortfalls. Conflict in Libya and new US sanctions on Venezuela are upside headline risk for oil. But the "Saudi call," stagnant global demand, and US production likely to increase by 1 million bbl/day by year-end, we see no sustained upside risk to oil. If anything, we face a potential glut.

[Strategy dashboard]

- *Full compliance is highly unlikely, especially from China – Iran's biggest remaining customer, at 613,000 bbl/day, which has already voiced opposition – unless it were to be integrated into a US-China trade deal. That is certainly a possibility, especially considering the ongoing discussions about China becoming a substantial customer for US crude. But it won't be in place when the waivers are lifted next week. In the meantime, China may be able to exploit the same loophole it found at the height of the global boycott against Iran in 2013 – that is, not importing crude, but rather condensate.*
- We can get a rough-and-ready estimate of what actual compliance might be, by looking back to 2013. In March 2013, the global boycott had reduced Iran's crude production to 2.5 million bbl/day (please see the chart below). If that's the benchmark, then from the most recent production estimates of 2.71, *Iran has only 210,000 bbl/day of production still to lose – which is to say, global supply has only 210,000 bbl/day to lose.*
- *1.1 million bbl/day of Iranian production – and global supply – has been lost over the year since President Donald J. Trump unilaterally pulled the US out of the Iran nuclear deal* (see "Iran Deal: More Fire, More Fury, Pure Trump" May 9, 2018) negotiated by the prior administration (see "Iran: The New New World Oil Order, Volume I" July 20, 2015). Yet over the ensuing year since Trump's withdrawal, the oil price has fallen from about $70 then, to about $66 now, in WTI terms (again, please see the chart above).
- Among the reasons for that seeming anomaly, Saudi Arabian production increased about barrel-for-barrel to make up for lost Iran production – or, from Saudi's perspective, to capture market-share from Iran (please see the chart on the following page).
- *When asked last week by the Trump administration if we thought there was a lot of upside risk to oil prices, we cited this comforting rock-solid evidence for an effective "Saudi call" – despite* persistent

Iran crude production, million barrels/day



Source: Bloomberg, TrendMacro calculations

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[About us]

Recommended Reading

A Specter Is Haunting Xi's China: 'Mr. Democracy'
Ian Johnson
New York Review of Books
April 19, 2019

Face It: You (Probably) Got a Tax Cut
Ben Casselman and Jim Tankersley
New York Times
April 14, 2019

Bernie Sanders Could Win This Time
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Wall Street Journal
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Europe's Alternative to Medicare for All
Regina E. Herzlinger and Bacchus Barua
Wall Street Journal
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The Quiet Revolt That Saved China
Michael Meyer
Wall Street Journal
April 16, 2019

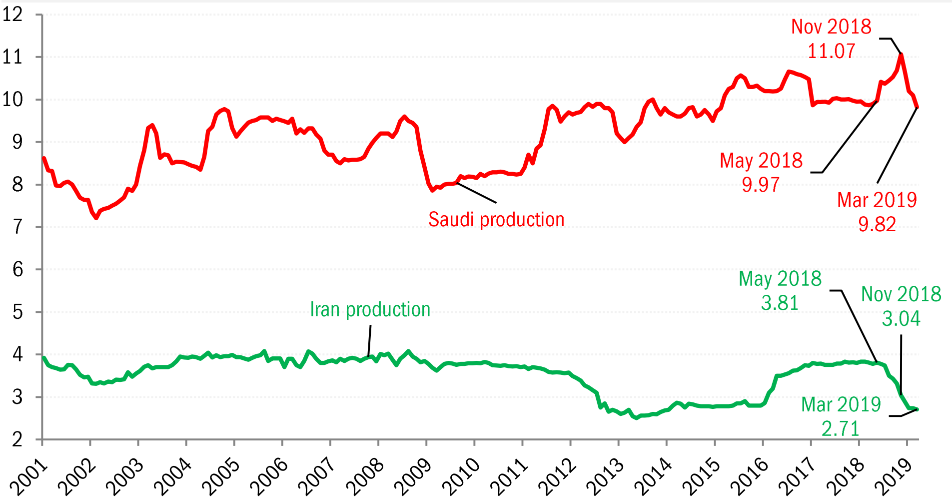
Donald Trump, China Savior? Some Chinese Say Yes
Li Yuan
New York Times
April 16, 2019

[Reading home]

belief in some quarters that Saudi doesn't really have any swing capacity. A Trump tweet on Monday indicates the president got the message.

- That said, last year falling global crude prices must have been a hint to Saudi that it had overdone it. Remember, during Q4-2018, crude underwent a 45% bear market, and traded as low as $42 in WTI terms. But if that weren't a strong enough signal, when the Trump administration reduced the pressure on Iran in November by announcing the waivers from US sanctions, Saudi slammed the brakes on production – at this point bringing it to a point lower than when Trump had first pulled out of the Iran nuclear deal (again, please see the chart below). *Yet oil prices remain lower.*

Compare: Saudi crude production, million barrels/day

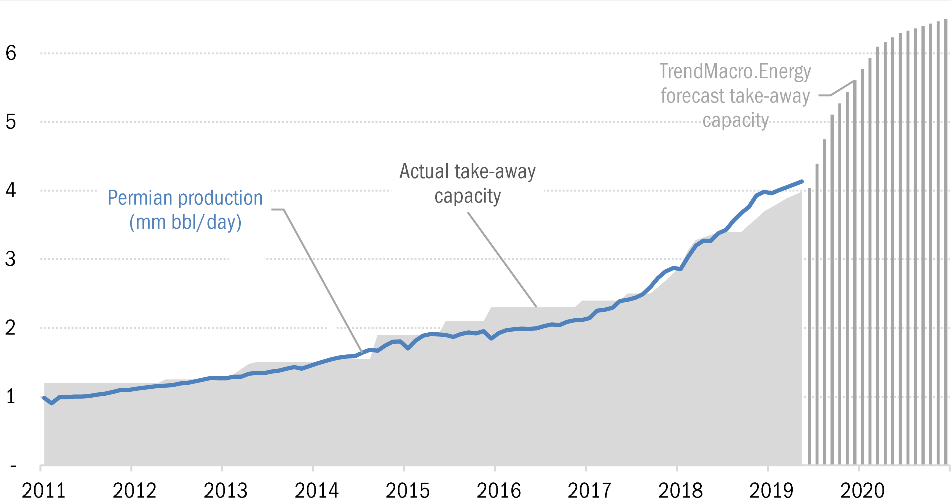


Source: Bloomberg, TrendMacro calculations

- Trump had been forced to grant the waivers last November, days before the US mid-term elections. The scandal of the alleged murder by the Saudi regime of the so-called dissident journalist Jamal Khashoggi (see "Recession Risk at Last?" November 20, 2018) left Trump no political choice but to dial back anything he was doing that might have been seen as helpful to Saudi – especially crippling Saudi's regional rival Iran, and transferring to Saudi Iran's market-share.
- It has been suggested – with some credibility, if no actual evidence – that Trump and the Saudi regime both felt betrayed by the other in the incident. With six months gone by, and oil prices having recovered substantially from Q4-2018's lows, presumably any such feelings have healed. Perhaps just to be sure, last week Trump vetoed a bi-partisan bill that would have forced an end to US assistance in Saudi's proxy-war in Yemen. Trump has also indicated his support for Khalifa Haftar, the Saudi-backed Libyan warlord whose forces have launched sweeping attacks against the United Nations-approved government
- *As if on cue Monday*, *Saudi oil minister Khalid Al-Falih announced that the Kingdom stood ready to step in to protect oil markets from any disruptions due to loss of Iranian supply*.

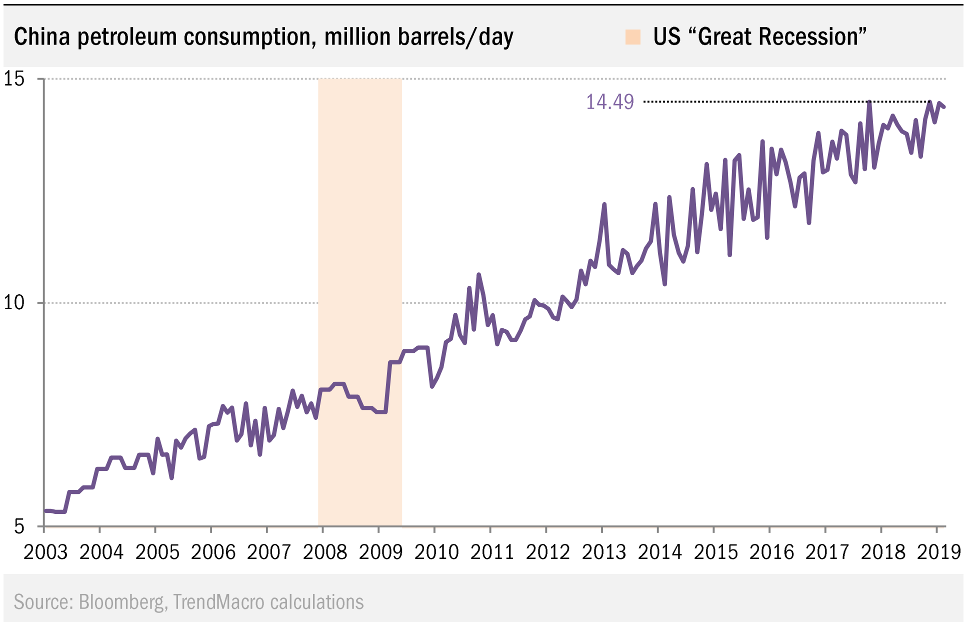
- Considering how little Iranian supply the world really stands to lose anytime soon, and the reliable presence of a "Saudi call," *we have to regard the present bump in oil prices as only a temporary overshoot of our forecasted range, $50 to $60 in WTI terms* (see "Why Aren't Oil Prices Higher?" February 12, 2019).
- To be sure, there are upside risks – or at least some headline risks.
- So far General Haftar's assault on Tripoli has not disrupted Libya's oil production – indeed, for what it's worth, Haftar has always been very good about keeping production and shipping going in regions he controls. Considering support of Haftar by both Saudi and Russia, there is little doubt that those two nations would help make up for any shortfalls if production is interrupted.
- Next week the Trump administration will begin requiring that payments for purchases of petroleum products from Venezuela's national oil company be made into a blocked account controlled by he interim president Juan Guaido. Then by the end of July, petroleum trade between Venezuela and US companies will cease altogether. This should have little impact on global markets, because Venezuela exports mostly heavy crude, which isn't as fungible on the global oil market as light – such as shale oil – because refiners need expensive heavy cat crackers to refine it.
- *Meanwhile, US production continues to explode to the upside.* We have upward-revised our proprietary bottom-up forecast for increases in take-away capacity in the Permian, and are now estimating that *new pipelines could support as much as 5.6 million bbl/day production, up from 4.1 million currently* (please see the chart below).

Crude in the Permian: production and take-away capacity



Source: DOE IEA, Various, TrendMacro calculations

- *At the same time, global demand for oil is stagnating. For the last several years it has been supported almost single-handedly by China. But as growth in China slows – no doubt worsened by the pressure of the trade war with the US – its oil demand has now not grown for over a year* (please see the chart on the following page,



and "Video: What you're not hearing about Chinese growth" April 17 2019).

- *With a US-China trade deal, over time demand growth could come back. But until then, and given the expected increase in US production, Saudi's production forbearance and the sanctions against Iran and Venezuela are the only thing preventing an outright global glut.*

Bottom line

Trump announced the end to waivers from US sanctions granted six months ago to eight nations that are large importers of Iran's oil. Four have already ceased oil purchases from Iran, with China being the largest remaining importer. Assuming perfect compliance, 1.3 million barrels per day would be removed from global supply, but at historical levels of compliance, only 210,000. Trump has recently been supportive of Saudi initiatives in the Middle East, and the Kingdom has announced it will make up for any Iran shortfalls. Conflict in Libya and new US sanctions on Venezuela are upside headline risk for oil. But the "Saudi call," stagnant global demand, and US production likely to increase by 1 million bbl/day by year-end, we see no sustained upside risk to oil. If anything, we face a potential glut.