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MACROCOSM

OPEC's Gifts to Trump

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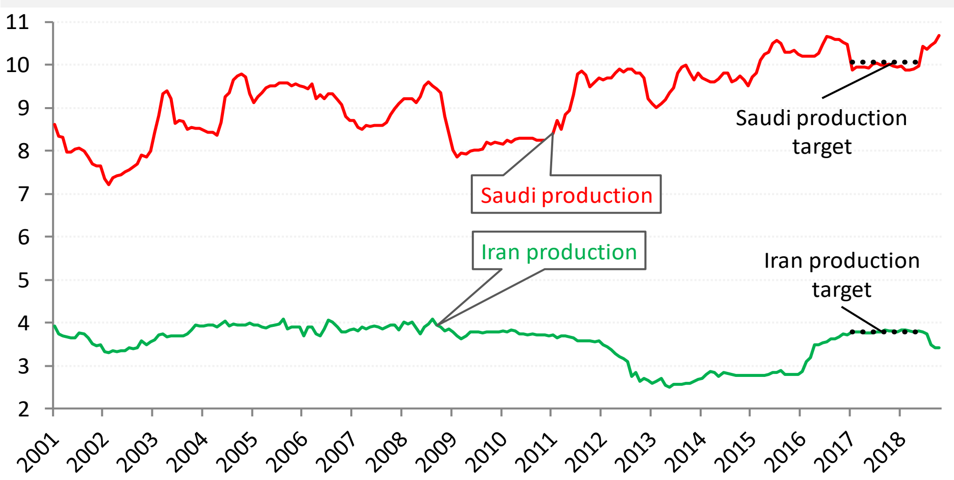
Production limits are coming. They'll support prices and transfer market share to the US.

It was only weeks ago, with WTI crude challenging our upside price boundary of $75, and the doomsday clock to Iran sanctions rapidly running down – we came *this close* to nudging our target higher. We didn't do it – Saudi Arabia was doing too good a job substituting for Iranian supply, barrel for barrel (please see the chart below) – and now WTI is 25% lower, crashing through our lower price boundary of $65, and there is talk that OPEC will have to re-impose production limits to support prices (and, at the same time, talk that OPEC may break up!).

Crude oil production Millions barrels/day



Source: Bloomberg, OPEC, TrendMacro calculations

- *Two weeks ago, when WTI was challenging our lower price boundary of $65, we discussed the downside dynamics in play* (see "Chinese Tariff Torture" October 29, 2018). *We didn't nudge our expected trading range lower. Obviously we should have, and we are forced to do so now. We'll lower our expected range to $60-to-$70, and treat today's prices as a panic undershoot. We don't see anything like the unlimited downside that oil experienced from 2014 to 2016.*
- *The strongest dynamic in play is the global blowback against Saudi Arabia for the alleged murder of a "journalist,"* a tragic but tiny event in the grand scheme of things, remarkably and improbably

Update to strategic view

OIL: Oil has broken through the bottom of our expected trading range as the US grants temporary waivers to eight nations from secondary sanctions on Iran oil imports. We are lowering our expected range to $60-to-$70, treating today's lower prices as a panic undershoot. OPEC will likely impose production targets at its upcoming meeting, which should be effective considering that the prior targets succeeded in rebalancing global petroleum stocks to normal levels. European nations without waivers will still have to back off Iranian oil, and further sanctions will click in soon enough. Meanwhile, crude demand from emerging economies – especially China – has slowed to a halt, while US production surges to new highs. OPEC will have to cede market share to the US, where production is moving to new highs and transport bottlenecks are finally clearing. OPEC has learned that price is more important than market share, and is not likely to repeat the 2014 mistake of free-for-all production.

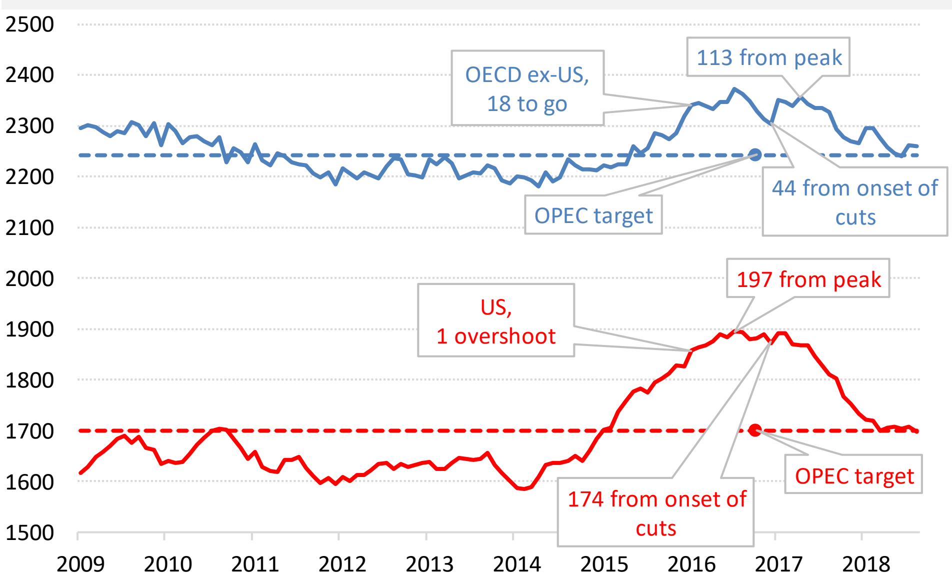
[Strategy dashboard]

amplified by the leverage of social media into the defining issue of US foreign policy. *The October 2 top in crude coincides to the very day that the murder was first reported in Turkish media.*

- As a result of it, President Donald J. Trump simply couldn't make a gift to Saudi Arabia of Iran's crude oil market share – call it revenues of $25 billion per year – and the shift in regional political influence that would go along with it. So the Trump administration has issued waivers on US secondary sanctions to eight nations who buy Iran's oil. *Iranian production is already off 400,000 barrels per day, and nations without waivers –primarily in Europe – will have to cut back even more. But catastrophic supply risk from Iran is off the table for a while.*
- OPEC will likely elect to tighten supply with production limits at the upcoming meeting in Vienna. Trump is seemingly stepping on that with tweeted warnings, aimed at reminding Saudi Crown Price Mohammad bin Salman of his political vulnerability, and his dependence on US patronage. *But we expect Trump understands that production cuts would, in fact, be a gift of market share from OPEC to US producers. And MBS owes Trump a gift, after the intensely embarrassing Trump during the mid-terms by offering such self-evidently dishonest excuses for the "journalist's" murder.*

- Such production limits would be a remarkable reversal for OPEC, which lifted targets just five months ago (see "OPEC Eases (Or So It Claims)" June 25, 2018), having successfully achieved over a year-and-a-half the goal of rebalancing global petroleum stocks (please see the chart below). *So new limits could be effective at supporting prices now, because they would be imposed on a global inventory position already substantially in balance* – when they had

Global petroleum stocks Millions of barrels, as of August 2018



Source: JODI, TrendMacro calculations

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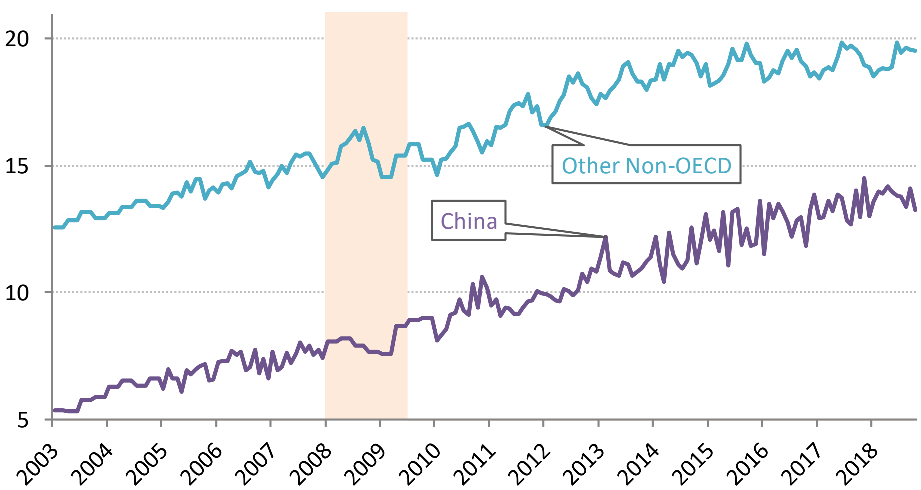
been initially imposed in January 2017 (see "On OPEC's Production Target" September 29, 2016), markets were awash with supply, and they took quite a while to work off (see "The Crude Stocks Conundrum" June 28, 2017).

- *But while OPEC has been rebalancing global inventories, global supply/demand dynamics have shifted.*
- *Emerging economies have been the engine of global petroleum consumption growth. But now non-OECD ex-China growth has been flat for almost four years, and China's growth has been flat for 18 months* (see "Data Insights: Oil" November 13 2018, and the chart below).

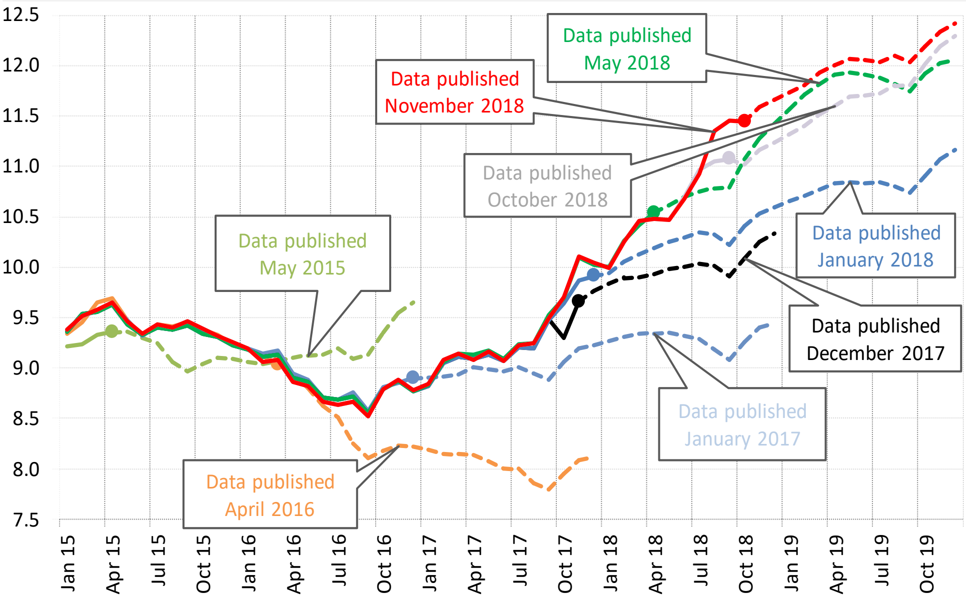
Crude oil consumption Millions barrels/day **Recession**



Source: Dept of Energy, Energy Information Administration, TrendMacro calculations

- There is some contradictory evidence on this. China's *imports* (as opposed to consumption) hit a new high last month, reportedly propelled by demand from tiny private "tea-pot" refineries.
- But we tend to believe the more pessimistic story here. China's economy is slowing dangerously under global trade pressure led by the US (see, among many, "On the Margin: China Sees the Cliff" October 19, 2018), and it's dragging other emerging economies down with it (see "No Pardon for This Turkey" August 14, 2018).
- *At the same time, US crude oil production has reached new all-time highs, and seems destined to surge higher as transportation bottlenecks begin to be resolved.*
- The production revolution here is astonishing (and very much what we've been predicting all along – see, among many, "I Have Seen the Future, and It Fracks" February 24, 2015). Official forecasts for year-end 2019 call for US production more than 50% higher than forecasts made just two-and-a-half years ago for year-end 2017 (please see the chart on the following page, and again, "Data Insights: Oil")!
- That means that any production limits imposed by OPEC on its members and allies (such as Russia) are effectively transfers of market share to the US. *But the cartel has little choice than to make*

US crude oil production **— Actual** **● Latest** **--- Forecasted** Mil bbl/day

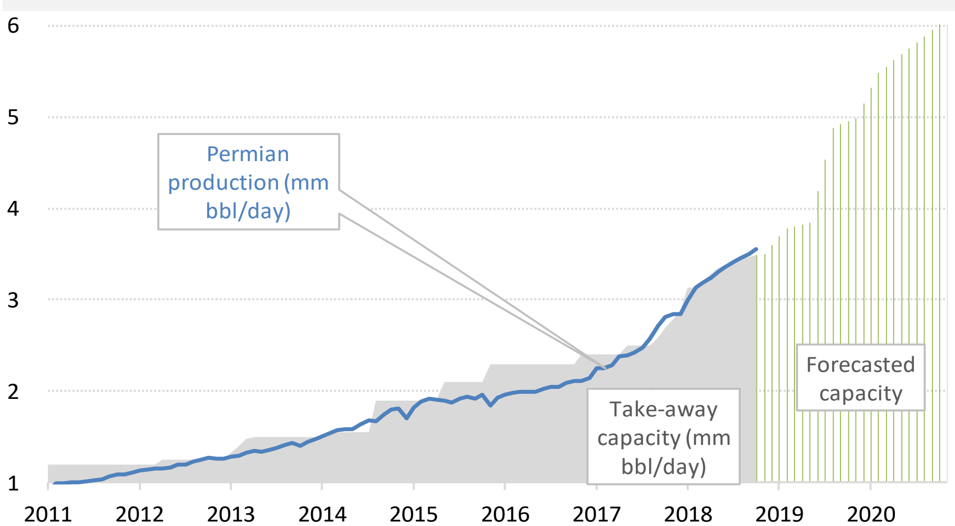


Source: DOE IEA, TrendMacro calculations

it up in price, having learned from its ill-fated 2014 experiment with free-for-all production (see "Oilmageddon" December 16, 2014) that ended up crashing the global oil price as low as $26 by early 2016, nearly wrecking the economies of oil-producing nations and almost causing a global recession (see "The Recession Caused by Low Oil Prices" January 8, 2016).

- The explosive upside forecast for US production is based, in part, on the actual and anticipated solution to logistical and transport bottlenecks that have blocked US crude from getting to export markets (see "Oil's Bullish Bottlenecks" April 24, 2018).
- We've revised and expanded our forecast for takeaway capacity in

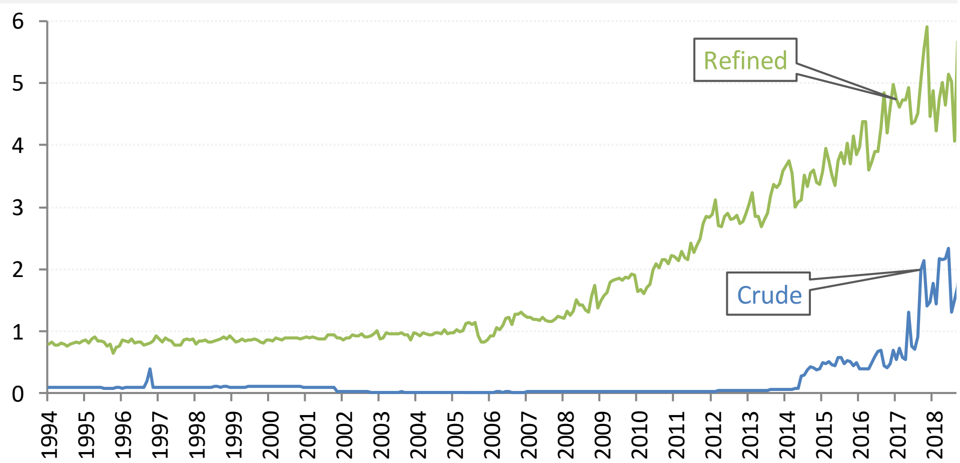
Crude oil production and take-away capacity in the Permian Mil bbl/day



Source: DOE, various, TrendMacro calculations the Permian (please see the chart on the previous page). We're now expecting a 75% capacity increase by year-end 2020, permitting a commensurate increase in production. *That's 2.5 million new barrels/day on the global market, which all by itself – from just a single US shale play – is about enough to meet demand growth from the entire world.*

- We have no doubt that the Permian producers can fill these new pipes. About 2,500 drilled-but-uncompleted wells have been put into inventory over the last two years (again, see "Data Insights: Oil"), just waiting for takeaway capacity to materialize.
- These additional volumes are primarily for export, which means they are bounded by bottlenecks at Gulf Coast ports, which have lacked the capacity to host efficient seaborne transportation (again, see "Oil's Bullish Bottlenecks"). These bottlenecks, too, are clearing.
- Someday massive infrastructure projects will have to be carried out. But for now, even relatively small-scale efforts have enabled US crude exports to make new all-time highs (please see the chart below).

US petroleum exports Millions barrels/day



Source: DOE IEA, TrendMacro calculations

- The Louisiana Offshore Oil Platform (LOOP) has been transitioned to handle crude, and has now begun to load Very Large Crude Carriers (VLCCs).
- Texas ports, too shallow to safely accommodate VLCCs, are now using "lightering" – the process of loading smaller, less efficient tankers such as Aframax and Panamax, and sending them offshore to transfer their cargoes to VLCCs and Ultra-VLCCs for the long-haul to Asian export markets.

Bottom line

Oil has broken through the bottom of our expected trading range as the US grants temporary waivers to eight nations from secondary sanctions on Iran oil imports. We are lowering our expected range to $60-to-$70, treating today's lower prices as a panic undershoot. OPEC will likely impose production targets at its upcoming meeting, which should be effective considering that the prior targets succeeded in rebalancing global petroleum stocks to normal levels. European nations without waivers will still have to back off Iranian oil, and further sanctions will click in soon enough. Meanwhile, crude demand from emerging economies – especially China – has slowed to a halt, while US production surges to new highs. OPEC will have to cede market share to the US, where production is moving to new highs and transport bottlenecks are finally clearing. OPEC has learned that price is more important than market share, and is not likely to repeat the 2014 mistake of free-for-all production.