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MACROCOSM

Oil's Bumpy Road to $100

Wednesday, March 22, 2023
Michael Warren

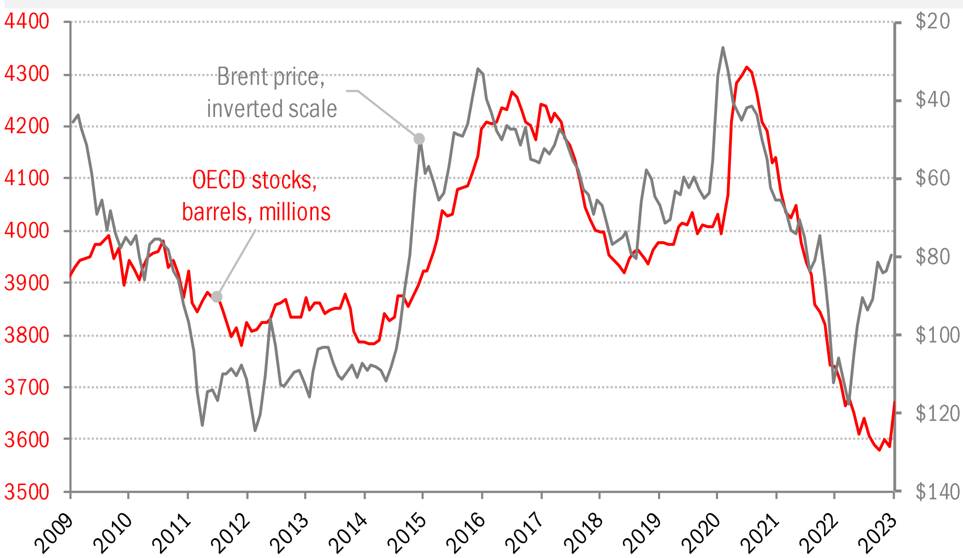
Unless the bank crisis proves a tipping point, all the fundamentals still point to $100 crude.

It's been painful. But *we maintain our outlook that Brent crude oil is destined for $100 this year*, despite the fact that WTI traded in the mid-$60s last week, and Brent in the low $70s, their lowest levels in 16 months. And yes, we know even the most stalwart bull has capitulated: Goldman Sachs revised lowered its 2023 oil price forecast due to the banking panic.

We're not in a perfect storm for higher oil prices – rather, a perfect puzzle, where many pieces are coming together to point in one direction: higher.

- The number one determinant of oil prices historically has been inventory levels for liquids (crude oil and petroleum products). While OECD inventory levels (less the Strategic Petroleum Reserves releases) have slightly bounced off their multi-decade lows, the last time inventories were this tight, for most of 2011 to 2014, Brent traded at $100 or higher (please see the chart below). Don't even ask about it on an inflation-adjusted basis.
- *A regression analysis of oil prices versus OECD stocks calculates that Brent should be at $111 now*.

World liquid inventories versus crude oil price



Source: JODI, Bloomberg, TrendMacro calculations

Update to strategic view

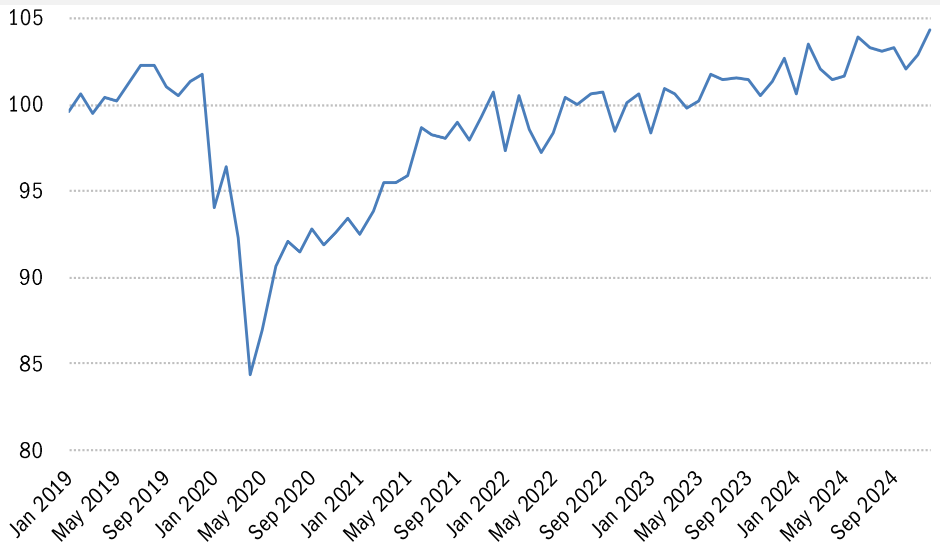
OIL: The bank panic has driven oil prices to the lowest levels in 16 months, and even Goldman has capitulated. But demand fundamentals have survived a global tightening of financial conditions. The re-opening of China is going without a hitch. Global official and commercial storage remains near the lowest levels in modern history, levels always associated with far higher prices. The Biden administration has flip-flopped on Alaskan drilling and refilling the SPR. But OPEC+ will lower production quotas in response to today's low prices. Russia is cutting production, nominally in retaliation for G7 price caps on crude and refined product. But it's as much due to the reality that Russian refining runs will have to be reduced in light of increasingly difficult logistics in seaborne shipping. Russia is using ships as floating storage, and use of smaller ships to aggregate volumes on the high seas is contributing to a spike in shipping rates. More Russian cuts are coming. We reiterate our call for $100 Brent this year.

[Strategy dashboard]

<u>While global banking has come under increasing pressure from over-tightened monetary policy</u> (see [“It’s Over For SVB – And the Fed”]() March 13, 2023), *<u>physical oil demand has held up</u>*. The crisis precipitated by Silicon Valley Bank may be a tipping point, but we doubt it (see [“It’s Over For SVB – And the Fed”]() March 13, 2023). At least the demand fundamentals have survived the precursor conditions to the crisis. For example, China, the world’s largest swing consumer, is managing its reemergence from its Covid scare without a hitch despite rising global rates.

- The Energy Information Agency upgraded its view toward our out-of-consensus demand forecast (see [“Surprises of 2023 Volume 2: Oil Demand, With or Without EVs”]() January 11, 2023) with its latest monthly update, calling for global liquids demand to fully recover by year-end and continue growing into 2024 (please see the chart below).

Actual and forecasted global liquids consumption (barrels per day, millions)

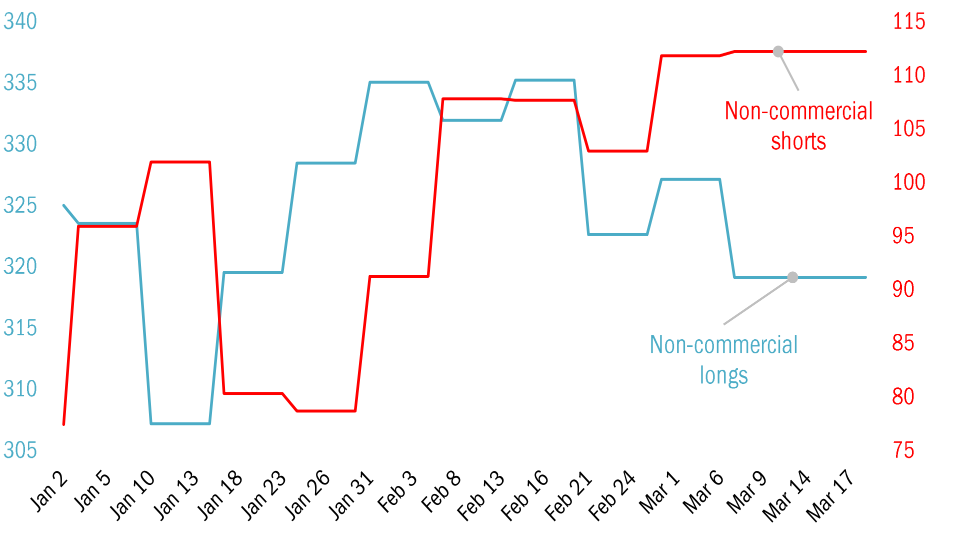


Source: DOE EIA, TrendMacro calculations

So far at least, the banking crisis has affected the *financial* oil markets – not the *physical* markets – as both West Texas Intermediate and Brent benchmarks fell by about $8 per barrel in the spot market after Silicon Valley Bank's problems emerged. Looking at the Commodities Future Trading Commission Commitments of Traders data, WTI speculative short contracts have increased by 45% since the beginning of the year while longs have been basically flat (please see chart on the following page). But the longs still remain well above the low level set on the week of January 10.

<u>Making matters difficult for the bulls is the Biden administration</u>, which can’t seem to get its story straight on oil. Bravo for disappointing the environmental lobby and [reversing its “no more drilling” pledge]() by approving the $8 billion Willow project in Alaska. But the administration has also violated [its pledge to refill the Strategic Petroleum Reserve]() when WTI

WTI futures contracts outstanding

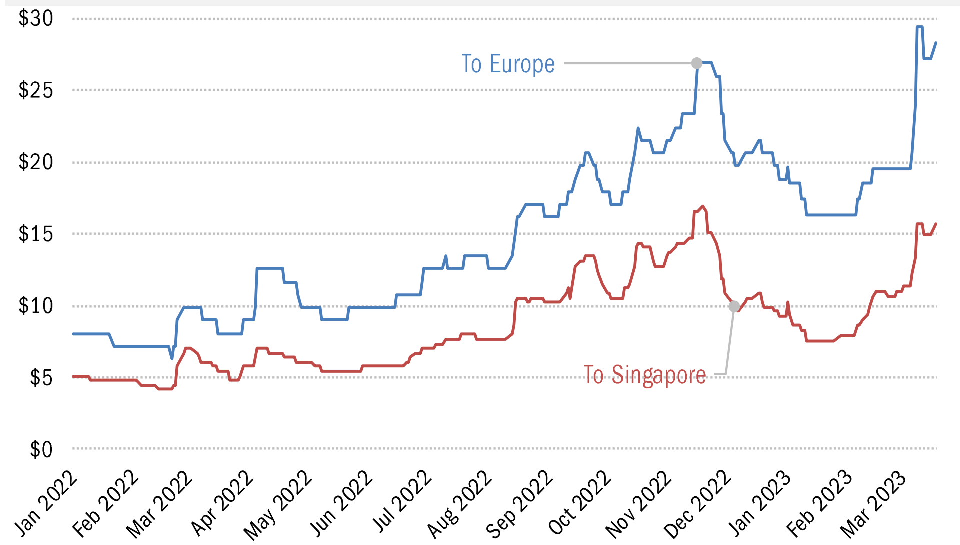


Source: CFTC, TrendMacro calculations

was in a range for \$67 to \$72 – which [it actually did in December] when the benchmark touched \$70. But now spokespeople are saying the administration ["wouldn't rush"] to purchase any more.

- For its first two years in office, it seems the Biden administration did everything it could do make oil more expensive (makes sense, if your climate agenda is to make people learn to use less of it). Then with invasion of Ukraine and an inflation scare in an election year, the political polarity seems to have reversed. At least until the next reversal.

Arabian Gulf tanker rates (USD per ton)



Source: Bloomberg, TrendMacro calculations

While US President Joseph Biden Jr. wants lower oil prices, Russian President Vladimir Putin – and OPEC+ – would like to see them rise toward the triple-digit mark (see "It's Official: OPEC Wants $100 Oil" September 30, 2022). Watch for OPEC+ to dial back production quotas again. And note that Russian Deputy Prime Minister Alexander Novak announced a 500,000 barrels per day production cut starting in March 2023 as retaliation for the G7 price cap on crude oil and petroleum products. Today he extended that cut through June. Our position was that Russia would gradually cut production by more than 1 million barrels per day to avoid the back-up in refinery runs when transporting diesel and crude on the high seas would become too logistically difficult when dealing with the price caps (see "Oil Markets One Year On from the Ukraine Shock" March 7, 2023).

Crude oil shipping rates are the canaries in the coal mine that demonstrate seaborne logistical transportation difficulty. Russian crude oil and diesel volumes are stuck at sea on tankers while the Kremlin tries to find buyers, which are pushing up dirty (oil) and clean (product) tanker rates. Russia's shadow and dark fleets are also siphoning off tankers that used to move oil and fuel for the West, thereby reducing the supply of carriers. Look no further than very large crude carrier shipping rates from the Arabian Gulf to United Kingdom/Continental Europe They have jumped to levels even surpassing the panic seen at the onset of the war in Ukraine (please see the chart on the previous page). Shipping rates to Singapore have also risen, but not as much at those to the Europe. Again, the lack of storage will dial back Russian refinery runs, which will reduce domestic production of crude oil.

Bottom line

The bank panic has driven oil prices to the lowest levels in 16 months, and even Goldman has capitulated. But demand fundamentals have survived a global tightening of financial conditions. The re-opening of China is going without a hitch. Global official and commercial storage remains near the lowest levels in modern history, levels always associated with far higher prices. The Biden administration has flip-flopped on Alaskan drilling and refilling the SPR. But OPEC+ will lower production quotas in response to today's low prices. Russia is cutting production, nominally in retaliation for G7 price caps on crude and refined product. But it's as much due to the reality that Russian refining runs will have to be reduced in light of increasingly difficult logistics in seaborne shipping. Russia is using ships as floating storage, and use of smaller ships to aggregate volumes on the high seas is contributing to a spike in shipping rates. More Russian cuts are coming. We reiterate our call for $100 Brent this year.