KF SPOTLIGHT: WHY IS CRUDE OIL STUCK IN THE $50'S?

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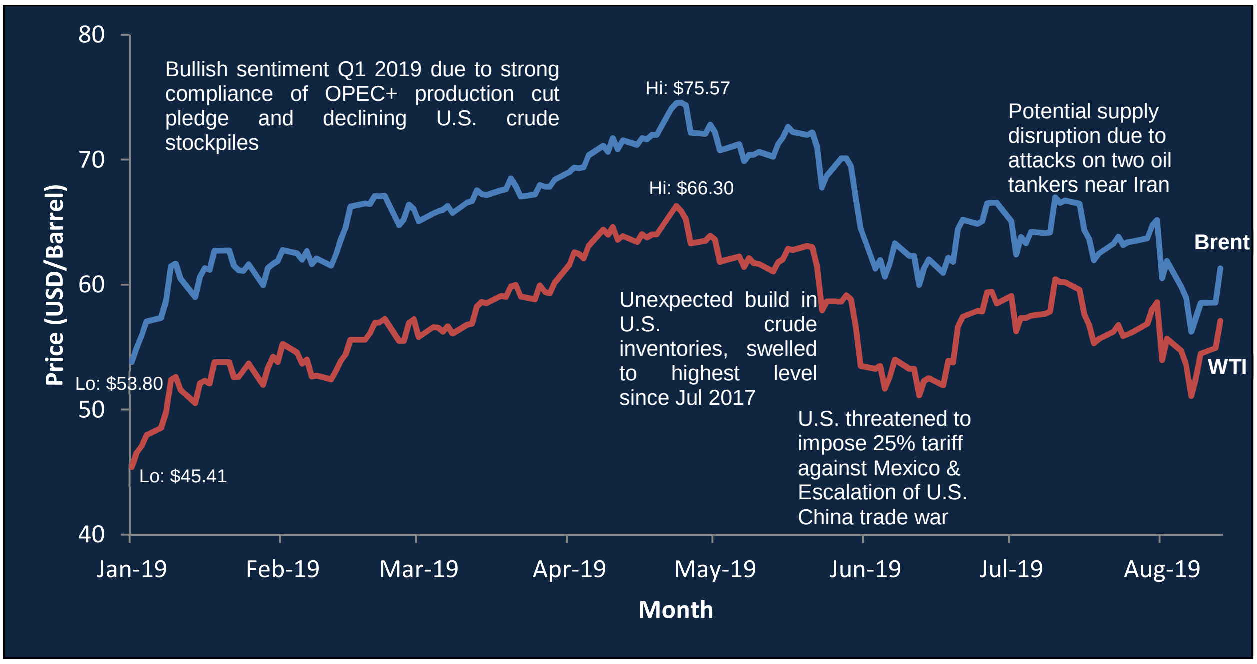

Source: Bloomberg

	Price (as at 15 Aug 2019)	YTD % Change
Brent Crude	US$ 58.23	+8.23%
WTI Crude	US$ 54.47	+19.95%
Brent – WTI Spread	US$ 3.76	

2019 Price Forecast

EIA US$64

WORLD BANK US$66

FACTORS TO WATCH IN 2H 2019

US Federal Reserve Interest Rate Decision :

Expectations of more rate cuts.

Tension in Strait of Hormuz :

Will Geopolitical Crisis Escalate Further?

US –China Trade War :

More Tariffs or Possible Truce?

Venezuela Political Crisis :

How Will This Impact the Nation with the Largest Proven Oil Reserves

US Shale Oil Production :

Continuously Charting New Records of Output

Mother Nature at Work :

Tropical Storm Barry and Atlantic Hurricane Season may Disrupt Supply

Crude oil has had a mixed 2019 so far. The West Texas Intermediate (WTI) crude oil started the year bouncing off a low in the mid-40s and climbed steadily to a high of $66 in late April. By summer, crude oil prices remains stuck in the $50-$60 range, as bulls and bears engage in a tug of war with both sides having convincing reasons to support their cases.

FACTORS TO WATCH IN 2H 2019

*1. **US –China Trade War**: More Tariffs or Possible Truce?*

Among the bigger clouds hanging over the heads of oil traders, investors and businesses is the over-a-year-long trade war between the U.S. and China.

The Asian giant is the world's top buyer of crude oil, a position it seized from the U.S. in 2017. The U.S., on the other hand, had recently hit a record high in crude oil export in February, and may in a few years displace Saudi Arabia as the largest exporter of oil, according to some analysts. Needless to say, any disruption to trade flows between the world's two largest economies will have significant impacts on oil prices.

The dent on China's industrial output due to U.S. tariffs has fueled concerns about the demand side, which may be compounded by any reactionary or retaliatory action by China.

In an attempt to jumpstart domestic economic growth, as well as to offset damage brought about by U.S. tariffs, China may be forced to take drastic measures. China's People's Bank of China (PBOC) in early August allowed the Renminbi to fall weaker than 7 per dollar, a psychological level last seen more than a decade ago, a few days after President Trump announced a new round of tariffs in the ongoing trade war. Dollar-denominated oil fell due to fear of a weaker currency would dampen China's demand for the commodity. Should the Renminbi depreciate further, either by design or market forces, crude oil prices would see greater downside.

*2. **Tension in Strait of Hormuz**: Will Geopolitical Crisis Escalate Further?*

The degree of geopolitical conflict in the Middle East is positively correlated to oil prices. With the recent flare-up in tensions between Iran and the West, oil prices in theory and by logic should spike, considering Iran produced 4 percent of global oil output in 2018, according to the U.S. Energy Information Administration (EIA).

True enough; the Trump administration's decision to end sanction waivers on buyers of Iranian oil in early May gave oil prices a boost from the supply side. Then again, the market is not expecting every country to abide with the directive. Bank of America Merrill Lynch estimated that oil could fall to as low as $20-$30 a barrel, if China disregards the sanctions and continues to purchase Iranian oil.

At the same time, it is also the conflict in the Middle East that has weighed on oil prices. Members of Organization of the Petroleum Exporting Countries (OPEC) have been slow in cutting production, despite routinely calling for action. Saudi Arabia, the world's largest exporter of crude oil, is seen to be dragging its foot on reducing supply, in what many believe to be a tactic to hurt its regional rival Iran by keeping prices low. The reinstated Iran sanctions, as well as Saudi's need for oil prices to return to levels at which it can manage its fiscal spending and its oil-dependent economy, may lend support to the commodity in the near term.

*3. **Rising U.S. Shale Oil Production**: Continuously Charting New Records of Output*

The fight for market share among oil producers is showing no sign of abating. Shale oil production in the U.S., which is partly responsible for the oil slump that began in 2014, is expected to hit a record high output of 8.77 million barrels per day (bpd) in September, according to the EIA. As a result, oil producers may be forced to take further action to trim inventories and prop up prices.

Initially, OPEC members have struggled among themselves to come to a consensus on production cuts, out of fear of losing market share. However, an agreement between OPEC and non-OPEC producers, known collectively as OPEC+, to reduce output by 1.2 bpd for the first six months of 2019 has so far supported oil prices.

Kuwait, in particular, had slashed its July production by more than what was agreed upon, according to the country's oil minister. Russia, the second largest producer outside the group, in June agreed to extend the production cut period from six months to nine, amid economic pressure from sanctions imposed by Western countries. Hence, aggression by shale oil frackers will likely corner OPEC+ members into a unanimous and concerted production cut.

4. ***Venezuela Political Crisis****: How Will This Impact the Nation with the Largest Proven Oil Reserves?*

Oil traders, however, should be mindful of other market-sensitive developments, one of which is the civil unrest in Venezuela whose embattled president Nicholas Maduro is pressured to resign due to economic mismanagement that has sent the country into hyperinflation and political chaos.

Maduro's refusal to step down has prompted economic sanctions and threat of a military intervention by the U.S. If Maduro does leave office, voluntarily or by force, sanctions are expected to be lifted and with the world's largest proven oil reserve, energy markets will be flooded with Venezuelan oil, adding pressure to prices from the supply side.

*5. **U.S. Federal Reserve Interest Rate Decision**: Expectations of more rate cuts*

Being a dollar-denominated commodity, the direction of crude is also dependent on the performance of the U.S. dollar. The Federal Reserve now faces an unprecedented challenge: committing to an apolitical and independent pursuit of its mandate, under a president who has consistently called for easy monetary policy.

All eyes are on the central bank's chairman Jerome Powell and his resolve in resisting President Trump's unrelenting demand for lower interest rates. In other words, the greenback may be a factor that could tip the scales in the favor of either oil bulls or bears, when all other catalysts have little momentum to move prices out of the doldrums.

*6. **Mother Nature at Work**: Tropical Storm Barry and Atlantic Hurricane Season Causing Supply Disruption*

Amid the human-driven factors mentioned above, oil traders should also be wary of nature-driven factors that may cause supply disruptions. However, such weather events may have less pricing impact on oil and gas compared to a decade ago due to increasing share of onshore production.

In July, nearly 7%, or 1.3 million barrels per day, of crude oil production has been cut in the U.S. – regulated areas of Gulf of Mexico due to Tropical Storm Barry, putting oil refining at the Gulf Coast at risk. According to the EIA, Gulf of Mexico federal offshore oil production accounts for 17% of total U.S. crude oil production. Any disruption to supply arising from this has helped to provide support to crude oil prices.

Tropical Storm Barry is one of the first set of storms to hit the Gulf area to mark the start of the Atlantic Hurricane season, which is expected to end in November 2019. Forecasters with the National Oceanic and Atmospheric Administration (NOAA) are also warning hurricane activity in the Atlantic Ocean is more likely to be above normal levels for the remainder of the 2019 Atlantic hurricane season, thanks to more favorable atmospheric and ocean conditions.

WHERE TO FROM HERE

EIA has forecasted Brent crude spot prices to average around US$64 per barrel in the second half of 2019 while expecting the WTI crude spot price is expected to hover around US$5.50 less than Brent prices, or (US$58.50 per barrel) during the fourth quarter of 2019.

Meanwhile, the World Bank stated in its April 2019 Commodity Markets Outlook that it also expects crude oil prices to be lower in 2019, averaging US$66 a barrel, on the back of slower-than-expected global growth and rising non-OPEC supply.

Unless there is a shift in dynamics in the ongoing trade war, or a major producer finally succumbing to pressure exerted by low prices on its economy, WTI crude oil is likely to remain stuck in the $50's for some time to come.

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