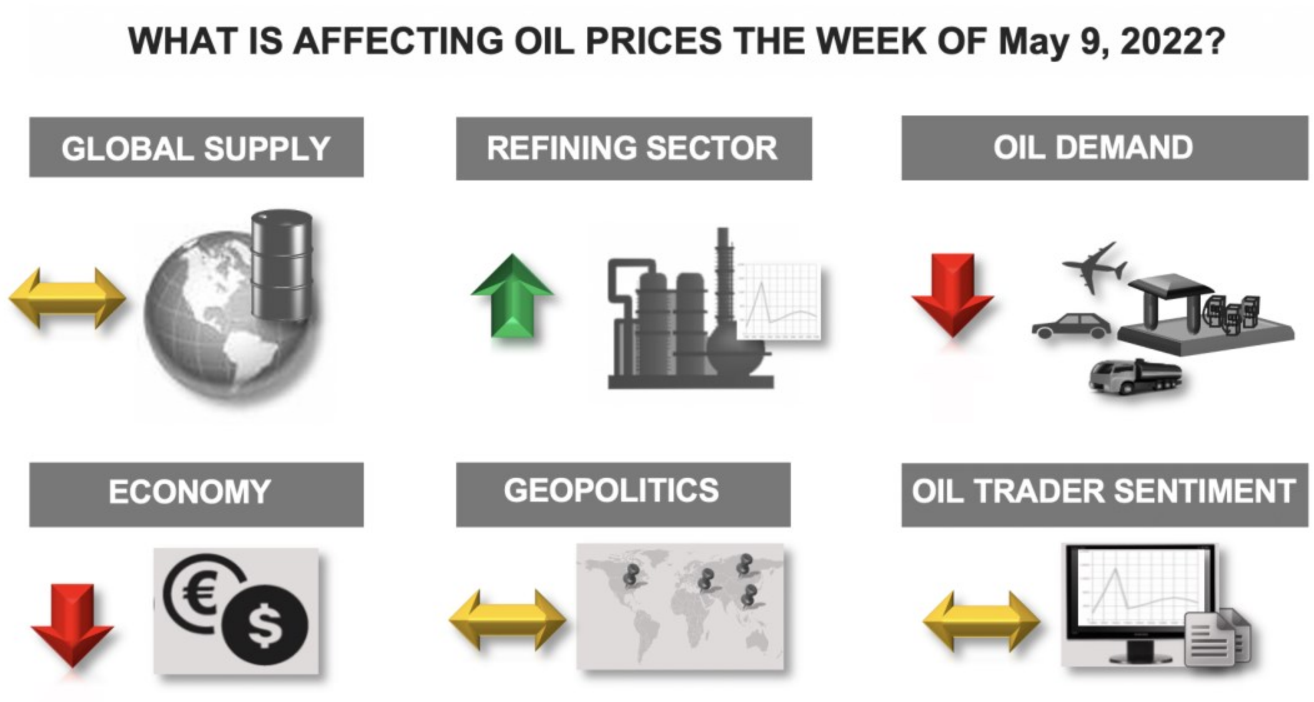
Uncertain Demand vs Tenuous Supply

This weekly report is an excerpt from our Short-Term Outlook service analysis, which covers a period of eight quarters and provides monthly forecasts for crude oil, natural gas, NGL, refined products, base petrochemicals and biofuels. Contact John Paisie (+1-832-517-7544 or E-mail) for the detailed analysis or for more information about the Short Term Outlook.



Source: Stratas Advisors

The price of Brent crude ended the week at $112.36 after closing the previous week at $107.22. The price of WTI ended the week at $109.77 after closing the previous week at $104.69.

In our note of last week, we raised the possibility of oil prices falling through their support levels because of the negative news about the global economy and the pessimism about future economic growth. Additionally, since February 25, the price of Brent crude (and WTI) has been going through cycles of lower highs before the price retreats to the lower support level, and it appeared that a similar pattern has happened for the fourth such cycle. In fact, the price of Brent crude fell to $104. 97 by Tuesday but rebounded on the news of EU drafting plans to ban imports. As such, instead of falling through the lower support level, the price of Brent crude remained another week in the channel between $98.00 and $115.00. Also, while the price broke out of the cycle of reaching lower highs before retreating to the lower level, it did not do so in a decisive manner.

Looking forward to this week, we still see concerns about the major economies despite the favorable jobs

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report. Last Friday, the Bureau of Labor reported that the US economy added 428,000 jobs in April (which was slightly better than forecasted) while the unemployment rate remained at 3.6%. Wages increased by 0.3% from the previous month and are up by 5.5% in comparison to one year ago. The other big news of last week was that the Federal Reserve increased the Federal Funds Rate by 50 basis points. The Federal Reserve also indicated that more rate increases are on the way. In response, the US Dollar Index reached 103.64, which is the highest level since the second half of 2002. The US interest rate on the 10-year bond reached 3.13%. The problem facing the Federal Reserve is that rate increases will do little in terms of addressing the higher costs of food nor in reducing energy costs. Additionally, wages have been increasing at a slower rate than overall inflation, which means that workers are continuing to experience shrinking income in real terms. Furthermore, the US economy is already showing signs of slowing down with US economy shrinking by 1.4% in 1Q of this year. While some of the factors underlying the negative GDP grow rate are temporary (such as a decline in defense spending), the US economy is poised to grow at a slower rate. It will be increasing difficult for the Federal Reserve to prevent a recession with the US economy facing elevated energy and food prices because of tight supply, coupled with declining real wages, while the monetary situation is shifting quickly from accommodating to tightening.

The situation in Europe is even less promising with the EU economies experiencing high inflation and declining consumer spending, while facing potential disruptions in the supply of energy and food, plus being exposed to economic slowdown in China, which is still dealing with COVID-19.

From a supply perspective, the EU is continuing with negotiations among its members to arrive at a formal agreement to ban imports of Russia crude oil and refined products. As we expected, since the sanctions needs to be approved by the 27 member states of the EU, extensive negotiation have been required, which have taken additional time – and the final agreement is likely to include a longer transition period. The European Commission has proposed phasing out imports of Russian crude within six months and refined products by the end of the year. However, several countries in Eastern Europe are pushing back against the proposal (including Hungary, Slovakia, and Bulgaria), even though the proposed ban included additional time for these countries to institute the ban in 2024, instead of 2023. It has been reported that Hungary is pushing to be completely exempt from the ban. Bulgaria is also pushing for an exemption to the ban and has indicated it will not support the ban without this exemption. The negotiations are to continue during this upcoming week, and ultimately, we are expecting that the EU will reach agreement on some version of a ban, but the initial focus will be on tanker shipments of crude oil and oil products with pipeline shipments being addressed later.

If the EU comes to an agreement this week, we are expecting that the price of Brent crude oil will increase and will break above $115.00. If an agreement is not reached this week, the price of Brent crude oil is likely to move sideways, unless there is a visible breakdown in the negotiations, at which point we think that the price of Brent crude will threaten the lower support level of $98.00. It seems that we are heading to an inflection point.

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