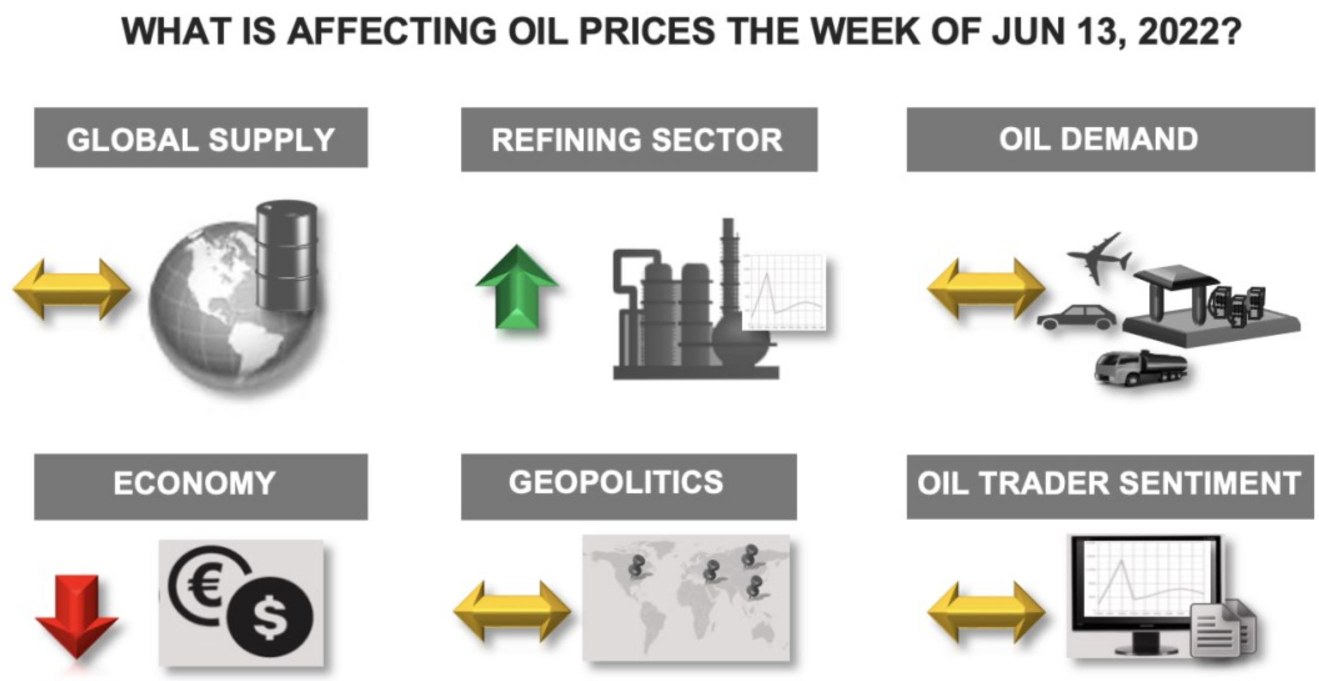
Demand Remains the Critical Factor

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 122.01 after closing the previous week at $119.72. The price of WTI ended the week at $120.67 after closing the previous week $118.87. In recent weeks, we have suggested that oil prices would not move significantly higher than $120.00 over the next few months, in part, because our expectation that the supply situation would stabilize, and that global demand growth would remain moderate.

While oil prices moved up last week, there are several factors that are putting downward pressure on oil demand.

- The US Dollar Index reached 104.19 (from 102.14 of the previous week) and is at a level not seen since December of 2002. The stronger dollar is making the cost of oil relatively higher for importing countries, and given the elevated strength of the US dollar, oil prices in local currencies are effectively higher now than during 2008

  1616 South Voss Road Suite 675 | Houston, TX 77057 | United States | +1.713.260.6426 | stratasadvisors.com

when the price of oil prices approached $150.00. Additionally, because of the tight refining situation, product prices are even higher than typically would be indicated by oil prices. Furthermore, the consumer is facing elevated costs for food and housing, which will further dampen demand.

- The latest data from EIA, indicates that demand is already being affected in the US where gasoline prices have moved above $5.00 per gallon and diesel prices are approaching $6.00 per gallon. The latest weekly report from EIA indicates that gasoline demand in the US increased to 9.20 million b/d from the previous week of 8.98 million b/d. However, based on the 4-week average, current gasoline demand is running 535,000 b/d less than for the same period of 2019, which represents a difference of 5.6%. Diesel demand in the US decreased to 3.65 million b/d from the previous week of 3.97 million b/d. However, based on the four-week average, diesel demand is running 131,000 b/d less than in 2019, which represents a difference of 3.3%.
- As we highlighted last week, while the number of COVID-19 cases have remained low, it does not appear that China will be moving away from its zero-COVID policies any time soon. Currently, mass testing is taking place in Shanghai after four cases were confirmed on Saturday. Additionally, five districts barred residents from leaving home during the testing period. Additionally, Beijing is being affected with a government spokesman announcing on Saturday that Beijing is experiencing an explosive COVID-19 outbreak.

Coupled with the moderating demand, we are expecting that the oil supply situation will stabilize. Given that the EU has recently agreed to ban the imports of Russia oil, we think that will be the last major announcement that will negatively affect future oil supply. While the EU is also working to implement a ban on insurers covering oil tankers (oil and refined products) that will be phased in over six months, we do not think the ban will have a major impact on Russian oil exports. We are holding to that view, in part, because we think there is sufficient tanker capacity to handle the increased distances that Russia crude oil (and products) will need to travel to reach markets other than Europe. For instance, in January of this year, global VLCC tonnes miles were still some 16% below pre-COVID levels. Additionally, the utilization rate for VLCCS was below 50%. And after an extremely difficult 2020 and a slow recovery, at least some of the vessel owners will be open to additional business.

We also think there is some potential upside to oil supply, including additional non-OPEC supply. Additionally, there is potential for several African producers to produce more oil, although it will require the easing of internal conflict for these producers to do so on a consistent basis. Conversely, we do not expect that there will be an increase in Iranian exports stemming from a renewed nuclear deal. While there has been some noise about the US reducing sanctions to allow Iran to export more oil, we think this is highly unlikely – and even more so now, given the recent actions by Iran to remove cameras that allows for monitoring by the IAEA.

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