Trade Idea – Commodities & Foreign Exchange

Crude prices at risk

20th January 2017

Volatility abound

- The OPEC/non-OPEC compliance and monitoring committee, charged with ensuring successful implementation of the November accord (which entailed a 1.2mbpd reduction in output), will meet for the first time this weekend as uncertainty continues to drive fluctuations in global oil markets. While statements professing compliance by key oil ministers in Saudi Arabia and Algeria have kept prices elevated (supported somewhat by reports of falling production in the latest monthly OPEC report), downside risks loom. Participants continue to be wary of whether Iraq will comply with the deal, as the nation has been asked to reduce production by the second largest amount (within OPEC) in spite of its challenging economic circumstances. Meanwhile, output and exports in the US continue to expand in the higher-price environment. Our view is that oil prices are likely to come under further pressure in the coming month as considerable downside risks overcome market optimism over the November agreement, which in itself is only expected to last until June.

Risks ahead

- During last week’s Global Energy Forum in Abu Dhabi, senior cartel officials from Saudi Arabia, Kuwait and Algeria all publically announced commitment to the November production agreement and some even stated a willingness to exceed requirements in order to see the deal work. While on the surface this appears very positive, the reality is that risks actually emanate from OPEC’s second largest producer, Iraq, where oil exports hit an unprecedented level in December. Therefore, the success of the landmark accord still remains in the balance and in any case, is only expected to be a feature of the oil market for a short six months. Also, with oil prices above the key $50/bbl level, US oil production is ramping up quickly (see Figure 1), with the Energy Information Administration (EIA) reporting that oil output has hit an eight month high. This creates a landscape where support for oil prices looks fragile and a downward correction looks likely.

From a technical perspective, momentum indicators appear to be waning for crude benchmarks and point to moves lower in coming sessions. Speculative futures positioning for Brent and WTI crude oil has moderated in recent weeks but still remains at levels that suggest downward correction potential. Any move lower in oil prices is likely to face resistance from their 8th December lows of around $52.8/bbl and $50.9/bbl for Brent and WTI respectively, which sits near their current 50 dmases.

*All figures quoted are sourced from Bloomberg unless stated otherwise.

Figure 1: US output grows

Source: Bloomberg, ETF Securities

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Prospects diverge

- While the short-term outlook above is broadly negative for the oil-exporting currency complex (CAD and NOK), prospects are not uniform. The CAD has the benefit of 76% of its exports going to the US and accordingly is directly exposed to the improving growth outlook there. Meanwhile, Norway is still struggling through a structural transition away from oil industries while growth and inflation are moderating, painting a less positive picture for the NOK. Beyond Q1-17, we expect to continue to see the global oil market returning to a balanced state and offering further upside to crude prices.

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