Flash note
19/05/2021

Alex Fusté
@AlexfusteAlex
alex.fuste@andbank.com

Good news! We believe that oil will not be an inflationary driver

As every month, I summarize the most important developments that have occurred in the energy industry during the last month, and that help us to determine the potential direction in the price of oil. On this occasion, most of the developments point towards a stabilization or even a fall in the price of crude oil in the short and medium term, which means that crude oil could cease to be a source of inflationary. Taking this into account, and considering that more than 33% of the price of any commodity is attributable to the price of energy, it is legitimate to think that a stable or low price of crude should lead to a stabilization also in the price of commodities, meaning that they could leave soon to be a source of acceleration for inflation too. Here are the main developments in the energy sector:

(Price Negative) – DUCs fall to near three-year lows and the EIA raises US output forecast strongly: EIA Drilling Productivity Report for May increased total shale output production for June by ~26K (to 7.733M bpd), up from a 2.8K increase in May, and up from last month's forecast for a 13K gain to 7.6M bpd. EIA officials highlighted higher productivity per rig and a faster rebound as factors behind the revision. The biggest increase will be from the Permian, with output forecast to increase by 54K bpd to 4.59M, the highest since Mar-20. Producers completed 754 wells in April, while total drilled but uncompleted wills fell by 241 to 6.857, the lowest since Oct-18.

(Price Negative) – Iran preparing to ramp up sales, but any additional supply may be gradual: while Iran is preparing to increase oil sales, a deal could only lead to a gradual increase of crude into global markets. Officials said the country could return to pre-sanctions production of almost 4M bpd in as little as three months, though they noted that any agreement must fully dismantle to US barriers on trade, shipping, and insurance involving Iranian entities (something difficult to happen imminently. While officials have said that an agreement is within reach, a deal may be hampered by rising tensions in the Persian Gulf between US and Iranian vessels, next month's elections in Iran, and a long lead time for the country to sign long-term agreements with refiners.

(Price Negative) – India: Lockdowns continue to weigh on India's oil demand: India's oil demand worsened in the first half of May amid the country's expanded lockdowns. Sales of road transport fuels in the first half of the month dropped by ~20% from April and held about 28% below 2019 levels. India's plunge in consumption is expected to weigh on sentiment and expectations for a global demand rebound, with the IEA last week lowering its 2021 demand forecast on India's COVID outbreak.

(Price Negative) – Colonial Pipeline says now delivering products to all markets, though at half capacity. Colonial Pipeline said it has made substantial progress in restarting its 5,500-mile pipeline system and is now delivering product to all its markets. Nevertheless, the system is running at less than half of capacity, with the operator warning that some areas may experience interruptions during the restart process. President Biden made a statement reassuring drivers that fuel supplies should start returning to normal by this weekend (22nd May) as fuel shortages worsened in the southeast.

(Price Negative) – Senator proposes federal assistance for the states that undertake the energy transition : Sen. Martin Heinrich (D-NM) yesterday introduced a bill aimed at providing financial assistance in the form of "energy transition payments" to states that otherwise rely on revenue from federal mineral leasing. The article notes that Heinrich's aim is to help states move away from their reliance on extractive industries and give them time to invest in new sectors as the economy moves away from dependence on fossil fuels. The bill comes after the Biden paused federal oil and gas leasing on federal lands, which accounts for ~25% of domestic petroleum production.

(Price Neutral) – Global COVID trends continue to be the key driver of the crude market. Global demand of oil has been supported by the US, Europe, and China as mobility data continues to show increasing demand trends, but new lockdowns in parts of India extended until later this month, while Japan, Taiwan and Singapore have introduced new restrictions following a rise in cases. These new restrictions are offsetting higher demand in western economies, and could eventually weight in global demand.

(Price Negative) – Investors in global oil market see strong recovery in demand but headwinds persist: The fact is that a pick-up in Asia's demand could be slower than other regions as China continues to work through its stockpile it built up last year, while Japan and South Korea have not yet rebounded to pre-pandemic levels. Higher global prices could also weigh on the demand rebound across Asia, as suggested by the growing gap between Brent and the physical crude price in Asia in recent weeks. Menawhile, crude bulls are looking weakness in China and India as temporary and expect a broad demand recovery in the months ahead. All said, China looks set for another month of modest/weak imports in May and India's imports have continued to be weighed down by its coronavirus wave.

(Price Positive) – Pandemic oil glut is almost drained (the only information that points towards a rise in price this month): The excess crude inventories built up during the pandemic have been drained almost completely amid improving mobility. All said, the world's major forecasters have also sounded notes of caution about the global demand backdrop. Both the IEA and OPEC have said that Q2 demand is ~4M bpd below the same period in 2019. Both the IEA and EIA have cut their demand forecasts for 2021, with the IEA's recent cut of 270K bpd to y/y growth (more than wiping out upward revisions it made in the previous month's report).