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Flash Notes
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The price of oil has gone up but it should not be a risk factor for the market

Factors that drive oil price down

- **Non-Opec producers will bring 2019 global supply higher despite OPEC efforts to cut output**: IEA's monthly report raised its projection for 2019 non-OPEC supply growth, led by US production. The IEA noted that by mid-year, US crude output will be higher than the production capacities of Russia and Saudi Arabia. The report also questioned Russia's commitment to implementing the supply cuts it agreed to last month, noting Russia increased crude production in December to a new record of 11.5M bpd. OPEC's success in cutting output depends on the continued cooperation of Russia, and the Kremlin has continued to caution against the alliance. By its part, the OPEC countries continue with the strategy to cut production and managed to cut global output in December (by 751k bpd) with Saudi Arabia accounting for the majority of the decline. Despite this, the IEA maintained its estimate for 2019 OPEC production at 31.6M bpd (in December, OPEC's production was fixed at 31.58M bpd after the cuts).
- **No higher global demand despite higher global supply:** The IEA recently left its demand growth figure for 2019 unchanged, saying a weakening economy is likely to offset any increase in oil demand caused by weaker prices.
- **Sanctions to Venezuelan imports, but not to Venezuelan oil exports will contribute to keep supply stable.** The Trump administration has sanctioned PDVSA, but has avoided to implement direct sanctions on Venezuelan oil flows out on concerns that oil prices could rise, and that sanctions could worsen the country's humanitarian crisis. Venezuela's crude production of 1.2M bpd in December was near the lowest since 2003, when volume fell as a result of a general strike. It is expected Venezuelan production to continue to fall, though at a slower rate of decline. With a longer-term view, Venezuelan bonds have rallied in recent days as the country's opposition has mounted a legislative challenge to Maduro. The Trump administration is weighing recognizing National Assembly President Juan Guaido as the legitimate Venezuelan leader. The opposition party calls Maduro's presidency illegitimate, arguing the country's constitution says a presidential vacancy can be filled by the National Assembly president. Any structural change in Venezuela's political landscape could mean an increase in crude production capacity worldwide of between 1M-2M bpd in the medium term. Something that should put downward pressure on oil prices considerably.

- **The US is winning the energy race. Shipments of US crude to China are resumed:** Three cargoes of US crude are headed to China, representing the first departures since the 90-day pause on the trade war was announced. China had been the top buyer of US crude in recent years, and imported 325K bpd before the conflict escalated in September. According to some analysts, these purchases are a follow through of statements by the Chinese government that it would begin purchasing commodities from the United States again. Bad omens then for OPEC exporters, who will have to lower their prices to increase their sales in other parts of the world.

Factors that drive oil Price up

- Alberta's OPEC-style decision to cut crude production has pushed prices higher, but has also shifted investment capital elsewhere. Alberta cut production by 325K bpd starting this month, helping shrink the discount on Canadian heavy oil from more than $40 in October to less than $7. However, executives said that as soon as they heard the curtailment would take effect, they shifted capital to other provinces like Saskatchewan (suggesting that output cuts are not sustainable).
- Global oil markets could continue its recent bout of volatility in 2019, due to the continuity of unpredictable geopolitical upheavals like Brexit and Trump's trade wars. Those factors can cause violent swings in market sentiment even without any changes in fundamentals. Global demand is becoming harder to predict. The IEA recently left its demand growth figure for 2019 unchanged, saying a weakening economy is likely to offset an increase in oil demand caused by weaker prices.

In summary, although the recent rally in the price of crude oil may be cause for concern for investors (since it puts a lot of pressure on some emerging markets and remove a lot of liquidity from the market), there are reasons to think that the increase in oil prices does not respond to structural reasons, but rather does respond to flows of speculative nature, and are, therefore, temporary.

We keep our strategy unchanged for oil (West Texas): Buy < 45$ pb; Sell > 65$ pb

Best