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Flash Note
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Reduced hopes of sustained increase in oil price despite tensions in Hormuz

The WSJ reported yesterday that an initial US assessment has indicated that Iran was likely behind the attacks on two Saudi tankers damaged over the weekend near the Strait of Hormuz, though it adds that the assessment is not conclusive. Iran, however, points to "Israeli mischief" (an Iranian parliamentary spokesman said that the tanker attacks of the coast of the UAE were "Israeli mischief), though he declined to provide any details on what role Israel may have played in the attacks. Satellite images show no visible damage, but the Norwegian-flagged MT Andrea Victory stated that the ship sustained a hole in its hull above the waterline from "an unknown object."

External sources do not believe that this episode can get out of control and feed the tension, as Vice Admiral Jim Malloy, commander of the US Fifth Fleet (based in Bahrain), said threats from Iran will not prevent him from sending an aircraft carrier through the Strait of Hormuz.

Outlook & positioning

Traders are increasing long positions in oil, but this strategy could prove to be wrong again (as in 4Q18)

Traders are increasing positions in options that would pay off if crude soars to as much as $110 a barrel, amid the backdrop of political risks, turmoil in some OPEC nations, and supposedly tight physical oil markets (with traders willing to pay a large premium to secure immediate supplies). In our humble opinion these traders could be wrong (again). The reasons that lead us to think this arise from the analysis of three fundamental aspects.

Market breath & bottlenecks analysis: As far as we know, oversupply of vessels in the VLCC market still persists (with 20 added to the fleet so far this year), as suggested by margins and earnings in the vessel industry down to levels near or below the operating costs of the ships. This, together with the good pace of oil & gas production in the USA (see the chart overleaf) and the improvement in supply cannels, makes us to think that there is no a bottleneck problem in the market.

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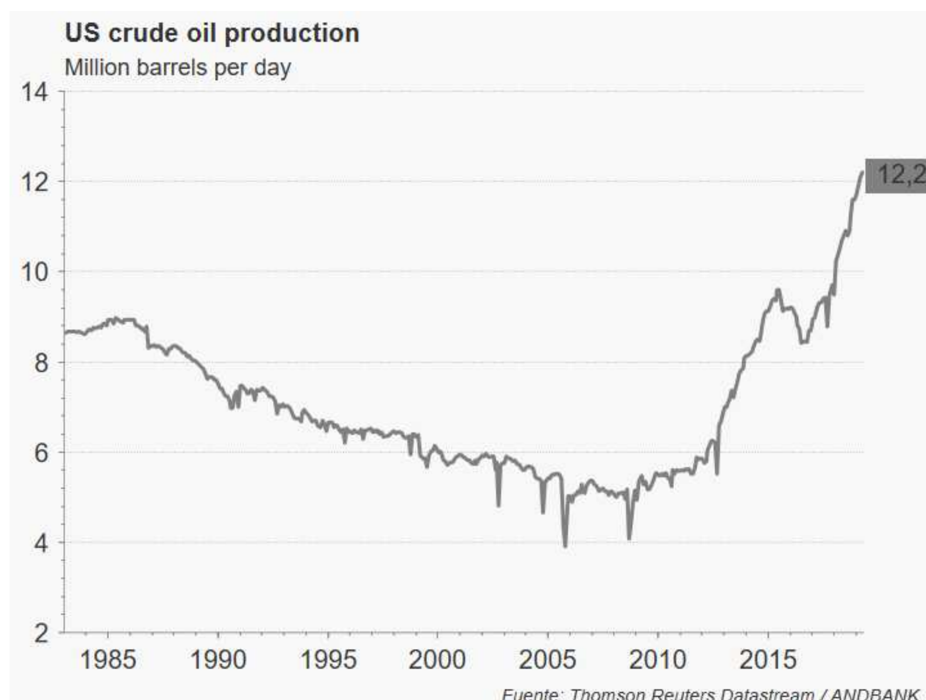

Chinese oil demand is likely to be much lower in the immediate future.

Supply side analysis: Total cartel production held steady (low) in April, rising just 30K bpd from March to 30.26M bpd. Despite this, the oil price has remained fairly stable. Iran's sanctions-induced slump were offset by significant rises in Nigeria, Iraq and Libya, but Saudi Arabia held its output at 9.82M bpd, the lowest in four years and well below its OPEC+ quota, suggesting that the Saudis are reluctant to boost oil supplies too quickly, and risk a price crash from a buildup in inventories.

Demand side analysis: While it's true that China crude imports unexpectedly hit a record high of 10.68M bpd in April -rebounding from 9.3M in March and topping the previous high of 10.48M bpd in November 2018-, this rise must be seen in the context of a likely stockpile build from state-run Chinese refiners coming before expected pressures from US sanctions on Iran in May. We tend to think that Chinese oil demand is likely to be much lower in the immediate future.

In summary (and according to this information), we continue to think that current oil could be close to the upper bound of a fundamental range. As such, we prefer to reduce the hopes of a sustained increase in oil prices, which in turn would be supportive for global capital markets.

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