

Crude Oil Market Outlook*By James Vlachonassios*

May 16, 2019

Since the 1990s, it was predicted that global production of oil would have declined to staggeringly low numbers. It is now almost 20 years later and global production has continually risen “from 5.1 million barrels per day (bpd) in January 2009 to 8.81 million bpd in October 2016” (CME Group). Now, why has this occurred? The short answer comes down to one word, shale. The shale boom in The United States is of unprecedented proportion. Production here in the US is expected to surpass almost 12 million bpd for crude oil and 30 trillion cubic feet per year of natural gas. With all of this increased production, there has been a massive spike in upstream, midstream, and downstream assets as there is a need to develop infrastructure to take advantage of this increased production. You see players like the Carlyle Group and Trafigura building deep-water terminals, that will be used to house ships, barges, and terminals that are capable of handling up to 500,000 bpd. These new inputs will allow for the US to become the largest exporter of crude oil, a title claimed by the likes of those in OPEC.

What does this mean for the international crude market? First off as one can see, the spread between the futures for Brent Crude and West Texas Intermediate (WTI) has drastically fallen. Traditionally, WTI trades at a discount of \$5-10 to Brent, yet, there have been instances over the last few years where the discount between the contracts has fallen to anywhere from \$1-2 dollars. This is a result of the excess confidence in US oil in soon becoming the global benchmark for which traders, producers, and refiners hedge their flat price risk from the spot market. More recently, within the last week, there were a number of important geopolitical issues that can serve as a microcosm for the markets moving forward. An escalation of trade tensions between the US and China we all know had a massive impact on equity markets across the globe, but what was interesting was that both WTI and Brent futures were down as well. Given the current state of the trade war, it is no wonder why oil was down. Traders lost confidence in the ease of producers and ability of refiners to move capital and products back and forth from Asia with increased tariffs. The reason this was very strange is due to the conflict occurring currently in the Middle East. On the same day, May 15, 2019, two Saudi oil tankers as well as a vessel from Norway and the United Arab Emirates were all attacked near the Strait of Hormuz, one of the most tactical waterways in the oil business. From early reports, it is presumed that Iran was the source of attacks. Given all other things equal, Brent oil should have skyrocketed, despite US and Chinese tensions, yet on this same day, Brent was down to \$69.80. Take from this what you will, as it is maybe a small example of Middle East decline and growing US oil supremacy, or it may solely be another large scale sell-off due to the world’s two biggest superpowers tip-toeing around full-scale economic war. In the next days following the crisis, oil markets have adjusted properly, as Brent is now trading upwards of \$72. It remains to be seen going into the summer, where demand can usually be greater due to the vacation months, how WTI will respond to this macro-level analysis.

References:

<https://www.cmegroup.com/education/files/wti-and-the-changing-dynamics-of-global-crude-oil.pdf>