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Oil prices: testing the highs

Hans van Cleef
Sr. Energy Economist
Tel: +31 20 343 4679
hans.van.cleef@nl.abnamro.com

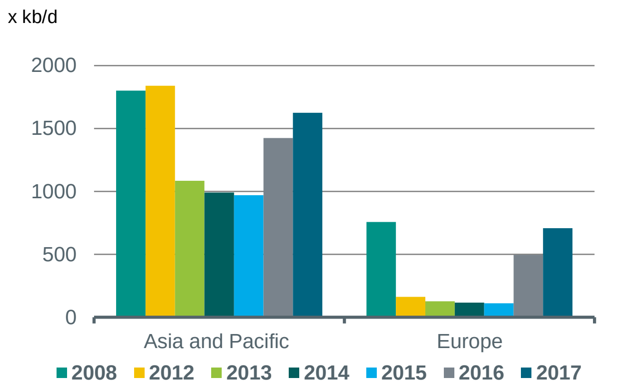
- **US stepped out of the Iran nuclear deal**
- **OPEC ready to increase supply if needed**
- **Oil price forecast unchanged (USD 75/bbl year-end, USD 80/bbl in H1 2019)**

The US stepped out, now what?

The US stepped out of the Iran nuclear deal and will impose new sanctions on the country. These sanctions also apply on any entity that continues to trade with Iran. This in effect is threatening billions of euros of European business. These entities – which could also be located in other countries – will get a maximum of 180 days to comply with these new economic sanctions and wind down their activities. Nevertheless, European leaders and the Iranian government are working on a solution to, as the French Finance Minister indicated, continue to trade with Iran and to 'nullify' the effects of US sanctions on European entities.

Although the market had largely priced in the scenario of the US stepping out of the nuclear deal, the hawkish comments by US President Trump came as a surprise. The initial reaction was a volatile movement in prices followed by higher oil prices. The Brent benchmark has risen to almost USD 80/bbl. What does this mean for Iranian exports of oil and global supply? In addition, what does this mean for oil prices? We answer these questions below.

Iran crude exports



Source: Bloomberg

Mainly risks for lower Iranian exports to Europe

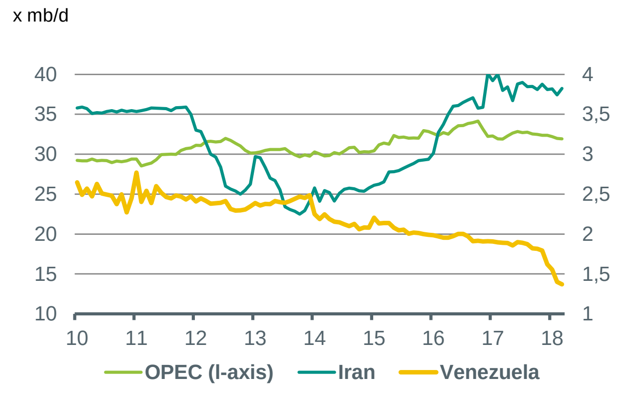
For a start, Iran produces roughly 3.8 mb/d, of which 2.2 mb/d is exported. Exports of crude oil to Europe amounts to 0.6 mb/d. US sanctions will impact these exports, even if European partners, Russia and China manage to extend the Iranian Nuclear deal. It is likely that Iran will shift a proportion of these exports away from Europe and redirect them to Asian countries, mainly China. The remainder (max 0.4 mb/d) will probably be either exported to other countries (with limited ties to US), consumed locally, or used for electricity generation.

As a result, Europe will import most likely from Saudi Arabia and Iraq. OPEC still has the production cut agreement in place. This means that there should be a spare capacity of 1.2 mb/d. Some of this can be used to mitigate lower Iranian exports.

OPEC ready to step up production in case of supply shortage

The OPEC meeting on 22 June will be even more important to watch to see how OPEC will deal with lower supply. After all, besides lower Iranian exports, the production in Venezuela and Angola are also under pressure. However, in the near term, supply shortages seem unlikely. In the longer term, supply shortages were already a threat and the situation has now aggravated. The energy minister of Saudi Arabia indicated that the OPEC is willing to mitigate if supply issues occur. OPEC will have its bi-annual meeting in Vienna on 22 June. During that meeting, the sanctions against Iran and its possible impact on global crude supply will be on the agenda. Other topics are the production issues in Venezuela and Angola, as well as the expiry of the OPEC/non-OPEC production cut agreement at the end of this year. OPEC must convince market participants that it will continue the production cut agreement until the end of the year. Moreover, it needs to provide more details whether the production cut agreement will be extended or not. In case of no extension, OPEC must explain clearly how it will manage higher production after the expiration of the production cut agreement in order to prevent a market shock and fears of renewed oversupply.

OPEC (lhs) and Iran & Venezuela (rhs) oil production



Source: Bloomberg

At the same time, OPEC must provide enough supply to the market to prevent shortages due to the unexpected production disruptions as well as export bans effectively imposed towards the end of the year. There is a fragile balance between supply and demand, and OPEC's forward guidance is crucial.

US crude production on the rise, but for how long?

US crude production has reached a record high level of 10.54 mb/d. US oil producers continue to benefit from the higher oil prices as oil production in most areas continues to increase. There are some concerns that certain developments could trigger a slowdown in growth though. High labour costs – due to a lack of skilled staff -, as well as infrastructural problems may cap the upside for further supply increases in the coming quarters. The US may see a continuation of its crude oil exports, especially now that Europe may face difficulties importing crude oil and condensates from Iran. Especially for condensates, the US may benefit by higher exports towards Europe. Global demand continues to grow at a solid pace of roughly 1.5-1.7 mb/d in 2018 and 2019. US oil is needed to meet higher crude oil demand. Therefore, we expect that even despite a moderate growth in US crude production, it is not sufficient to meet the global rise in demand. That leaves some room for the OPEC to end production cut agreement in the course of 2019.

Oil price forecasts unchanged

The Brent oil price rallied to USD 80/bbl. In the near-term we expect that oil prices will remain driven by supply related uncertainties. Nevertheless, since an immediate supply shortages is unlikely, the upside potential for oil prices appears to be limited. Most of the fears of supply shortage seems to be already priced in. Obviously, if tensions in the Middle East were to escalate, then oil prices will rise further. However, this is not our base case scenario. Also technical analysis provide a positive near-term outlook. The recent break of the upward trend channel suggests further upside potential for Brent oil towards USD 90/bbl. The market is still positioned for further price gains although the forward curve is in backwardation, suggesting lower prices in the future.

The question is whether oil prices could continue to rise on the supply-related news, or whether we have seen most of it. In case of the latter, a profit taking wave on the excessive net long positions is likely in our view. We do expect higher oil prices – back towards current levels – when the effects of the US sanctions against Iran will become effective towards the end of the year. We expect oil prices to trade around USD 80/bbl for the first half of 2019 as well, as we expect supply issues to trigger market worries for supply shortage in the course of 2019.

Overall, for the time being, we do not see a reason to revise our forecasts. We maintain our end of year forecast for Brent of USD 75/bbl before prices appreciate back to current levels during the first half of 2019. For more details, please see Table 1.

Table 1: Oil and gas price forecasts ABN AMRO

End of period		15-mei	jun-18	sep-18	dec-18	mrt-19	jun-19	sep-19	dec-19	mrt-20	jun-20	sep-20	dec-20
Brent	USD/bbl	*76,97*	*70*	70	75	80	80	75	75	75	80	85	80
WTI	USD/bbl	*70,56*	*65*	66	70	73	74	70	70	70	70	75	75
Natural Gas (HH)	USD/mmBtu	*2,82*	*2,75*	2,50	2,75	3,00	3,00	2,75	3,00	3,25	3,00	3,25	3,50
TTF	EUR/MWh	*21,18*	*18,00*	17,00	20,00	20,00	19,00	22,00	24,00	25,00	23,00	24,00	25,00
Average		**Q2 18**	**Q3 18**	**Q4 18**	**2018**	**Q1 19**	**Q2 19**	**Q3 19**	**Q4 19**	**2019**	**Q1 20**	**Q2 20**	**2020**
Brent	USD/bbl	70	70	73	71	78	80	78	75	78	75	78	79
WTI	USD/bbl	64	66	68	66	72	74	72	70	72	70	70	72
Natural Gas (HH)	USD/mmBtu	2,75	2,75	2,75	2,70	3,00	3,00	3,00	3,00	2,90	3,25	3,25	3,30
TTF	EUR/MWh	19,00	18,00	19,00	19,00	20,00	20,00	21,00	23,00	21,00	25,00	24,00	25,00