FINANCIAL MARKETS

WHY HAVE CRUDE OIL PRICES FALLEN?

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LET'S TALK ABOUT OIL

FOREWORD

Earlier in 2018, we saw oil prices soar. The combination of output decisions by OPEC and a strong US dollar excited investors.

However, in the last month, US crude oil prices have fallen - and investors aren't taking any chances.

In this eBook, we look at the causes of the price drop and what we can expect to happen as the year comes to a close. We'll also explore the broader effect on the markets and US dollar.

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WHY HAVE OIL PRICES DROPPED?

THE SUPPLY & DEMAND DYNAMIC

Over the past month, crude oil prices have continuously dropped following concern over an imbalance of supply and demand.

Though oil demand is likely to exceed 100 million barrels per day next year, revised OPEC forecasts have found that the outlook for demand growth is significantly lower - around 70,000 fewer barrels per day.

In their monthly report, OPEC did mention that there was "weaker-than-expected oil demand from the Middle East and to a lesser extent, China" in the third quarter of 2018. The risk of oversupply has worried investors, putting pressure on oil prices.

Despite the latest forecast, OPEC, Russia and the US have all increased their oil production in recent times.

But this could soon change. In response to concerns about oversupply, Saudi Arabia Energy Minister, Khalid Al-Falih, stated: “We need a reduction approaching one million bpd to balance the market.”

Following this, President Trump pressured Saudi Arabia and OPEC to stick to the current plan and continue to gradually increase output. On Twitter, he said: “Hopefully, Saudi Arabia and OPEC will not be cutting oil production. Oil prices should be made lower based on supply!”

After these comments, oil prices dropped for the 12th consecutive time on Tuesday 13th November down below $57 a barrel - the lowest price since mid-December 2017.

This losing streak has been record-breaking for US crude oil. The beginning of this downfall began back in October during the broad market sell-off. Investors chose to shed riskier assets - and prices have continued to fall since.

THE ROLE OF IRAN

Fresh US economic sanctions on Iran have also had an impact on the supply and demand dynamic of oil.

Remember - after abandoning the Iran Nuclear Deal, the US imposed economic sanctions on Iran in March 2018. As a result, Iranian oil exports saw a loss of approximately one million bpd. At the same time, crude prices climbed close to four-year-high.

Keep in mind that the US relies on Saudi Arabia to counteract Iran’s reduced oil exports and keep supply levels steady.

However, some of this pressure was alleviated from oil prices when the US decided to issue waivers to certain countries, giving them permission to import Iranian crude oil over a 180 day period. These countries include Japan, India and South Korea - with China, Taiwan and Turkey still looking to be potentials.

According to the US Secretary of State Michael Pompeo, these waivers have only been offered to countries that have made “important moves” to shun Iranian oil entirely over the long-term.

Both an increase in production and potential waivers for large crude importers like China could mean more volatility for oil prices in the coming months.

WHAT DOES THE FUTURE HOLD?

WHAT HAPPENS NEXT?

On December 6th, 2018, there is a meeting in Vienna where OPEC will be setting its policies. The level of oil production will be at the top of the agenda.

During this meeting, there is the chance that OPEC could announce production cuts. This comes after many, including Matt Badiali, Senior Research Analyst at Banyon Hill Research, believe there is “too much oil in the market”.

President Trump’s resilience on the matter has, however, now made this look less likely. This only increases market uncertainty ahead of the meeting.

On top of all of this, broad concerns regarding the state and future of the global economy and the expectation of slack corporate earnings have only forced more pressure on the already despondent oil industry.

MARKET REACTION

After the rhetoric from Saudi Arabia and President Trump, US est Texan Intermediate Crude fell to a low of $56.85 on Tuesday 13th November. This was a drop of 5%. During its previous session, it fell 4.1% to $57.47. At this rate, this could be the WTIs lowest ever finish to a year.

After seeing losses 12 times in a row, WTI is now in its biggest decline since it began trading back in 1983. Tuesday also saw London-traded Brent crude fall to $68.75 which was a loss of 1.95% per barrel.

There was also evidence of the US dollar trading lower against other currencies. First of all, the dollar index, which measures the dollar against other major currencies, fell by 0.35%. On Wednesday, the dollar was down against the Canadian dollar and the Mexican peso in comparison to late Tuesday. It was worth 1.32 Canadian dollars and 20.36 Mexican pesos.


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