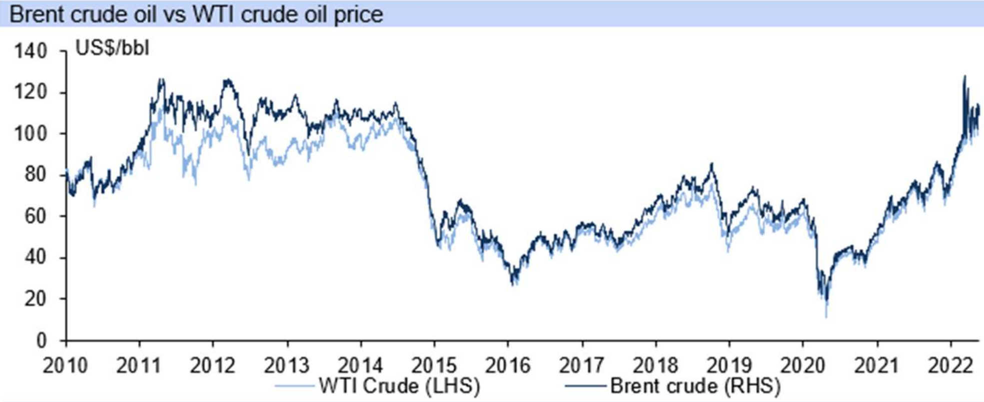
Investec | Out of the Ordinary

SA Economics

Tuesday 14 June 2022

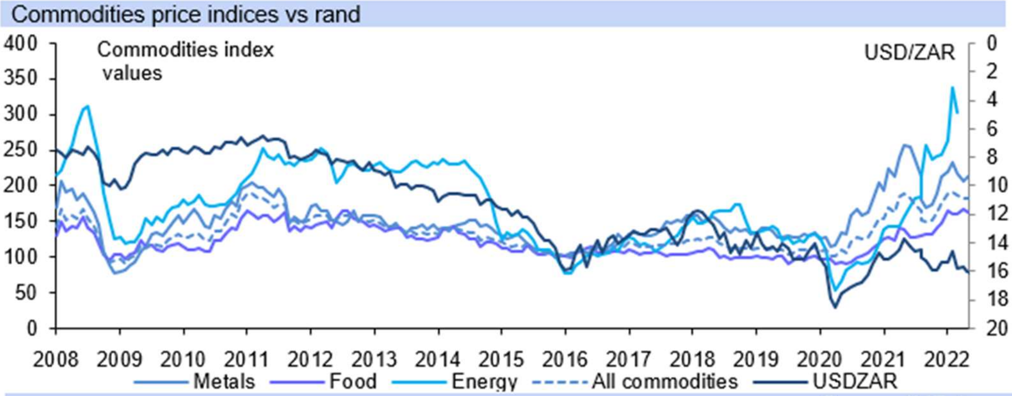
Oil note: high, and rising, oil prices signal still more inflationary price pressure to come for consumers

Brent crude oil vs WTI crude oil price



Source: Iress

Commodities price indices vs rand



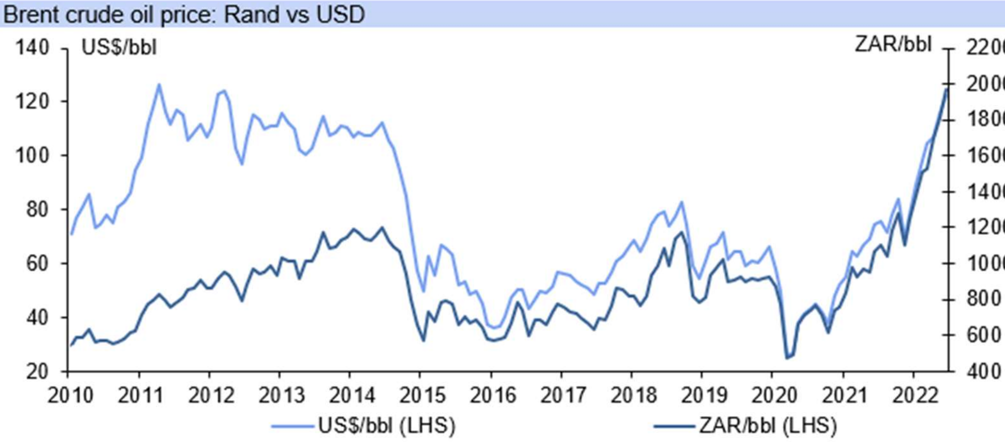
Source: IMF, Iress

Commodity prices

Commodity	Price	% 1 month change	% change ytd
Energy			
NYM WTI crude	121.81	+10.1	+61.96
ICE Brent crude	123.19	+10.4	+58.38
ICE ARA Gasoil	1,276.00	+15.4	+91.30
NYM NYH Gasoline	406.04	+2.8	+82.20
NYM NYH Heating oil	432.65	+10.4	+85.68
NYM HH Nat gas	8.67	+15.1	+132.52
ICE NBP Nat gas	164.00	+17.9	-3.89
Metals			
LME Aluminum	2.628.00	-5.7	-6.39
LME Copper	9.294.00	+1.5	-4.39
Spot Gold	1 822.24	-0.3	-0.38
DCE Iron ore	895.50	+7.3	+49.12
LME Nickel	25.929.00	-4.9	+24.92
Spot Silver	21.12	-2.5	-9.40
SHF Steel Rebar	4.661.00	-7.1	+2.46
Agriculture			
CME Live cattle	133.88	+1.5	-3.53
ICE Coffee	224.30	+5.9	-0.71
CBT Corn	717.00	-3.8	+28.66
ICE Cotton	122.06	-0.2	+29.17
CBT Soybeans	1,537.75	-0.4	+29.11
ICE sugar	18.81	-2.4	-1.06
CBT SRW Wheat	1,074.25	-9.4	+37.43

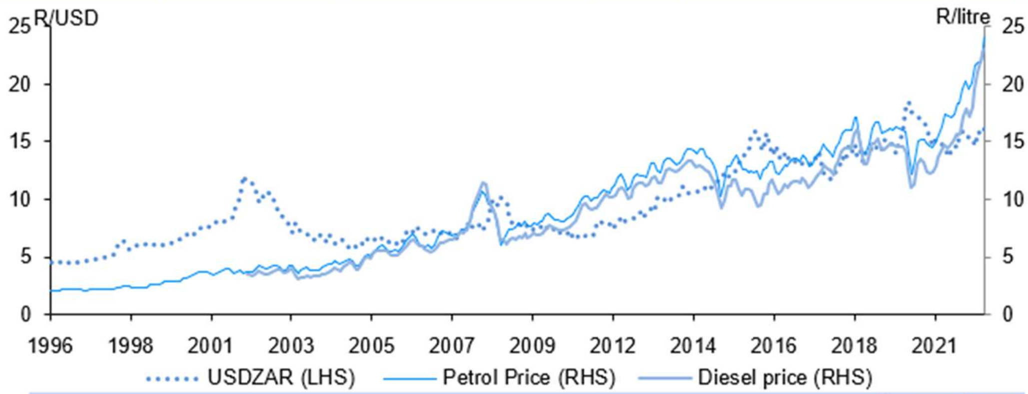
Source: Bloomberg

Brent crude oil price: Rand vs USD



Source: Iress

Rand versus petrol and diesel prices – rand weakness pushes up fuel costs



Source: Iress

- With tomorrow the midway mark in June, and oil prices for both Brent and WTI over US$10/bbl to date for June, versus May's average, there is currently likely be further upwards pressure in July on both SA and US inflation from fuel costs, meaning inflation would not have peaked.
- The current under recovery (implied fuel price increase in SA) is for another R2.00/litre hike in the petrol price in July, to R26.18/litre, the highest petrol price SA has ever experienced, while the diesel price is set to rise by R1.18/litre, taking it to R24.27/litre, again unprecedented.
- Higher fuel prices are being driven by the sharply higher oil price (and petroleum product prices), while further rand weakness is a risk, as financial markets increasingly factor in 75bp hikes from the FOMC instead of 50bp moves, with the FOMC meeting on 15th June.
- Petrol prices in SA are around double what they were about two years ago, and unsurprisingly inflation is more than double as food cost inflation has increased substantially as well, while second round price effects are building, and the SARB warns against a wage/price spiral.
- In the US, food price inflation is running at 10.1% y/y, and fuel (gasoline and oil) at 50.3% y/y. Excluding food and energy, commodities inflation in the US is at 8.5% y/y (all US Bureau of Labour Statistics for US CPI). Overall US May CPI inflation was 8.6% y/y (1.0% m/m).
- Gasoline prices are also higher for the month of June to date versus May's average, by 10% currently, which would place upwards price pressure on the US inflation figures at this rate. Global supply chain cost pressures are seeing high aviation and shipping fuel costs.
- The rise in the oil price over June, with Brent at US$123/bbl today, steadily higher from US$115/bbl at the end of May, has been driven by tight supply, with OPEC+ production significantly below its quotas, even with some recent increase in supply.
- Refined oil products have felt supply pressure too, and along with increasing sanctions on Russian energy commodities, have seen overall supply concerns outstrip worries on slower demand for oil, while oil inventories are decreasing.
- In SA, the rand is at risk of further marked weakness as the differential between SA and US interest rates are eroded on the US interest rate hike this month, which would add to

fuel price pressures, as rand weakness increases the rand oil and petroleum product prices.

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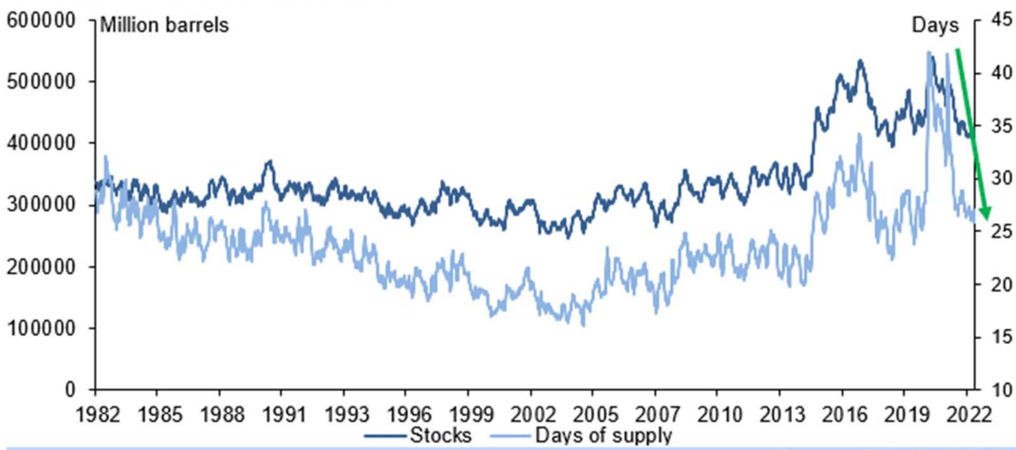
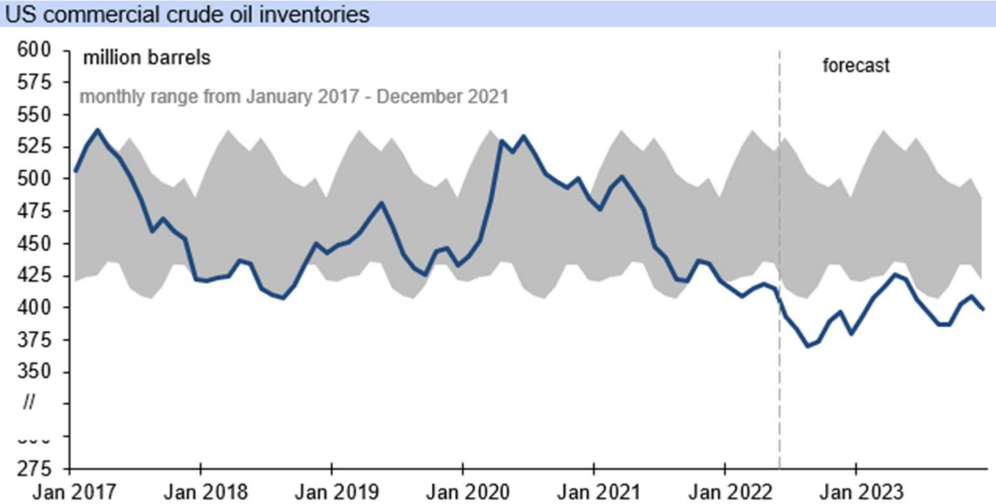
US crude oil stocks and days of supply



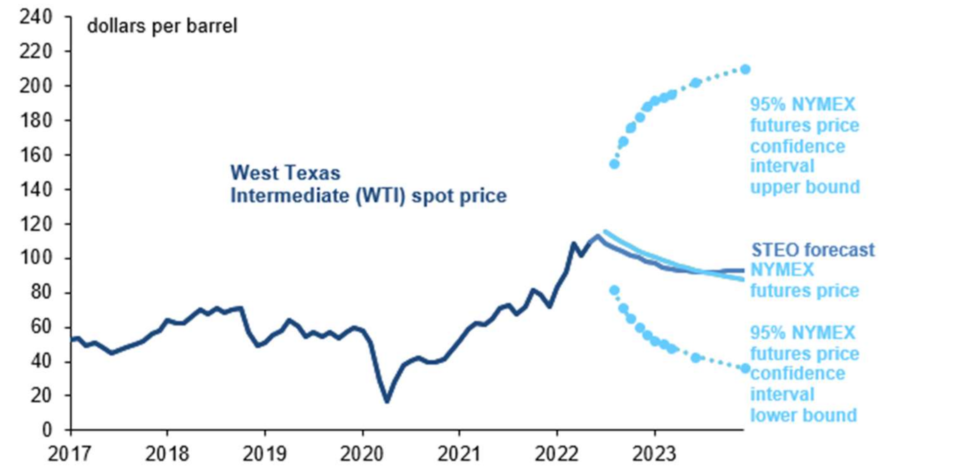
Source: EIA, April 2022

US commercial crude oil inventories



Source: EIA, Short-Term Outlook June 2022

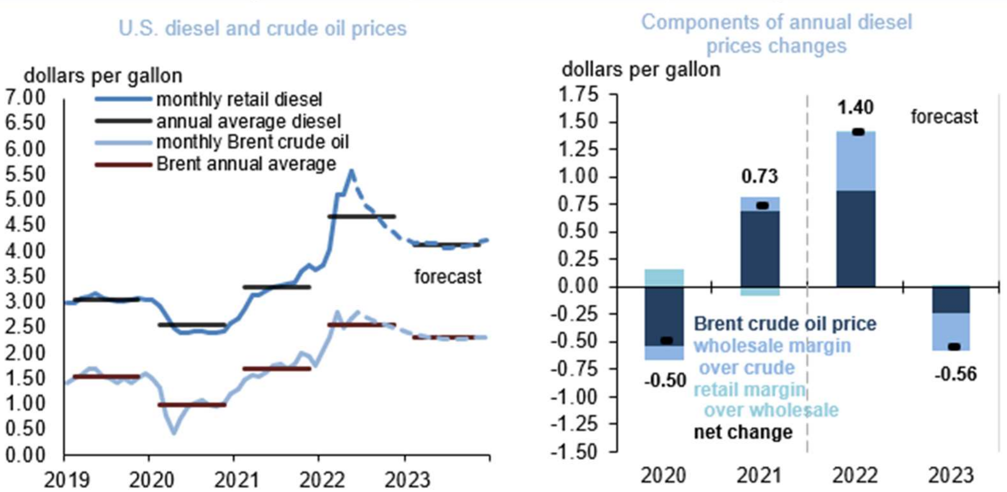
West Texas Intermediate (WTI) crude oil price and NYMEX confidence intervals



Source: EIA, Short-Term Outlook June 2022

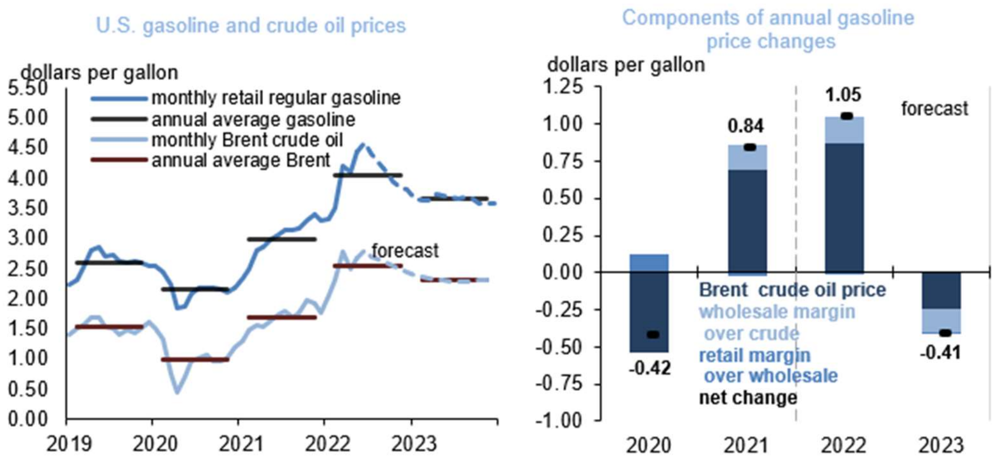
Note: Confidence interval derived from options market information for the five trading days ending June 2, 2022. Intervals not calculated for months with sparse trading in near-the-money options contracts.

US diesel and crude oil prices and components of annual diesel price changes



Source: EIA, Short-Term Outlook June 2022

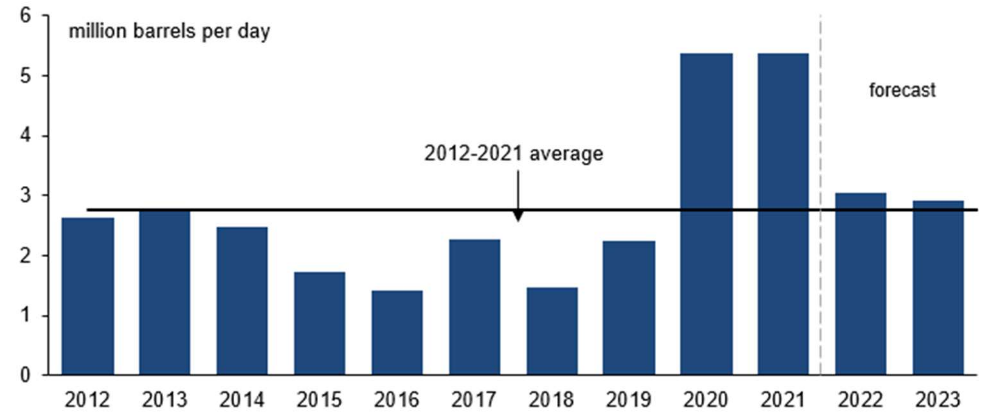
US gasoline and crude oil prices and components of annual gasoline price changes



Source: EIA, Short-Term Outlook June 2022

- A 50bp hike from the FOMC tomorrow instead of a 75bp increase would see some potential relief for the domestic currency, but a full 75bp lift is now factored in by markets, and this would likely drive the domestic currency weaker if it transpires.
- The Brent crude oil price is up 68% y/y (Brent), despite the base of a year ago increasing noticeably from around US$50/bbl at the start of last year, to around US$70/bbl by June 2021 as oil prices continued to climb this month, and indeed from May.
- In fact, July and August last year saw oil prices around US$70/bbl, and so with no further price increase in oil from current levels, there will still be substantial upwards price pressures on a year ago into Q3.22 on a year on year basis.
- Demand for oil in Q2.22 is being supported by the northern hemisphere summer driving period, easing Chinese lockdowns and increases in demand for aviation as travel picks-up, which is expected to continue into Q3.22.
- However, slower global economic growth and high fuel costs will provide a limiting effect on oil demand, but supply will also continue to be impacted by the ongoing war in the Ukraine, along with production likely below quotas from OPEC+ still.
- The drawdown in inventories earlier in the year to limit price rises has not been sufficiently replenished, let alone built up over the recent historical average in the US, and so this thinning of the buffer will contribute to oil price volatility.
- “The EIA “expect(s) the Brent price will average $108/b in the second half of 2022 (2H22) and then fall to $97/b in 2023”. “We forecast Russia’s production of total liquid fuels will decline from 11.3 million b/d in the first quarter of 2022 (1Q22) to 9.3 million b/d in 4Q23”.
- “This … incorporates the recently announced EU ban of seaborne crude oil and petroleum product imports from Russia. We assume the crude oil import ban will be imposed in six months and the petroleum product import ban in eight months”.
- However, these EIA forecast do not build in any unexpected shocks to the system, nor the high risk that OPEC+ continues to underperform in meeting targets, but gaining revenue through very high oil prices before climate change forces a material switch from oil usage.

Organization of the Petroleum Exporting Countries (OPEC) surplus crude oil production capacity

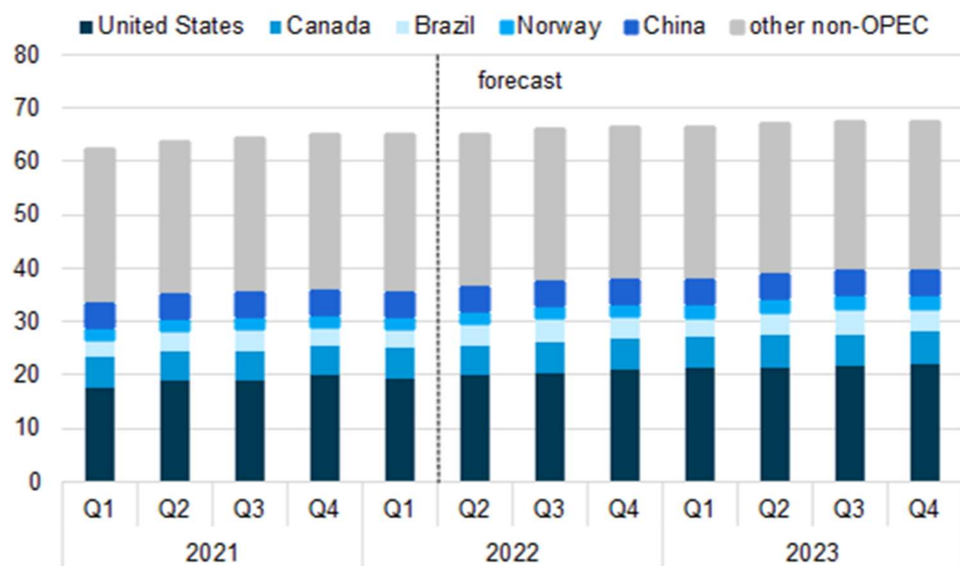


Source: EIA, Short-Term Outlook June 2022

Note: Black line represents 2012-2021 average (2.8 million barrels per day).

Other non-OPEC liquids annual production growth

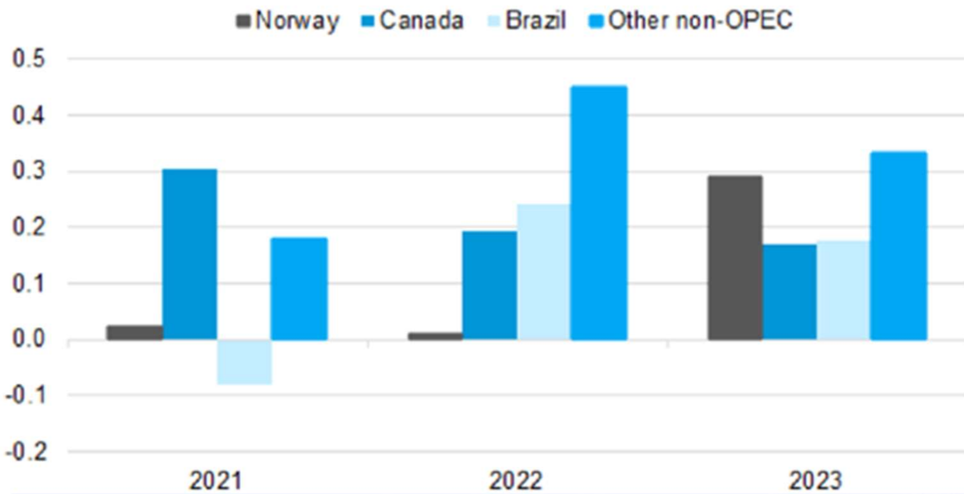
million barrels per day



Source: EIA Short-term energy outlook, June 2022

Non-OPEC petroleum liquids production forecasts

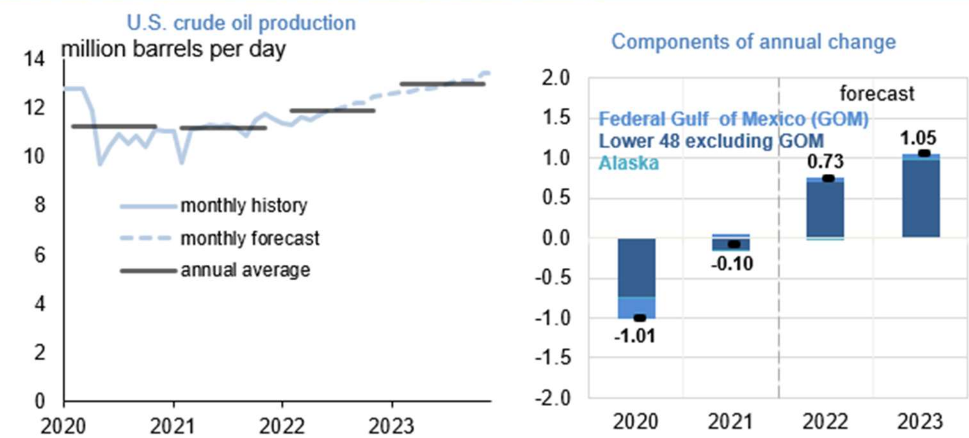
million barrels per day



Source: EIA Short-term energy outlook, June 2022

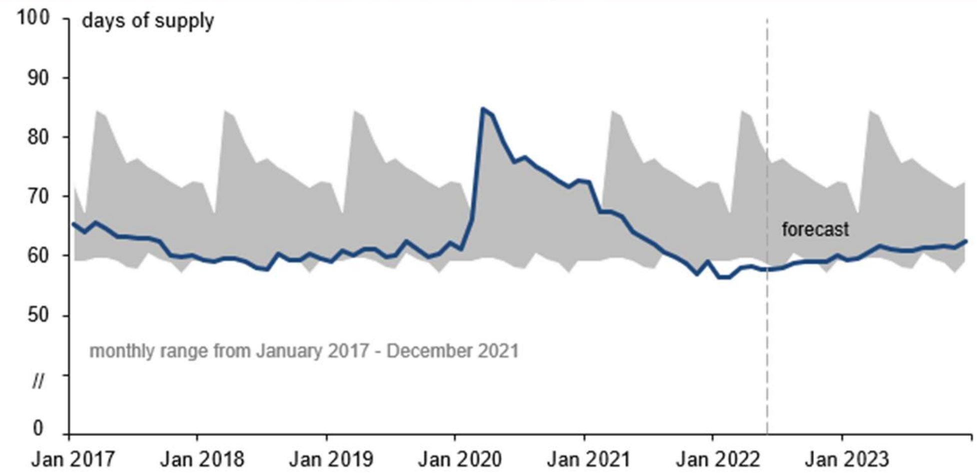
Note: Other Non-OPEC excludes the United States and Russia but includes China, Argentina, Guyana and Kazakhstan

US crude oil production and components of annual change



Source: EIA, Short-Term Outlook June 2022

OECD commercial inventories of crude oil and other liquids



Source: EIA, Short-Term Outlook June 2022