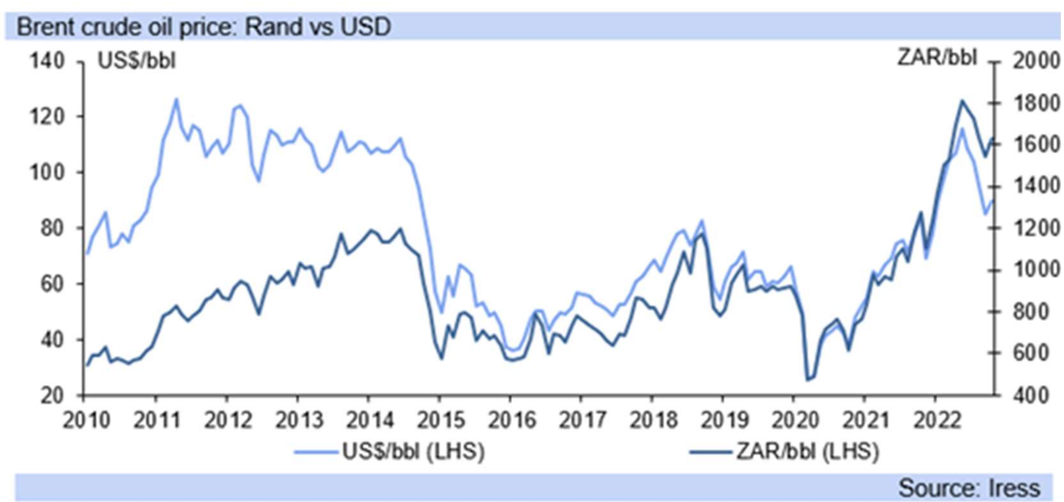
Investec | Out of the Ordinary

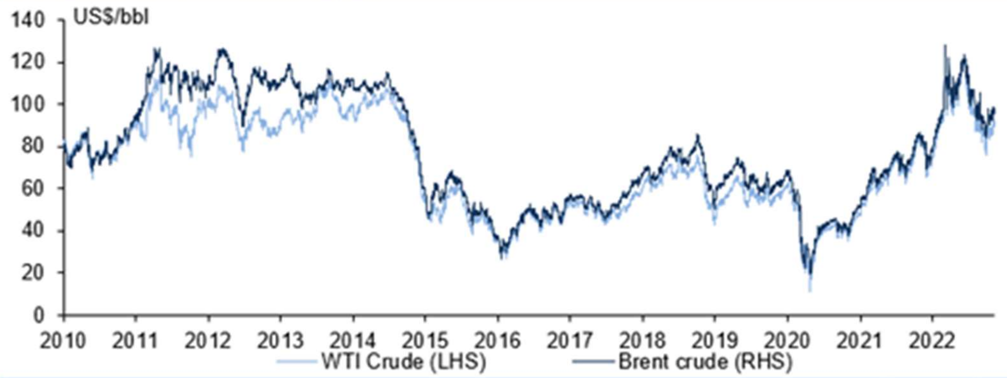
SA Economics

Wednesday 9 November 2022

Oil note: the oil price likely to run above US$90/bbl for the remainder of this year and a large part of next year, driven by OPEC+

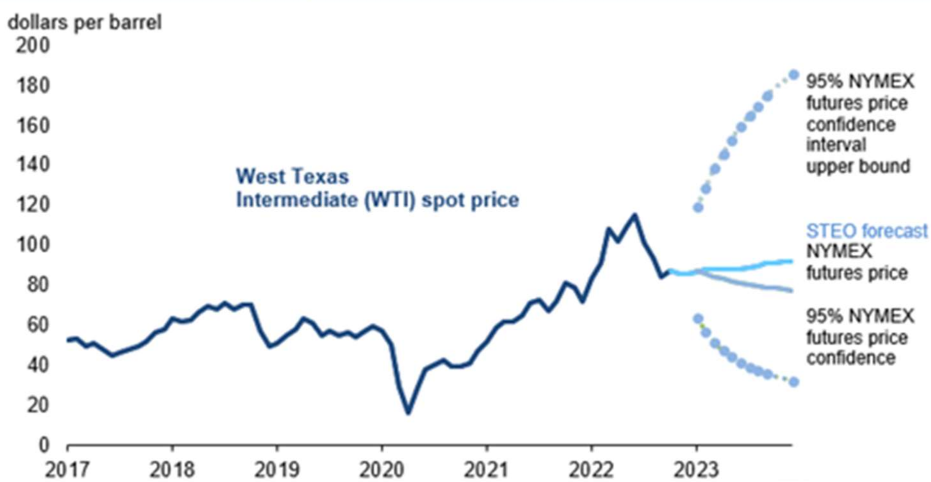


Brent crude oil vs WTI crude oil price



Source: Iress

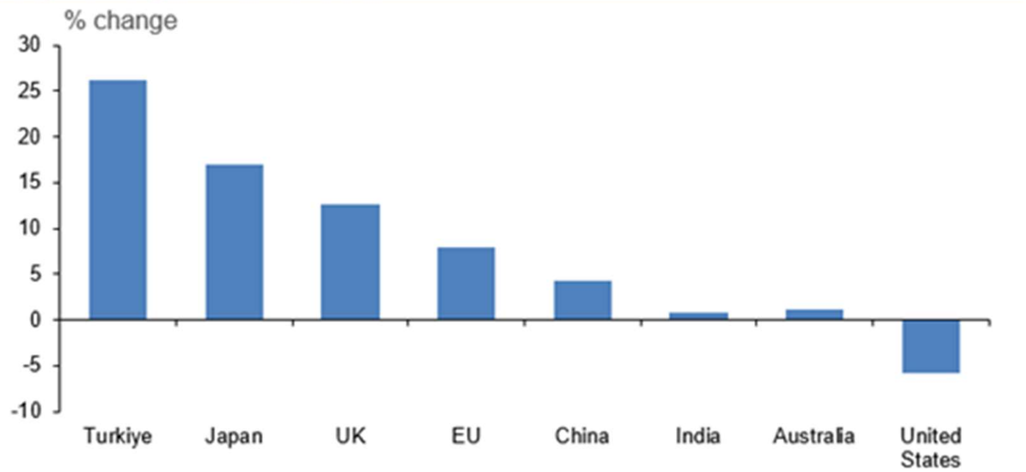
West Texas Intermediate (WTI) crude oil price and NYMEX confidence intervals



Source: EIA, November 2022

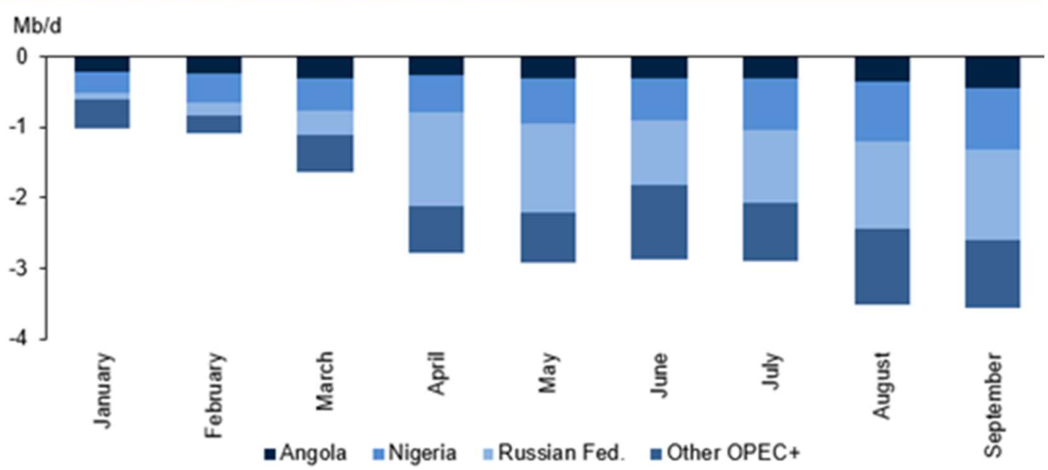
Note: Confidence interval derived from options market information for the five trading days ending November 3, 2022.
Intervals not calculated for months with sparse trading in near-the-money options contracts.

Oil price changes in local currencies



Source: World Bank

Shortfall in OPEC+ production from quota, 2022



Source: World Bank, Commodity Outlook October 2022

Note: OPEC = Organization of the Petroleum Exporting Countries. Data based on the IEA Oil Market Report October 2022.

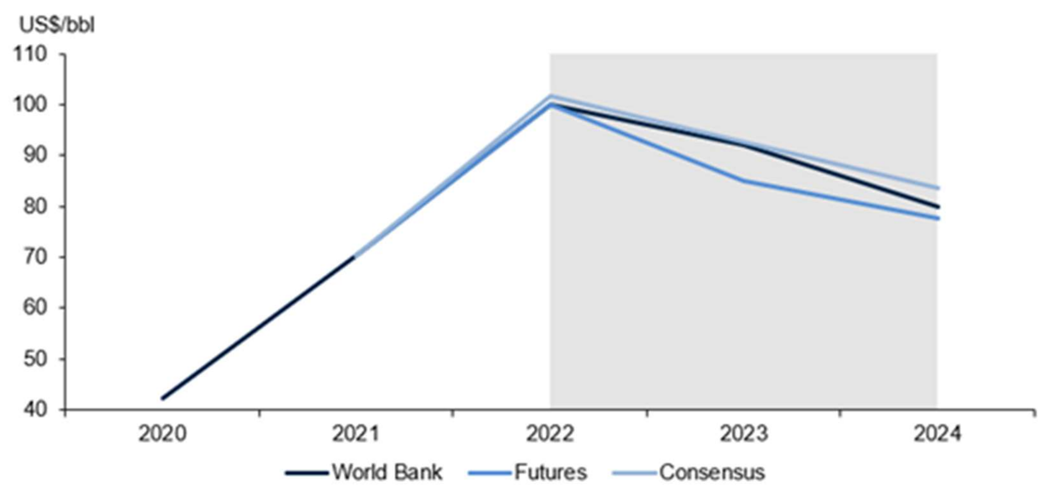
- After oil prices dropped since June on average, resulting in several months' worth of fuel price cuts in SA, the recent increase has now seen petrol and diesel price increases this month, and further price hikes building for December too, with the rand stable and not a contributor.
- That is, for the oil price in rand terms there has been a similar trajectory, with the rand's exchange rate reflective of sentiment in global financial markets, and the movement's in the US dollar, and the latter stabilising over October, then weakening in November.
- Markets have been gaining cheer recently on building expectations that the US will not see a severe recession, and that its interest rate hikes have been fairly easily absorbed in a strong labour market, while the pace of average hourly earnings (y/y %) subsiding since April.
- A slowdown in the quantum of US rate hikes is expected by December, with markets factoring in a 50bp instead of a 75bp lift. Progress on suppressing wage growth is also

seen in US unit labour costs, which have fallen since June, and markets are becoming less risk averse.

- The rand has consequently strengthened against the US dollar, reaching R17.66/USD today, from R18.41/USD after the FOMC meeting last week, although still not enough to counter higher oil prices, with December currently factoring in a R1.35/litre petrol price hike.
- The Brent crude oil price is lower, at US$94.6/bbl, compared to the average for the year to date of US$101/bbl, but in rand terms it is at R1 690/bbl currently, higher than the average for the year so far of R1 639/bbl, with OPEC+ now supporting the oil price above US$90/bbl.
- OPEC+, which includes Russia, has been supporting the oil price by cutting quotas on supply, and has lifted the level from US$75/bbl a few years ago, and with reductions in carbon emissions over the longer-term, as OPEC+ continues to seek to maximize returns.
- Typically when economic cycles slow down, commodity prices do too, as demand weakens, allowing for lower inflation and then interest rate cuts on a significant cycle, but high, and rising oil prices, have not allowed for a rapid subsidence in inflation.
- Falling fuel prices pulled SA inflation down since July, but this effect wore out in November and now likely will continue in December, which will slow the descent in inflation this year and into next, as high energy prices support slower pace of disinflation (falling inflation).

Please scroll down to the second section below

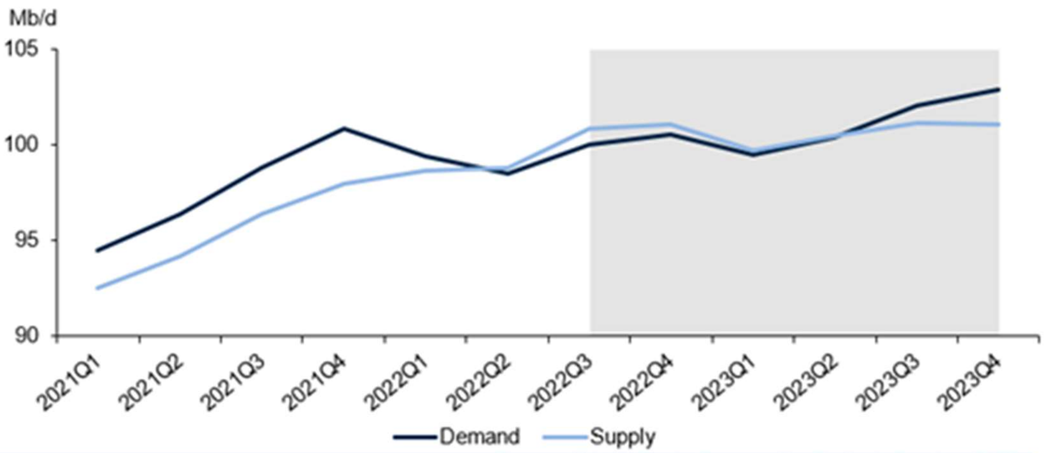
Oil price forecasts



Source: World Bank, Commodity Outlook October 2022

Note: Consensus forecasts taken from the October 2022 survey. Futures prices average of October 3 to October 21, 2022.

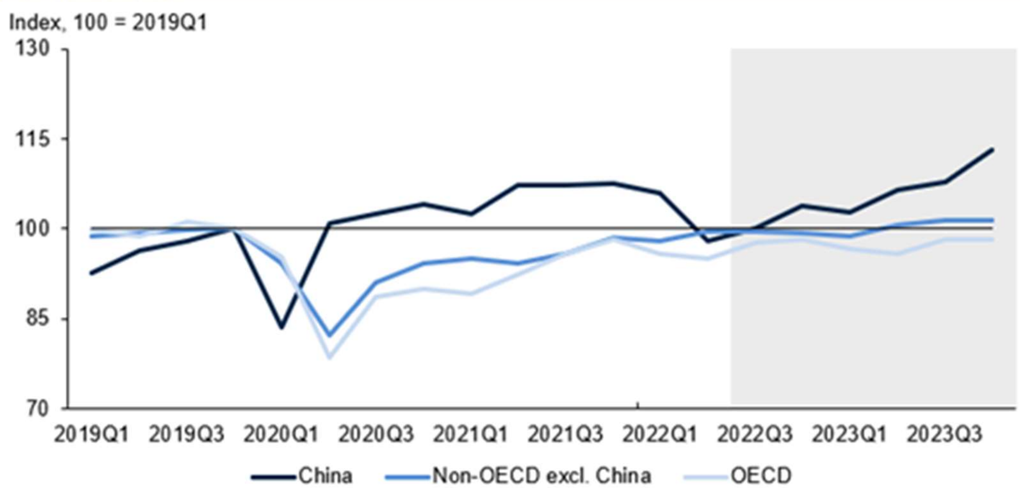
Oil demand and supply forecasts



Source: World Bank, Commodity Outlook October 2022

Note: Shaded area indicates IEA forecasts.

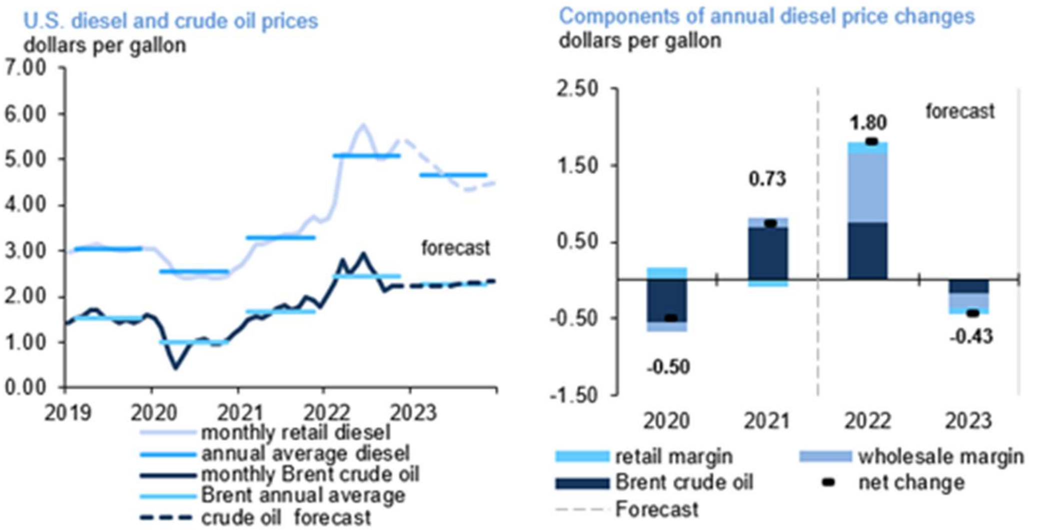
Oil consumption



Source: World Bank, Commodity Outlook October 2022

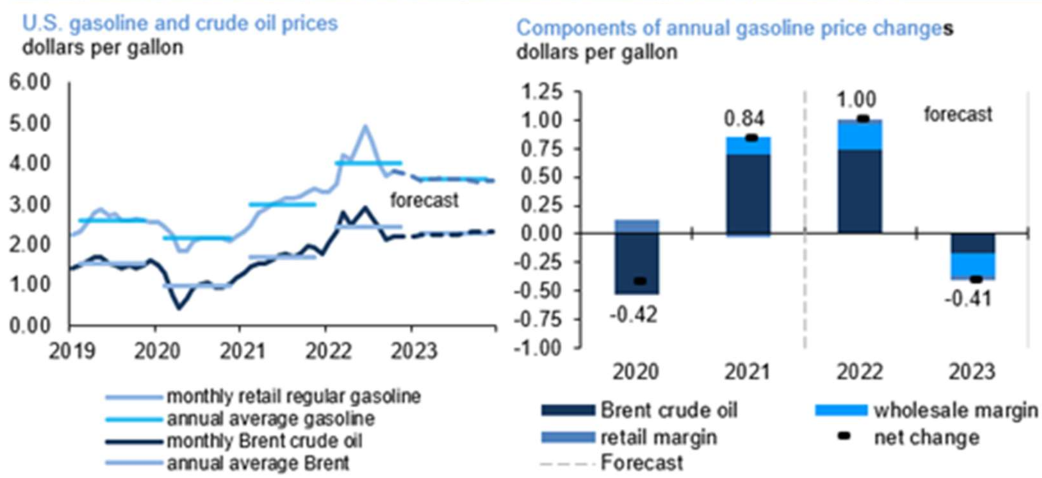
Note: OECD = Organisation for Economic Co-operation and Development. Shaded area indicates IEA forecasts. Last observation is 2023Q4.

US diesel and crude oil prices



Source: EIA, November 2022

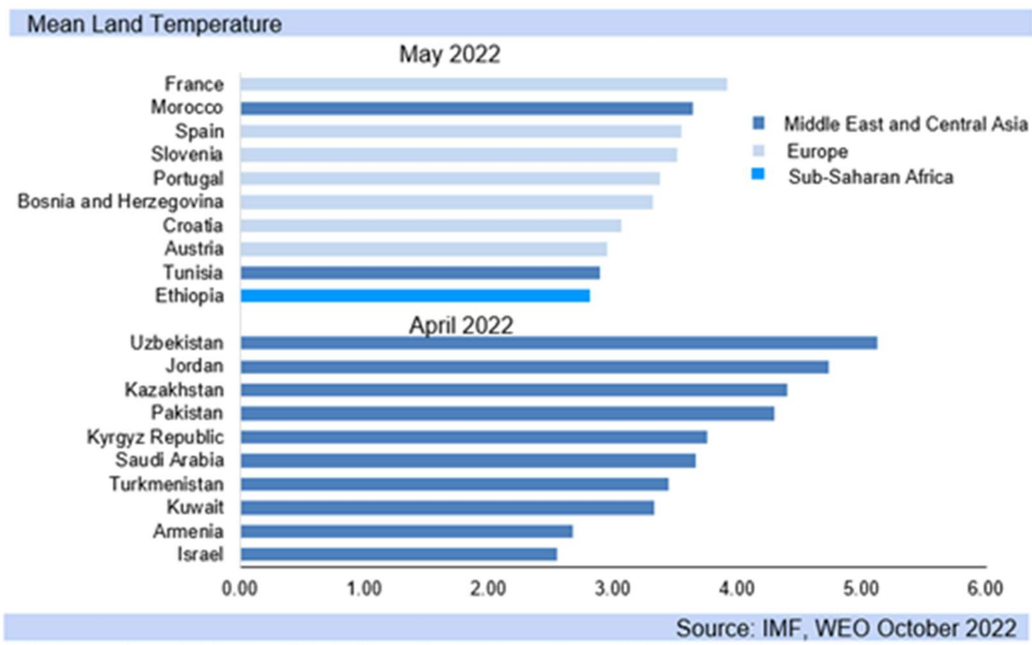
US gasoline and crude oil prices and components of annual gasoline prices changes



Source: EIA, November 2022

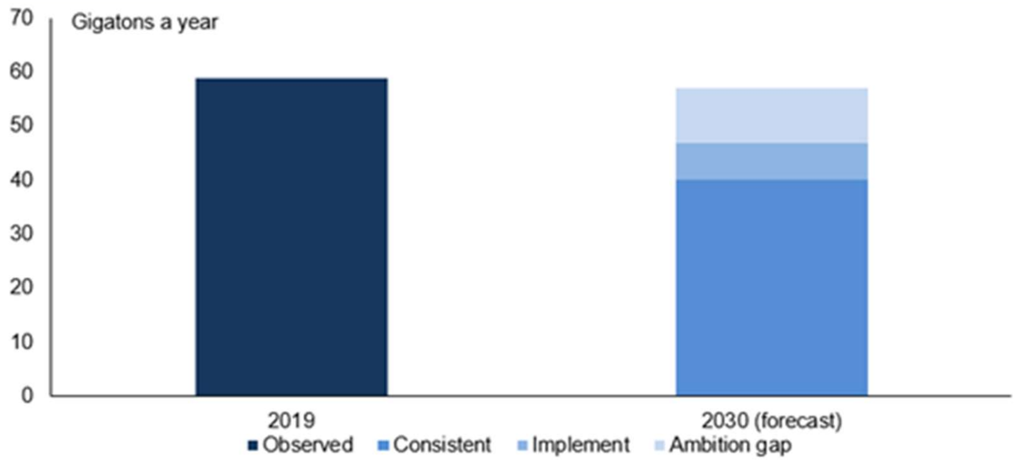
- With COP27 underway (the 2022 United Nations Climate Change Conference- or Conference of the Parties of the UNFCCC), focus is on the risks of failing to transition away from fossil fuels, and in particular the slow pace of transition currently.
- The IMF has come in advising that “(t)he price of carbon needs to average at least $75 a ton globally by the end of the decade for global climate goals to succeed”, and that currently “the pace of change in the real economy was still way too slow”.
- "The problem is that in many countries, not only in poor countries, across the world, the acceptance of pricing pollution is still low, a situation made worse by the current environment of high living costs.”

- COP27 has also seen wealthy nations support South Africa's transition plan away from coal, with an US$8.5b package funded by the U.S, Germany, the US and France (the International Partners Group), via both grants and loans to aid SA's decarbonisation.
- The funding is to be aimed at decommissioning coal fired power plants and accelerating renewable energy, and the expected deal is seen as a template which can be rolled out to other developing economies to aid in their transitions to clean energy.
- President Biden adds "(o)ur support for … (SA's) clean energy and infrastructure priorities, which include efforts to provide coalminers and affected communities the assistance that they need in this transition, will help South Africa's clean energy economy thrive".
- The IMF adds, "(w)hat we need is very massive education campaign, because if people are overtaken by current difficulties and they are not mindful of climate change being an existential risk to humanity, they would be slow to do their part for the transformation".
- "We can survive recession. We can survive inflation … we cannot survive, as humanity, is an unmitigated climate crisis. We "need to gradually increase the price of carbon to the level necessary to create the incentive for businesses and consumers to bring down emissions."
- Keeping energy costs elevated at current levels and forcing countries to adjust more quickly to lower carbon emissions would not have necessarily an inflationary effect as it's a y/y calculation, while a carbon price floor has also been touted.



Note: Figure shows deviation from 196 to 1991 normal monthly temperatures and hottest 10 countries by month. BIH = Bosnia and Herzegovina

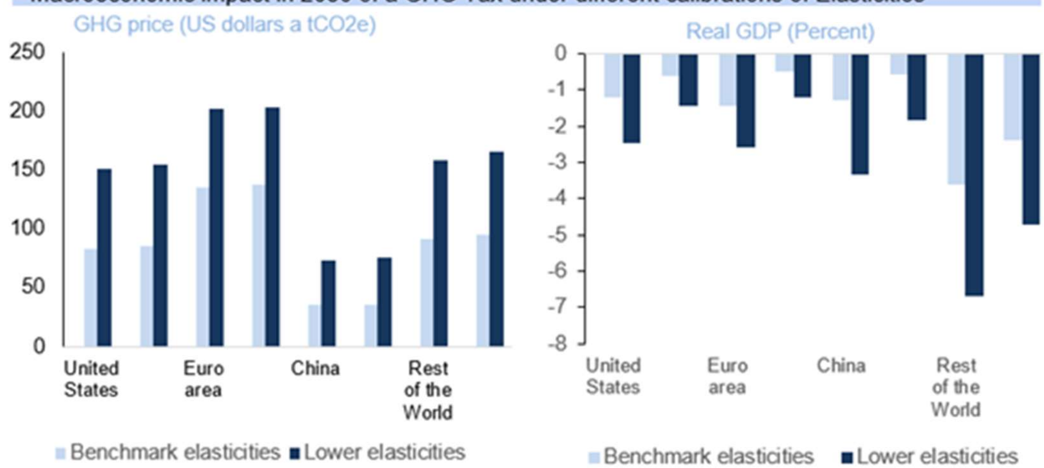
Historical and Projected Global Emissions



Source: IMF, WEO October 2022

Note: The overhang of projected emissions in 2030 over the amount compatible with 2°C arming consists of the ambition gap (the amount by which pledged emissions exceed the 2°C-compatible amount) and the implementation gap (emissions pledged to be avoided but forecast to arise under current policies).

Macroeconomic impact in 2030 of a GHG Tax under different calibrations of Elasticities



Source: IMF, WEO October 2022

Note: GHG = Greenhouse gas; tCO2e= metric tons o carbon dioxide equivalent

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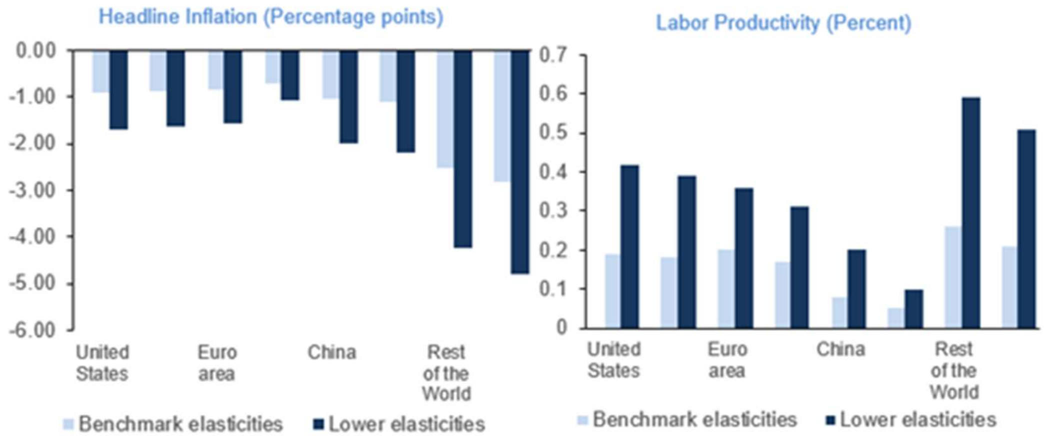

Source: IMF, WEO October 2022

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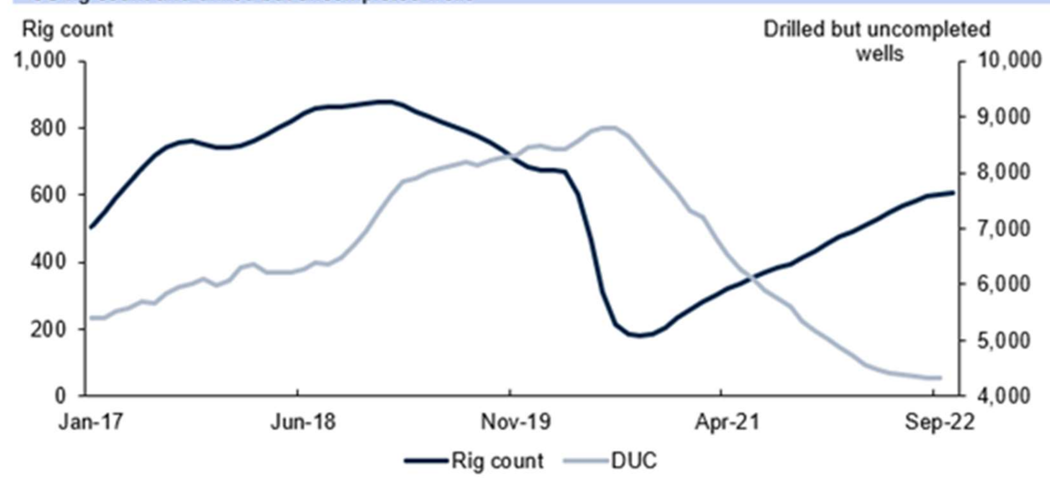
US rig count and drilled but uncompleted wells



Source: World Bank, Commodity Outlook October 2022

Note: Last observation is the week of October 21, 2022 for rig count and September 2022 for DUC.