Crude oil: How high can it go?

Bulls continue to control the oil market. But we believe speculators are over-extended and expect a correction

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US oil supply

US crude oil inventory withdrawals over recent weeks have clearly been supportive for the oil market. Inventories in the US have declined by more than 34 million barrels since the start of December 2017, and the last time the EIA reported a stock build was in November. Current US oil inventories stand at 419.5 million barrels, leaving them within striking distance of the five-year average of 407.2 million. The drawdown in stocks looks even more impressive when we consider that in March 2017, they stood at a record 536 million.

However, all good things come to an end, and the latest data from Baker Hughes may be the first sign of this. It showed that the number of active rigs in the US increased by 10 over the last week, to 752. This is the biggest weekly increase since June 2016, and a clear sign that current prices will drive US production higher. The EIA in its recent Short Term Energy Outlook also revised higher its estimate for 2018 US oil production from 10 million barrels per day to 10.3 million, a 1MMbbls/d increase year-over-year. Moving forward, if we continue to see a consistent increase in the US rig count, the market will likely become more convinced by the EIA's forecasts.

Toppy speculative positioning

How much further can it go? That is one of the key questions in the oil market at the moment when it comes to speculative positioning. The managed money net position in ICE Brent currently stands at a record 574,152 lots, having increased by 373,948 lots since June 2017. The gross long position stands at a significant 641,958 lots while the gross short stands at a much more modest 67,806 lots. It is just not in lot size that this position looks overstretched, the dollar value suggests the same, as it's also at an all-time high, with the position worth US$39.5b.

Similarly, speculative positioning in NYMEX WTI is also starting to look somewhat overdone, with the managed money position standing at a record high of 437,770 lots. The right catalyst would be needed to see significant liquidation in these positions, and potentially consistent increases in the US rig count in the coming weeks could be the trigger.

Iranian tension

Civilian protests and demonstrations in Iran against the ruling class over the last several weeks sent a chilling reminder of the Arab Spring, which resulted in heavy disruption to oil supply. Violent clashes between security forces and protesting civilians have been reported from the country. However there have been no reports of disruption to oil supply, and more recently the situation does appear to have calmed down somewhat. Still, the risk around Iran moving forward is likely to be shaped by its relationship with the US, particularly with regards to the nuclear deal.

While many see a heightened level of geopolitical risk, disruption to oil supply within OPEC countries remains low. EIA data shows unplanned OPEC outages at 1.14MMbbls/d, which is near the bottom end of the range of 1.13-2.84MMbbls/d reported over the last four years.

Author

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com