

The Commodities Feed: Uncertainty and risks build in the Middle East

Oil price action this morning is muted despite Iran's attack on Israel. The market had already priced in some form of attack, while limited damage and no loss of life means the potential for a more measured response from Israel. How Israel responds is now the key uncertainty. For oil, the risk is that we are moving closer towards supply being directly impacted



Source: iStock

Energy - Middle East tension builds

Oil price action is fairly muted in early morning trading today considering developments in the Middle East over the weekend. The market had been expecting some form of retaliation from Iran following a suspected Israeli attack on Iran's embassy in Syria earlier in the month. The fact that there was limited damage and no loss of life may also provide some comfort to the market, as it may mean a more measured response from Israel. However, the scale of the attack over the weekend and the fact that it was the first time Iran has directly attacked Israel means that there is still plenty of risk of further escalation in the region. While Iran considers the altercation "concluded", markets will have to wait to see how Israel responds. The US and allies are pushing for

a diplomatic response, while the risk is that hardliners within the Israeli government push for a more aggressive response.

For oil, events clearly increase the risk of supply disruptions. Iran pumps a little over 3m b/d of crude oil currently and is the fourth largest producer within OPEC. The first risk is that oil sanctions are more strictly enforced against Iran, which could see anywhere between 500k-1m b/d of oil supply lost. This would ensure that the oil market remains in deficit for the remainder of the year. Secondly, there is the risk that Israel's response includes targeting Iranian energy infrastructure, which would mean the potential for even more significant supply losses. And finally, if we were to see further escalation, there is the risk that Iran would attempt to disrupt or block oil flows through the Strait of Hormuz, through which roughly 20m b/d of oil moves. We believe the risk that is most likely to materialise is stricter sanction enforcement against Iran.

If we were to see significant supply losses, the US could always release further crude oil from its strategic petroleum reserves. It is also important to remember that OPEC sits on more than 5m b/d of spare production capacity. If prices were to rally significantly on the back of supply losses, one would imagine that the group would look to bring some of this spare capacity back onto the market. OPEC will not want to see prices going too high given the risk of demand destruction.

While risks are clearly elevated, which should keep oil prices relatively well supported, oil supply remains intact for now. Therefore, we are leaving our ICE Brent forecast unchanged at US\$87/bbl for the second quarter, until there is some clarity on how events play out.

Metals – LME bans Russian metals after US, UK sanctions

The London Metal Exchange (LME) banned delivery of new Russian metal following sanctions imposed by the US and UK for Russia's invasion of Ukraine.

No Russian metal produced from April 13 onwards will be eligible for delivery to the LME, or to the Chicago Mercantile Exchange (CME). The move will be bullish for prices on the LME short-term, which are used as a benchmark in contracts around the world. The LME nickel prices, in particular, remain vulnerable to violent price spikes following the nickel squeeze in March 2022 after Russia's invasion of Ukraine and a build-up in short positions on the exchange. However, the LME has placed daily limits that prevent prices from rising more than 12% a day for copper and aluminium and 15% for nickel.

Russian metals had broadly escaped sanctions until December, when the UK prohibited British individuals and entities from trading physical Russian metals, including aluminium, nickel and copper. The UK is the only country in Europe to have adopted such measures. The LME had previously considered banning Russian metal in 2022 but ultimately decided against it and said it would be guided by government sanctions.

Russia accounts for about 6% of global nickel production, 5% of aluminium and 4% of copper.

European buyers have been self-sanctioning since the invasion of Ukraine, leading to fears that LME warehouses could be used as a dumping ground for unwanted Russian metals. Over the past year, large surpluses of Russian metals have built up in LME warehouses. At the end of March, Russian metal accounted for 36% of the nickel in LME warehouses, 62% of the copper and 91% of the aluminium. These existing inventories would not be affected by sanctions, the LME said.

As consumers in the EU have continued to self-sanction, China's imports of primary aluminium from Russia hit new highs last year. This trend is likely to continue this year with Russian aluminium continuing to be diverted to Asia, particularly China, the world's biggest aluminium consumer. China is likely to continue to buy discounted Russian material to use domestically and export its aluminium products into Europe leaving the US to fill the gap left by Russian import ban.

Prices of copper, nickel and aluminium are likely to initially move higher and in the short term, the market will remain volatile, mainly due to the large uncertainty in supply and LME delivery post the sanctions changes. However, the market is likely to adapt to the new dynamics while Russian material will continue to find new sanction-neutral buyers.

In April 2018, the US administration placed sanctions on Russian aluminium producers. LME prices jumped to \$2,718/t, at the time the highest since 2011 before gradually falling in the following weeks and months. Sanctions were then lifted in January 2019.

Agriculture – UNICA reports record CS Brazil sugar production

The latest fortnightly report from UNICA shows that sugar cane crushing in Centre-South Brazil rose to 5mt, up 6.5% year-on-year in the second half of March. The cumulative sugar cane crush for the season increased by 19.3% YoY to 654.4mt. Sugar production rose 9% YoY to 183kt in 2H March, with 33.5% of cane allocated to sugar production in the fortnight, lower than the 35.7% allocated in the same period last year. Cumulative sugar output stands at 42.4mt, up 25.7% YoY, which is a record amount for the region. This data marks the official end of the 2023/24 season, with the 2024/25 CS Brazil cane crush starting in April.

The latest trade numbers from Chinese Customs show that China's soybean imports fell 20% YoY to 5.5mt in March, following lower feedstock demand due to restrictions on pig production capacity. Cumulative imports fell 10.8% YoY to 18.6mt over the first three months of the year.

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