Energy Market Drivers:

Geopolitics is back on the agenda, but for how long? EUAs under structural pressure

January 12, 2023

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Market view: Iran and Strait of Hormuz back In focus

The attack by the Houthis in Yemen on commercial ships in the Red Sea has accelerated over the last four weeks, and overnight, American and British forces targeted 16 locations, including airports, radar installations and storage and launch facilities for missiles and drones.

Unsurprisingly, the Houthis have woved to retaliate and continue the attacks. We don't know if the Houthis can retaliate or dare to fight back. But many of the Houthi attacks have come from drones that are relatively easy to operate and hide.

Nightmare for the oil and gas market if the Strait of Hormuz Is next

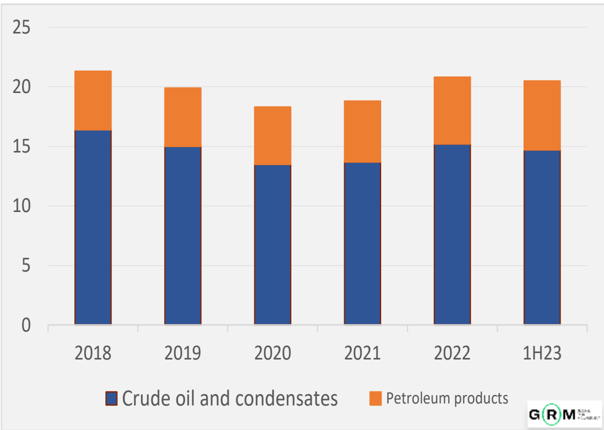
The attack on the Houthis came one day after Iran's navy captured the oil tanker St Nikolas off the coast of Oman. The tanker, previously known as the Suez Rajan, was seized by the US in April accused of carrying sanctioned Iranian oil. It is unclear if the capture of the St Nikolas is related to the current situation or if Iran just saw "an opportunity" to re-capture the oil tanker.

So far, we have seen the expected condemnation from Iran, saying the attack will fuel insecurity and instability in the region. The question is if this will lead to a spread of the conflict, implying a more active involvement of Iran?

The Houthi attacks on the ships in the Red Sea are severe for international shipping and have forced many container, tanker and other shipping companies to go South of the Cape. But importantly, no oil or gas production has been shut-in. However, this will change materially if the crisis spreads to the Strait of Hormuz. If the narrow passage is closed, it will severely impact the global oil market. Roughly 20.5 mb/d of oil flowed through the Strait in H1 2023, of which 28% are petroleum products, and the rest is crude oil and condensates. 27% of the world's maritime oil trade and 20% of global LNG go through the strait yearly.

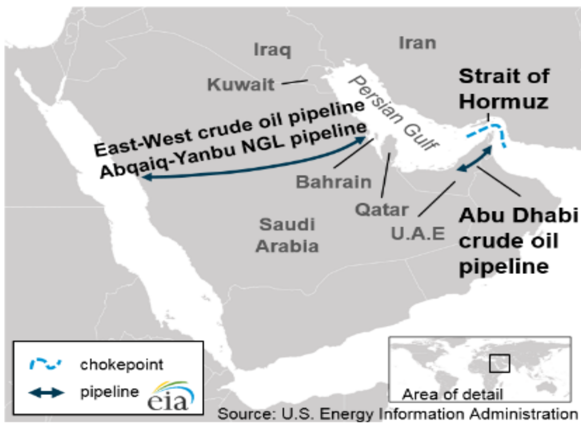
Saudi Arabia and the UAE have pipelines that can circumvent the Strait of Hormuz. Ironically, the Saudi East-West crude oil pipeline can transport 5mb/d to the Red Sea. The UAE links its onshore oil fields to the Fujairah export terminal on the Gulf of Oman with a 1.5 million b/d pipeline.

Crude oil, condensates and petroleum products transported through the Strait of Hormuz, mb/d



Source: EIA

The Strait of Hormuz is vital to global energy markets



Source: EIA

Higher risk premium, but for how long?

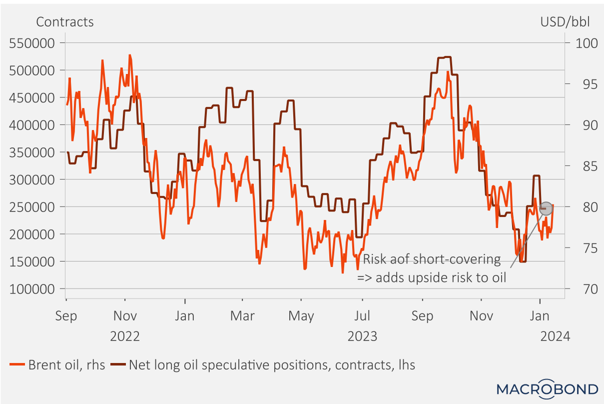
Today, Friday, Brent oil moved above USD80/bbl after trading at USD 77.5/bbl when the BBC said last night that the UK Cabinet would meet to discuss UK and US military action.

The question is, how significant a risk premium should the market price in? We have a long weekend ahead of us as the US is closed for Martin Luther King Jr Day on Monday. Hence, we would expect many speculative accounts and market makers to be careful going short into a long weekend. Notably, as we know from the CFTC data, that the speculative part of the market has been adding to net short positions since the peak in oil prices in late September. Hence, short-covering adds to the upside for oil.The chart to the left below shows a combined measure of net-short oil positions among speculative accounts at Nymex and ICE for WTI and Brent.

However, if nothing happens over the extended weekend, the oil market will soon focus on fundamentals again. Suppose a war in Gaza and military attacks on the Houthis in Yemen are not enough to trigger a response from Iran. In that case, the market will again somewhat cynically conclude that the crisis will not spread to Iran and that the risk of closure of the Strait of Hormuz is still minimal. That does not mean the situation will normalise in the Red Sea, but we would return to the state before the US/UK attack overnight.

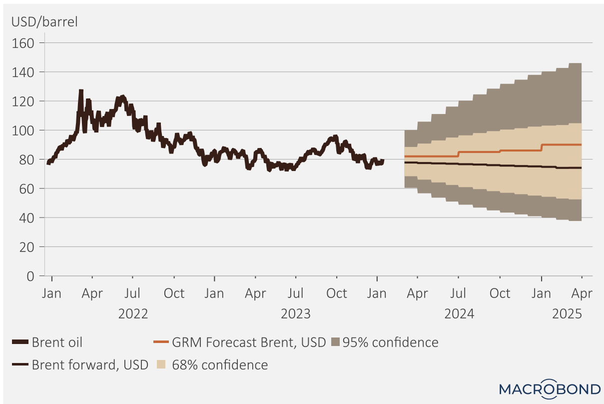
But the situation underlines that the risk of a sudden spike in oil prices cannot be ruled out. It is something consumers of oil and oil products should consider when hedging exposure. The chart below to the right shows a probability cone for the next 12 months for Brent oil prices. It is based on option prices. Hence, the market tells us that by 95% probability, the oil price in one year will be between USD40 and USD145 a barrel. It is wide range and underline the high uncertainty in the oil market. Note that the cone is skewed to the upside.

The market is speculative short oil. It could short-coveirng ahead of long weekend, number of contract and oil price



Sources: Macrobond, Bloomberg, GRM

Wide range for oil price in 2024 according to the option marrket



Sources: GRM

Market Drivers next week: OPEC and IEA oil market report

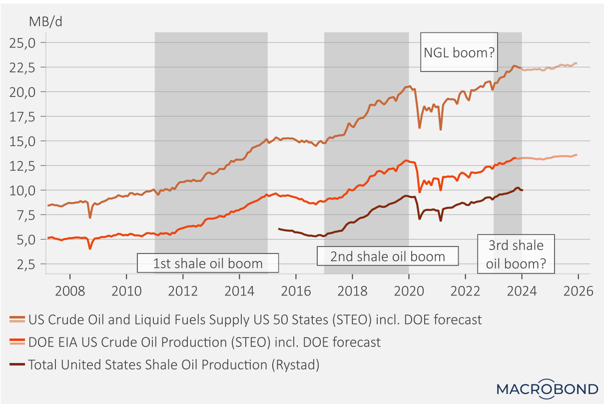
The main driver for the global energy markets will be the situation in the Middle East. As elaborated above all yeys will be on Iran and the reaction to the American and British attack on the Houthis.

This week, we got the Short-Term Energy Outlook report from the US Department of Energy (DOE). The DOE forecast that US crude oil and, importantly, NGL production are close to a peak. However, as we have earlier pointed out, that was also the DOE forecast a year ago for 2023, and US oil production still surprised strongly on the upside in 2023.

The continued rise in US oil production is one of the biggest price jokers for the oil market. Hence, we will scrutinise how the IEA sees US and non-OPEC oil production in 2024 when the Monthly Oil Market Report is out on Thursday.

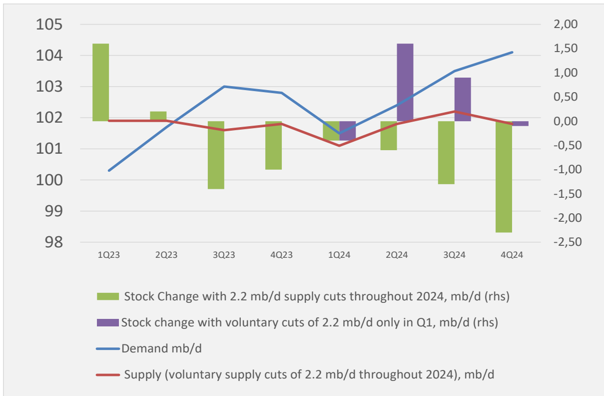
We will also focus on the general oil market balance, which is the benchmark for the oil market. The chart below to the right shows the market balance according to the IEA based on whether OPEC+ extends the voluntary 2,2 mb/d extra cuts to Q2-Q4 2024 or ends them after Q1 as announced. We expected that the cuts will be in place throughout 2024.The latter is one of the main reasons we expect oil prices to move to the mid-80s in H2 2024.

Will US oil production continue in 2024. The EIA says no, mb/d



Sources: Macrobond, Bloomberg, GRM, EIA

Oil market balance based on December IEA Oil Market Report, mb/d



Sources: GRM, IEA

OPEC will also publish their oil market report. However, the market is not normally reacting to the report, as it is not considered independent. The OPEC+ have said they will have an extra meeting in the beginning of February. In that respect, the report might attract more attention this month. It is out on Wednesday.

Concerning the weekly oil inventory data from the US, we will get the first set of data not influenced by the Christmas or New Year holidays. The recent weekly reports have indicated weak overall demand for distillates, especially. Hence, we we follow closely if that is reflected in the new set of data out on Thursday. Due to the bank holiday on Monday, the data are delayed one day.

Regarding the usual economic data, we see noone that should impact the global commodity markets next week. We are monitoring the pricing of the first Fed rate cut. A 25bp rate cut in March is priced by 75% probability despite the slightly higher US CPI data this week. We still see a US rate cut in March. It should weigh on the US dollar, dspite the ECB is expected to cut rates also during the spring.

EUA prices are under pressure due to weak structural demand

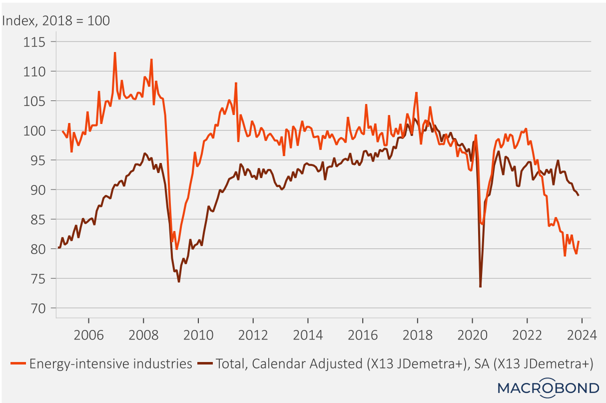
The EUA market has been under pressure for the first two weeks of 2024. The price has fallen from EUR 80/Mwh to below EUR 66/Mwh for the benchmark Dec-24 contract. The market has started to price in that demand for EUAs from the power sector was likely much lower than expected in 2023, and that the outlook is similar for 2024.

The use of renewables for power production is almost rising daily, and industrial emissions, especially in Germany, remain low. The chart to the left shows German industrial production in total and in energy-intensive industries. The industrial production in energy-intensive industries was down 20% in November compared to 2022. The use of renewables in EU power production also rose strongly in 2023. The share was 71.6% in 2023 compared to 64.1% in 2022.

January 15, the EUA actions will be back at the EEX exchange after they have been on hold since mid-December. We follow the so-called cover ratio at the auctions (bids relative to sale) as it reflects the demand for EUAs in the market.

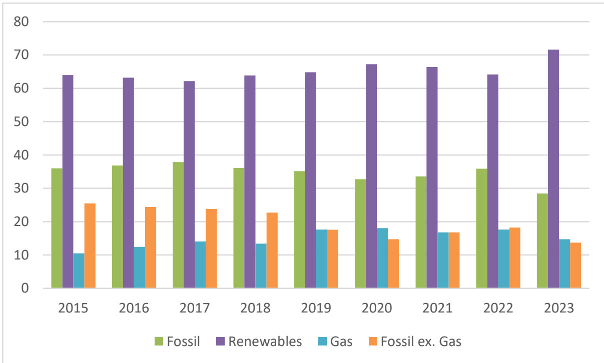
The weather forecast is for an end to the cold spell across Northern Europe, and with the calendar saying we are halfway through the winter season, the downward pressure on EUA prices may have another leg next week. The same applies to natural gas prices. The geopolitical situation remain a joker.

German industrial production is under pressure. It implies less demand for EUAs



Sources: Macrobond, Bloomberg, GRM, EIA

The rising use of renewables in power production in EU means less demand for EUAs, share in %



Sources: GRM, Entsoe, Frauenhofer

Hedging views: Hedge when Brent is below USD80/bbl

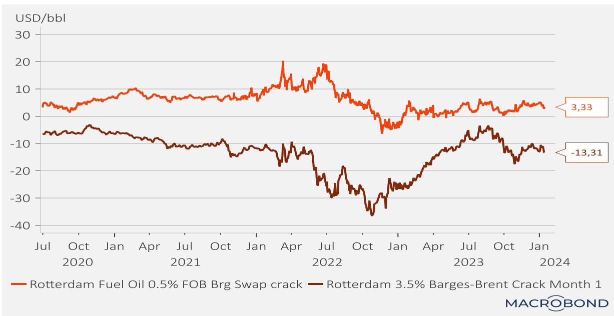
Table 1 on the next page summarises our market views and hedging recommendations in the different markets.

We maintain that Brent prices below USD80 offer an attractive entry level for new consumer hedges for 2024. We recommend that consumers have a hedging ratio at the individual company benchmark or maybe slightly lower. We have become more cautious about the price outlook due to rising non-OPEC crude oil production. That said, geopolitics are back on the agenda and OPEC+ might try to convince the market that they will tighten the market balance here in Q1.

Hence, in that way the risk of a sudden price spike triggered by the war in Israel and the upcoming OPEC+ production cuts still supports a high hedge ratio for the next two to three months.Importantly, we still forecast prices above the forward curve in 2024. The Brent futures curve implies an average price of USD 78.6 in 2024. The ICE Gasoil, the Jet fuel CIF NWE and the ULSD 10ppm CIF NEW diesel curves remain in backwardation throughout 2024.

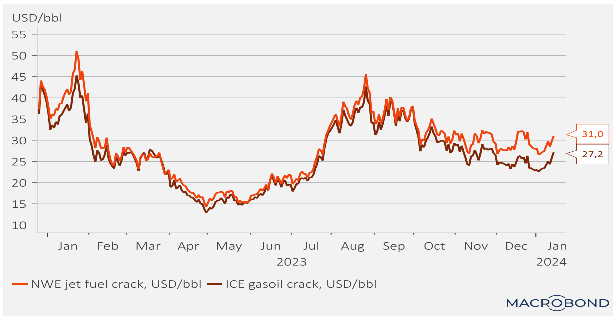
The VLSFO crack has come under pressure as VLSFO export from the Al Zour refinery has started to pick up. Despite seasonally low demand, HSFO might see renewed support from the OPEC+ cuts. The geopolitical tensions between Venezuela and Guyana might imply lower exports of Venezuelan heavy oil in the future, indirectly supporting the HSFO market. The business cycle-sensitive ICE Gasoil and NEW CIF jet fuel cracks have moved higher over the last week supported by low inventories and notably strong jet fuel demand. Jet fuel is also sensitive to the Red Sea tensiosn. We expect a ICE Gasoil vs NEW CIF jet fuel spread of around USD5/bbl throughout 2024.

Fuel oil cracks are higher (vs Brent), USD/bbl



Source: Bloomberg, GRM and Macorbond

ICE Gasoil/jet fuel cracks are trending lower, USD/bbl



Source: GRM and Macrobond

Brent and ICE Gasoil forecast GRM

	Spot	Q1 2024	Q2 2024	Q3 2024	Q4 2024	2024
Brent GRM Forecast avg., USD/bbl	**79,7**	80	82	85	86	83
Brent forward avg., USD/bbl		80	79	78	77	79
Brent Consensus forecast (Bloomberg)		83	83	85	85	84
WTI GRM Forecast, USD/bbl	**74,3**	76	78	81	82	79

	Spot	Q1 2024	Q2 2024	Q3 2024	Q4 2024	2024
ICE Gasoil crack avg., USD/bbl (GRM Forecast)	27	26	26	28	29	27
ICE Gasoil avg., USD/MT (GRM Forecast)	806	792	805	842	857	824
ICE Gasoil Forward, avg., USD/MT		787	751	741	731	753

Source: GRM, Bloomberg

HSFO and VLSFO forecast GRM

	Spot	Q1 2024	Q2 2024	Q3 2024	Q4 2024	2024
HSFO (1M 3.5% Rotterdam Barge) crack avg., USD/bbl (GRM Forecast)	-13	-12	-10	-10	-12	-11
HSFO (1M 3.5% Rotterdam Barge), USD/MT (GRM Forecast)	419	434	457	476	470	459
HSFO (1M 3.5% Rotterdam) Forward, avg., USD/MT		422	417	409	395	411

	Spot	Q1 2024	Q2 2024	Q3 2024	Q4 2024	2024
VLSFO (1M 0.5% Rotterdam Barge) crack avg., USD/bbl (GRM Forecast)	3	2	2	1	1	2
VLSFO (1M 0.5% Rotterdam Barge), USD/MT (GRM Forecast)	525	523	533	546	552	632
VLSFO (1M 0.5% Rotterdam Barge) forward, USD/MT		527	514	505	494	510

Source: GRM, Bloomberg

Table 1: GRM market and hedging views – updated January 12, 2024

	Market view next month	Market view from one month and beyond	Hedging implications
Brent oil	We expect Brent to trade around USD 80 the coming weeks. Geopolitical risks are upside risks, but also room to price out risk premium.	Focus on OPEC+ cuts in H1 2024. OPEC+ production cuts to be extended throughout 2024 to support prices. Range : USD 75-95 that is expected to last throughout 2024. Some downside pressure in H1 2024 depending on non-OPEC supply growth.	We recommend that consumers have a hedge ratio at the individual company benchmark. The 2024 curve remain slightly in backwardation. We see prices above the forward curve in 2024. Add to hedge ratio when Brent trades below USD80.
ICE Gasoil (Diesel/MGO)	Still, a tight physical situation in ARA for Gasoil/diesel though inventories are not dropping anymore. Still some upside risks to prices and crack. Strong jet fuel demand expected.	To follow Brent. But risk of new spikes in crack vs Brent as refineries have a difficulties keeping up with demand. A weaker recovery in Chinese product demand (higher export) could loosen the market.	We recommend that consumers have a hedge ratio at the individual company benchmark. ICE Gasoil is in backwardation. We see prices above the forward curve. Add to hedge when Brent trades below USD80. Suppliers (inventory hedging): Consider rolling hedges early (if possible).
VLSFO	The market to become better supplied with VLSFO as the Al-zour refinery in Kuwait have stepped up export. Still modest demand in Port of Rotterdam though "south of Africa" could add to demand.Dowenside to crack short-term.	To follow Brent. VLSFO is expected to stay weak vs Brent (small premium or even negative) as supply from Al-zour refinery returns and muted demand.	We recommend that consumers have a hedge ratio at or below the individual company benchmark as VLSFO premium might fall further. Flat price to follow Brent higher.
3.5% HSFO	3.5% HSFO is expected to perform vs Brent in January (less negative crack). Residual oil availability is to stay low as Saudi and Russia have extended production cuts of heavy/sour crude. But seasonality points to a weaker market. Risk of more heavy/sour crude from Venezuela though recent tensions regarding Guyana makes it less likely.	3.5% HSFO is expected to stay strong vs Brent (modest discount). Shipping demand might rise also due to the Red Sea tensions. Feedstock availability to stay low as Saudi and Russia is cutting back heavy/sour crude. We see prices above the forward curve. More oil from Venezuela is a risk, though we do not see an extension of the US waiver for exports from Venezuela.	We recommend that consumers have a hedge ratio at or marginnaly above he individual company benchmark. We expect prices to trade above the forward curve and a more expensive crack.
Natural Gas TTF	EU gas inventories are still high. Reecent cold weather adds short-term upside. But spring is approching. Expect front-month to trade below EUR30/Mwh	Inventories remain high and as spring appraoches new downward pressure on prices. Rising use of renewables could also add to downward pressure on prices. But still risk next winter.	We recommed that consumers hedge especially the 2023/24 winter as the risk of a new price spike is still evindet. Consider hedging the 2024/2025 winter season on price set-backs (front-month at EUR 27-30/Mwh)
EUA/emission	The weak German economy and high use of renewables in power production weighs on demand. Auction supply is coming back this week also negative. However, speculative short-covering could add support.	The set-back in prices is probably an overreaction. The inclusion of shipping could add to demand. An expected recovery in the German economy also positive. Range EUR 70-80 MT. Sensitive to gas prices and weather.	The current level looks attractive from a buying perspective. The EUA curve reflects the interest rate curve and is in contango. Entities that have to hand in allowances should compare internal funding costs to the implicit cost-of-carry in the EUA futures curve when considering buying EUAs "physically" or using the futures curve to hedge EUA risks.

	Market comment (updated January 12, 2024)	Hedging implications
Power	The cold spell moving from north to Europe didn't play out, and prognosis are forecasting milder weather in Europe. Last week cal 2025 in Germany traded 93,50 €/MWh, this has fallen to 88,50 €/MWh, with a low at 86,50 €/MWh. It has been driven lower on bearish gas prices and ampel supply. Particular carbon, which has experienced nearly a 10 €/ton drop, has pushed the contract lower. Investment funds has rebuild the short positions, and technical support at 69 €/ton has been broken. This opens up for at test of 65€ area. Fridays move higher was influenced by the USA and allies attack on the Houthies in Yemen.	Cold snap loosing its grip in both Scandinavia and a bit earlier in Europe. Wind will pick up and residual load will be smaller, hence no really burn of coal and gas. The Finland incident shouldn't be repeated, but when it comes to interconnectors and production sites, you will never know.

Source: GRM

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