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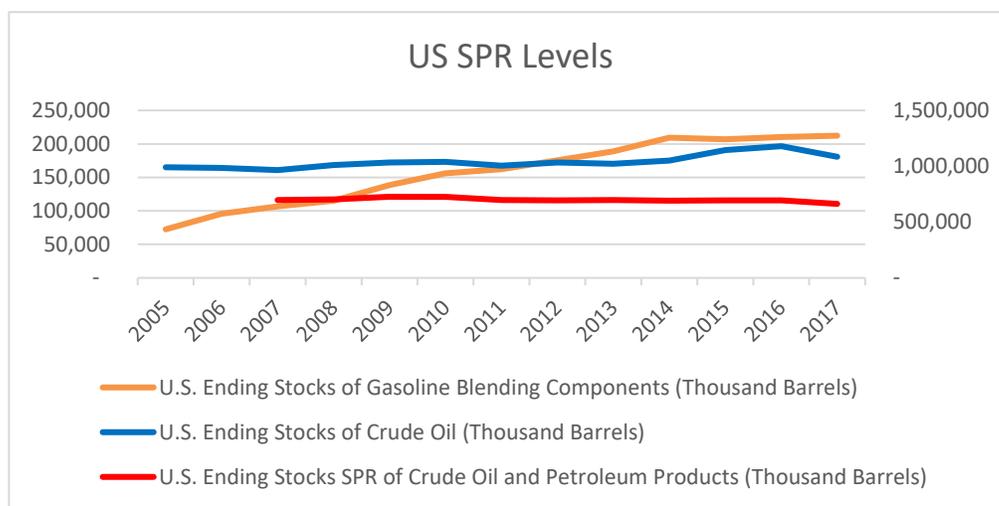
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Trump looking to tap SPR in October despite DOE objections

By: Greg Priddy – DaMina Senior Fellow, Oil Geopolitics; Co-Head, Research

Contrary to the advice of the US Department of Energy, it is increasingly likely that President Donald Trump will tap the US Strategic Petroleum Reserves in October ahead of the contentions US mid-term elections. We currently estimate the probability at about 40%. As the 4 November deadline approaches for full implementation of US secondary sanctions targeting Iran's oil exports, it is becoming increasingly clear that the Trump administration drive to undermine Iran's economy and regional power will have the unintended consequence of tightening the world oil market and supporting higher prices. While the Saudis have implemented their pledge to increase production more slowly than they implied at the June OPEC meeting, they will reach at least 10.8 million bpd soon, but that will leave them with extremely low effective spare capacity, which is itself a bullish factor as regional tensions rise. In the short-term however, President Trump does have one tool with which to both deter speculative inflows and interrupt market momentum – a release of oil from the US Strategic Petroleum Reserve (SPR).



Source: US EIA

India becomes the fulcrum for the impact of sanctions on Iran on export volumes

As outlined previously, the growing realization that India will at least sharply cut its purchases of Iranian crude oil is driving the market toward pricing in a large loss of Iranian volumes, and one which will go beyond the roughly 1 million bpd increase from the effective end of OPEC/Russia production restraint at last ministerial meeting in June. The current headlines may be overstating the impact, however. It is true that no Indian refiners have yet scheduled cargoes for November, but there are substantive signs from the Indian government that they expect to receive a waiver to continue some purchases at a sharply reduced level – including granting an authorization for the use of Iranian tankers operating with only Iranian insurance to dock at Indian terminals. If India did in fact go to zero imports in November, that would be more bullish than our baseline scenario of a sharp (at least 40%) reduction, but it is still not the most likely outcome. US officials including Secretary of State Mike Pompeo alluded to some flexibility in the US position at the “2+2” (foreign and defense ministers) bilateral meetings on 6-7 September, and the economic impact of higher oil prices is already starting to hit the Indian economy and equities markets. India is one of the most oil-intensive EM economies.

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ABOUT DAMINA

DaMina Advisors is a preeminent Africa-Asia focused independent frontier markets political risk research, due diligence, M&A transactions consulting and strategic geopolitical risks advisory firm.

DaMina Advisors is legally registered and has offices in the US, Canada, The UK and Ghana. DaMina is headquartered in Toronto.

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Dissonant Saudi signaling does not mean a shift back toward an overtly price hawkish stance

The apparent difference tacks in media reports signaling to the market last week do not support the extreme bullish case that the Saudis will revert to an overtly price hawkish stance or fail to hit the promised production level, if a bit belatedly. The US-Saudi understanding from May on offsetting sanctions volume losses from Iran will hold. First, a Bloomberg article on 18 September cited people “people familiar with the kingdom’s view,” not Saudi officials, after they had held a series of meetings with top traders and IOC executives in London, New York, and Houston. Alongside that, Trump’s tweet on 20 September signaled his personal pique at the Saudis about the 18 September headline, and they are going to be reluctant to push him further on this in October before the US midterm elections. While the headlines regarding the OPEC/Russia Joint Ministerial Monitoring Committee meeting in Algiers on 23 September focused on the lack of a commitment to an “OPEC headline” production increase, this is not particularly relevant. Saudi oil minister Khaled al Falih was clear that Saudi volumes would incrementally increase in the September and October data.

The Trump administration has been very friendly to substantive Saudi interests, most recently when Secretary of State Mike Pompeo signed a legally-required certification that the Saudis and their partners in Yemen were making their best efforts to contain civilian casualties. This went against the advice of the State Department’s Near East bureau and infuriated many members of Congress who are concerned about the humanitarian situation in Yemen. Thus, Trump is going to feel like he can call in a big favor, just like he did after nixing the Iran deal in May. For the Saudis, it is clear that they are going to benefit mightily from Iran’s volume losses, and a short-term shift in tack in their public signaling won’t change that.

... But the Saudi increase will not balance the market

The Saudis message to their Western counterparts in the oil business that prices will rise past \$80 eventually even with their production increase is spot on. However, while Al Falih’s comments in Algiers repeated the claim of production capacity of 12.5 million bpd, almost nobody in the market believes they could reach that volume rapidly. Much of that capacity is essentially “mothballed” wells carried on the books since the 1980s, which probably could add some volume, but which would take extensive work to bring online. After the Saudis get to the 10.8 million bpd level they cited in June, there is probably only a very modest amount of spare capacity which could be brought online quickly, which includes the Saudi share of the Neutral Zone.

The volume lost to the market will almost certainly push well past 1 million bpd. US officials had suggested after Pompeo’s last visit to Beijing that China would at least not take additional volumes of Iranian crude (still having Chinese entities sanctioned), but that now looks doubtful with a rise in tanker loadings scheduled, and the big increase in US-China trade frictions. Still, even if we assume a 50% rise in Chinese purchases, Turkey continuing to take Iranian volumes, and the waiver for India, that still implies a loss of 1.3-1.5 million bpd from Iran (depending on how much decline is assumed from the peak exports in April of 2.7 million bpd without sanctions, including condensate). The production increases from the de-facto end of the OPEC/Russia deal in June are not going to fully cover this volume, and they will be left with extremely thin spare capacity to deal with any volume losses elsewhere.

Trump SPR release is a short-term risk to bullish momentum

With the US midterm elections coming up on 6 November, the Trump administration has two tools available – pressuring the Saudis to talk the market down, and releasing volumes from the SPR. It is quite possible that the Saudis could be convinced to shift their public messaging, as outlined above, but the impact will be limited by the market’s belief that they have limited spare capacity. The more effective short-term approach would be to use the SPR, which would still yield only a couple of dollars difference on crude prices, but can keep traders off balance and disrupt momentum for a few weeks. As US Secretary of Energy Rick Perry pointed out in comments recently, it would only have a short-term influence on the market, and the Department of Energy will continue to advise President Trump against such a move. But Trump could easily overrule the DOE for short-term political reasons. Trump is focused on other issues this week, but the first two weeks of October will see a 40% chance that Trump will authorize some sort of release, probably about 30 million barrels.

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To schedule an in-depth Q&A briefing with Greg

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