Comment

Oil stocks must go

- *The oil market, after large price swings, is sensitive to each new data point*
- *US oil stocks are one such release, but such weekly data risk missing the big picture*
- *The trend in US stocks is strongly upward, suggesting rebalancing could be far from over*
- *If oil stocks continue to rise, the oil price could well then fall to a new low for the year*

Reading the runes

The oil market is sensitive to weekly data releases

Large swings in the price of oil over the past two years have, perhaps unsurprisingly, made market participants particularly sensitive to each new data point. Each release is pored over and analysed for any potential oil market implications and the likely outlook over coming weeks and months. Market participants are also seeking to assess whether a turning point in the supply / demand balance has been, or is close to being, reached.

One particularly closely watched data release is the Energy Information Administration's (EIA) weekly release on US oil inventories. A draw-down (or build-up) of commercial stocks has on occasion moved the oil price up (or down) by as much as 5%, minutes after publication.

One swallow does not a summer make

But, single-week data need to be seen in perspective

Weekly fluctuations in stocks by 4 or 5 million barrels (mb) need to be viewed in perspective. A broader sweep of history reveals that US oil stocks have been rising since 2008, and sharply so over the past year or so. Stocks are at their highest since the 1980s (Figure 1). One week's data – e.g. last week's 3 mb draw, perhaps reflecting recent interruptions in Canada and Nigeria – risks missing something of potential strategic significance: the supply glut seems persistent.

There are many potential reasons why stocks are trending upwards: weak final demand; stronger than expected supply; companies building inventories at 'low' prices in expectation of rising prices further out. But stocks seem unlikely to remain at such elevated levels indefinitely.

Rebalance now or rebalance later

Oil market rebalancing could be far from over

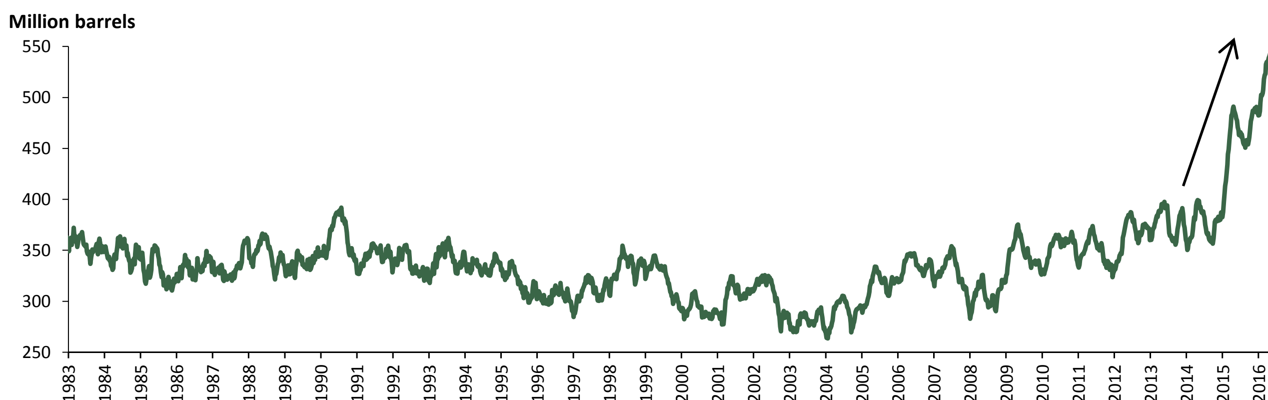
The main reason for the oil price halving in 2014, and again in 2015, was the basic global imbalance of supply and final demand: supply was, in certain months, running as much as 2 mb/d in excess of final demand (the gap being global stock building). Such excess supply suggested that a rebalance, through the price mechanism, was inevitable. Many posit, not least given recent interruptions, that rebalancing has now run its course, and that prices stand to rise, perhaps markedly, hereafter. US stock levels, however, might well suggest otherwise. The process could be far from over.

If the market is yet to rebalance fully, the implications for the price of oil seem clear: the market may not have yet reached its low. Moreover, any rise in price might encourage further stock building, delaying rebalancing, and resulting eventually in a larger price correction.

Watch for

- Oil stocks continuing to rise (or fall), and the oil price falling (continuing to rise). ■

Figure 1: US commercial stocks of crude oil, 1983-2016



Source: U.S. Energy Information Administration

Note: Excluding Strategic Petroleum Reserve (SPR)

#Comment: To the extent that oil stocks continue to rise, the more the oil price stands eventually to fall

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