



THE SPECIALIST IN TRADING AND INVESTMENT

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Brent crude approaches the danger zone

Ole S. Hansen, Head of Commodity Strategy

The price of Brent crude has rallied strongly during the past month and yesterday it reached the highest level since last August when the market was still coming to terms with the loss of Libyan oil. The rally has been driven by numerous geo-political events which collectively have increased the risk of supply disruptions from countries, such as Libya, Syria, Nigeria, Sudan and not least Iran, the world's third-largest oil exporter.

Yesterday's spike to 120 dollars per barrel occurred after Tehran's state media announced a pre-emptive strike ahead of the July European embargo of Iranian oil by halting supplies to six European countries. Although later denied by the oil ministry it nevertheless highlights the increased sense of unease with so much of the world's production and especially all of its spare capacity originating from the area around the Persian Gulf.

Since the middle of December and especially during the last month oil traders have been reacting to this by focusing solely on the supply side risk and as a result have accumulated long positions of Brent and WTI crude as the risk of a sharp move has been decidedly skewed towards higher prices. Compounding the geo-political risk are freezing temperatures in Europe which have increased competition between Asian and European buyers of Brent crude, where production is running at low levels, and as a result the physical market has seen an increased tightening and subsequent demand for spot deliveries which has driven spot prices higher than deferred.

During the same period the doubts about the demand side have been given little attention despite both OPEC, the International Energy Agency revising down its forecasts for oil demand growth in 2012 primarily due to the impact of the Eurozone debt crisis and a still fragile global economy. As the price of oil has continued to rise so has the direct tax on global consumers with more of the world's disposable income being spent on oil. This eventually (and just like in 2011) carries the risk of weaker fundamentals followed by weaker prices. At the current levels Brent crude is trading 7.5 percent above the 2011 average and priced in Euros it is less than two percent from the 2008 peak as the rally in oil has been accompanied by a strengthening dollar.

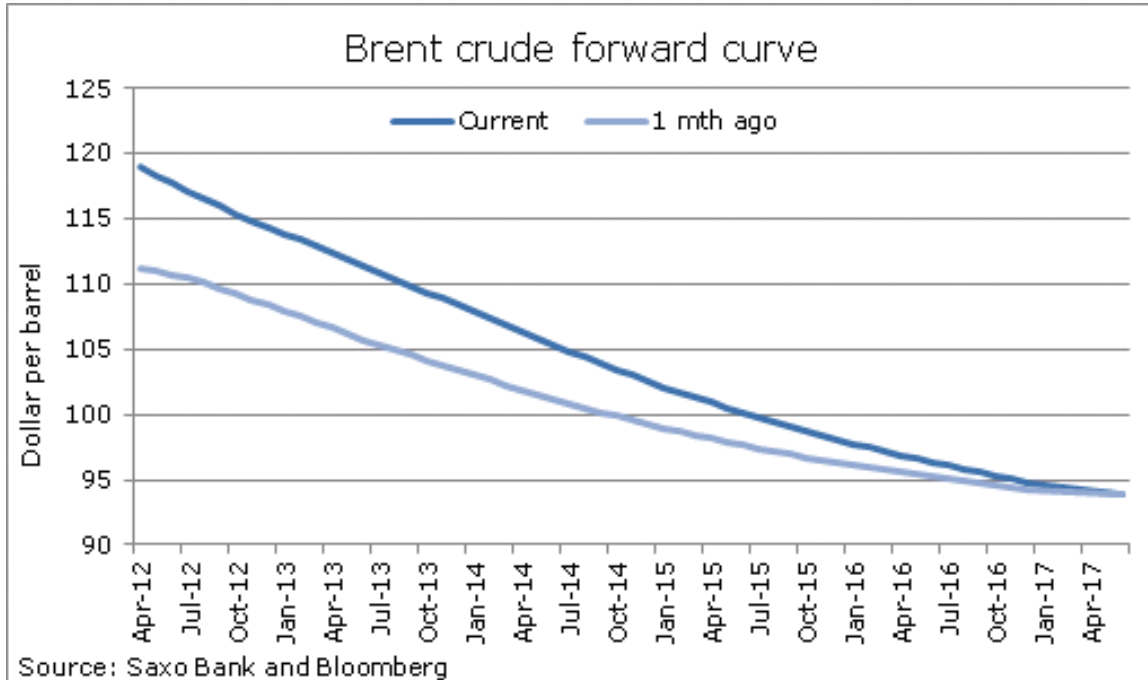
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The above mentioned tight conditions in physical markets combined with the fact that most speculative long positions are held in the front end has resulted in a big shift in the oil curve. During the past month the price for spot delivery has rallied more than seven dollars while further out the curve the price has hardly changed. The downward slope also called backwardation reflects this tightness as the price for immediate delivery trades at a premium to future deliveries.

With the focus squarely on the risk of supply disruptions oil markets will remain supported but as prices stay elevated or move even higher focus will begin to shift towards demand destruction which eventually carries an equal risk of sharp downside correction. The next few weeks could be significant as we move towards the parliamentary election in Iran on 2 March and efforts to avoid a Greek default become more frantic. Furthermore how will commodities and energy in particular react to stock markets which seem to be hitting a soft patch at a time where the dollar looks set to strengthen again?

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Ole Sloth Hansen is a specialist in all traded Futures, with over 20 years experience both on the buy and sell side. Hansen joined Saxo Bank in 2008 and is today Head of Commodity Strategy focusing on a diversified range of products from fixed income to commodities. He previously worked for 15 years in London, most recently for a multi-asset Futures and Forex Hedge fund, where he was in charge of the trade execution team. He is available for comments on most commodities, especially energies and precious metals.

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