Inflation By Any Other Name: Iran to the Rescue???
2/23/22

In its simplest form, inflation is defined as too much money chasing too few goods. That has held true for the energy markets as well, with too much demand chasing too little supply. Even with the sharp increase in 2021/22, U.S. production will still fall short of the 2019 levels.

Oil inventories declined steadily throughout 2021 both globally and in the U.S. Prices rose accordingly, and in an August note we suggested that we would be range-bound with prices trading between $70-90/BBL. Many analysts believe that the stock declines of 2021 will be reversed in 2022.The stock build is likely to occur early second quarter, so we are less pessimistic as to the size of the stock builds. A number of independents have proclaimed that their production targets won't be impacted even if prices move above $100.

There continues to be a shortage of skilled labor, sand, truckers and trucks, as well as an explosion of inflation in the shale sector. Exxon and Chevron have announced sharp increases in production for 2022 along with some private oil companies, but the outlook for an increase of 800,000-1MillionB/D this year could turn out to be overly optimistic.

OPEC+ has also fallen short of market expectations. Their monthly quota increases have been 400,000B/D. Yet they have barely been able to produce two thirds of that since a number of countries have been unable to reach their monthly allotment. More countries over the next several months will be in that situation.

In May, the quotas increase for 5 members Saudi Arabia, Russia, UAE, Kuwait, and Iraq, and actual production could slightly exceed 400,000B/D. That's the good news. A problem may be brewing inside Saudi Arabia. We may already be seeing a short-term problem with

Russian capacity. Under the new May agreement, the Saudi quota increases about 150,000B/D monthly through September. That would place the Saudi quota at over 11.1MMB/D by then. While the Saudis have stated that their sustainable capacity is 12.1MMB/D, there is reason to believe that it is visibly lower. The question on the table is: will the Saudis let their production rise to the quota level and leave themselves with only operational space and not a comfortable strategic level of spare capacity? They and the Russians might choose to freeze their production levels in July - September below their quota levels.

And then there is Iran. Ironically, the Iranian oil might be needed this summer if prices are to remain range-bound. The Saudis are already in talks with Iran suggesting that when sanctions are lifted the Iranians would come back into the quota fold. If the Russian and Saudi capacity issues are real, than the Iranian oil could turn out to be complimentary and not competitive, as the market currently assumes.

In 2014 there were no energy sanction of note imposed by the U.S nor NATO on energy. We believe in tic tac toe. There would be no winners if energy sanctions were included in the first round of sanctions on Russia, nor do we believe that the Russians would take the initiative and cut supplies on their own.

P.S. The fear that the current political situation in the Ukraine might lead to a further explosion in energy prices may at least in the first phase be overblown.