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Insight

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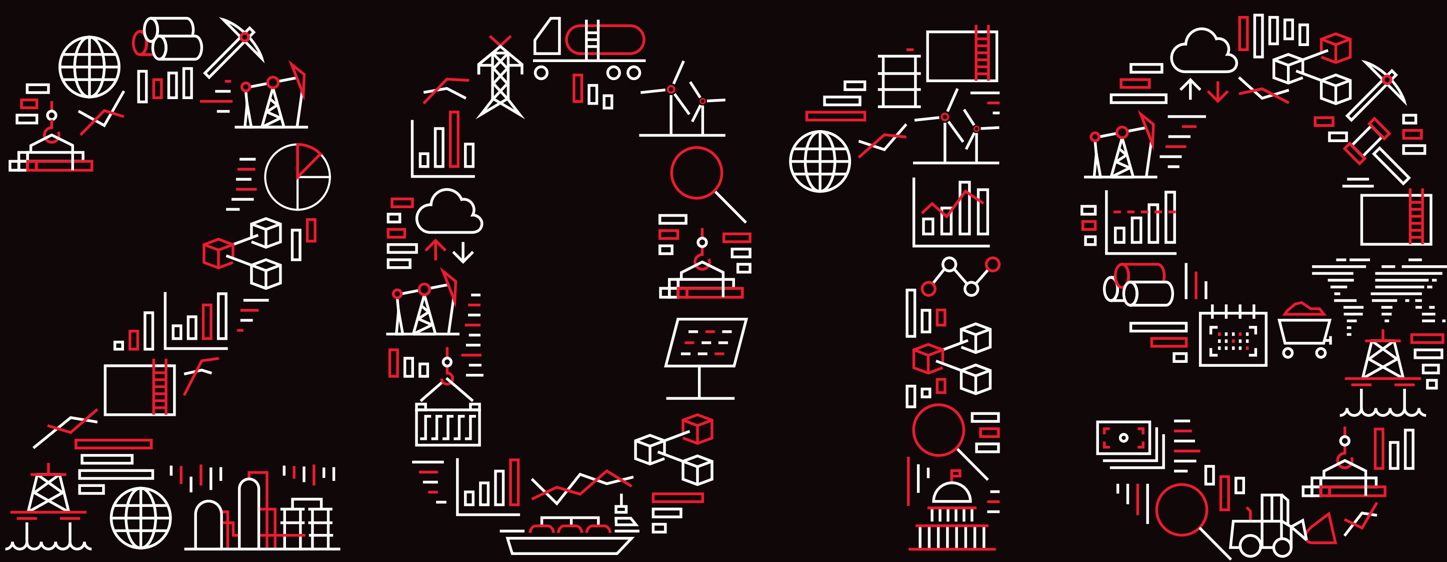
The five themes to watch next year

US midterm elections: energy impact

How blockchain could disrupt commodities

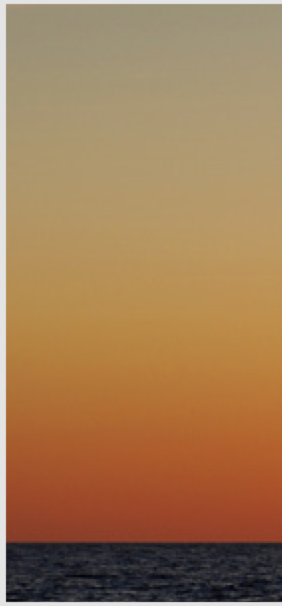
Disruptors, dealmakers and new developments

Looking ahead to



Five commodity themes for 2019

As the curtain closes on 2018, what will be the five themes to watch in energy and commodity markets during 2019? Martin Fraenkel delivers his verdict



After a year of seismic shifts in policy, geopolitics and trade, 2019 could be eventful. The landscape for commodity markets is also changing rapidly. During the last few years, the fundamentals of supply and demand were the main drivers for commodity markets. However, as was the case during the 1970s, geopolitics is now increasingly influencing decision-making across all parts of the resources industry from the well head to the trading floor.

Although trade flows remain an important driver for commodity markets to focus on, we see factors such as technology disruption, policy change and trade barriers increasingly influencing prices.

Despite the world's growing demand for oil, which is expected to average 100 million b/d for the first time ever, concerns over climate change and the energy transition in mobility will remain in the background. Looking ahead, heightened levels of risk, new disruptive technologies and political uncertainty could make 2019 a year when the unpredictable becomes the norm.

Geopolitical risk: the only certainty is uncertainty

Geopolitical tensions in some of the world's major resource-producing regions could intensify in 2019. The Middle East will be at the forefront of these risks as US sanctions bite into Iran's crude exports.

Saudi Arabia – the region's largest producer of oil and its biggest economy – could also emerge as a concern if social reforms backfire. The actions of Riyadh's political elite have come under increasing international scrutiny. How the kingdom reacts to these challenges could be a major factor driving oil prices in 2019 and beyond.

Meanwhile, traders will continue to closely monitor the Middle East's key oil export routes through the Strait of Hormuz and Red Sea for any potential disruptions.

Russia's evolving relationship with the US could be another major geopolitical narrative in 2019. The world's largest producer of energy and commodities has increasingly clashed with the biggest consumer of crude in a way not seen since the Cold War. This bilateral relationship is a key driver for commodity markets. Moscow is increasingly encroaching on traditional areas of US influence in the Middle East. The Kremlin also faces the prospects of tightening sanctions and ongoing condemnation.

Of course, commodities markets could also shrug off all of these concerns in 2019. Greater co-operation between OPEC and partners outside the producer group led by Russia is a source of optimism. The grouping – which controls 45% of global oil supply – has shown discipline in reducing the global stocks overhang and looks increasingly aligned on policy despite political tensions. Maintaining its discipline will be crucial to supporting prices in 2019, especially in such a fraught geopolitical environment.

Offsetting these geopolitical concerns is the continued strong performance of North American shale producers. The US is currently producing 11 million b/d and output is forecast to climb even higher, ensuring markets are well supplied in the event of shocks.

Trade wars: US and China lock horns

Deteriorating trade relations between the world's two largest economies has already had a visible impact on energy flows. Oil prices have been dampened due to concerns of a slowdown in demand, but LNG markets could also face significant long-term headwinds from their ongoing trade war.

China is Asia's biggest oil consumer. Before trade tensions escalated, crude flows from the US to China had almost tripled through both term contracts and spot market purchases. In June, US exports to China hit 450,000 b/d, accounting for 5% of the country's total crude import bill. However, US shipments have been falling since June on escalating trade tensions, with more US crude being diverted to other customers in Asia.
S&P Global Platts sees consumers in Southeast Asia buying more US crude and this trend could become more visible in 2019.

Simultaneously, Chinese refiners are actively looking to diversify their spot exposure by securing volumes from wide-ranging destinations, including Europe, Africa, Canada and Latin America. Meanwhile, Beijing imposed a 10% tariff on US LNG exports in September. Chinese customers are looking to the Middle East, Nigeria, Southeast Asia and Australia for alternative LNG supplies.

Nevertheless, China's demand for LNG will continue to grow and losing Asia's biggest consumer as a buyer would be a blow for US producers in 2019. If America's trade war with China intensifies then disruptions already being felt in oil and LNG markets will increasingly become apparent across the full spectrum of commodities.

Protectionism: disruptive forces in metal markets

Protectionist policies are having a significant impact on metals markets and this trend is set to continue in 2019. One example is the US administration's decision to impose 10% tariff on aluminum imports, which hit the domestic market by pushing up prices. Sanctions imposed on Rusal – the world's largest aluminum producer – drove prices up further.

Trade policy aside, there have been some US initiatives which have boosted metals demand. Tax and regulatory reforms have energized the US manufacturing base to the point where the National Association of Manufacturers' monthly index reached an all-time high in June 2018 of 63.6 points. In October, the NAM's Outlook Survey, which indicates the percentage of small-to-large manufacturers that are upbeat about their own company's outlook, stood at 92.5% — after posting an all-time high of 95.1% in June. It is a robust indicator of US manufacturing's ability to absorb commodity price fluctuations.

New frontiers: national oil giants eye trading

National oil companies are becoming more involved in traditional trading as direct participants, or joint venture partners, in an effort to boost their profitability.

Middle East-based companies are at the forefront of this emerging trend. Oman Trading International (OTI) was the first regional player to venture into trading via its joint venture with Vitol and S&P Global Platts now sees it is increasingly active in a range of Asian markets, from oil and refined products to petrochemicals.

Aramco Trading Company (ATC) has opened a Singapore office and voiced intentions to move into crude trading. Iraq's SOMO and Russia's Litasco set up a joint venture last year and it is clear the Baghdad-based oil marketing company is looking at how it can be more active in international trading markets. Abu Dhabi National Oil Company (ADNOC) has created a new trading arm in order to maximize returns on every barrel for its stakeholders.

The landscape for traditional players is also evolving. Various trading regimes and market changes have boosted spot activity and created new opportunities in areas such as LNG.

More changes in the trading industry could materialize in 2019.

Technology: commodities 2.0

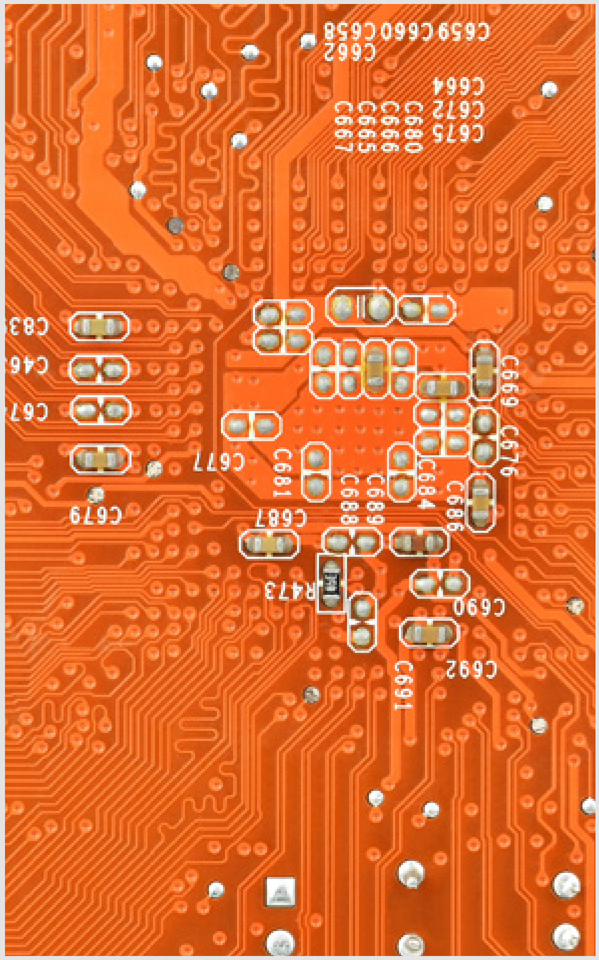
New technology is increasingly bringing efficiencies to all corners of the commodities industry. Blockchain is at the forefront of this trend changing the nature of our markets, where smart contracts are already a reality.

The reconciliation and physical documentation of trade can all now be streamlined securely through an encrypted digital ledger, helping companies to maximize the value of their data and talent. Attendees at the S&P Global Platts Digital Commodities Summit this year saw the seriousness of these efforts to harness the power of blockchain.

Digital processes replacing people, phones and paper trails could significantly reduce trading costs. Blockchain can also reduce the settlement risk and in some instances remove the need for central clearing authorities. Faster know your customer (KYC) processes thanks to more secure, individual and corporate identity management makes it easier to trade with new counterparties. More real-time and interconnected supply chains, with corresponding digital invoicing, shorter payment times and more ways of sharing transaction data may also change the intracompany risk profile and appetite.

Smaller industry players can now benefit from these efficiencies by experiencing fewer barriers to entry, potentially trading without fees, settlement risk, clearing costs, or intensive capital requirements. However, it is still early days for the technology and the pace of its widespread uptake is far from clear.

Data manipulation and interpretation in commodities will also play an increasingly transformative role in 2019. For



decades, successful trading has been focused on nimble operations and scale, but tighter margins have made participants look closer at accessing faster data, instead of operating scale, to gain an advantage.

Fast access to data such as geospatial imagery, smart metering, or better visibility of tankers on water are increasingly giving traders an edge. S&P Global Platts sees data science playing an increasingly core role in multiple decision-making ranging from cross-regional arbitrage to daily stock management. These technologies will increasingly shape our markets in 2019. ■

Martin Fraenkel is President of S&P Global Platts