Troubling Signals from the Oil Market

• Markets unmoved by events in Gulf of Oman
• Oil spiked 4%, but move didn't breach week's high
• Indications are emerging that oil prices are reacting to possibility of global slowdown

The attacks in the Gulf of Oman yesterday morning (coming one month after a similar incident, and a day after an attack on a Saudi airport) revived memories of the Tanker War of 1984 to 1988.

Given the location of the incident yesterday this is also a direct reminder of the strategic significance of the Strait of Hormuz.

The truly interesting thing, therefore, was the relative lack of market reaction to yesterday’s news.

Starting with oil prices themselves, while it’s true that crude prices spiked higher (Brent and Dubai prices were up in the region of 4% at one point) the moves weren’t particularly dramatic when compared to others seen this year.

1. China/Iran: President Xi Jinping tells President Hassan Rouhani that no matter how the situation changes, China will promote the steady development of ties with Iran. (via Reuters)

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Indeed, it’s worth recalling that Brent prices saw a 7% daily drop back at the end of May. It’s also worth noting that yesterday’s moves didn’t even manage to breach this week’s highs.

Given that about 18.5 million barrels a day travels through the Strait, this seemed telling.

The response from the FX markets was also interesting. About 80% of the oil travelling through the Strait heads for Asian markets, with China, Japan, India, South Korea, and Singapore the largest destinations.

It was therefore telling that none of the related currencies showed any particular response to the news.

Similarly, oil-related currencies such as the RUB and NOK couldn’t even break out of their previous day’s ranges against the USD. A similar story applied to safe haven currencies, with the JPY barely moved while the CHF move had far more to do with post-SNB relief than anything else.

Oil prices are beginning to react to the possibility of a global slowdown

Why does this matter?

My New York-based colleague John Velis has pointed out that the NY Fed’s regular Oil Price Dynamics Report helped highlight that while oversupply had been the key dynamic for oil prices, they were seeing demand factors starting to weaken as well.

In other words, oil prices are beginning to react to the possibility of a global slowdown (much as they did in the summer of 2008).

The relative lack of reaction in the oil market yesterday to a supply side issue would seem to suggest this is indeed the case.

This, in turn gives a slightly clearer picture of how the ripples from the trade tensions could play themselves out in the FX markets beyond some of the typical commodities and currencies normally discussed with regard to China. In particular bring into focus currencies such as the CAD.

2. OPEC/Russia: The Nikkei cites Russian energy minister Alexander Novak as saying that OPEC and other producers including Russia are in final talks for an agreement, that may be signed in early July, to cooperate on oil supplies on a long-term basis. >

3. China/US/EU: China says that it is raising anti-dumping duties on certain alloy-steel seamless tubes and pipes used at utilities and imported from the United States and the European Union. >

4. China/currency war: Former PBOC governor Zhou Xiaochuan says: “If the trade war breaks out, it will easily bring changes to the exchange rate, and it is likely to challenge the consensus reached in the past to prevent competitive devaluation.” >
NOK and RUB. It’s even possible that some mild impact could be felt by currencies that have heavyweight oil companies in underlying stock indices such as GBP.

Please direct questions or comments to:

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On the Radar

June 14, 2019

• US May retail sales (1330 BST): Reuters consensus forecast 0.6% m/m; previous -0.2% m/m

• US May industrial production (1415 BST): Reuters consensus forecast 0.2% m/m; previous -0.5% m/m

• US U Mich sentiment (prelim) (1500 BST): Reuters consensus forecast 98.0; previous 100.0

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