RJO Previews and Perspectives for Tuesday, Sep 17

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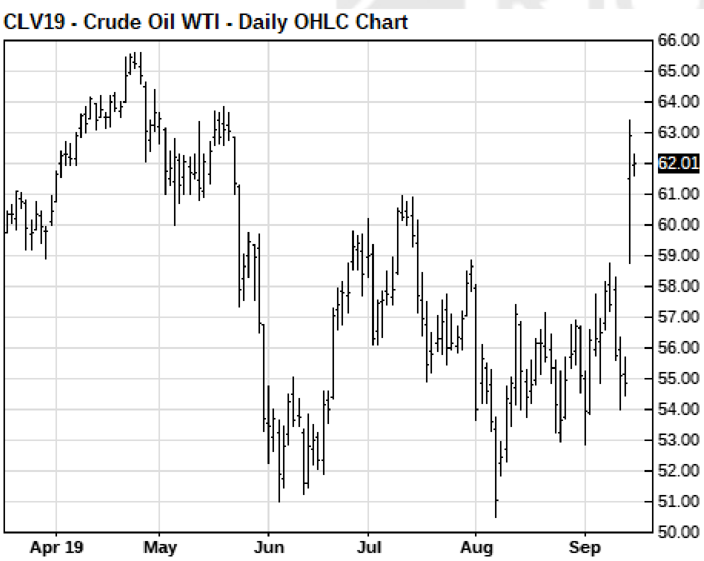
Oil price direction now depends heavily on whether U.S. retaliates -- Nov Brent crude oil prices on Monday spiked to a 5-month high of $71.95, where the contract was up +19.5% on the day. However, Nov Brent then fell back and closed the day up +8.80 (+14.61%) at $69.02. Oil prices rallied sharply on Monday but only returned to the area seen last spring.

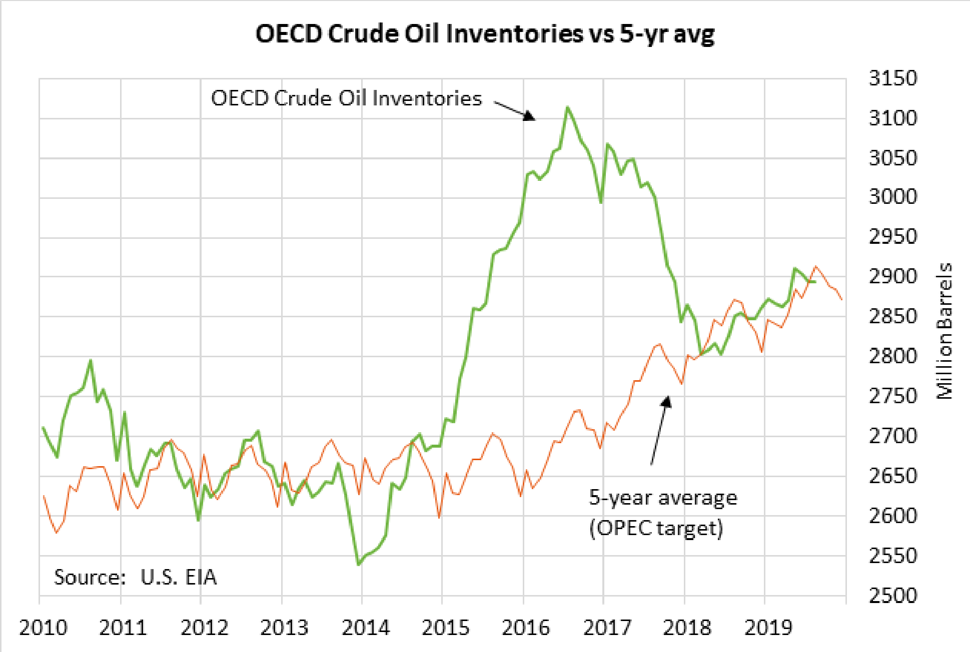
The drone attack on Saudi Arabia's most important oil processing center managed to knock out about 5 million bpd, or half, of Saudi Arabia's oil production, which represented about 5% of world oil production. Damage estimates increased during the day and Saudi Arabia is now indicating it will take months to recover all the production.

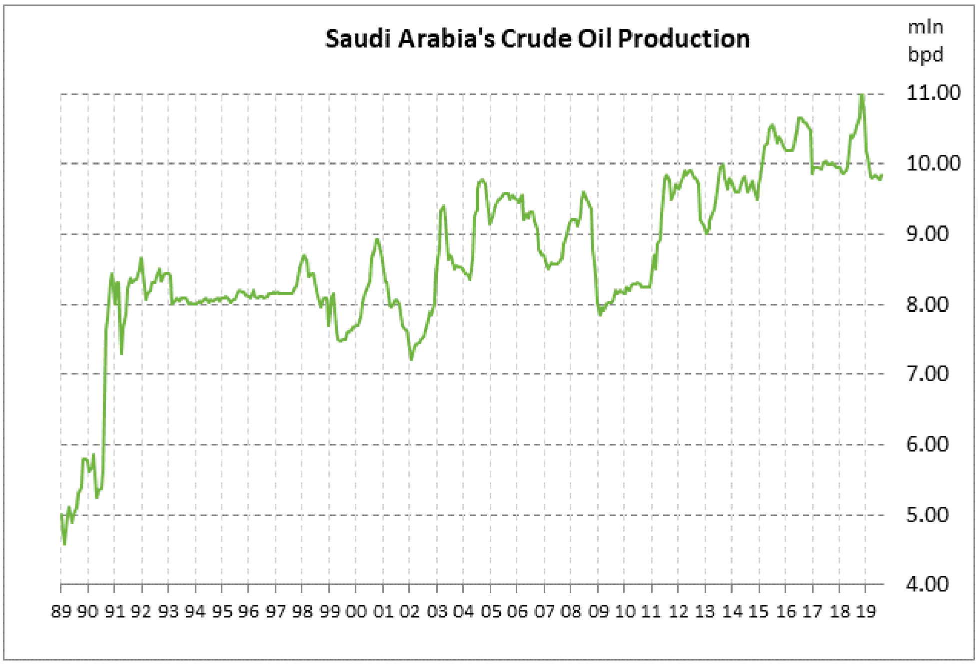
The good news is that the price spike was curbed by the fact that world oil production is now much more diversified than it was decades ago. Big producers now include Russia and the U.S., as well as other non-OPEC countries such as China, Canada, India, Mexico, Norway and others. In addition, the world is holding extensive quantities of oil in storage, which provide a buffer to the lost Saudi production. Indeed, President Trump on Sunday said that the U.S. would release oil from its Strategic Petroleum Reserve, as necessary, to stabilize oil prices.

World oil inventories are currently at relatively high levels since OPEC+ has not cut production by enough to bring inventories back down to the levels seen in 2014 before U.S. oil production surged and Saudi Arabia began its ill-fated attempt to preserve its market share. There are currently about 2.9 bln barrels of stored oil inventories in OECD countries, close to the 5-year average, but 200 mln barrels above the 2.7 bln barrel level seen in late 2014. The world oil markets can absorb the hit to Saudi Arabia's oil facility, assuming there are no new attacks on other Saudi oil facilities, which have now been exposed as relatively easy to hit.

A significant part of Monday's oil rally was due to uncertainty about whether the U.S. and/or Saudi Arabia will retaliate against Iran with military action. Saturday's attack constitutes an act of war against Saudi Arabia if the attack was directly launched by the Iranian government. President Trump contributed to fears that the Persian Gulf might be engulfed in an all-out war after he said on Sunday that the U.S. was "locked and loaded." Yet, if there is no military response, or only a proportional response, then some of the current premium in oil prices will likely be drained from the market.







US/Chinese deputy level talks reported for Friday -- U.S. Chamber of Commerce CEO Donohue on Monday said that the U.S. and China will hold lower-level talks this Friday and will hold high-level talks within the next 1-1/2 weeks. Mr. Donohue apparently got his information after talking with USTR Lighthizer on Monday. The markets have been expecting lower-level talks some time this week, followed by high-level talks in early October.

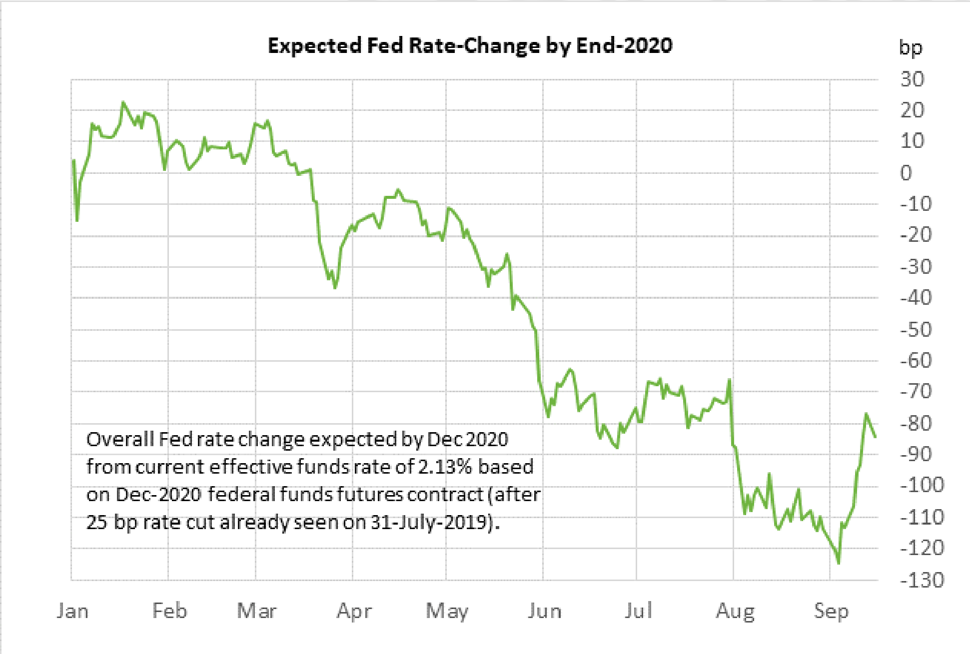
The markets are hoping that the U.S. and China in the upcoming talks can make some progress on a so-called "interim" agreement whereby President Trump holds off on new tariffs and possibly rolls back the Sep 1 tariffs in return for Chinese ag purchases and commitments on IP protections.

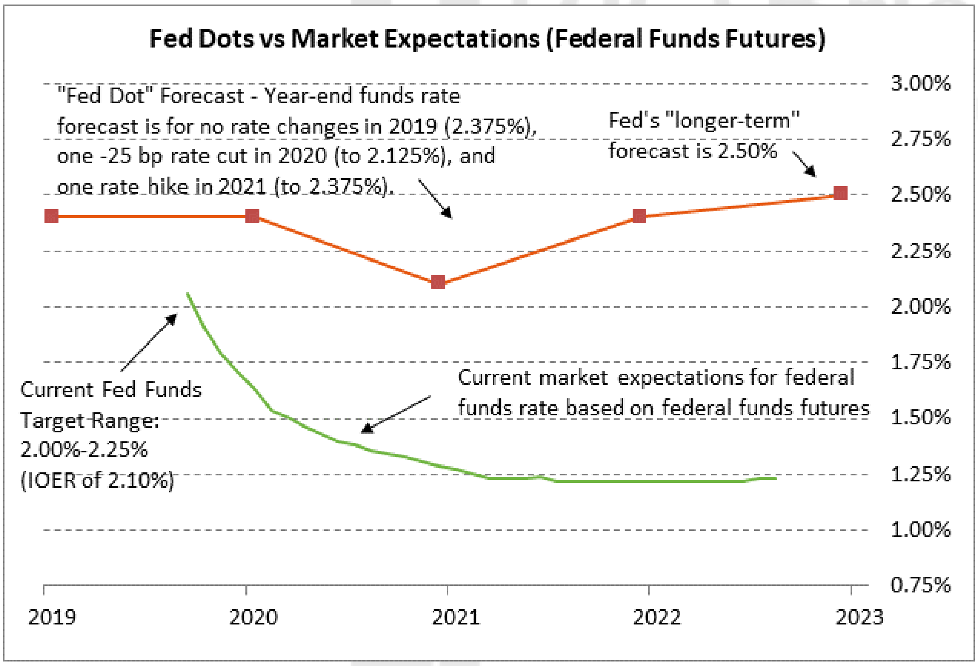
U.S. tariffs over Airbus are coming soon -- The U.S. is expected to soon announce WTO-sanctioned tariffs on about $25 billion of European goods after the WTO last Friday ruled in favor of the U.S. claim that the EU improperly subsidizes Airbus. However, the EU is not far behind with its WTO action against the U.S. for subsidies to Boeing. Europe will then retaliate with its own sanctions. Meanwhile, the broad US/EU trade talks to avert U.S. tariffs on European autos have yet to even begin.

PM Johnson has a bad day in Europe -- UK Prime Minister Johnson on Monday met with European Commission President Juncker in talks that Mr. Juncker described as "good." However, Mr. Johnson was then lambasted after meeting with Luxembourg's Prime Minister Bettel, who said Brexit is a "nightmare" and that there are "no concrete proposals at the moment on the table." He added, "We need written proposals" and that Mr. Johnson should "stop speaking and act." For his part, Mr. Johnson refused to appear at a joint press conference with Mr. Bettel because of protesters. GBP/USD on Monday fell by -0.56%.

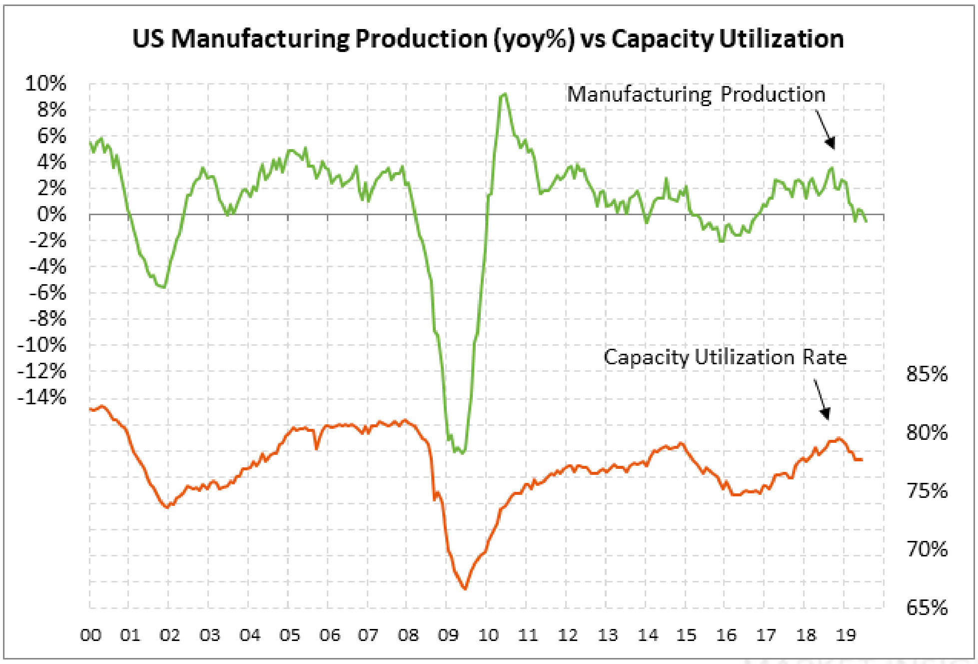
Oil spike locks in an FOMC rate cut for this week -- The market is discounting a 100% chance that the FOMC at its 2-day meeting that begins today will cut its funds rate target by another -25 bp to 1.75%/2.00%. That rate cut became even more certain after Monday's +15% spike in oil prices, which presents another significant downside risk for the global economy.

Since a rate cut is considered a done deal, the markets will mainly key on Fed Chair Powell's assessment of the risks facing the U.S. and global economy and the new Fed-dot projections. The last set of Fed dots released in June are substantially out of date since the median forecast was for no rate cuts in 2019, one rate cut in 2020, and one rate hike in 2020. The FOMC has already made its Fed-dot projections obsolete by implementing a -25 bp rate cut to 2.00%/2.25% at its last meeting on July 30-31.





U.S. manufacturing production expected to show a small recovery -- The consensus is for today's Aug manufacturing production report to show a +0.2% increase, recovering half of July's -0.4% decline. The U.S. manufacturing sector is in weak shape with manufacturing production down -0.5% y/y in July, just above April's 3-year low of -0.6%. The ISM manufacturing index in July fell by -0.5 points to a new 3-year low of 51.2. Meanwhile, Aug industrial production is expected to show a +0.2% gain, reversing July's -0.2% decline.


US Manufacturing Production (yoy%) vs Capacity Utilization
Manufacturing Production
Capacity Utilization Rate
10%
8%
6%
4%
2%
0%
-2%
-4%
-6%
-8%
-10%
-12%
-14%
85%
80%
75%
70%
65%
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