

*Out of the Ordinary®*

 **Investec**

Specialist Bank



# **Dealing with Oil**

## **The Challenge for Consumers**

### **The ERA General Assembly: October 2017**

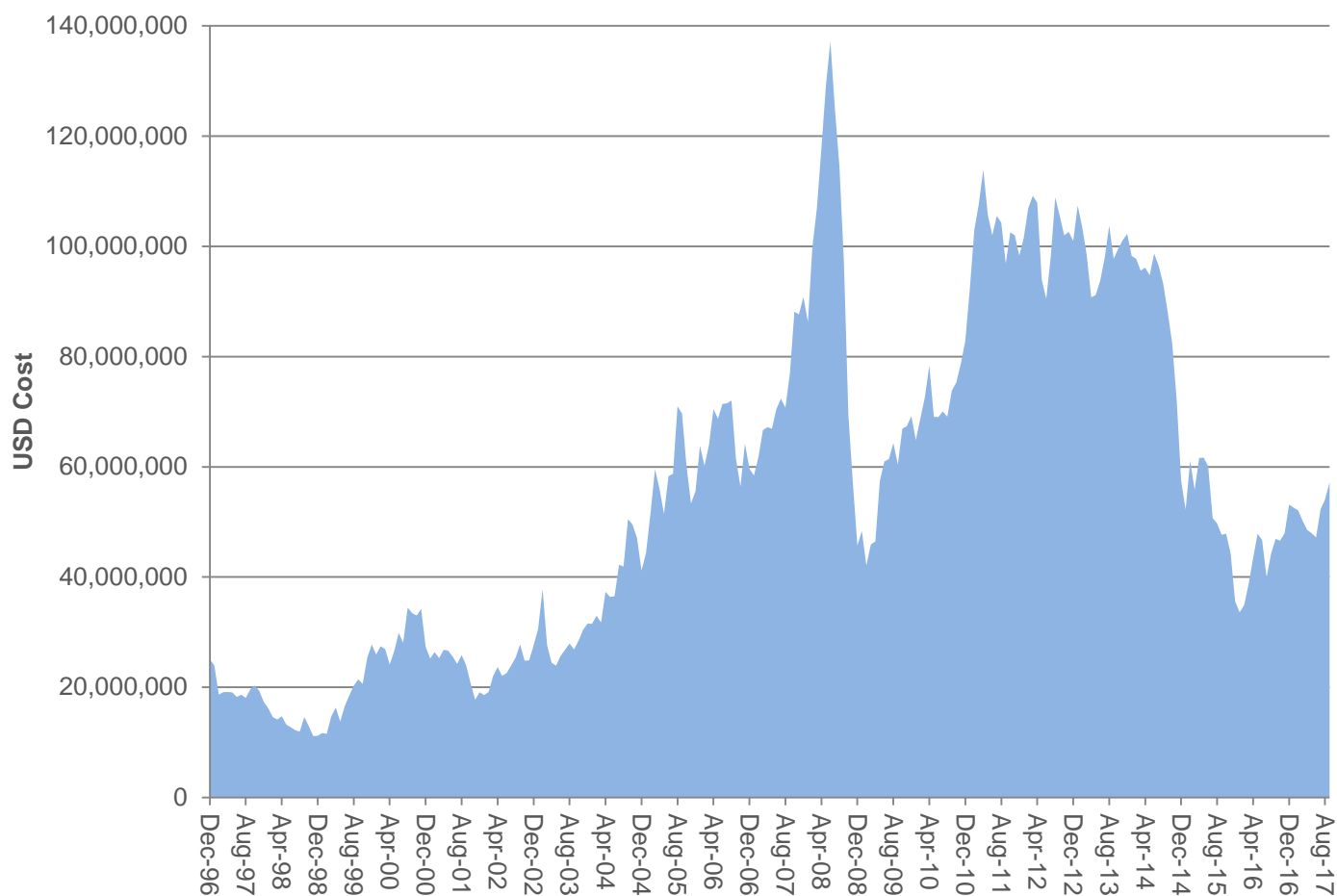
**Callum Macpherson**

Investec Commodities

# The Problem

## The cost of buying 100,000 tonnes of jet fuel

## Summary Statistics



High	\$137m
Low	\$11m
Ave	\$55m
Volatility	32%

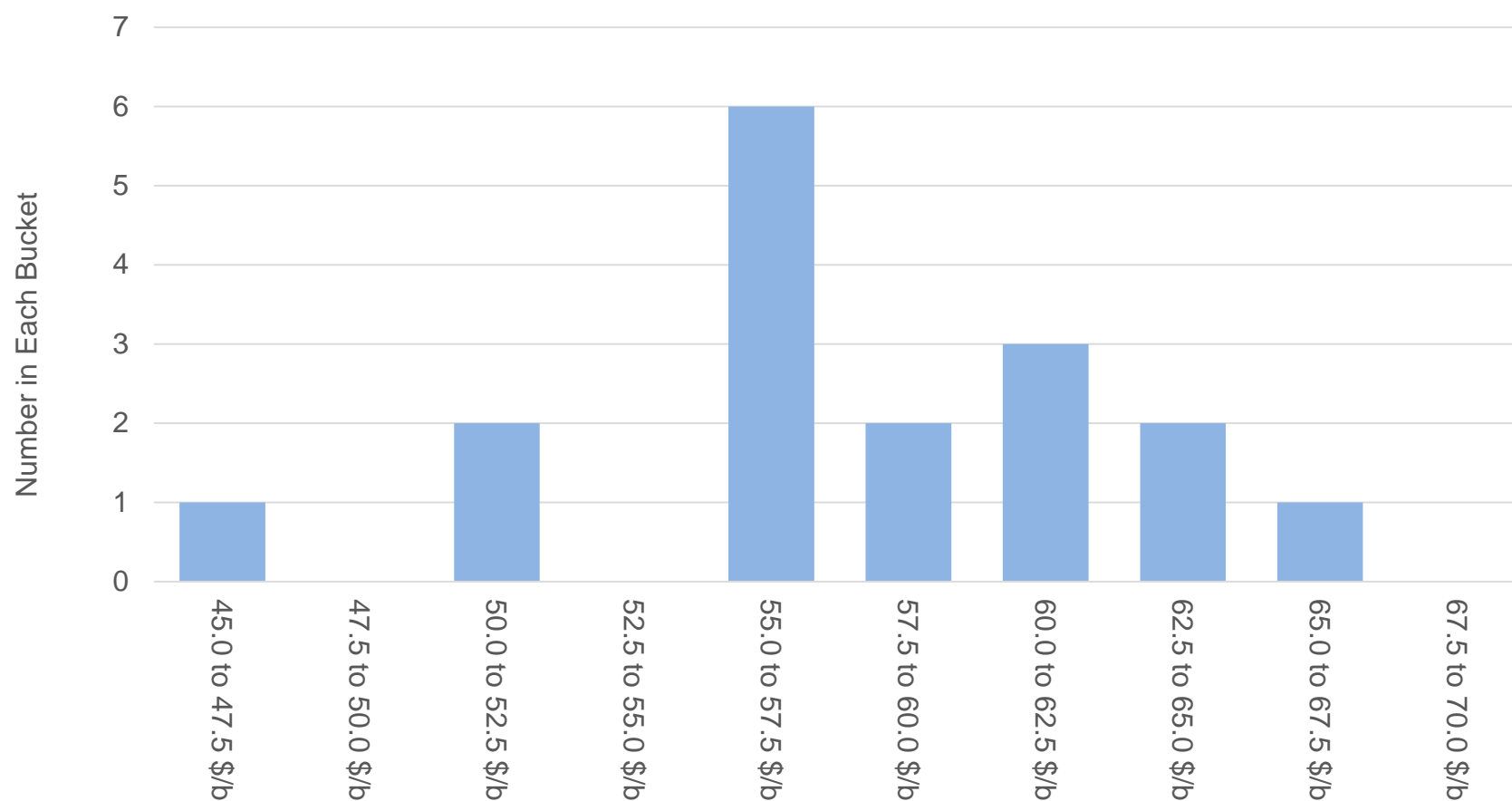
Source: Investec, Bloomberg, Platts



# The Difficulties of Forecasting

# Forecasts Predict that Brent Stays Where it Is

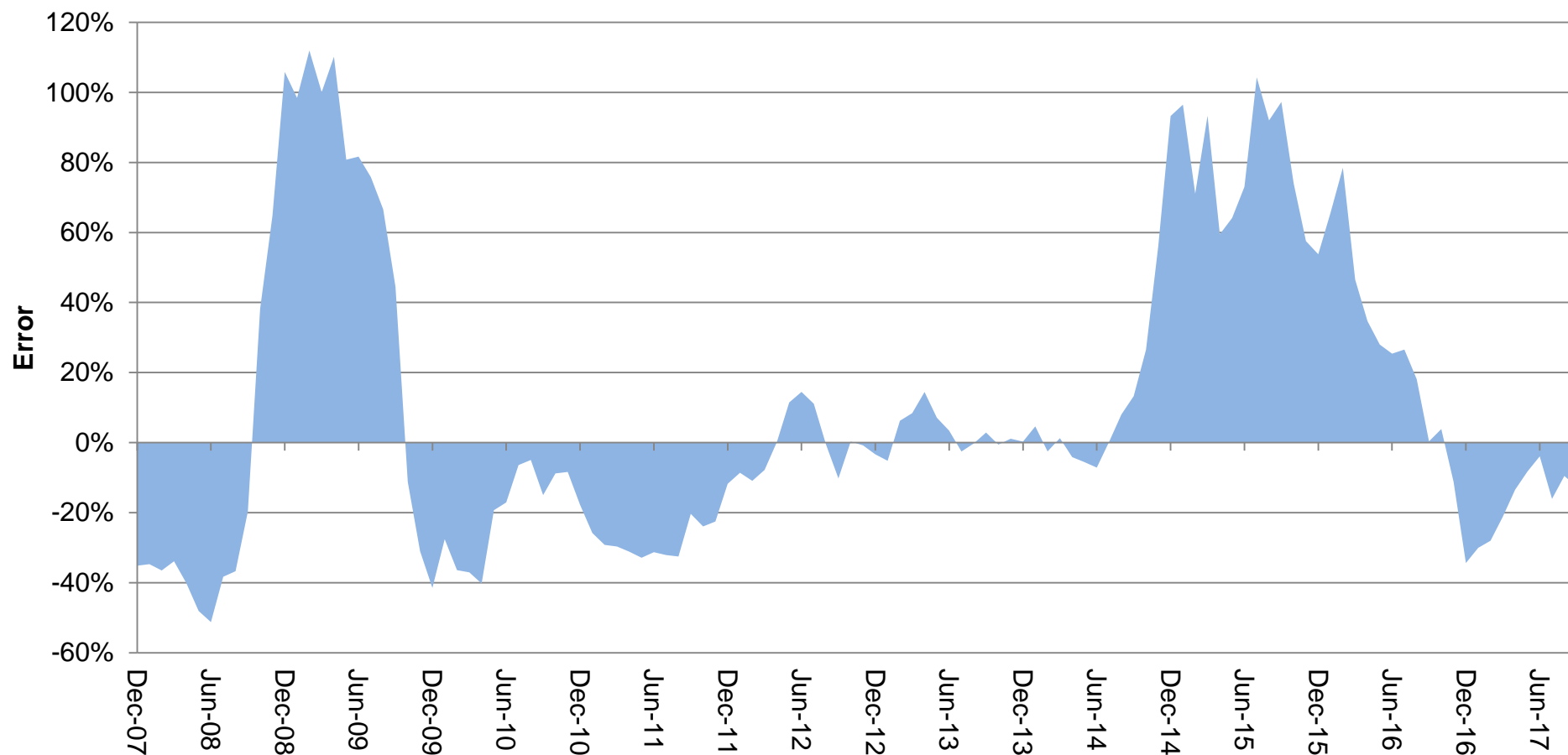
The distribution of forecasts for Brent in Q4-18



Source: Investec, Bloomberg

# The Challenge of Forecasting

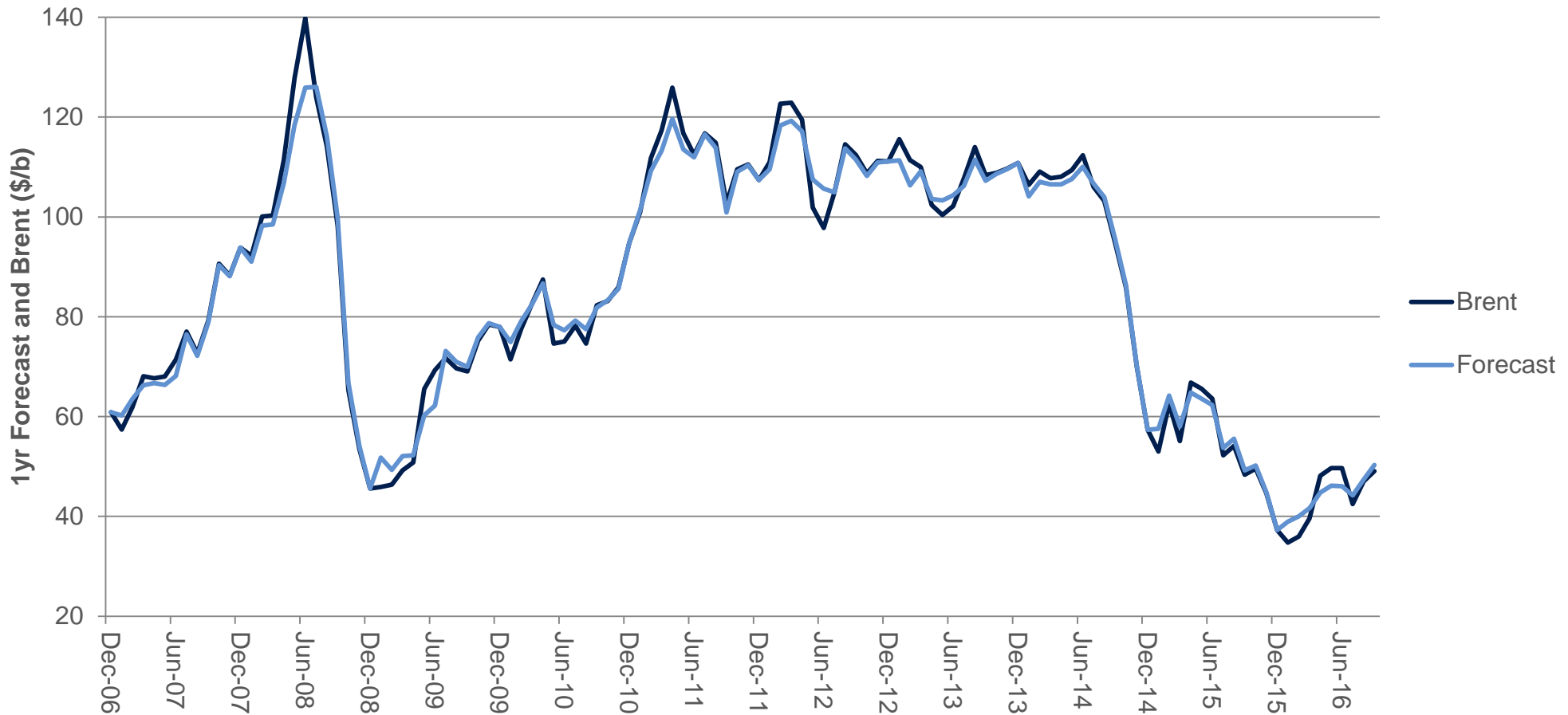
## The error in 1yr analyst Brent consensus forecasts



Source: Investec, Bloomberg

# Forecasts Assume The Current Price is Right

## 1yr Brent forecasts and the price of Brent at the time of forecast



Source: Investec, Bloomberg

# OPEC Production is a Matter of Opinion?

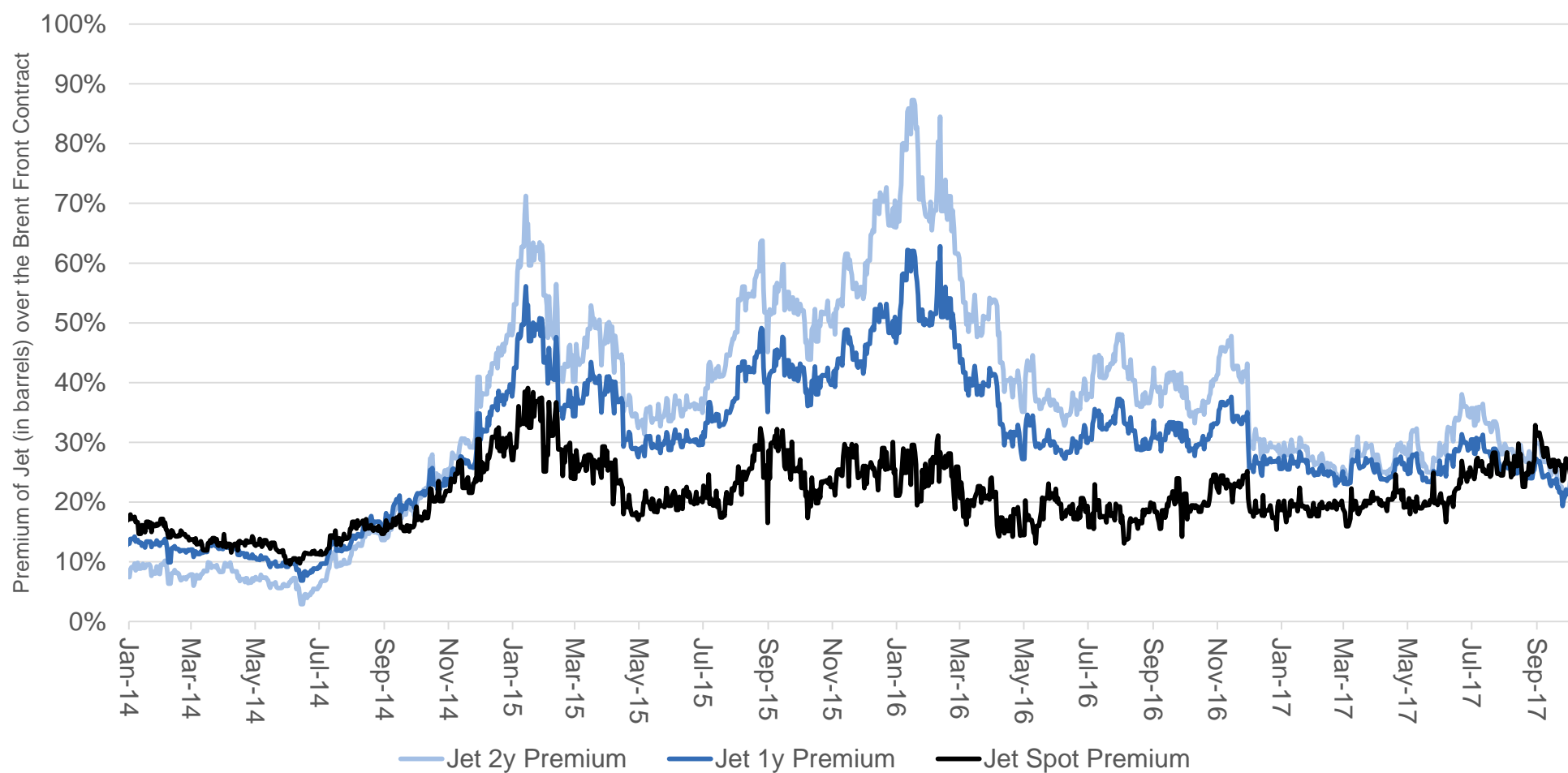
## OPEC Production in October 2016

	OPEC Member Submission (kb/d)	OPEC Estimate (kb/d)	Difference (kb/d)	IEA Estimate (kb/d)
Algeria	1,171	1,088	83	1,120
Angola	1,507	1,586	-79	1,520
Ecuador	542	549	-7	560
Gabon	NA	202	NA	200
Indonesia	NA	722	NA	740
Iran	3,920	3,690	230	3,720
Iraq	4,776	4,561	215	4,590
Kuwait	3,000	2,838	162	2,930
Libya	NA	528	NA	510
Nigeria	1,476	1,628	-152	1,570
Qatar	639	646	-7	620
Saudi Arabia	10,625	10,532	93	10,550
UAE	3,188	3,007	181	3,080
Venezuela	2,316	2,067	249	2,120
		<b>33,644</b>	<b>968</b>	<b>33,830</b>

Source: IEA, OPEC, Investec

# The Brent Front Contract Can Be Misleading

## Jet prices do not always track the Brent front contract



Source: Investec, Bloomberg, Platts

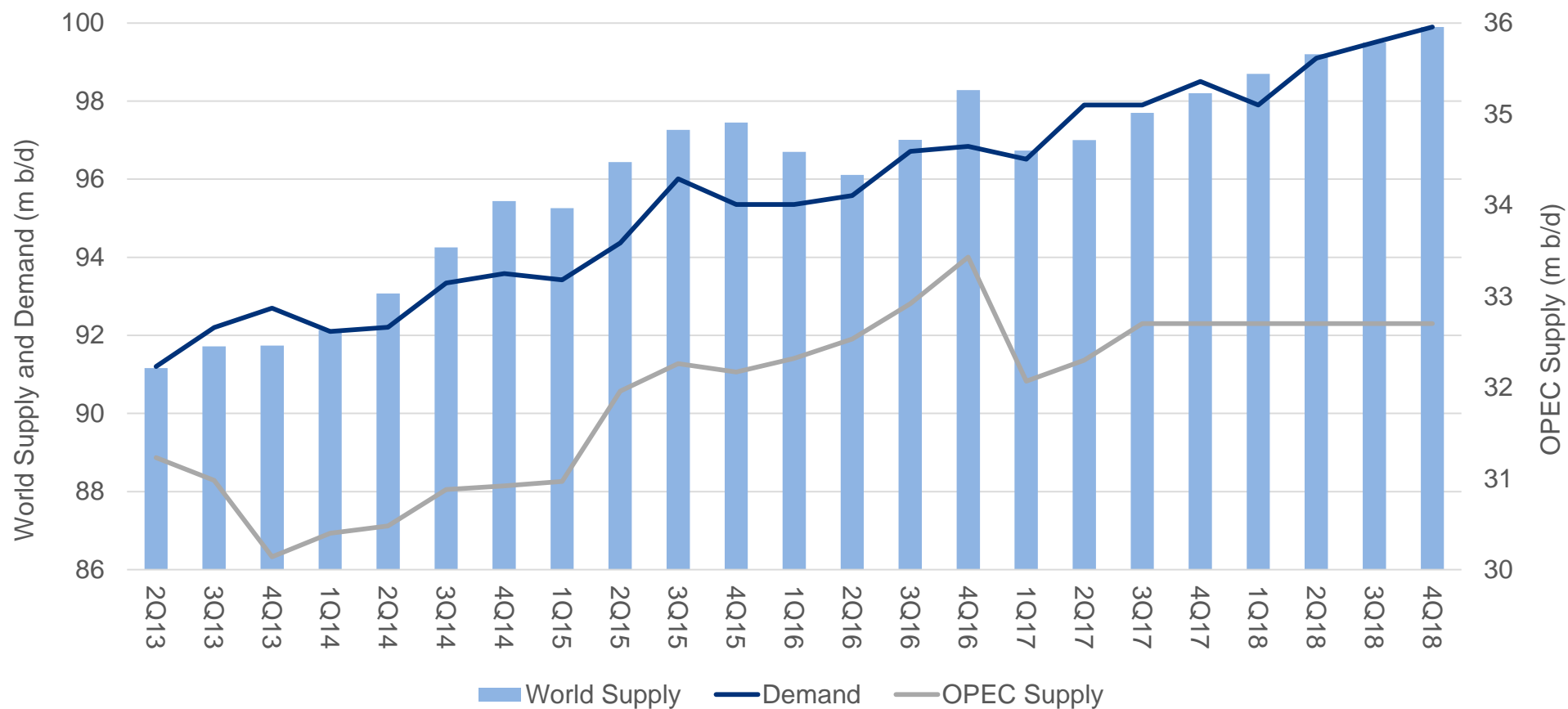




## **Where Do We Stand in the Cycle?**

# The Market is Rebalancing

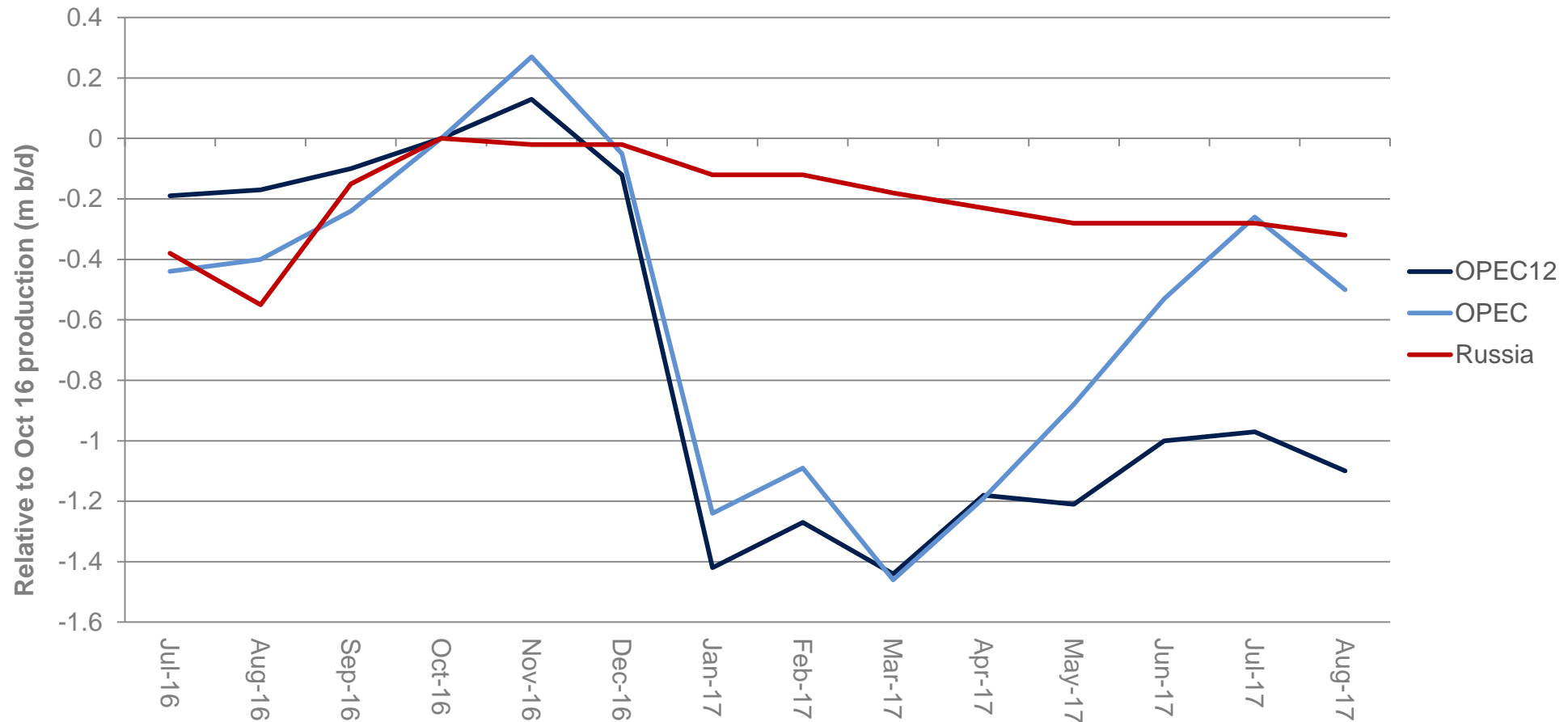
IEA supply and demand figures, with projections from 4Q17



Source: IEA, Investec

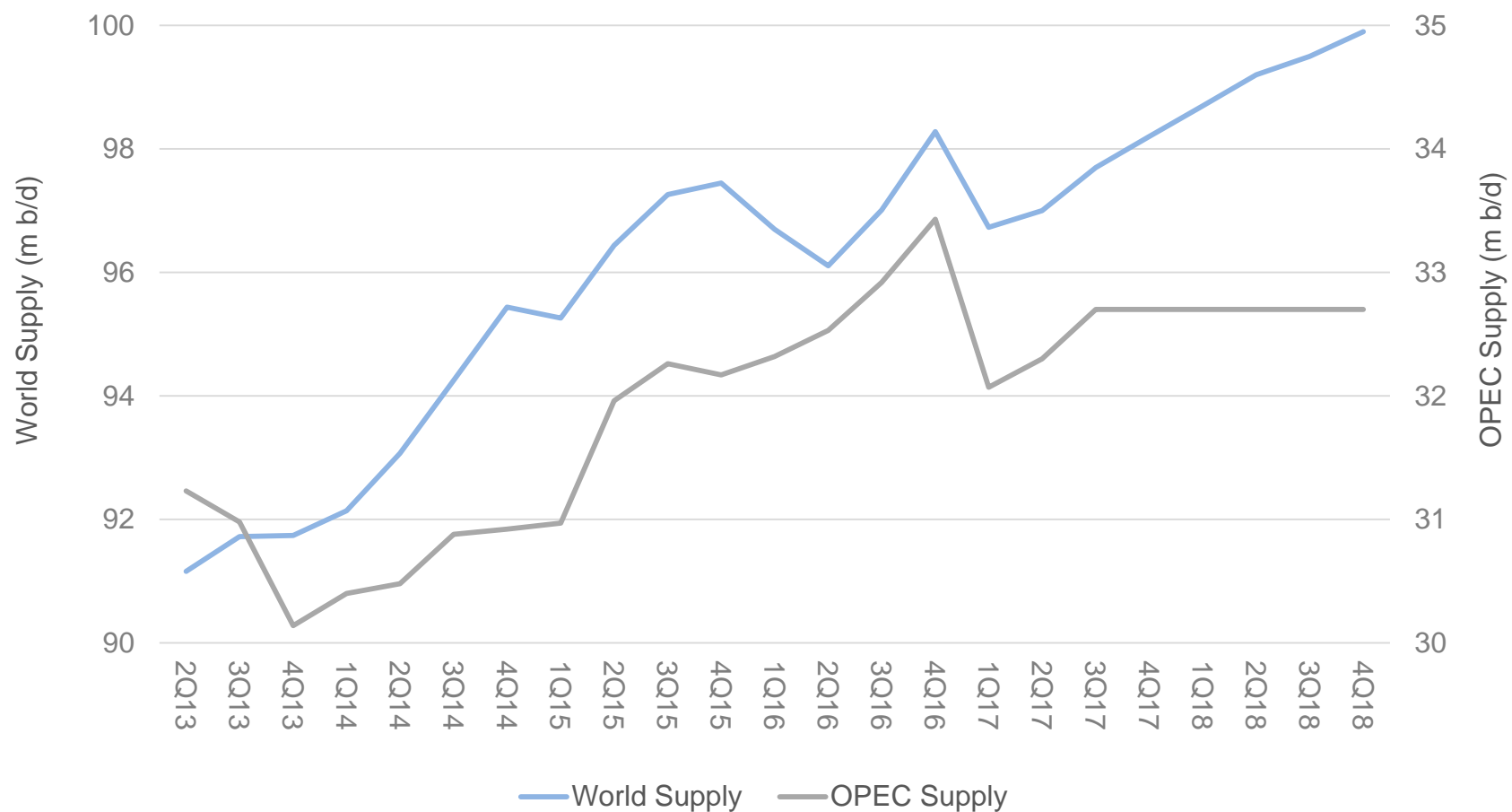
# OPEC/Russia: Appearances can be Deceptive

## Changes in production relative to Oct 16 Reference Point



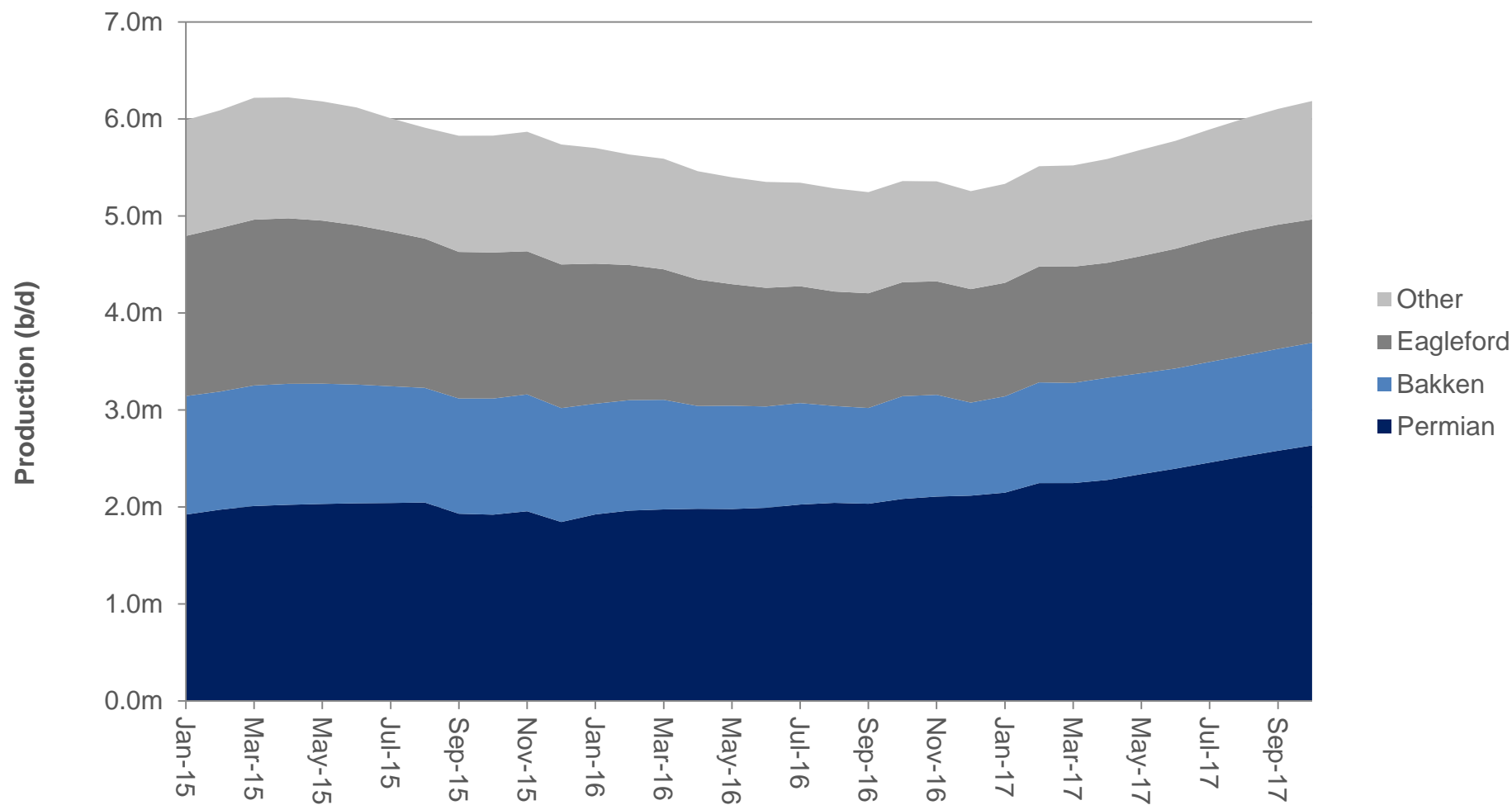
Source: IEA, Investec

# World Supply Has Grown Significantly



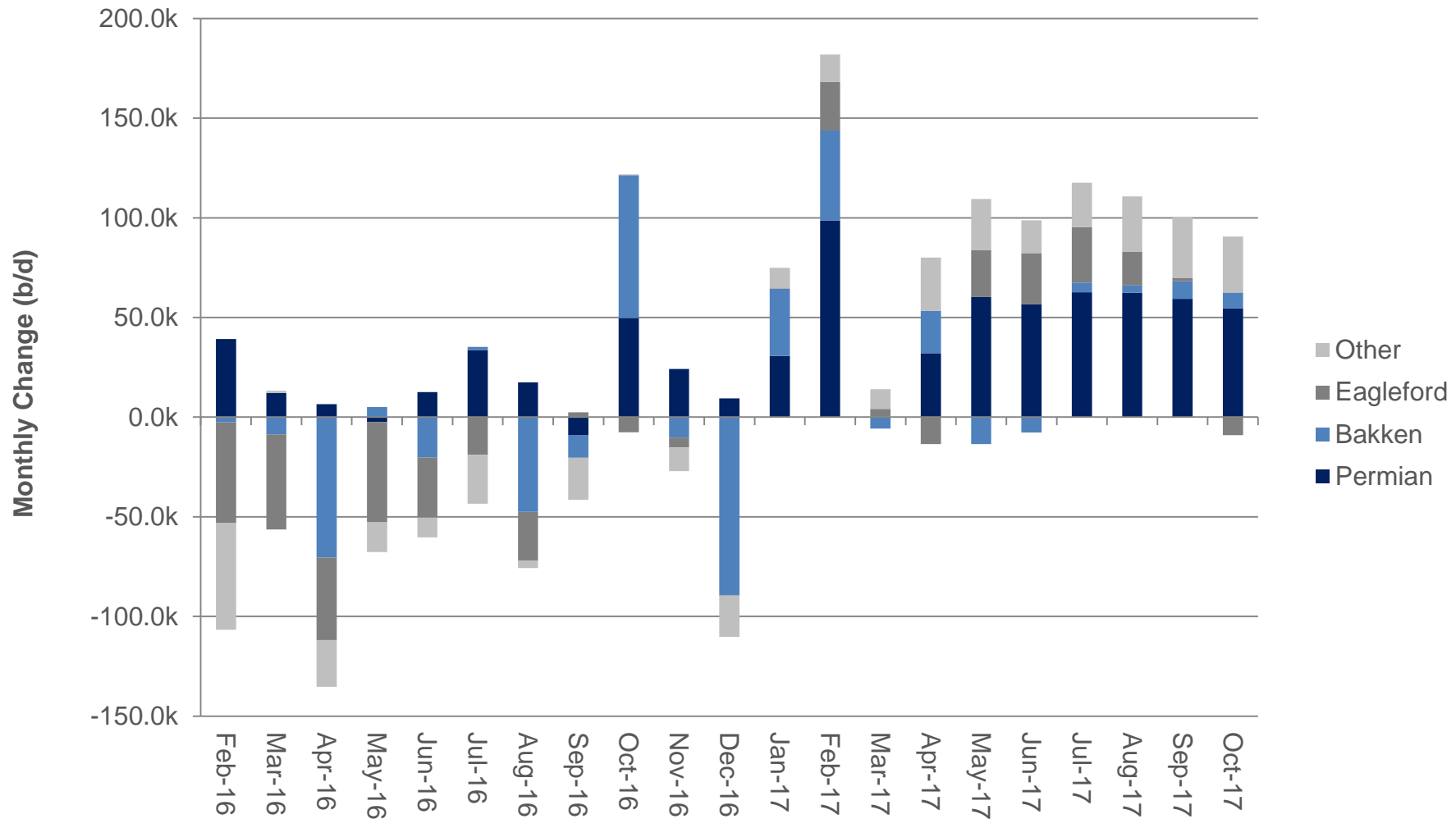
Source: IEA, Investec

# US Shale Production is Back to the 2015 Highs



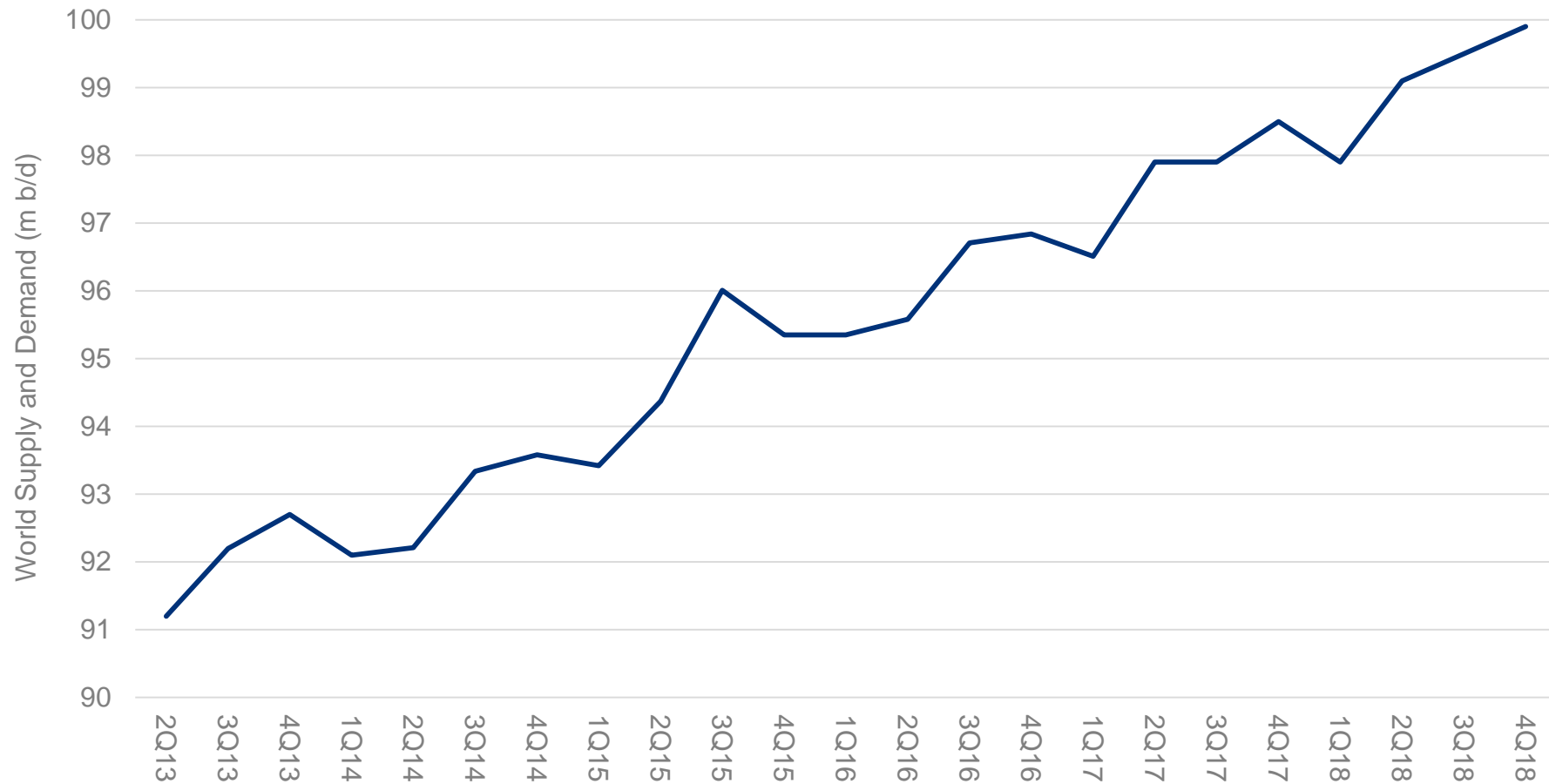
Source: Investec, Bloomberg, EIA

# Shale Production Growth has been Slowing...



Source: Investec, Bloomberg, EIA

# Demand Is the Key



Source: IEA, Investec

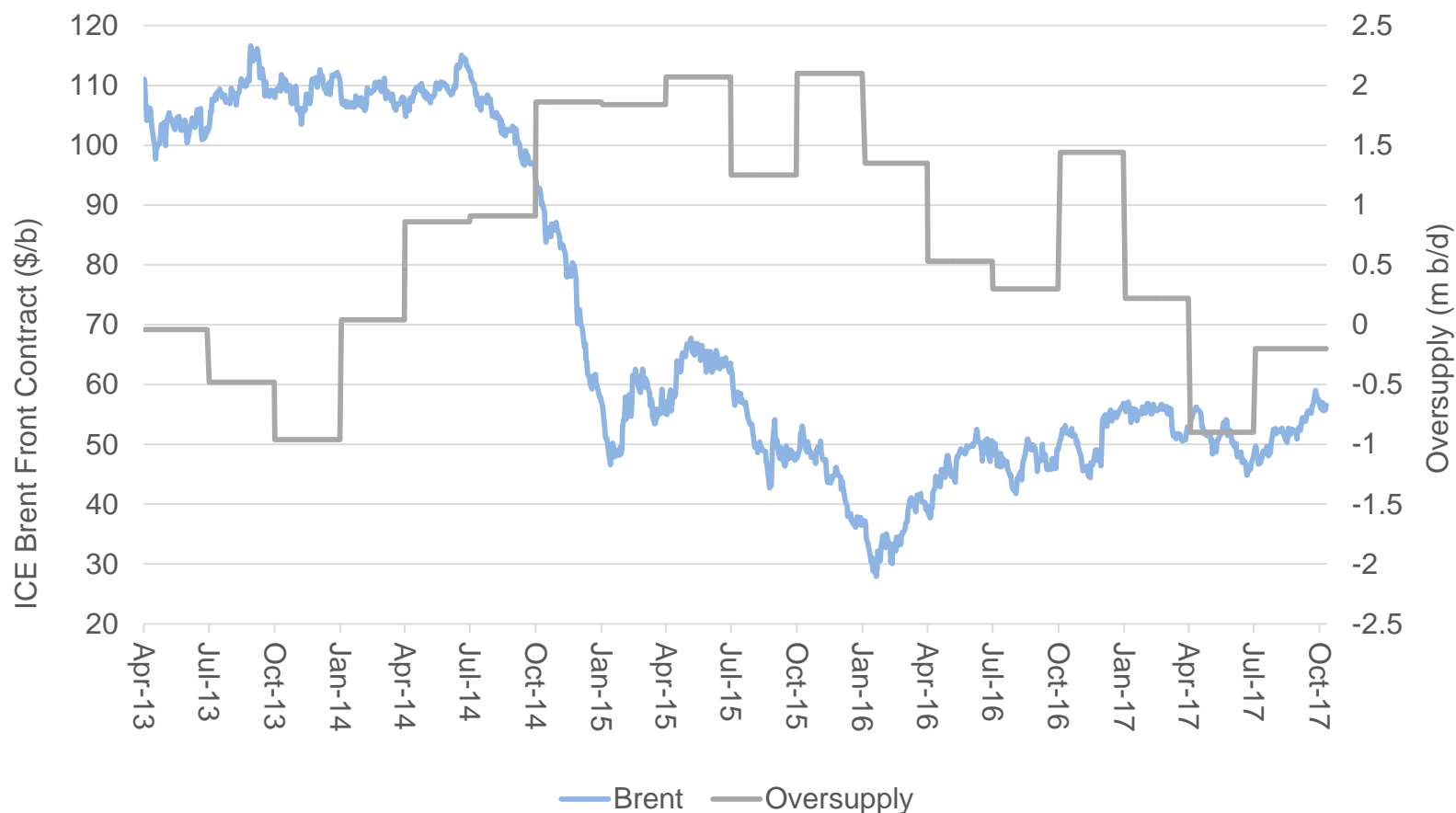


## **Other Market Influences**



# Do Fundamentals Drive The Market?

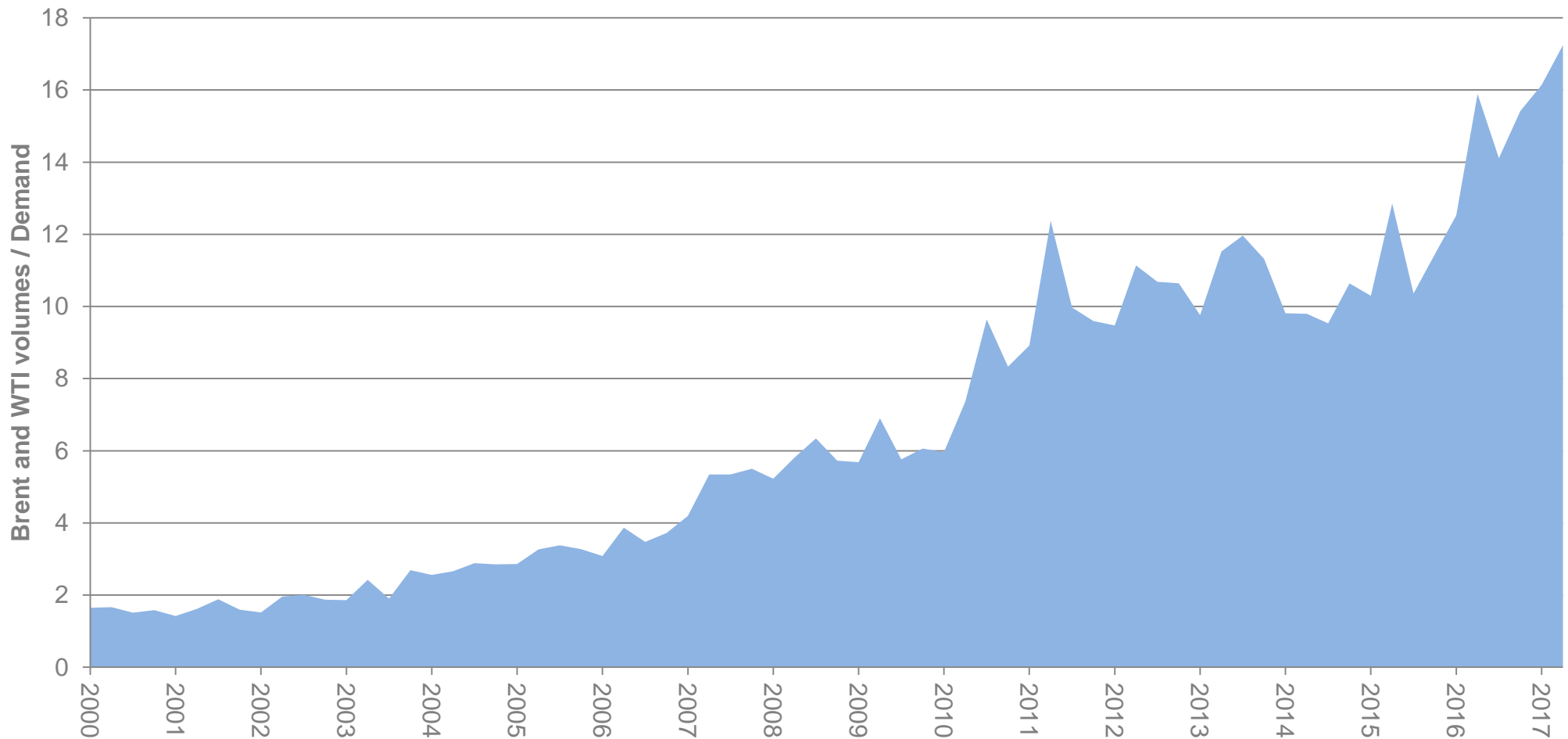
The oversupply (supply – demand) and the price of Brent



Source: Investec, Bloomberg, IEA

# Futures Trading has Grown Massively

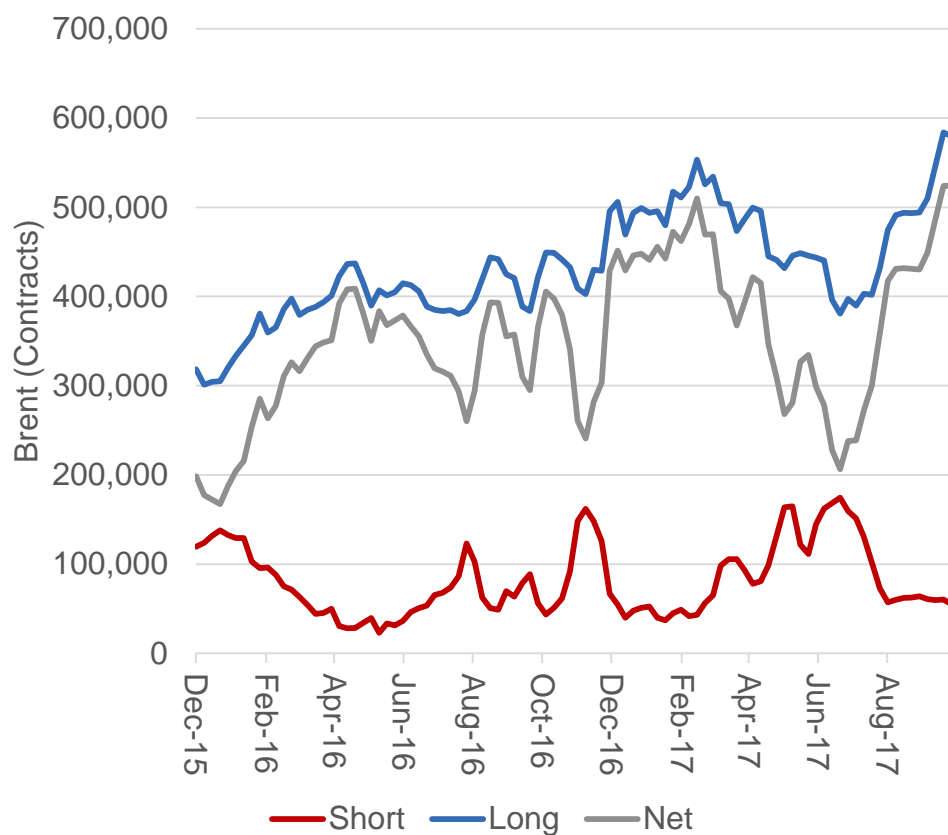
Brent and WTI futures trading volumes relative to physical demand



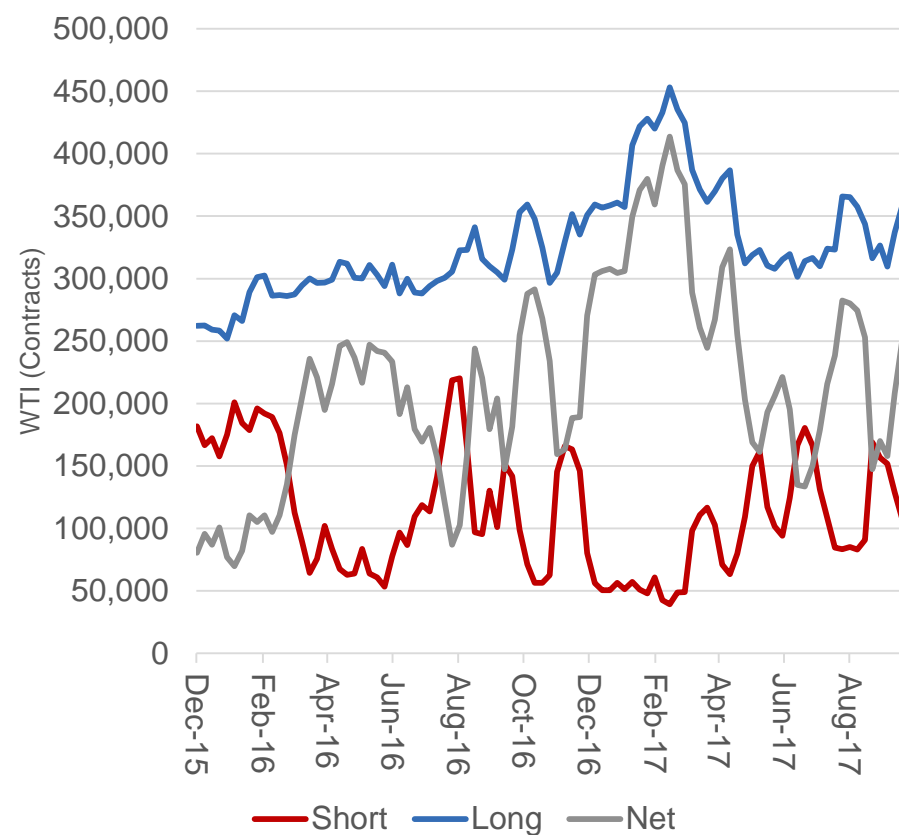
Source: Investec, Bloomberg, CFTC

# Speculators Have Substantial Bullish Bets

## Brent Speculative Positions



## US (WTI) Speculative Positions



Source: Investec, Bloomberg, CFTC



## How To Protect Budgets

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# Hedging Is a Common Solution

Some examples of Hedging Programmes from public data, collated by Bloomberg

## Ryanair

Fiscal year to March 2018

- 2Q 91% at 494 \$/MT
- 3Q 90% at 476 \$/MT
- 4Q 90% at 491 \$/MT
- FY 90% at 493 \$/MT

Fiscal year to March 2019

- 1Q 50% at 492 \$/MT
- 2Q 40% at 475 \$/MT

## IAG

2017

- 3Q 94% hedged
- 4Q 79% hedged

2018

- 1Q 62%
- 2Q 47%
- 3Q 37%
- 4Q 29%

## Easy Jet

Fiscal year to Sep 2017

- FY 85% at 611 \$/MT

Fiscal year to Sep 2018

- FY 71% at 514 \$/MT

## Lufthansa

2017

- 3Q 78% at 541 \$/MT
- 4Q 77% at 546 \$/MT

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# Gambling Or Risk Management?

**We can't foresee the future. Hedging provides certainty**

- Doing nothing is not riskless
- A layered approach reduces the risk of hedging at the “wrong time”
- Hedging can help to smooth out price fluctuations
- Hedges give you time to adjust to market shifts
- The policy should fit the airline
- Consistency is key
- Document the hedge policy

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