Our View: When in Need, Manipulate

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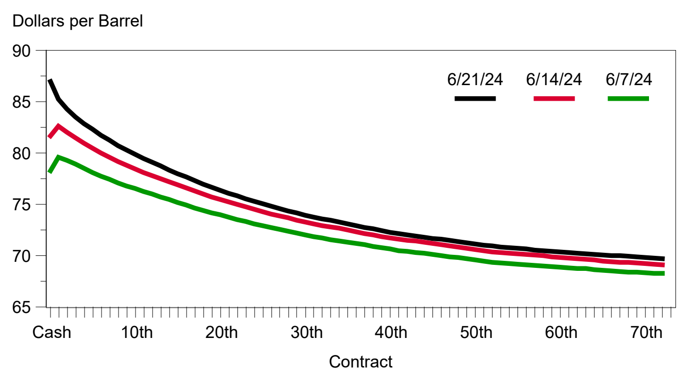
Dated Brent prices have risen by eleven percent in two weeks as the market moved from a slight contango into deep backwardation. **By one relevant measure, the increase matched the cash price increase that followed Iraq's invasion of Kuwait in 1990.** In the one thousand eight hundred weeks we have followed Brent, markets have experienced a weekly price movement this large on only six other occasions.

The recent surge in prices can be attributed to trading firms' strategic moves. Gunvor, for instance, has acquired a significant portion of the Brent cargoes, while Trafigura has secured most of the Midland WTI crude that can be delivered against the Brent contract. These actions have had a direct impact on the market, leading to the observed price hike.

Similar efforts to corner Brent have occurred. It is a small market with limited liquidity that is used to establish the price of most crude sold in the world market. The trader-led Brent squeeze seems to be a "behind the scenes" effort by oil producers to raise prices after their production cuts and strategies to punish speculators failed to do so. In this case, Saudi Arabia is likely orchestrating the push to boost Brent. As *The Wall Street Journal* noted on June 21, "Saudi Arabia's $54 Billion Haul Still Leaves It Craving Cash." Every dollar increase in crude prices is worth more than $2 billion per year to the Saudis.

Dated Brent rose $8.70 per barrel from June 7 to June 21, an increase of over eleven percent. As Figure 1 shows, the market moved from a slight contango between the Dated Brent and first future prices to an extreme backwardation. A review of past week-to-week changes in search of comparable changes revealed that this was the seventh-largest decline I have recorded. While I could not identify the causes for all of the other six, I noted that the excess returns declined by sixty-four percentage points from August 3 to August 10, 1990, following Iraq's invasion of Kuwait and the decision not to release strategic stocks in response.

Figure 1
Forward Price Curve for Brent on June 7, June 14, and June 21, 2024



Source: PKVerleger LLC.

That finding led me to ask what made last week like the week after the Kuwait invasion and why did cash Brent prices rise by eleven percent over the previous two weeks. Obviously, no political events occurred to cause such a change.

What did occur, however, was the significant crude oil buying by key trading companies described above. Some commentators attribute the trading companies' aggressive buying to the refinery restarts in Europe and the arrival of summer demand. Others cite lower inventories. I believe another explanation applies.

According to a June 21 *Wall Street Journal* article, Saudi Arabia is "craving cash."[1] The country's revenue requirements are dictated by Crown Prince Mohammed bin Salman's efforts to build Neom, the massive project in the desert that will stretch one hundred miles inland from the Red Sea. One source speaking to the *Journal*'s Eliot Brown told him that the initial Neom construction of less than two miles would cost more than $100 billion. Brown adds, "That would require the equivalent of more than eight offerings of Aramco stock on the scale completed this month."

The key to a Brent squeeze succeeding is to corner the physical market, take delivery of the crude, and transport it away from Europe. The action would force buyers to bid up the price of the physical oil until other supplies are brought in, probably coming mostly from West Africa, the United States, or the Middle East. These alternative crudes, though, would cost more because most are priced off Dated Brent.

If the traders' purchases of most Brent cargos are part of an effort to boost crude prices, as I believe they are, the parties involved are taking advantage of the vulnerable manner in which global crude oil is priced. The use of Dated Brent to establish the transaction cost of perhaps sixty percent of the crude moving in global trade has been subjected to significant criticism for years. Efforts to change the system, though, have failed. Now, it appears that the weakness is being exploited to raise crude prices and that Saudi Arabia has the most to gain from this.

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[1] Eliot Brown, "Saudi Arabia's $54 Billion Haul Still Leaves It Craving Cash," *The Wall Street Journal*, June 21, 2024 [https://tinyurl.com/ye2743y2].