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Is oil demand at risk from EM sell-off?

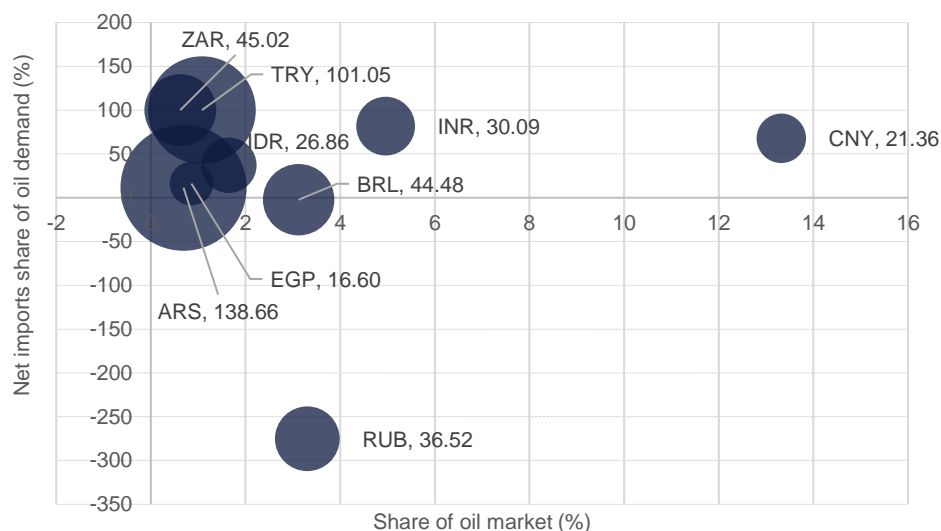
The recent rapid sell-off in emerging assets is providing another negative risk for commodities in the near term, compounding fears of what a trade war between the US and China could have on overall commodity demand. But while EM currencies and equities have been weakening in lock step since mid-August, we don't expect to see a feed through to weaker oil demand on a global level from the current financial markets sell-off.

Across the major emerging markets that have been under the most financial pressure in recent weeks Turkey and Argentina are stand-out cases. Both have seen rapid sell-offs in their currencies while inflation in both countries is running in double digits (17.9% and 31.2% y/y respectively) in their latest data prints. From an oil market perspective, both countries have seen the value of crude in local currencies soar by more than 100% year-to-date compared with an increase in front month Brent futures of 15%. Turkey is essentially entirely reliant on imports of crude oil to meet demand and a sharp increase in oil prices will weigh negatively on the country's balance of payments. Turkey's government adjusts taxes on domestic fuel prices to limit the pass-through effect of higher oil prices and a weaker currency. Thus, domestic gasoline prices have kept their gains to 25% y/y in August compared with a more than 40% gain in Brent futures y/y. Argentina is able to cover a large share of its demand from local production, insulating it to a degree from movements in international prices.

But neither Turkey nor Argentina are particularly large oil markets in a global context. Turkey accounted for just over 1% of global oil demand in 2017 while Argentina represented just 0.7%. Thus while their oil import bill has exploded it is unlikely to move the needle significantly if both countries saw oil demand slow. Far more essential is the outlook for China and India, the second and third largest oil consumers respectively. Both countries have seen a deterioration in their currencies in recent weeks—the INR has touched record low levels above 71.90. But overall economic fundamentals still look robust enough to support oil demand growth going into 2019. Both countries have also seen a far more muted increase in oil prices denominated in domestic currencies than some of the more exposed emerging markets (see chart below) and we don't see a major risk to oil demand from the current financial uncertainty.

In some cases the weaker currencies may be welcome. Both Brazil and Russia are net oil exporters and the value of oil receipts in their local currencies is outperforming benchmark prices. Brent denominated in rubles is at record high levels and discounts to Brent for Urals, a major Russian export grade, have been compressing, presenting what should be a positive outlook for Russian oil producers, all else remaining equal.

EM oil demand at risk?



Source: EIKON, BP Statistical Review of World Energy 2018, Emirates NBD Research. Note: size of bubble represents % change in prompt Brent futures ytd denominated in local currencies.

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