Mizuho Chart Speak: Oil

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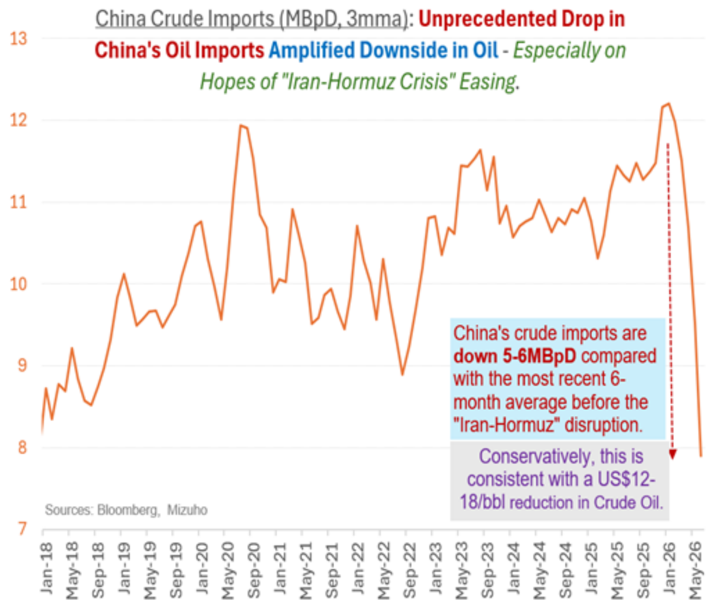
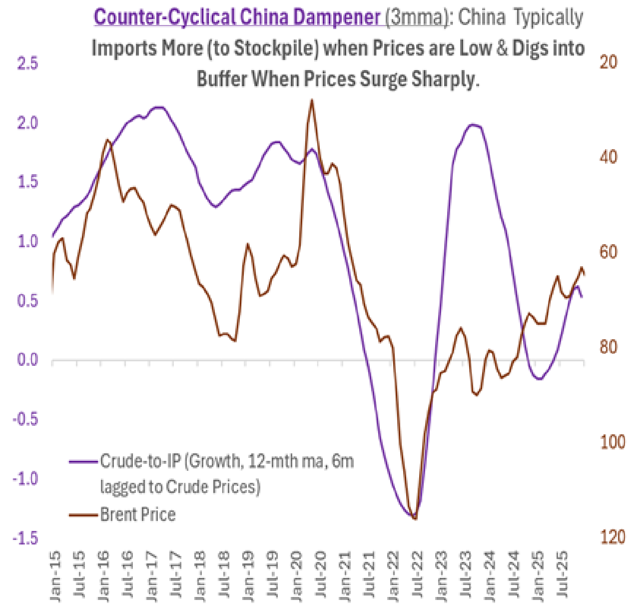
China's Double-Edged "Crude Put"

"When you look at the Dark Side careful you must be. For the Dark Side looks back." - **Master Yoda**

In a Nutshell:

- Admittedly, a **conspiracy of exceptional supply cushion** helped to *subdue oil prices through the "Iran-Hormuz" shock*.
- Nonetheless, it was **China's extraordinary 4-6MBpD** crude import cutback that **single-handed dampened up to half oil's price surge** (*easily by $12-18/bbl*).
- **Neither** the **coordinated SPR release nor US supply buffer came close** – not even a third of Beijing's buffer.
- But the **"China put"** as the **most consequential oil shock dampener** **risks sharp payback** **as** China's **strategic reserves** are increasingly **exhausted**.
- *Potentially,* driving prices considerably higher beyond merely reinstating the $12-18 "China put" discount. Especially **on emphatic demand for replenishment**.
- *Accentuated upside sensitivity in oil prices* is a risk *as the Middle East prolongs,* with **Asia most vulnerable** to Beijing flipping from cushion to competition.
- FX Implications: ***When**,* not if, the **"China put" wanes**:
  1. *CNH will be liable to soften* on the Current Account dynamics Beijing's net oil import resumption.
  2. *AXJ will also weaken,* likely with **higher-beta**, as higher crude price shock – via inflation and fiscal transmissions – is **exacerbated by CNH correlations**.





- **China has been the dominant force**, *not merely a contributing factor,* in significantly **suppressing crude supply shock arising from the "Iran-Hormuz crisis"**.
- With an **extraordinary *4-6mBpD cutback of crude import***, Beijing single-handedly dampened a third to half* of the "Iran-Hormuz crude shock".

- While the precise supply-to-price math is fraught, it is **not outlandish to suggest** that **Beijing durably lowered crude costs by some $12-18/bbl**.
- **Whereas** the **coordinated global strategic petroleum reserves** (SPR) **release**, *for all fanfare of its record 400MB response,* **delivered far more modest price-dampening** (~$4-6/bbl).
- Notably*,* **struggling to sustainably exceed 1.6-1.8MBpD** rate of release –** *given* the *inherent challenges* in the ability *to extract and deliver with speed.*
- Point being, for all the huffing and puffing, the *sputter-prone* **"global SPR put"**, *barely able to summon even a third of Beijing's real-time buffering ability,* is **dwarfed by a far more profound "China put"**.
- Admittedly, **US** production is **a structural price dampener**.
- Nevertheless, in this instance, US **supply response*** ** to the **"Iran-Hormuz crisis" falls far short of Beijing's**.
- Moreover, the *US-Persian crude grade mismatch* (light vs. medium) *further diminishes the effective US buffer,* unlike the emphatic impact from China's like-for like imports forgone.
- The upshot is that **China has overwhelmingly driven exceptional crude price dampening.**
- So much so that **crude prices action has turned out to be comparatively more benign** *despite "Iran-Hormuz crisis" being a far higher-order shock* than Russia-Ukraine.
- But this **disproportional dependence on the "China put"** is precisely **why the prevailing oil shock** risks – <u>even with oil's surge on US-Iran conflict</u> – **is misleadingly understated**.
- For one, **China's imports restraint is on borrowed time** as **the requisite** *compensatory inventory drawdown* **nears thresholds that may trigger replenishment**.
- **And when**, ***not if****,* that happens, China will turn *from dampening,* **to lifting**, **crude price** to – with *<u>at least part of the effective $12-18 price dampening being reversed</u>.*
- So, *as US-Iran conflict extends/expands,* **oil price sensitivity may become more pronounced as the "China put" wanes** (or worse, reverses) **on depleting supply buffer** (replenishment reflex).
- The **impact** may be **most profound** in, albeit not confined to, **Asia**.
- Especially given that as **China's resumed/ramped-up demand** will *turn Asia's crude supply concession* (cushion) *to competition* that **impinges access and affordability**.
- <u>FX Implications</u>: ***And when****,* not if, the **"China put" wanes**:
  1. *CNH will be liable to soften* on the Current Account dynamics Beijing's net oil import resumption.
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* Assuming that the "Hormuz blockade" seized up around 12-16MBpD at its peak before s easing to 8-12MBpD seizure later as flows picked up via alternatives, including "dark vessels".

**Even at the height of the Russia-Ukraine war, global SPR release never crossed 2MBpD, appearing to be strained at sustained weekly rates of 1.6-1.8MBpD.

*** Estimated to have, at best, averaged ~1-2MBpD from net imports data that included strategic reserves.