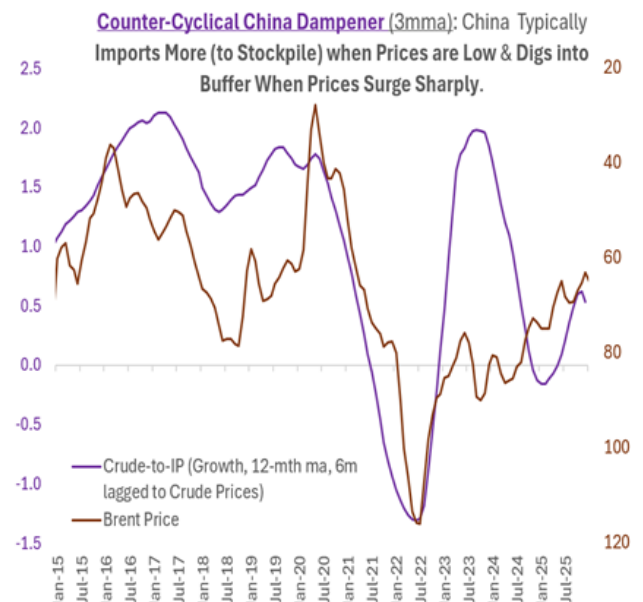
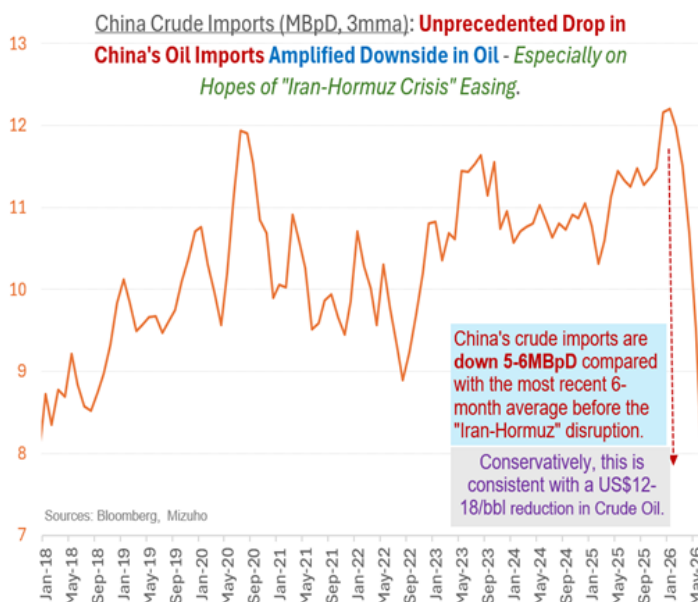


China's Double-Edged "Crude Put"

"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-handedly 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** – even with oil’s surge on US-Iran conflict – **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 at least part of the effective \$12-18 price dampening being reversed.
- 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**.
- FX Implications: **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.
 2. *AXJ will also weaken*, likely with **higher-beta**, as higher **crude price shock** – *via inflation and fiscal transmissions* – is **exacerbated by CNH correlations**.

* Assuming that the “Hormuz blockade” seized up around 12-16MBpD at its peak before 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.

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