بنك الإمارات دبي الوطني
Emirates NBD

Commodities

15 January 2019

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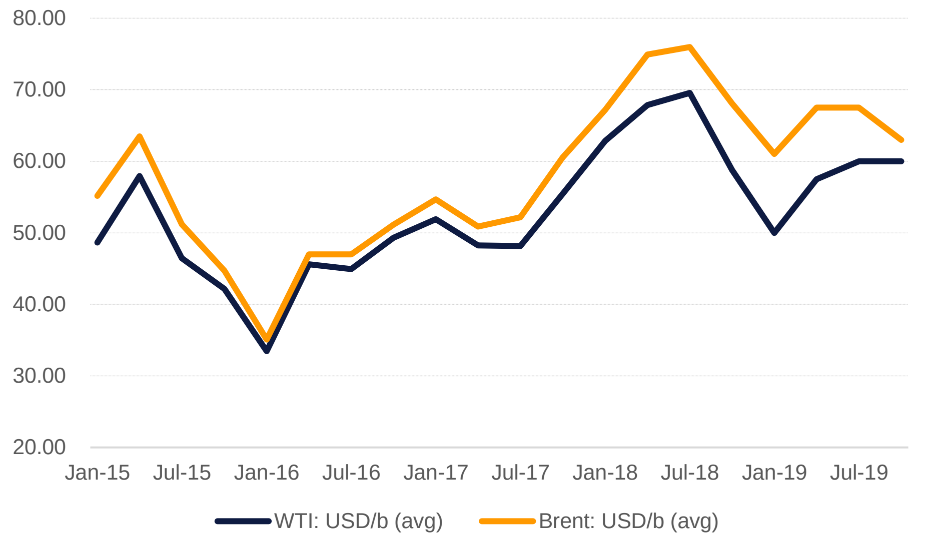
Oil price outlook for 2019

- We are revising our forecast for average Brent prices lower to USD 65/b (compared with USD 73/b previously). WTI prices expected to record an average of USD 57/b (compared with USD 66/b previously).
- Demand growth is set to slow in 2019 and remain below its long-run averages. In major consumers oil demand is set for considerably slower pace of growth.
- The US-China trade war hangs over oil and commodity demand generally with the scale of downside in a no-deal outcome more severe than any possible relief if an agreement can be reached.
- Persistent, and rapid, non-OPEC supply growth will offset OPEC efforts to balance markets. The US will remain the major contributor to supply growth in 2019, even if at a slower pace.
- OPEC forced into cutting production but scale of cuts as announced won't be enough on their own to push market into deficit. On a historic basis, the new target levels still represent near record levels of production for several large OPEC members.
- Inventories will continue to build in 2019 and will account for more than 61 days of OECD demand compared with less than 60 estimated for 2018.
- Prices will be characterized by elevated volatility, particularly as major policy issues (US-China trade dispute, Brexit, Fed rates trajectory) remain uncertain.
- Brent/WTI spread to remain wide until H2 2019 when new pipelines will help to improve takeaway capacity from major producing regions.

Emirates NBD Research oil price assumptions



Source: Eikon, Emirates NBD Research.

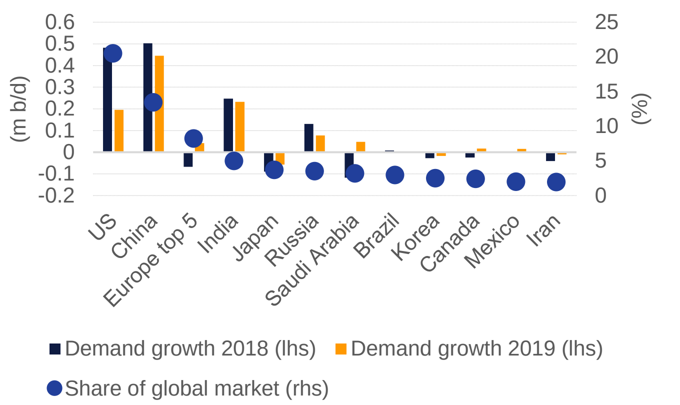
	Jan 2019	Apr 2019	Jul 2019	Oct 2019	2019	% y/y
Brent	61.00	67.50	67.50	63.00	64.75	(9.5)
WTI	50.00	57.50	60.00	60.00	56.88	(12.2)
Spread	(11.00)	(10.00)	(7.50)	(3.00)	(7.88)	n/a

Source: Emirates NBD Research. Note: quarterly average USD/b.

Demand conditions set to underperform in 2019

Oil demand growth is projected to underperform its long-term trend in 2019, expanding by 1.41m b/d compared with a five-year average of 1.53m b/d (IEA projections). While demand growth will be positive in most markets this year it will be at a slower pace in critical markets. The US, representing more than 20% of global oil consumption, will see demand growth slow to around 200k b/d compared with closer to 500k b/d estimated for 2018. Consumption in China, which accounts for 13.5% of global oil demand, will remain positive but also a slower pace than in 2018. Where an acceleration is expected, the impact on global oil markets is relatively muted. Saudi Arabia, Canada, South Korea, Mexico and Iran will all report faster demand growth (or slower declines) but collectively they still represent less than China's total share of demand.

Oil demand in 2019



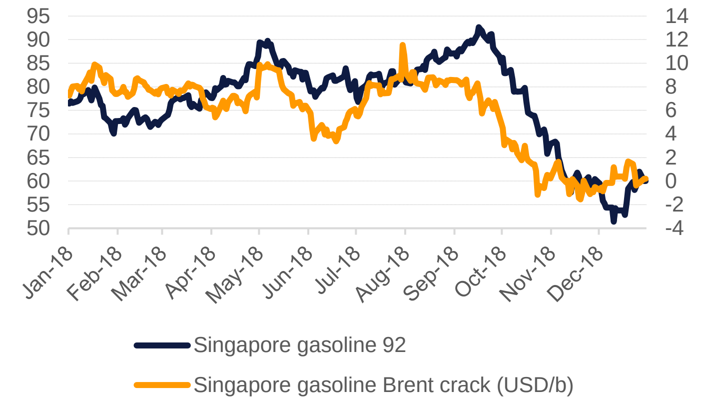
Source: IEA, Emirates NBD Research.

On oil fundamentals alone there is some scope to be optimistic on demand. Several new ethane crackers (petrochemical plants) are set to open in the US this year that will contribute to faster year on year demand growth for light products while the effect of IMO 2020 on diesel/gasoil production looks positive as refineries run harder to replace high sulfur fuel oil with cleaner burning maritime fuels.

For now, though, refineries face challenging conditions as cracks remain at soft levels. Singapore cracks across the barrel have been weakening as higher input costs grind against a weaker outlook for regional fuel pricing. Gasoline margins running Dubai-linked crudes are close to their lowest levels in the last 12 months while diesel/gasoil cracks have lost much of the strength they saw at the start of Q4 2018 when the market seemingly refocused its attention on the pending changes to maritime fuel specifications.

Singapore inventories have recovered back to their five-year average level and in the light end of the barrel are considerably higher. In the Asian economies that report to JODI gasoline consumption was running as a softer pace y/y as of September 2018 and there were few signs that it would turnaround. The pace of decline in diesel demand was even starker as of September (-3.63% compared with 2017 average).

Singapore refining margins



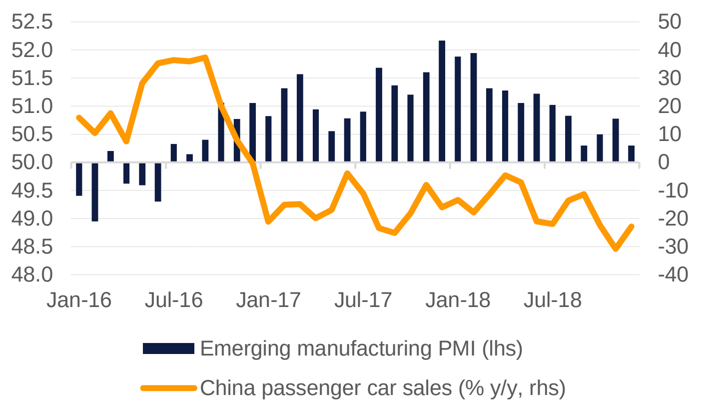
Source: EIKON, Emirates NBD Research.

Broad slowdown in EMs will weigh on commodity demand

Slowing growth, higher financing costs and a volatile external environment will all drag on commodity demand in 2019. Data from both developed and emerging markets displayed a steady decline in activity over 2018 and manufacturing PMIs for emerging markets ended the year just above neutral. Visibly, after several years of strong growth vehicle sales in China were on track to record a second year of decline, down more than 30% y/y in November alone.

Casting a shadow over demand for oil, and commodities more generally, is the US-China trade dispute. Without a deal, the US will raise tariffs on USD 200bn of Chinese imports to 25% and impose tariffs on another USD 267bn from the start of March. Both countries have an interest in a positive resolution to talks but the risk of miscalculation is high, particularly in light of the personalities involved. US president Donald Trump will need to resist the urge to portray achieving a deal as a 'win' over China to prevent a return to retaliatory tariffs.

EM economies start 2019 on soft footing



Source: EIKON, Emirates NBD Research.

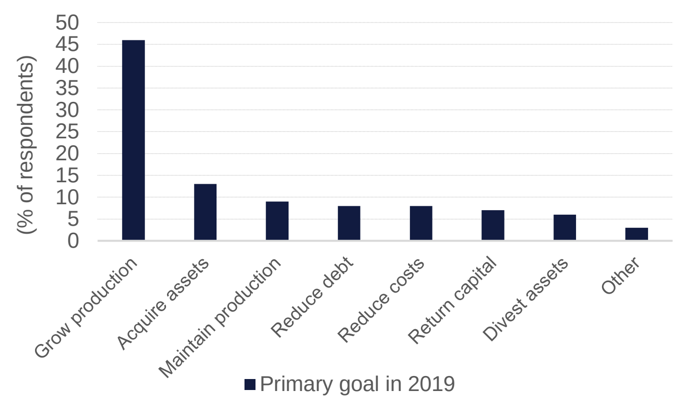
Measuring the impact of protracted US-China trade war on oil prices is admittedly a woolly endeavor but it will have undoubtedly been a major part of the more than 40% drop from Brent's 2018 peak of USD 86.29/b to USD 50.47/b. So long as the trade dispute remains unresolved it will act as a weight on prices. But a positive resolution on trade only gets markets back to focusing on the decelerating trend of global growth: both the IMF and World Bank have lowered their growth projections for 2019 based on factors beyond the US-China trade war. The upside quantum of a trade deal is consequently more muted in our view than the scale of decline if negotiations fail.

Supply remains battle between OPEC and non-OPEC

Oil supply in 2019 will again be a battle for influence between OPEC efforts to get prices close to fiscal breakeven levels and rapid, flexible growth from alternative producers, notably in the US. Non-OPEC supply growth will ease to 1.49m b/d in 2019 from almost 2.5m b/d recorded last year but is still well above its long-run average (we are excluding Qatar which has left OPEC from the calculation for now to ensure a consistent base for comparison).

Most of the non-OPEC supply growth will again be concentrated in the United States. Shale oil producers continue to surprise on the upside in terms of supply and the EIA has steadily revised its outlook for growth in 2019 higher. Even as prices plummeted in December oil and gas companies in Texas, which has provided bulk of US supply growth, remained aggressive in their capital plans for 2019. Nearly half of companies surveyed by the Dallas Fed planned to focus on increasing production, even as WTI prices grind against breakeven costs. Most of the firms surveyed by the Dallas Fed were basing their capital spending plans on WTI prices around USD 50-55/b, not far off levels in early January.

Dallas Fed Energy Survey

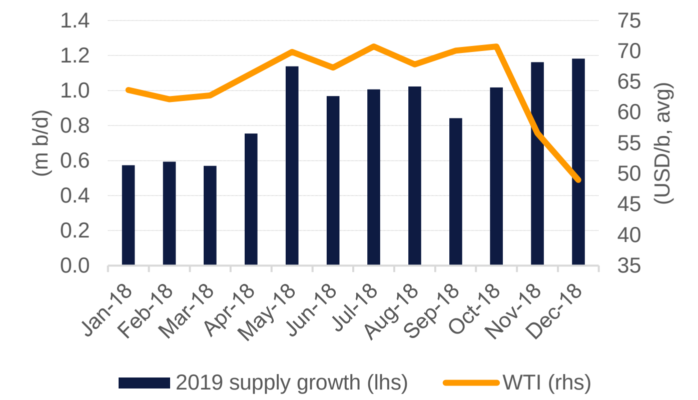


Source: Dallas Fed, Emirates NBD Research.

As we have outlined in the past, logistics constraints to getting crude out from producing regions to export terminals remains a challenge for the US oil industry to surmount this year. So far it has not prevented supply from growing but has meant that physical prices at the wellhead remain discounted and inventories have become a 'buyer of last resort' for producers. This trend will remain intact for at least H1 2019 after which some pipeline relief will come online. These exact same dynamics have contributed to the unprecedented steps taken in the Canadian province of Alberta where the government has enforced a production cut to try and run down inventories and narrow the discount for domestic crude prices.

The drilling rig count in the US has levelled off around 875 active oil-focused rigs since around May 2018, around half its peak level in Q4 2014. However, the number of drilled uncompleted wells has broken to over 6,000 and drilling productivity has continued to creep upwards. The short-cycle and capital flexibility of producers in US shale basins will allow them to take advantage of much shorter moves in crude pricing and curve structures; even as average WTI prices fell the EIA continued to revise higher its production growth forecasts.

EIA growth projections



Source: EIA, EIKON, Emirates NBD Research.

OPEC forced into cutting supply

With an unremitting supply picture beyond their control, OPEC countries have started 2019 with another round of production cuts. Some producers got an early start to the cuts with market surveys of production showing that already in December collective OPEC production fell by 630k b/d. In order to achieve the targeted cut from October 2018 levels OPEC production should decline another 800k b/d from the obligated members (Libya, Venezuela and Iran are exempt from the cuts).

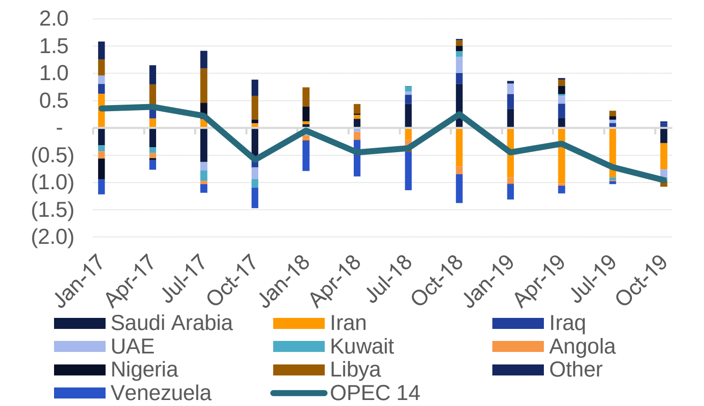
OPEC ministers, particularly from Saudi Arabia and other large producers, have stressed that they are prepared to do 'whatever it takes' to restore oil market balances to neutral. We interpret this as a pledge to cut production even further than the semi-official target of 3% cuts from October 2018 levels. OPEC producers will then return to 'over delivery' on production targets despite this having a mixed result when they tried it in 2017-18. Limiting volumes to such a degree should help to stabilize oil prices; Brent prices appear to have found a floor around USD 50/b as the year has begun. But even with compliance to the cuts in H1 coming in close to the same degree of compliance seen in 2017 and the first half of 2018, oil market balances will still keep accruing inventories.

Our expectation is that both Saudi Arabia and the UAE cut more than the apparent 3% target and will start 2019 with output 4.6% and 5.3% lower than October levels respectively. There will be an immediate near term hit on economic performance but prices still remain far below fiscal breakevens in both countries (USD 82.7/b for Saudi Arabia and USD 68.8/b for the UAE). We doubt that Iraq will participate in cutting production and that few other OPEC members will slash output as aggressively. Commitment to this round of cuts appears far less assured than the 2016 Declaration of Cooperation between OPEC countries and partners like Russia, risking that OPEC+ diplomacy will be far more fractious this year (note Qatar's decision to leave the club with effect from January 2019).

Production cuts need to be seen in context

Production from OPEC will end up lower on average in 2019 but most of the decrease will be from declining Iranian and Venezuelan production, rather than countries that have committed to cutting output. In Saudi Arabia, Iraq, the UAE and Kuwait output targets (assuming the new lower targets are held) still represents levels well above historic averages and close to 2016 record average output.

OPEC production growth y/y



Source: IEA, Emirates NBD Research.

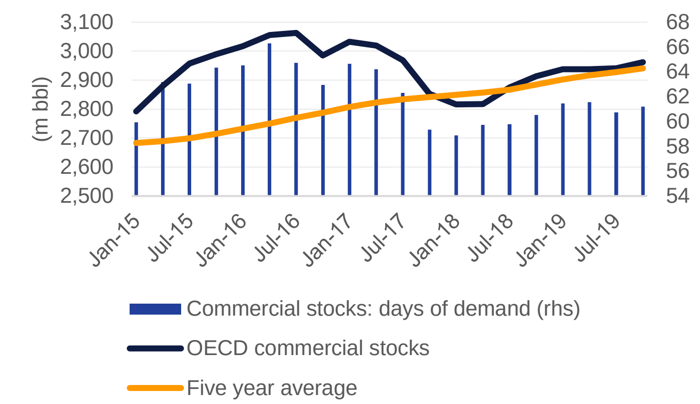
Cutting production runs another risk for OPEC countries: Trump's Twitter finger. The US president has repeatedly lambasted OPEC for limiting production that led to prices rallying to well over USD 80/b in Brent futures. A level between USD 70-80/b in Brent markets appears to be the range where oil prices come to the fore of the president's mind and spark a reaction. US influence over OPEC production goals is limited but politicians are evaluating a so-called 'NOPEC' bill that would remove sovereign immunity of OPEC nations to US anti-trust laws. So far president Trump hasn't stepped in to quash the bill as previous presidents have done and we don't expect he will let up pressure on OPEC this year.

President Trump has been an unreliable ally of OPEC countries in another sense. Part of the reason Saudi Arabia, the UAE, Iraq and others raised production from May onward was to compensate for the impending drop in supplies from Iran as US sanctions on the country tightened. By granting importers of Iranian crude waivers for six months from November the US administration helped to remove one of the sources of anxiety over supply heading into this year. The waivers will expire in Q2 2019 just as the year/year decline in Iranian volumes accelerates. Other OPEC members will need to resist the urge to swamp markets with additional output in order to take advantage of the decline in Iranian volumes. Our forecasts, however, assume that production will increase in H2 and that gains in Saudi Arabia and the UAE among others will offset the declines in Iran.

Stockpiles will keep growing

Taken together, these supply and demand factors result in a market balance still in surplus for 2019, moving from around 500k b /d in Q1 to flat over the middle quarters the year before widening again in the final quarter. Measured against OECD consumption, stocks will average out at around 61 days of demand, compared with 59.7 in 2018.

Inventories on track to grow again



Source: IEA, Emirates NBD Research

We are revising our forecast for oil prices this year as fundamentals and sentiment have shifted considerably since we last laid out our forecast (September 2018). We now expect Brent futures to record an average of around USD 65/b in 2019, moving from USD 61/b in Q1 to USD 67.50/b over the middle months of the year before slipping again in Q4. We expect WTI prices to record an average of around USD 57/b, characterized by a wide Brent/WTI spread in H1 as pipeline shortfalls dislocate US pricing from global moves. We stress that markets should be prepared to endure substantial volatility in 2019 with considerable swings above and below our forecast. We wouldn't rule out Brent moving back below USD 50/b or touching USD 80/b.

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