



بنك الإمارات دبي الوطني  
Emirates NBD

## Commodities

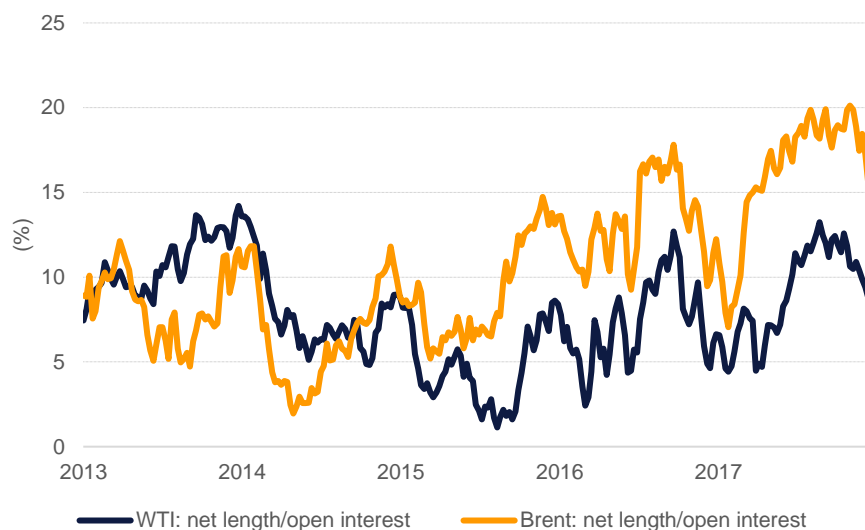
30 May 2018

# Bearish sentiment grows on oil

Oil markets have shifted heavily to the downside in recent days as markets respond to comments from the Saudi and Russian energy ministers that OPEC and its partners could raise production in coming months to accommodate the loss of output from Venezuela and potentially from Iran. Front month Brent futures have lost more than 4.4% since the close on May 24, the day prior to the commentary from Khalid al Falih, the Saudi energy minister and Alexander Novak, his Russian counterpart. Both ministers stressed any change in production would be gradual and the need for an increase would be assessed at the upcoming OPEC meeting in June.

Even ahead of the statements investors had been pulling out of long speculative positions in both Brent and WTI. However, we believe that was more likely due to some profit taking and a long Brent trade in particular becoming increasingly crowded. The backwardation in Brent markets has been receding since the end of April, weakening roll yields and incentives to stay long. Brent has actually pushed into a narrow contango in the 1-2 month spread as the market seems to have pre-priced in the US withdrawal from the JCPOA and has fewer immediate fundamental catalysts to push it higher. December 18/19 spreads for Brent are now at their narrowest level since the start of April at around USD 4/b.

### Investors close out some long positions



Source: Eikon, Emirates NBD Research.

Is this the start of a wider rout? Spot futures had rallied hard and were due for some downward correction but we are sceptical that Saudi Arabia, its unencumbered OPEC partners and Russia will allow enough of a production increase in H2 to deliver on growing bearish aspirations. The fact that the declines in spot prices have also occurred in a wider risk asset sell-off related to Eurozone political risk also clouds how directly they are driven by fundamentals.

As we outlined previously, we expect that 100% compliance with the production cut agreement will be the ceiling for any production increases by OPEC members: for Saudi Arabia this implies a roughly 120k b/d increase from current production levels (and a total of around 150k b/d increase if the other GCC producers hit 100% of their target as well). Our forecast for market balances in H2 assumed 100% compliance by those OPEC members who were able to achieve it and it still results in a wide deficit in H2.

Edward Bell

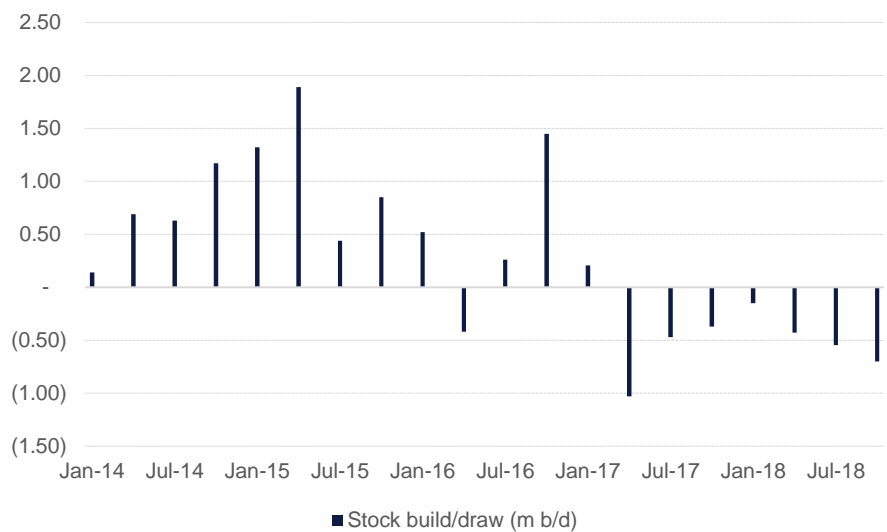
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While Saudi Arabia alone has as much as 1.6m b/d of total spare capacity, more than enough to offset the anticipated decline in production from Venezuela and Iran, its effort in limiting production has resulted in Brent prices recovering back to above USD 75/b. **The optics of lifting production would likely result in a rapid unwinding of these gains.** Just the commentary alone at the end of last week cut prices by nearly USD 3.50/b in front month Brent futures. Action would be much more potent than words.

### Deficit to remain even with increases in OPEC output

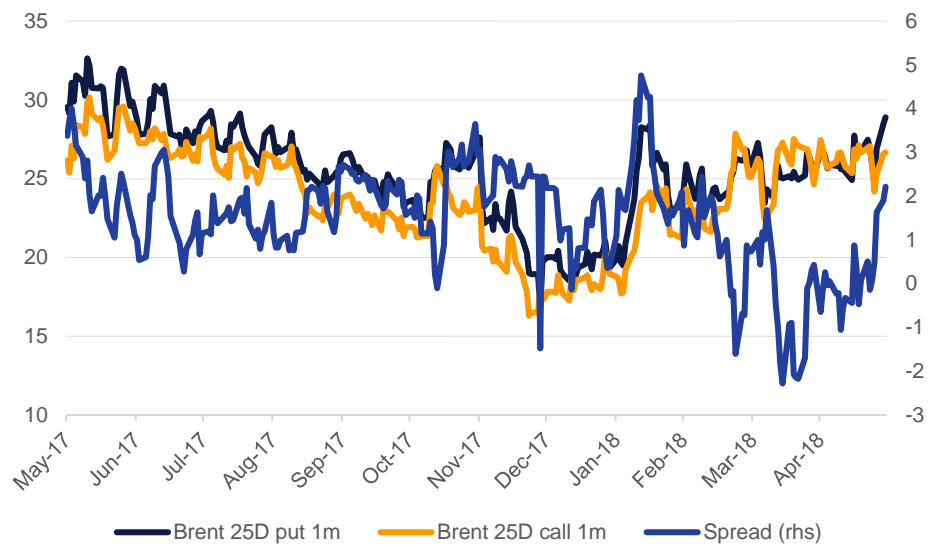


Source: IEA, Emirates NBD Research.

OPEC and its partners had initially set inventory levels as the target of their production cuts but have now shifted the focus onto upstream investment. **This is much more directly related to long-term price assumptions and OPEC and Russia together have shown they have significant ability to set a floor under prices while allowing demand and inventory draws to take on the work of raising the upside.**

**With that in mind, we believe some of the gains in downside structures are likely to be unwound and long positions could be built up once again.** The 25D risk reversal in 1m Brent futures has moved back into positive territory as put volatility has spiked since the end of last week. We suspect it could push back lower once downside risk dissipates (see chart on next page). There is a good likelihood that OPEC’s announcement at its June meeting may disappoint bears looking for a large increase in production and there is still little clarity on how substantially Iranian production could decline in H2 2018 or how severely the US will pursue sanctions against the country.

## Negativity en vogue?



Source: EIKON, Emirates NBD Research.

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