



بنك الإمارات دبي الوطني
Emirates NBD

Commodities

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Crude oil update

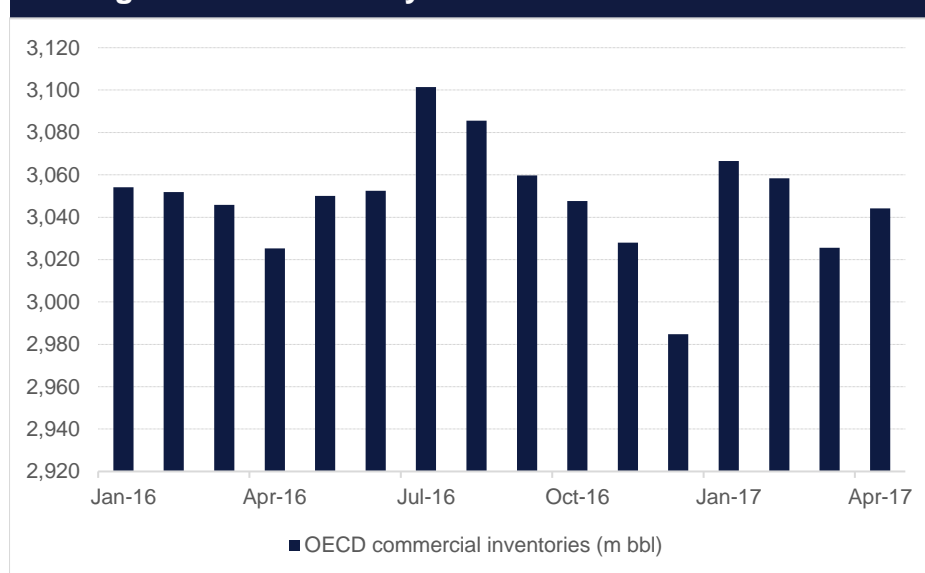
Oil market sentiment has soured significantly in recent weeks, taking prices to new lows for the year. Brent and WTI futures are now down more than 20% year to date and have given up 17% since OPEC announced it would extend its production cut deal into the first quarter of 2018. The recent sharp sell-off hasn't been prompted by any fundamental change in our view but has nevertheless turned the market sharply negative and the near-term outlook has darkened.

Will these new lower levels persist? We expect that prices will go lower before they go higher but that prices lingering at USD 45/b and below for a sustained period is unlikely. At the start of last year prices plunged in January-February, testing levels around USD 25/b but then promptly recovered to oscillate on either side of USD 50/b. For now, we still hold the view that prices will gradually recover and are maintaining our forecast for Brent at an average of USD 54/b and WTI at USD 52/b. As we approach the end of Q2 our targets are not too far off market performance: we had expected a Q2 average for Brent of USD 53/b and it has averaged around USD 51/b. Our H2 target for Brent is an average of USD 55/b which implies a considerable recovery from current levels but as volatility has escalated in recent weeks, any small positive indicator could be enough of a catalyst.

That said some of the downside risks we have warned about in the past are worth highlighting.

- Inventories have yet to show a significant draw in response to lower OPEC volumes. The IEA estimates that OECD commercial stocks have risen by 60m bbl since the start of the year and remain stubbornly at the 3bn bbl level. OPEC's objective of moving stocks back to their five-year average is misguided, in our view, as by the end of this year any rolling average will be at historically elevated levels and not imply a truly tight market.

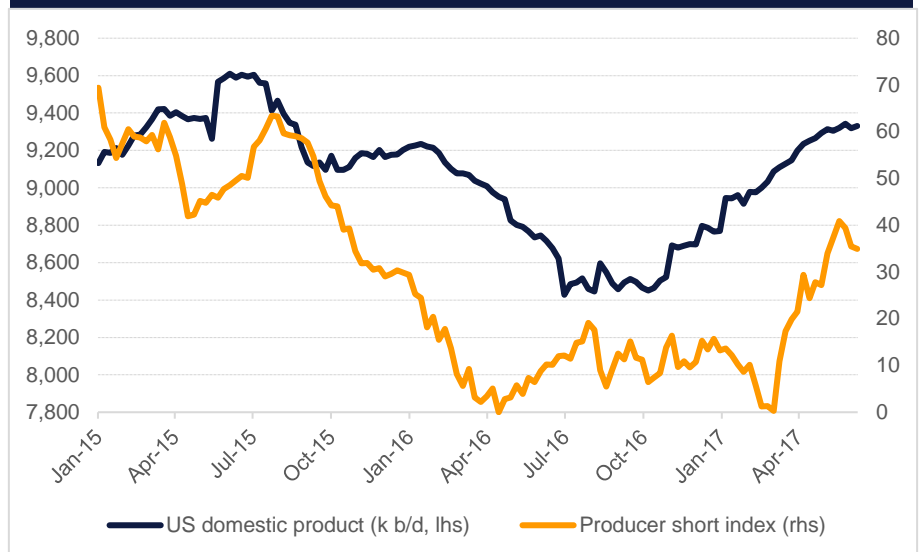
No sign of a stock draw yet in OECD stocks



Source: IEA, Emirates NBD Research.

- There appears to be no topside limit to production in the US or at least it hasn't been discovered yet. US production has risen by nearly 1m b/d since hitting a cyclical low in the middle of 2016 and the persistent rise in the drilling rig count suggests the market will need to withstand more not less US oil in the near term. One potential glimmer of hope is that producer hedging using WTI futures and options has come off from the exceptionally high levels we saw in 2016, meaning that producers will be exposed to the pain of lower prices. How effective low prices will be in clearing out the low hanging fruit in the US remains to be seen thanks to lower production costs, improved efficiencies and new markets available via exports.

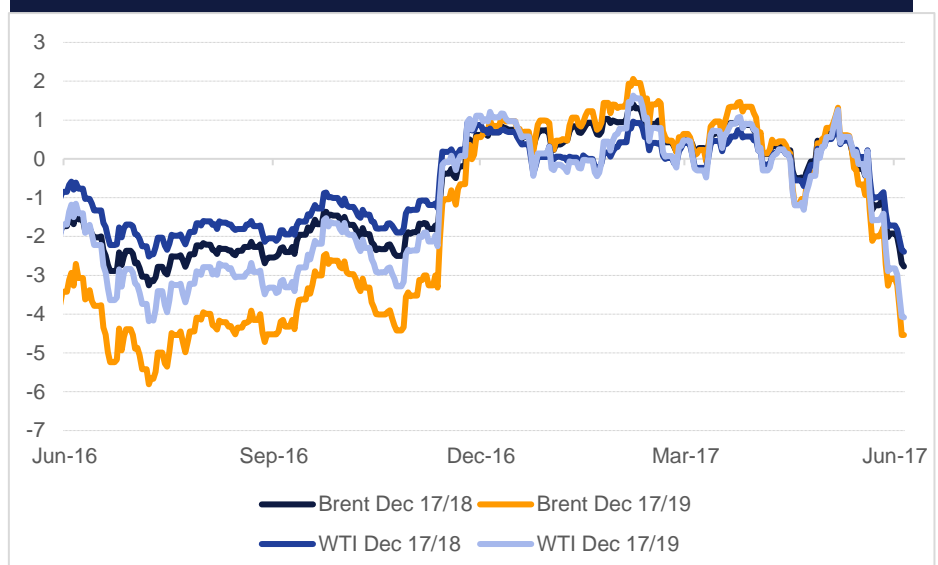
Will the surge in US output eat itself?



Source: EIKON, Emirates NBD Research. Note: index is relative level of hedging using WTI compared with the last three years. Lower values indicate more hedging, higher values less.

- The contango structure appears entrenched. We cautioned in October last year that the market would remain in contango in 2017 and any flirtation with a move into backwardation has been sharply rejected this year. Dec spreads for Brent 17-19 were as wide as USD 4.54/b this week and the longer dated 1st-24th spread is now over USD 5/b. The reemergence of a stable contango, amid low borrowing costs, could make storage trades appealing again, worsening efforts to draw down inventories.

Contango back to mid-2016 levels

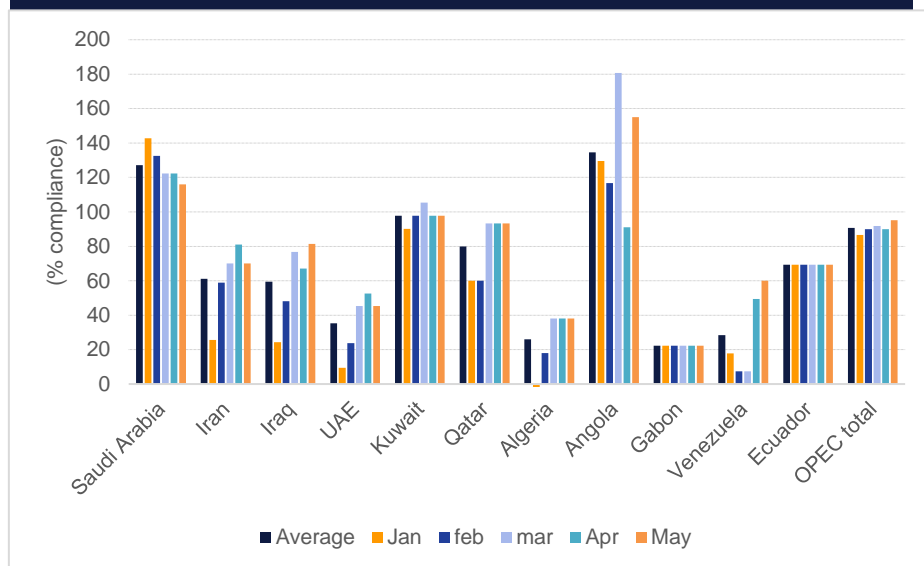


Source: EIKON, Emirates NBD Research.

- OPEC has set itself up for weakening compliance with its production cuts. Aggregate compliance has averaged about 90% for the first five months of the deal, largely on the back of excess cutting by Saudi Arabia which has compensated for lackluster levels from other producers. We are doubtful

these levels can be maintained for the tenure of the OPEC and non-OPEC agreement and any slippage to lower levels would send a negative signal to the market about OPEC volumes.

OPEC compliance: too good for its own sake?



Source: EIKON, Emirates NBD Research.

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