



بنك الإمارات دبي الوطني  
Emirates NBD

## Commodities

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# Crude oil update

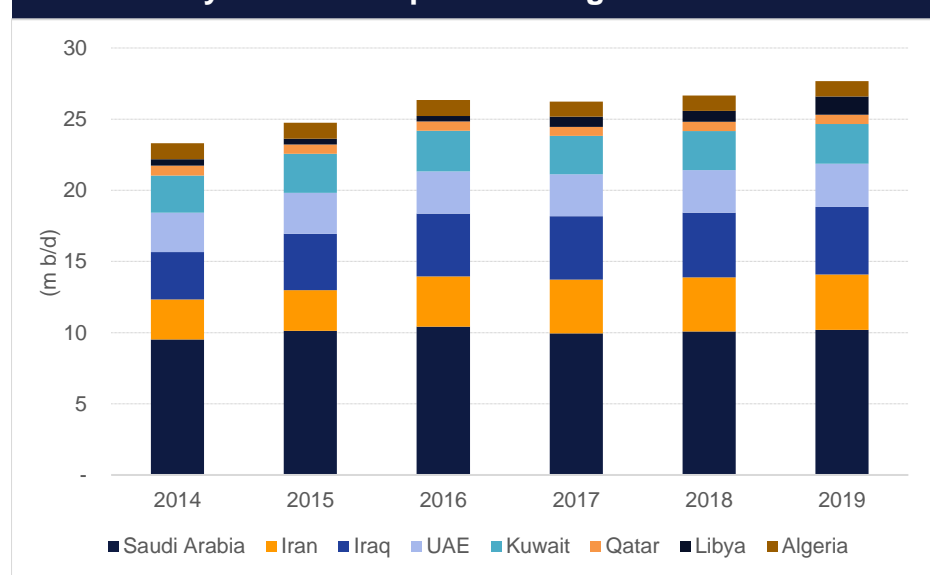
We expect OPEC will return to a strategy of production growth in 2018 as the imperative to secure market share will be pressing in a context of strong supply growth outside the producers' bloc. Six months into OPEC's plan to rebalance markets by limiting production in conjunction with partners, there are few signs of success nor do we expect that the second half of the year will see a substantial improvement. With a potential reversal in policy coming in the next 12 months we caution that downside risks for oil prices are growing clearer and are revising lower our expectations for 2018.

At the halfway point of 2017, OPEC has removed roughly 600k b/d from the market since the start of the year as collective compliance with production targets had been strong. Saudi Arabia has provided the bulk of OPEC's output restraint, achieving average compliance with its production target of more than 100%. Across the rest of MENA OPEC producers, compliance has been more varied: Kuwait and Qatar have been close to target while the UAE, Iraq and Algeria have fallen short. Iran has inadvertently helped by not achieving the production increase it had been allowed.

Saudi Arabia's 'over-cutting' signifies to us that the OPEC agreement has largely been a Saudi project and we would expect their compliance to remain strong during the course of the deal. But for the other producers, with few obvious signs that the agreement is helping to actually balance markets, we expect to see waning compliance and expect a return to production growth in 2018.

For the six months OPEC has been trying to actively manage markets, they have been unable to meaningfully erode the market surplus or catalyze a drawdown in excessive inventories. OECD inventories of crude and products were higher in April than they were at the end of 2016 and appear to have leveled off but not declined considerably in Q2.

### MENA likely to return to production growth in 2018

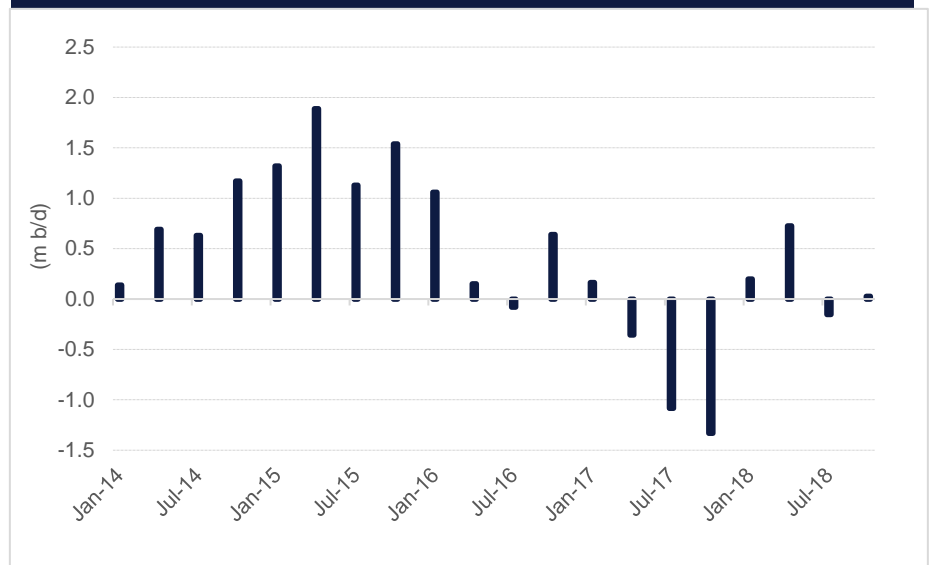


Source: IEA, Emirates NBD Research.

Forward-looking signals from the market are also undermining expectations that crude balances are noticeably tightening. The contango structure in futures markets has remained largely intact throughout the year, despite several approaches to flipping into backwardation. Prompt prices have also failed to receive a boost from lower OPEC volumes—both Brent and WTI futures have fallen 18% year to date and are hovering at levels below break-even levels for even the most fiscally assured GCC economies.

Even as prices have floundered and inventories have yet to show considerable tightening, non-OPEC supplies have been able to grow. US production has surged ahead in 2017 and is expected to grow as much as 1m b/d in 2018, according to the IEA. There is a risk that the industry in the US is growing too fast for its own good but its ability to respond quickly means that higher prices will see a short-term positive reaction in output. This increase in US production won't be entirely absorbed domestically and already in 2017 we have seen exports of US crude exports into traditional OPEC markets growing strongly.

### Market surplus to re-emerge if output increases



Source: IEA, Emirates NBD Research.

Initial projections for 2018 from the IEA expect non-OPEC supply to expand by nearly 1.5m b/d, capturing all of its forecast growth in demand. If OPEC maintained 100% compliance with its production cuts for the duration of 2017-18, it would see its share of global oil supply pushed back below 40%, assuming its partners also maintained their cuts.

Voluntarily accepting lower market share and lower prices is not a formula we believe MENA OPEC producers will endure in perpetuity. We doubt that OPEC members would make an official statement acknowledging that the production cuts have failed to balance the market but instead will allow the production cut deal to lapse at the end of Q1 2018. The ambiguity about what would happen at the end of the cut deal is already in place even if the cuts bite into market balances more significantly over the remainder of 2017.

A return to production growth from most OPEC members, even if Saudi Arabia unilaterally withholds output, could end up with total supply growth breaking above 2m b/d. This would ensure the market will return to surplus in 2018, reinforce the contango structure and act as a serious topside barrier to oil prices recovering.

We are revisiting our expectations for oil prices for the remainder of 2017 and 2018 and don't expect much of a recovery from current levels. We have revised lower our 2017 forecasts for Brent to an average of USD 51.50/b from USD 54/b previously. For next year, we expect prices will stay roughly at those levels with a risk they drift lower if OPEC production surprises to the upside. For WTI we expect prices will hold at an average of around USD 48/b for the remainder of 2017 and into next year.

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