



بنك الإمارات دبي الوطني
Emirates NBD

Commodities

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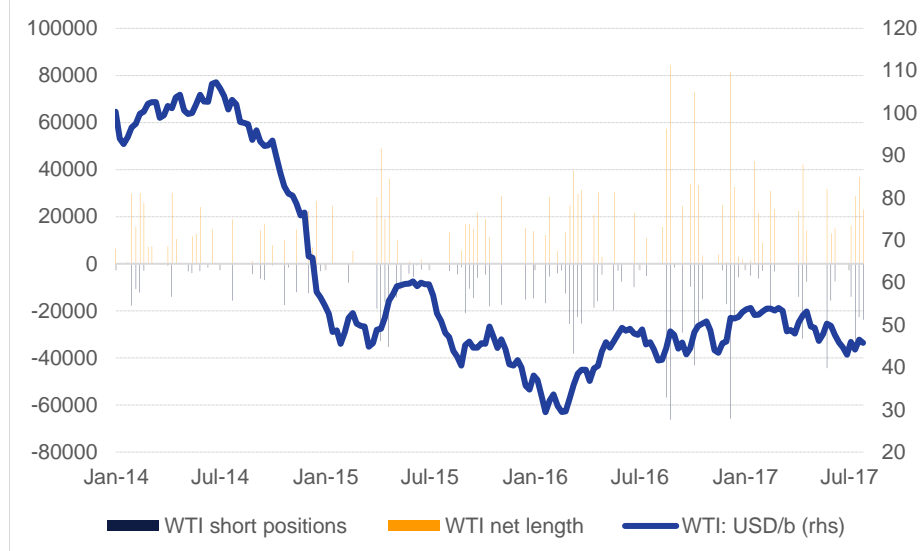
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Crude oil update

Since hitting their 2017 low in mid-June oil prices have shown signs of rallying sustainably. A steady decline in US inventories—including some large weekly draws—along with constructive commentary from OPEC and its partners about extending their production cuts further into 2018 have helped to reinforce prices at current levels.

Investors appear to have bought into the rally: speculative net length in Brent futures and options has expanded by over 88k contracts since the start of July and by an even larger level in WTI. However, the increased length has come through liquidation of shorts rather than significant new long positions. Part of the rally will be down to this short-covering as investors may be more comfortable that oil prices have found a new floor.

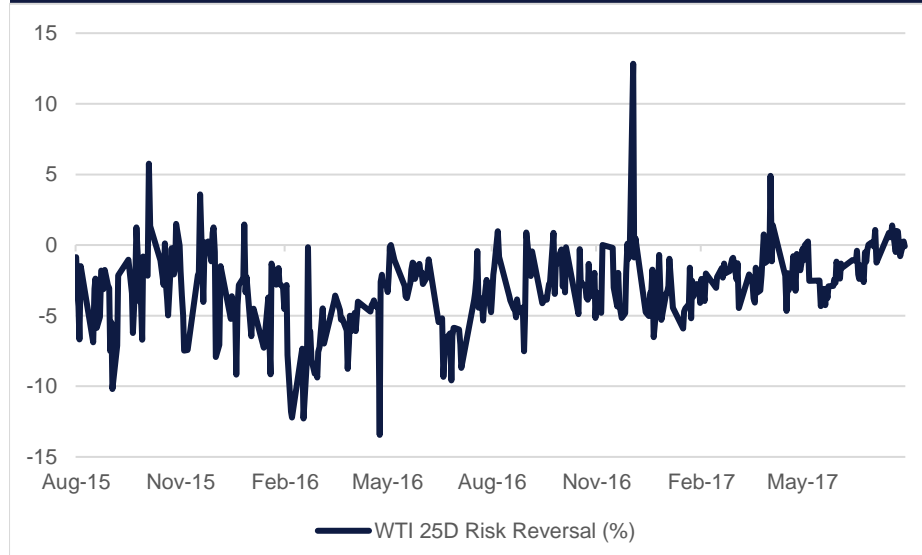
Investors aren't showing much faith for more upside



Source: EIKON, Emirates NBD Research.

Measures of put (downside risk) premiums taken from options volatility show a steady discounting of the downside risk for oil markets. Puts have become steadily less expensive relative to calls since the end of May as the market discounts how much further 1 month futures could move. We noted a similar move in the 25-delta risk reversal in February but correctly pointed out that put premiums would widen as fundamentals reasserted themselves. At this point fundamentals have had another six months to run and while we don't expect an imminent crash, it's hard to argue for much more upside.

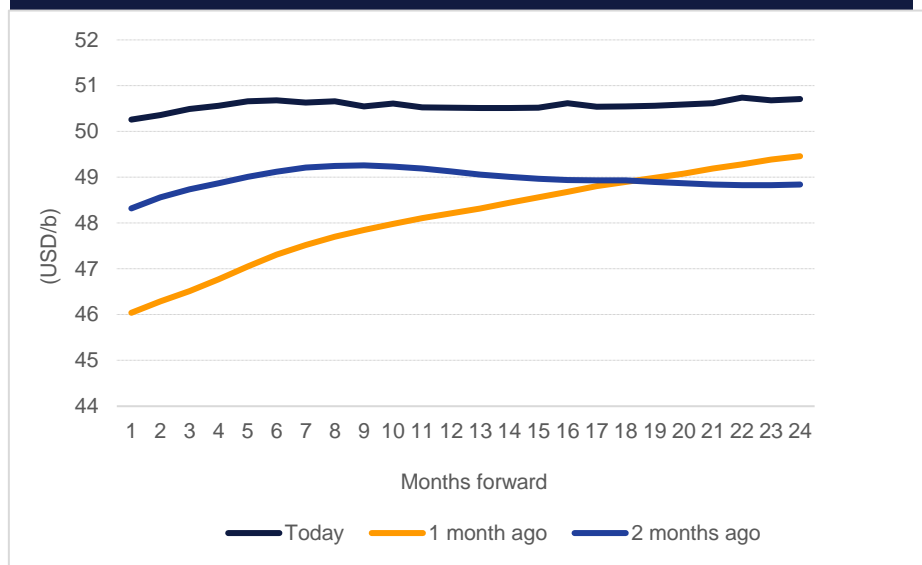
Put premium narrowing as market discounts downside



Source: Bloomberg, Emirates NBD Research. Note: market pricing.

- The oil forward curve—for WTI in particular—has flattened considerably over the last few weeks. The whole WTI curve for the next 24 months is at roughly USD 50/b, a level which should encourage some hedging activity by US producers. Hedging largely looked to have fallen off in Q1 2017 but we have seen a recent resumption of new short positions taken by the producer/merchant category in CFTC data. The expectation of persistent US supply growth—volume notwithstanding—will act as a topside limit in the near term.

Flat enough to skate on: WTI holds at USD 50



Source: EIKON, Emirates NBD Research.

- OPEC compliance with its production cut deal is waning. Estimates of July production show aggregate compliance of 84%, its lowest level all year and again largely down to over-cutting by Saudi Arabia and Angola. Already Ecuador has said it will abandon production restraint to support its economy and we expect to see compliance decrease further, particularly if oil prices hold close to current levels.
- Inventories in the US have drawn substantially since hitting a peak in early April this year but at over 480m bbl are still at enormous levels. The draw has also followed seasonal patterns and means we can't rule out a build in stocks later on this year. A potential disruption of supplies from Venezuela could have a short-term impact on US inventories if imports from the country are blocked. The size of the change in inventories matters less rather than the general trend and several weeks of modest builds may undermine confidence in the market.

We cut our oil price forecasts for the remainder of 2017 and into 2018 a few weeks ago and are holding to the view that any market deficit will be relatively short-lived and potentially quite shallow. We expect Brent to average USD 50.25/b for the rest of 2017 and USD 51/b in 2018 and WTI to average USD 47.50/b for the rest of 2017 and USD 48.50/b in 2018.

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