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Crude oil update

An uncertain story for demand next year

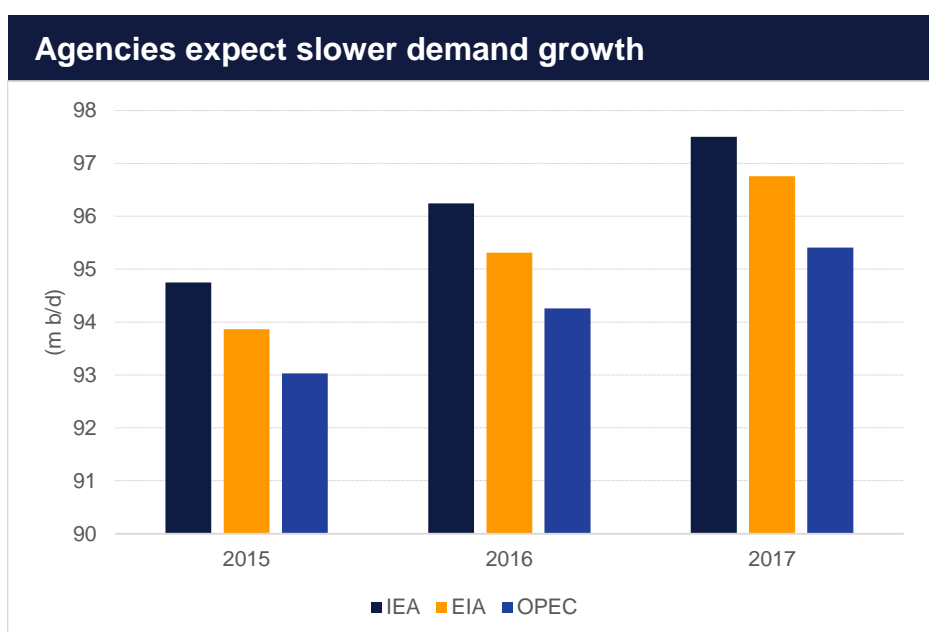
Oil markets have managed to escape the clutches of the bear market they were stuck in from late May until the end of July, in part helped by news that OPEC countries would hold an informal meeting on the sides of an energy event in Algeria in September. The prospect of OPEC cutting output or reintroducing the freeze seems to have captivated markets but we doubt that an agreement will be achieved at the event. Since these proposals were last floated, more OPEC members have seen production disrupted, most notably Nigeria, and we think it is highly unlikely that any member will voluntarily limit production.

While it doesn't quite capture the headlines as much as surging output from major producers like Saudi Arabia (which self-reported a blistering 10.67m b/d of output in July), we think that the outlook for demand will be keeping oil ministers a little uncomfortable in their seats in Algiers. Since the oil price began its current slump the market's attention has been on how quickly supply can be cut to help alleviate the downward pressure on prices. A bump in demand in relation to low was taken as a given and indeed oil consumption did rise at its fastest pace in 2015 (1.86m b/d according to the IEA) since the post financial crisis recovery in 2010.

However, that low price-high demand effect has shown signs of waning and with prices expected to continue their upward grind into 2017 (we forecast Brent at an average of USD 55/b next year, some ways between market consensus and the current forward strip) consumers may begin to reevaluate how much marginal oil they need.

Oil agencies have a mixed outlook for next year

The three major oil market institutions—the IEA, OPEC and the US government's EIA—all project oil consumption growth will slow in 2017 albeit with considerable divergences in their forecasts. The most bullish is the EIA which expects growth of 1.44m b/d in 2017, only marginally slower than their estimate for this year. More significantly, the EIA has kept its outlook for 2017 reasonably stable with a slight upward bias since its initial projections in January. OPEC is the most bearish, anticipating demand growth of just 1.16m b/d in 2017 compared with 1.22m b/d this year. OPEC has only published two forecasts for 2017 so far but its outlook is much closer to the 10-year average for oil demand estimated by the IEA of a little more than 1m b/d. The IEA splits the difference with a forecast of 1.2m b/d of demand growth in 2017, a slowdown from 1.4m b/d this year.

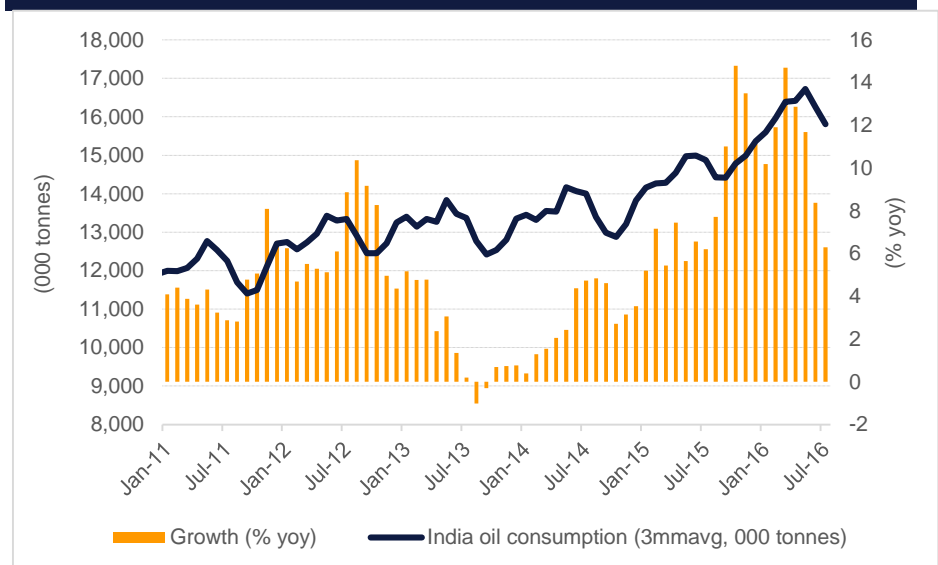


Source: IEA Oil Market Report, EIA Short-Term Energy Outlook, OPEC Monthly Oil Report, Emirates NBD Research.

Emerging markets expected to be demand growth leader again

Where all the agencies do align is in their views on the origins of growth in 2016-17. Emerging markets or the non-OECD will carry the burden of pushing global oil demand higher while consumption in developed markets squeaks out growth of barely 200k b/d on average. Much of this projection centres on consistent above trend growth from India. Consumption there has soared over the past few years and its recent decline appears to be part of a highly seasonal lull in Q3 as monsoon weather displaces the need for diesel-powered irrigation pumps. We expect another year of fast (8%) real GDP growth in India next year which should help to keep oil consumption growth elevated, particularly on the back of continued government capital spending and incentives for domestic manufacturing.

India's oil demand is running hot



Source: Petroleum Planning and Analysis Cell, Emirates NBD Research.

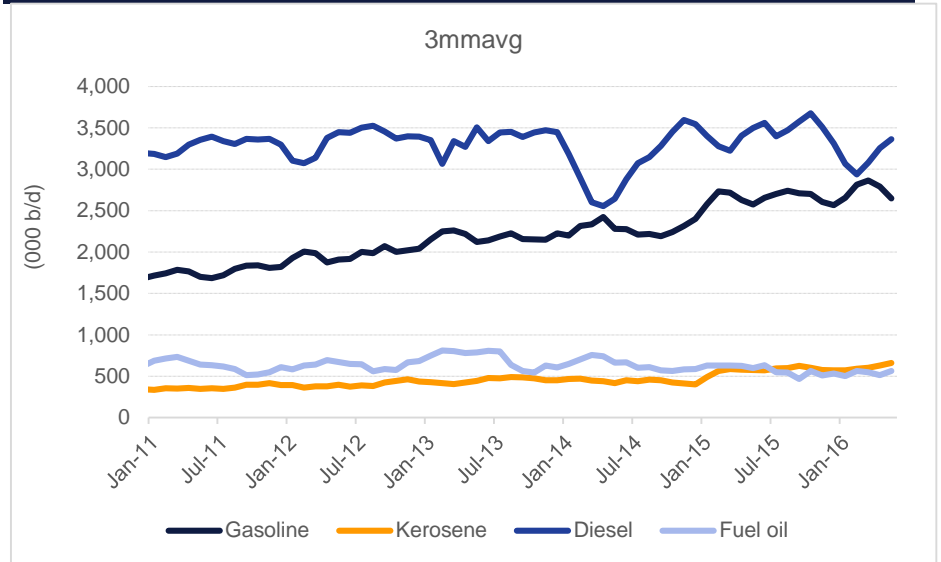
That said, there are signs of plateauing in the drivers for India oil demand. New car sales have essentially flat-lined in 2016, averaging yoy growth of less than 0.5% as of the end of July. Softer refining margins and upgrades to fuel specifications will also crimp refinery run rates after they surged in H1 2016. The impact of GST, which we expect will be implemented at least by the middle of 2017, is uncertain as the rate and range of energy products which will be included has not yet been finalized.

The long-term outlook for Indian oil consumption remains extremely strong as transportation ownership spreads across the country and the country's catch up potential is high: at present India consumes barely more than 1 barrel of oil each year on a per capita basis, compared with 22 in the US or more than 3 in China. However, even with the fastest expected demand growth in the world, India will need less than 300k b/d to accommodate its marginal demand next year. The more significant variable for the oil demand outlook in 2017 of course remains the trajectory of China.

Are expectations for China's demand too sanguine?

After demand rose by an enormous 740k b/d in 2015 (almost 7%) China's oil demand story appears set for some moderation. Expectations for 2016 growth range from 270k b/d (IEA) to 400k b/d (EIA) and all the agencies expect a similar increase in volumes in 2017. We expect China's economy to expand by 6.3% in real terms next year as the transition away from heavy investment toward services continues. This transformation need not spell the end of fast oil demand growth in China. Indeed, kerosene (including jet) and gasoline demand are both closing in on doubling over the past five years. Much like in India, the long-term potential for China oil demand remains strong on demographic and broader macro trends in the economy.

China's demand moves to light ends but diesel drag means short-term softness

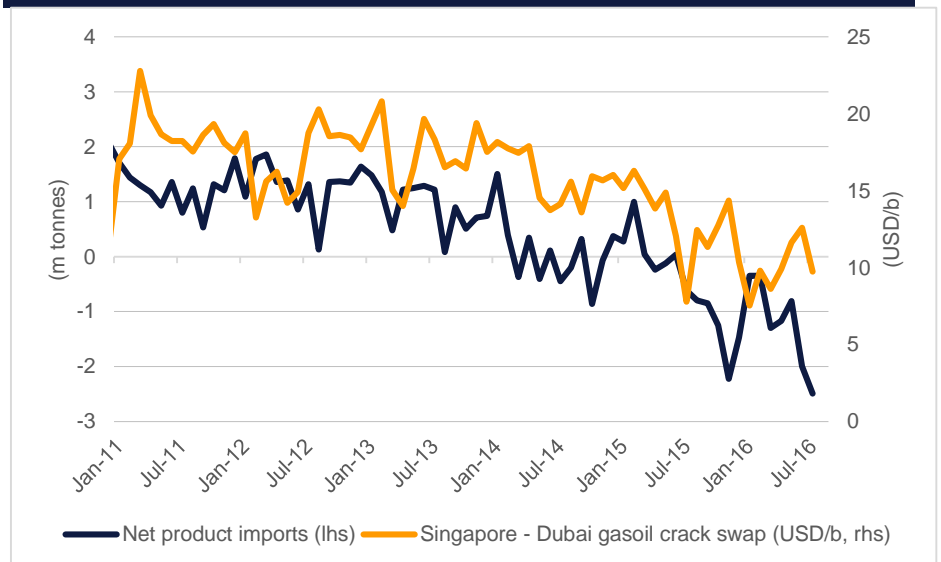


Source: Bloomberg, Emirates NBD Research.

But in the short term there are some signs of softening. Again, like in India, refineries have been running hot over the past 18 months to profit from advantageous refining margins. With still elevated inventories at major trading hubs in Asia and spot crude prices rising, refining cracks are now being squeezed, putting pressure on refiners to cut run rates.

At the same time, there are doubts about the strength of domestic demand. Even with imports of crude running at high levels demand for diesel—still the dominant component of Chinese oil demand—has been languishing as government efforts to curb excess industrial capacity and clean up the country's energy mix away from coal are having an impact. Net imports of oil products have been running negative for more than a year as refiners push unneeded oil products onto international markets. Exports of Chinese refined products have gone from a statistical anomaly to a chief catalyst for softer diesel cracks in Asia.

China's product exports weighing on Asia refining margins

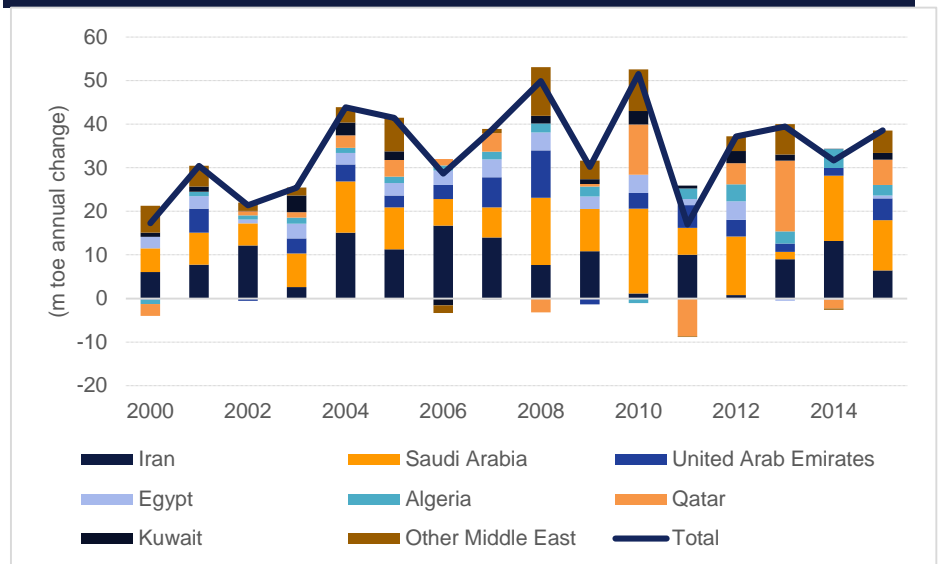


Source: Bloomberg, Emirates NBD Research.

MENA demand shows signs of sagging

As a net exporting region of petroleum products the impact of low oil prices is showing up starkly in MENA demand levels. The Middle East is widely expected to be a major contributor of demand growth going forward thanks to fast rising populations and energy intensive industries, particularly in the GCC countries. Traditionally the region has bucked economic axiom that slower economic activity slows energy demand.

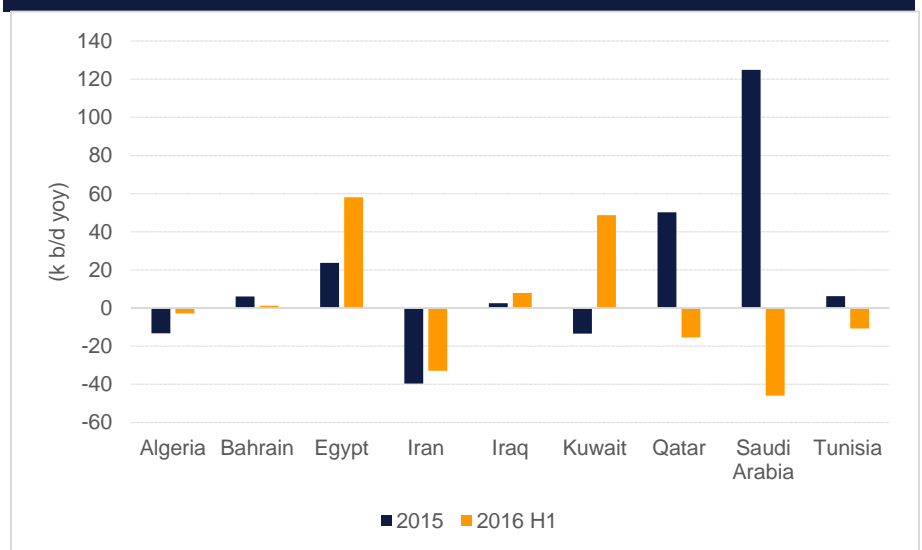
Middle East energy demand stays up even in slow growth



Source: BP Statistical Review of World Energy 2016, Emirates NBD Research.

But there are signs of wavering in regional oil demand as GCC countries see slower economic activity and governments cut back on extensive energy subsidies. Demand growth generally is slowing across the region with some of the largest oil producers seeing some of the steepest declines.

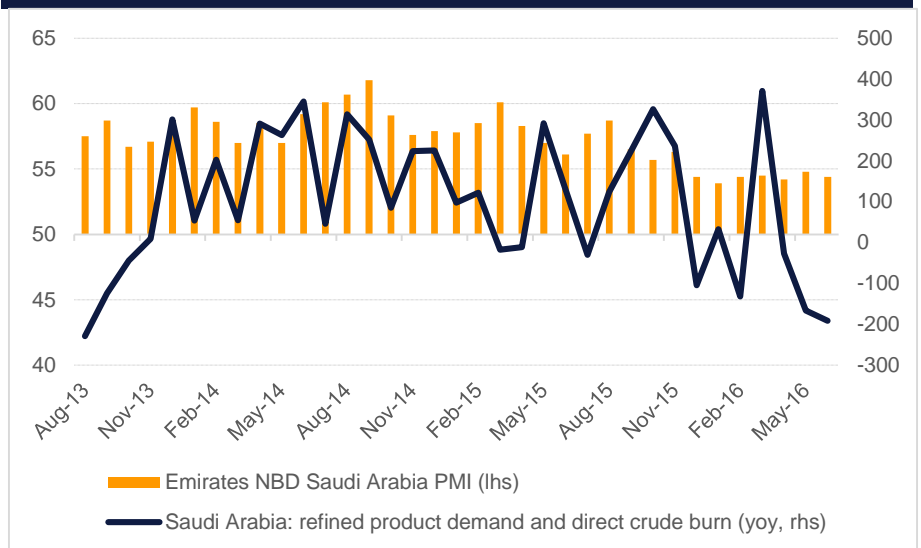
2016 see signs of MENA refined product demand waning



Source: JODI, Emirates NBD Research. Note: Kuwait Jan-Apr, all others H1. Refined products only.

In Saudi Arabia, the largest energy market in the region, consumption of refined products and direct burn of crude oil has fallen by an average of 19k b/d year on year in the first half of 2016. In 2015, year on year growth averaged over 115kb/d. Several months of heavy decline in gasoil/diesel and fuel oil—which account for almost half of Saudi demand—have been behind the drop in consumption.

Demand in Saudi Arabia wavering as economy slows

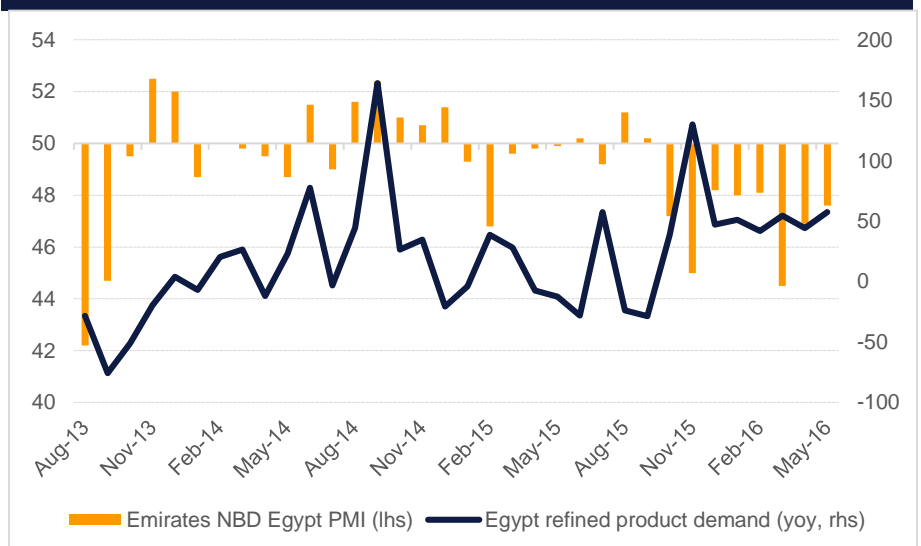


Source: JODI, Emirates NBD Research.

We expect Saudi Arabia's economy will expand by 2.6% in 2017, faster than our estimate of less than 2% this year but still much slower than some of the headier levels seen over the past decade. The removal of subsidies on petrol products may start to affect demand levels more substantially in 2017 if crude prices continue their general trend higher and as living costs rise in general.

Egyptian oil demand is a notable standout as product demand has been storming ahead as of the end of May, averaging growth of nearly 50k b/d compared with 20k b/d for the whole of 2015. This appears anomalous considering the softness we are witnessing in the Egyptian economy, the recent IMF deal notwithstanding.

Egypt's demand surprises to the upside



Source: JODI, Emirates NBD Research.

But going into 2017 the outlook for Egypt's demand is less assured. The government will need to take reform steps as part of its new deal with the IMF, some of which will likely fall in the form of further cuts to energy subsidies and likely a devaluation of the pound. In tandem with a higher benchmark oil prices this bodes poorly for Egypt's oil demand in 2017, even if we expect an acceleration in the economy.

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