



بنك الإمارات دبي الوطني  
Emirates NBD

## Commodities

24 November 2016

**Edward Bell**  
Commodity Analyst  
+971 4 230 7701  
edwardpb@emiratesnbd.com

www.emiratesnbdresearch.com

# Crude oil update

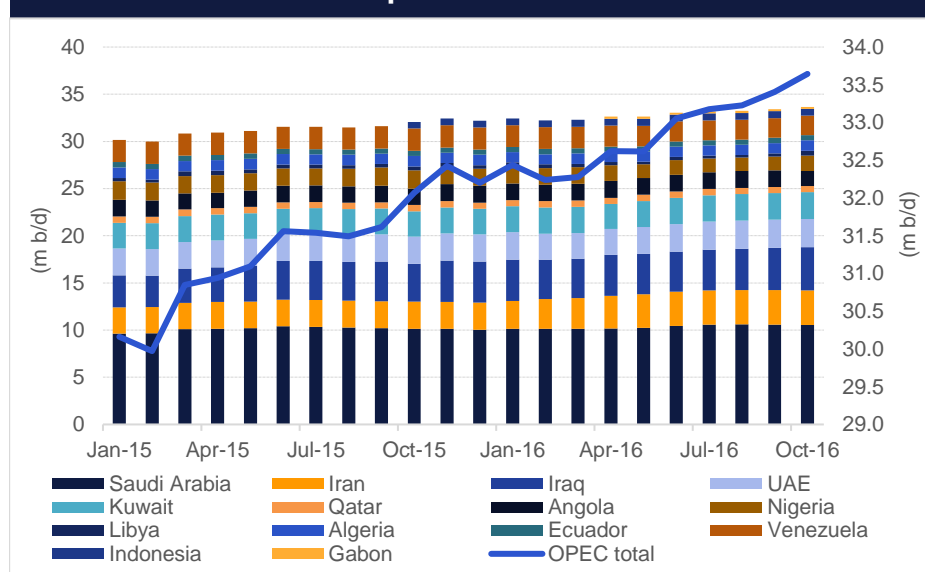
## Decisions, decisions: what does 2017 hold in store for oil?

OPEC's decision next week will set how oil markets start 2017. Considering their performance in January 2016 it wouldn't take much to be an improvement. While we believe the odds of OPEC firming up their production cut agreement have shortened, it is important to remember that we have been close to a deal several times so far this year only for it to be upended at the last minute.

There are several potential outcomes from next week's meeting, each one of which will have its own impact on prices.

- Do nothing. OPEC fails to reach an agreement on how to distribute production cuts and members are left to their own devices. Prices would likely react sharply to the downside in the immediate aftermath but the low prices would mean less non-OPEC oil entering markets and could ultimately be beneficial in the aim of rebalancing and securing long-term market share.
- OPEC reaches a verbal agreement but it is short on details. This is the 'cosmetic cut' option and has essentially been OPEC's main channel for affecting prices so far this year. This is the easiest and lowest cost option but unless it is backed up by removing barrels from the market, it essentially preserves the status quo.
- Commit to a target range of 32.5m – 33m b/d and allow several countries exemptions. This would put the Algiers agreement into force and would mean carve-outs for Nigeria, Libya and Iran as their production has been impacted by factors outside their control. The burden of cuts then would fall heavier on the rest of OPEC, particularly on producers like Saudi Arabia, the UAE and Kuwait.
- A firm deal on cutting production. OPEC agrees to a collective target of 32.5m b/d to be implemented from Q1 2017. While this would not balance the market immediately it would help push the market into deficit by the second half of the year and would be supportive for prices, at least for a few months. A price rally on the back of an OPEC cut however would help non-OPEC producers too and could mean any market deficit is fleeting as they add on production.

## OPEC's increase in output makes cuts that much harder



Source: OPEC, Emirates NBD Research.

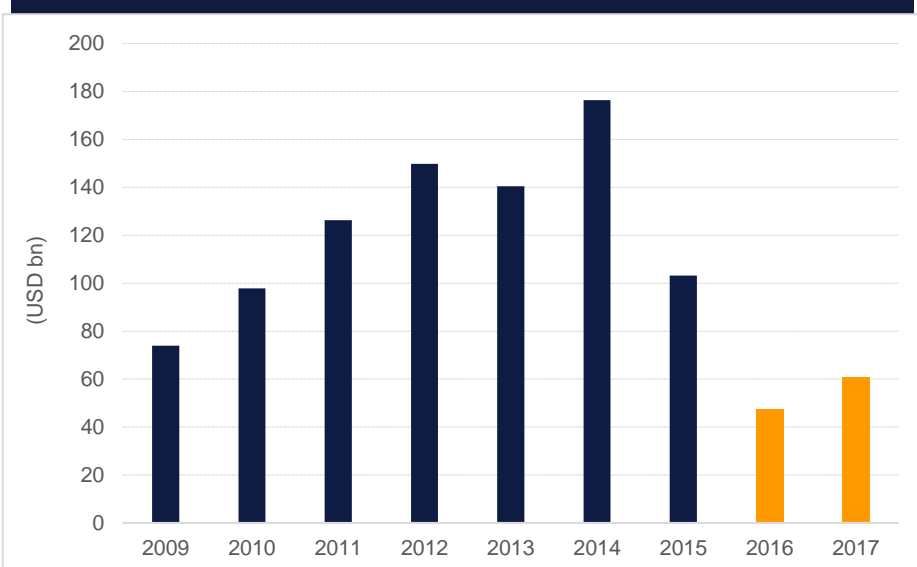
As the market grew skeptical that the Algiers deal could be easily implemented oil prices gave up more than their post-agreement gains, falling more than USD 10/b from their year-to-date peak of USD 53.73 in early October. Considering the scale of the move, the stakes are high for OPEC to come out of next week's meeting with a positive outcome.

## Non-OPEC set to recover in 2017...

Whatever OPEC decides at the end of November, the rebalancing of oil markets will be a moving target for much of 2017. All the major international forecasting agencies—EIA, IEA and OPEC itself—expect non-OPEC supplies to expand in 2017, reversing this year's decline. Major contributions to supply growth are expected from Brazil (250k b/d increase expected by OPEC), Canada (170k b/d) and Kazakhstan (210k b/d) thanks to a full year of output from the Kashagan oil field. Overall, OPEC expects an increase of over 200k b/d from non-OPEC suppliers while the IEA is more bullish, forecasting nearly 500k b/d of more non-OPEC supplies to enter markets.

The major question mark for supply next year is what will happen in the US. The EIA estimates crude output has fallen more than 500k b/d since the start of 2016 and it is down almost 1m b/d from its mid-2015 peak. However, for most of Q3 2016 US output stabilised at around 8.5m b/d and ticked up sharply at the start of November to just shy of 8.7m b/d.

## North American E&P spending to expand in 2017



Source: Bloomberg, Emirates NBD Research. Note: Capex consensus estimates for North American independent E&P companies.

Market activity does seem to indicate that some stabilization, if not expansion of output is on the cards. Producer shorts have moved consistently upward in 2016, taking advantage of fleeting rallies in oil futures while after bottoming out in May this year, the US oil drilling rig count has now risen more than 130 rigs (up 42%).

Market consensus also expects an uptick in capex from North American E&P companies next year to over USD 60bn, far below recent highs of nearly USD 180bn but still an improvement on 2016. All the major agencies are aligned in forecasting a decline in US output next year but it may be prudent to expect to be surprised to the upside.

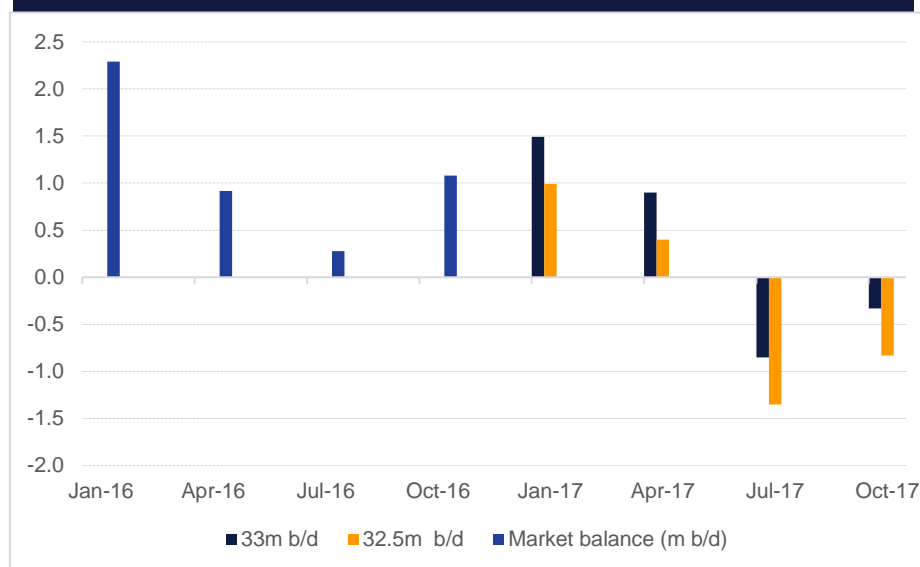
## ...but demand will be worse off

The demand side of the oil market ledger makes for some less inspiring reading. Consensus among the major forecasting agencies is for demand growth to slow next year despite some relatively strong performances from India and other Asian markets. OECD demand growth will essentially vanish as Europe will see no growth in oil consumption at best and potentially move back to negative if political risks disrupt the trajectory of Europe's economy.

Middle East oil demand growth in our view can no longer be taken as a granted as consumption has slowed sharply this year as low oil prices take their toll on some of the major consumers, concentrated in the GCC economies.

Using OPEC's current 2017 supply and demand forecasts as a baseline, the bloc's proposed production cut targets of 32.5m-33m b/d won't be enough to balance markets with any immediate impact. Even the lower target would contribute to a market surplus of nearly 1m b/d in Q1 and a deficit starting to emerge by the second half of the year. But that deficit is contingent on non-OPEC supplies restraining output growth to around 200k b/d.

### Market to move to deficit by second half of 2017

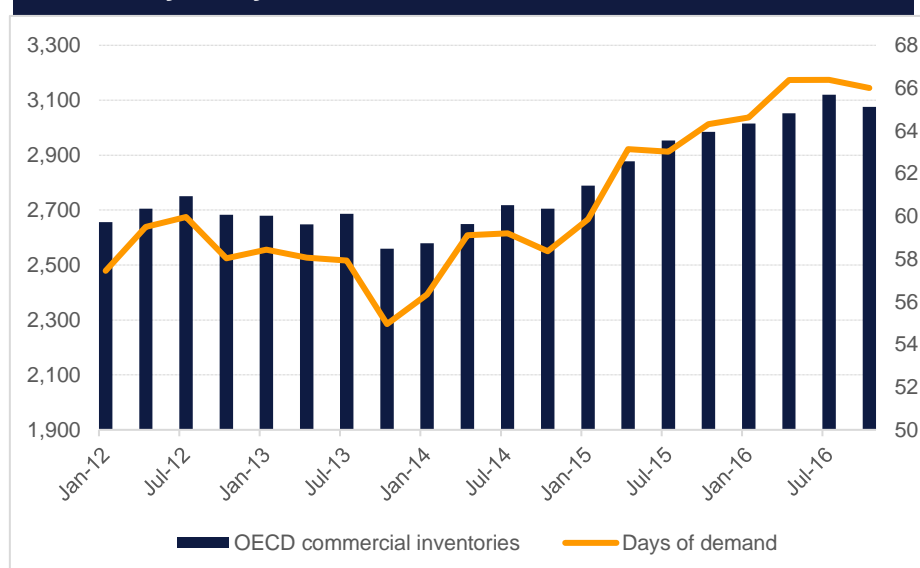


Source: OPEC Monthly Oil Market Report, Emirates NBD Research.

### Inventories threaten to spoil the party

A balance of oil market flows is just one part of the story. Crude inventories held in OECD economies are on track to enter 2017 with over 3bn bbl of crude stockpiled, representing close to 70 days of forward demand. Spot prices may react sharply to expectations of production cuts but any steep upward movement will slam hard into this wall of stockpiled crude and products.

### Inventory carryover at extreme levels



Source: IEA Oil Market Report, Emirates NBD Research.

## Would proposed cuts be enough?

The challenge then for OPEC is hardly enviable. Any decision that comes out of next week's meeting would have to meet several criteria, in our view, to set prices on a more solid higher trajectory:

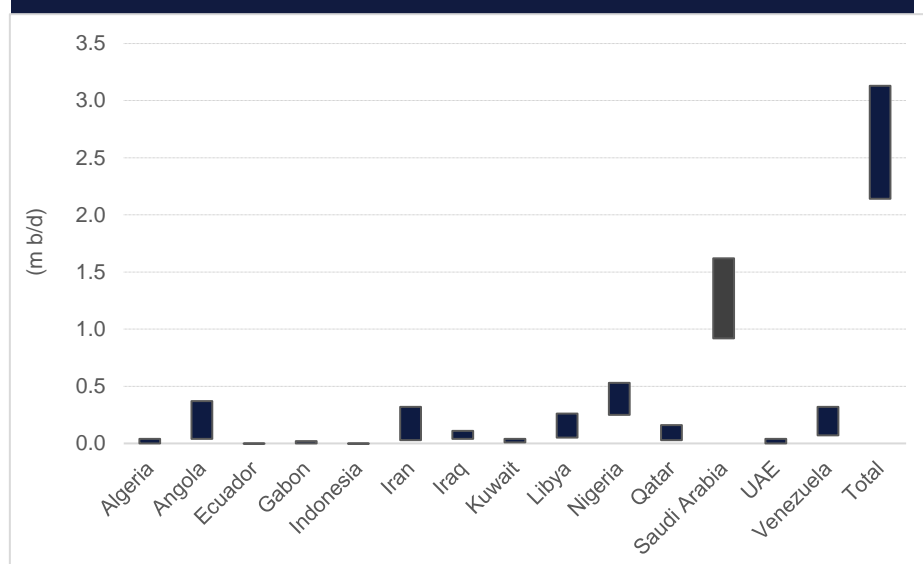
- A cut must occur. OPEC has successfully talked up the market several times in 2016 only to follow with higher output. A failure to match talk with changes to physical supply will see a sharp vote of no confidence from prices.
- The cut will probably need to be deeper than the 32.5m – 33m b/d target already announced. Cutting this amount will only see a deficit emerge in Q3 2017 and that is a tentative forecast on non-OPEC supply not growing much.
- The cut must last. If the cut only last six months and then OPEC members try to recover higher output targets later in the year, the market will most likely move back into surplus by the end of 2017.

Any OPEC decision won't be taken in a vacuum. Failure to provide details and follow through on the Algiers agreement has already seen oil prices slump and getting them back to convincingly hold at USD 50/b will be a first challenge. There is also no guarantee that a cut will result in the kind of price increase most OPEC governments would be hoping for.

Higher prices for OPEC also mean higher prices for other producers. Calibrating the right amount of oil to take out of the market to ensure prices rise but don't encourage non-OPEC producers will probably need more finesse than fickle futures market investors have the attention for.

The most significant challenge though is whether any cut agreement will be accepted and adhered to. Already, Iran, Nigeria and Libya are meant to be exempt. Total spare capacity in OPEC is estimated between 2.1m - 3.1m b/d. Any slippage or cheating from members could keep markets stubbornly in surplus.

### Scope for members to seep oil even if cut agreed



Source: IEA Oil Market Report, Bloomberg, Emirates NBD Research. Note: range of spare capacity estimates.

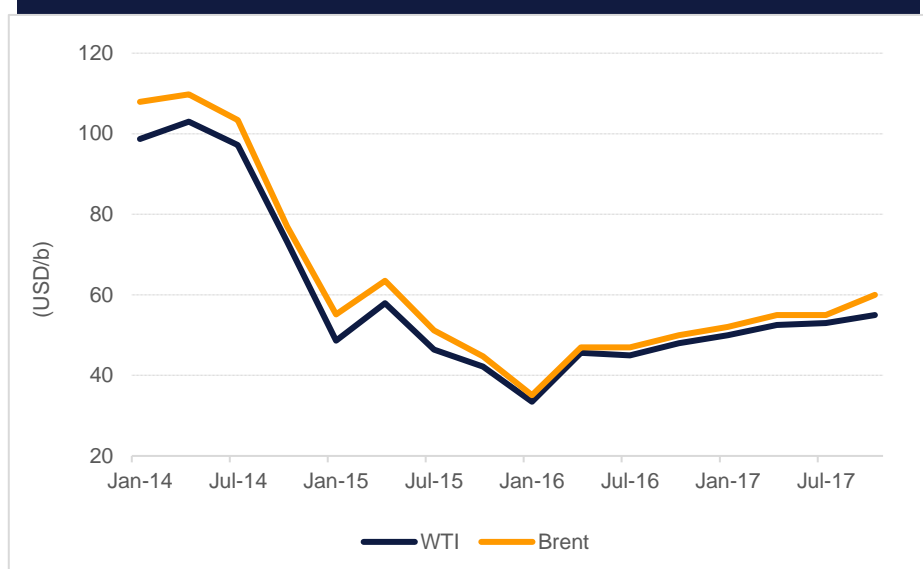
## What does this mean for prices in 2017

Considering the intensity of market scrutiny over what happens at OPEC's meeting on November 30th, we expect the producers' bloc will endorse form of action, most likely a cut to the lower end of OPEC's proposed range.

For 2017 we are still cautiously optimistic about the direction for oil prices and expect futures to average around USD 55/b for Brent and about USD 53/b for WTI, generally rising over the course of the year as the market tightens. If OPEC fails to implement its production cut then we could be facing another step down in oil and delaying the process of market rebalancing probably at least another six months.

Upside risks are far harder to sketch out in the current market conditions. Demand spikes occur with far less frequency than supply shocks and the availability of inventories and assets near to completion (at least in oil market terms) would mean any irrational rally will be hastily brought down to earth.

### Emirates NBD Research oil price assumptions



Source: Bloomberg, Emirates NBD Research. Note: Quarterly average prices.

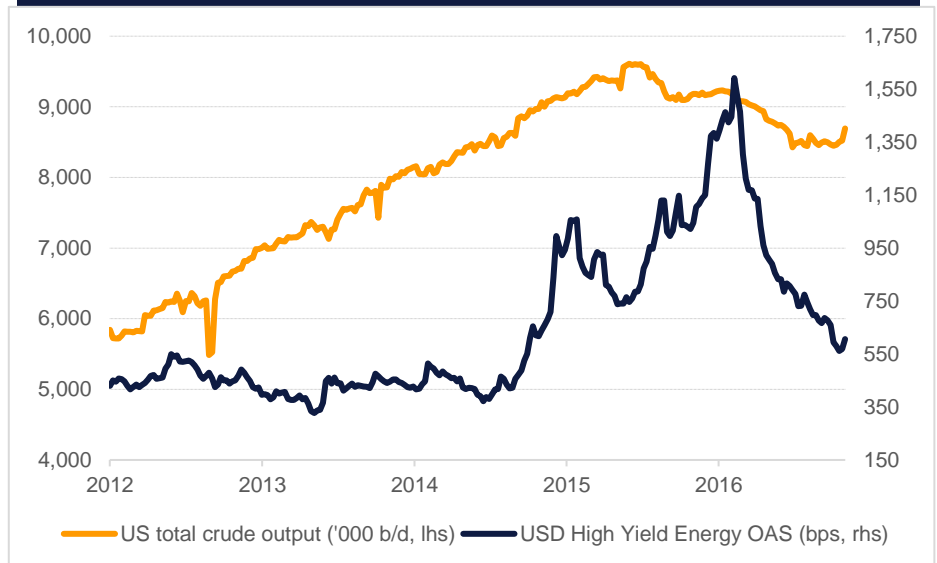
### The Trump effect

What will the impact of a Trump presidency be on oil markets? We expect two headline issues to play out over 2017, one local to the US and one related to international dynamics. Mr Trump's campaign positions on energy focused on 'unleashing' untapped shale oil and natural gas reserves in the US and making the country 'totally independent' of OPEC oil. The president-elect has also pledged to ease restrictions on oil and gas production in the US by allowing drilling on federal lands. In practice though, most US oil and gas production regulations are determined at the state level and the states which will be at the forefront of any increases in US oil output—Texas and North Dakota—are hardly antagonistic toward the oil industry. President-elect Trump may use executive authority to approve new pipelines—reversing President Obama's decision on Keystone XL would look like a first step—but this would bring more oil into the US, to the benefit of refiners and consumers, but not a major help to the E&P industry.

We think the more direct impact a Trump administration would have on US oil output would come actually from the trajectory for US rates rather than energy specific policies. We expect the Fed to raise rates in December and see two to three hikes next year. The shale industry in the US has been a major beneficiary of the low rate environment following the GFC: Bakken-focused producers have averaged debt-to-capital ratios greater than 50% in 2013-15 compared with 31% on average for major, diversified IOCs.

Shale-oil producers, particularly those with limited international exposure will be on the front line in terms of feeling the pain of higher US rates which may slow investment into new fields if oil prices do not improve substantially. Mr Trump may be a more accommodative president to the US oil industry but ultimately the market will determine how much of the country's reserves will be 'unleashed.'

### US oil industry benefited from years of low rates



Source: Bloomberg, Emirates NBD Research.

The second way President-elect Trump could affect oil markets next year would be if he removes US support for the JCPOA nuclear deal with Iran. The US walking away from the JCPOA would not annul the deal but the uncertainty of whether the US—either via the president or an emboldened and unhindered Republican congress—sought to reintroduce sanctions on Iran would undermine it. Uncertainty over the US's Iran policy would also spook markets.

A broader US disengagement from the Middle East in a Trump administration may lead the market to reintroducing a sizeable political risk premium back into oil prices, warranted or not. While the presence of the US shale industry can help to neutralize the impact of political issues on oil prices, the absence of large Iranian and Libyan volumes from 2012-14 certainly helped to keep oil prices in an elevated range.

## Disclaimer

PLEASE READ THE FOLLOWING TERMS AND CONDITIONS OF ACCESS FOR THE PUBLICATION BEFORE THE USE THEREOF. By continuing to access and use the publication, you signify you accept these terms and conditions. Emirates NBD reserves the right to amend, remove, or add to the publication and Disclaimer at any time. Such modifications shall be effective immediately. Accordingly, please continue to review this Disclaimer whenever accessing, or using the publication. Your access of, and use of the publication, after modifications to the Disclaimer will constitute your acceptance of the terms and conditions of use of the publication, as modified. If, at any time, you do not wish to accept the content of this Disclaimer, you may not access, or use the publication. Any terms and conditions proposed by you which are in addition to or which conflict with this Disclaimer are expressly rejected by Emirates NBD and shall be of no force or effect. Information contained herein is believed by Emirates NBD to be accurate and true but Emirates NBD expresses no representation or warranty of such accuracy and accepts no responsibility whatsoever for any loss or damage caused by any act or omission taken as a result of the information contained in the publication. The publication is provided for informational uses only and is not intended for trading purposes. Charts, graphs and related data/information provided herein are intended to serve for illustrative purposes. The data/information contained in the publication is not designed to initiate or conclude any transaction. In addition, the data/information contained in the publication is prepared as of a particular date and time and will not reflect subsequent changes in the market or changes in any other factors relevant to their determination. The publication may include data/information taken from stock exchanges and other sources from around the world and Emirates NBD does not guarantee the sequence, accuracy, completeness, or timeliness of information contained in the publication provided thereto by or obtained from unaffiliated third parties. Moreover, the provision of certain data/information in the publication may be subject to the terms and conditions of other agreements to which Emirates NBD is a party.

None of the content in the publication constitutes a solicitation, offer or recommendation by Emirates NBD to buy or sell any security, or represents the provision by Emirates NBD of investment advice or services regarding the profitability or suitability of any security or investment. Moreover, the content of the publication should not be considered legal, tax, accounting advice. The publication is not intended for use by, or distribution to, any person or entity in any jurisdiction or country where such use or distribution would be contrary to law or regulation. Accordingly, anything to the contrary herein set forth notwithstanding, Emirates NBD, its suppliers, agents, directors, officers, employees, representatives, successors, assigns, affiliates or subsidiaries shall not, directly or indirectly, be liable, in any way, to you or any other person for any: (a) inaccuracies or errors in or omissions from the publication including, but not limited to, quotes and financial data; (b) loss or damage arising from the use of the publication, including, but not limited to any investment decision occasioned thereby. (c) UNDER NO CIRCUMSTANCES, INCLUDING BUT NOT LIMITED TO NEGLIGENCE, SHALL EMIRATES NBD, ITS SUPPLIERS, AGENTS, DIRECTORS, OFFICERS, EMPLOYEES, REPRESENTATIVES, SUCCESSORS, ASSIGNS, AFFILIATES OR SUBSIDIARIES BE LIABLE TO YOU FOR DIRECT, INDIRECT, INCIDENTAL, CONSEQUENTIAL, SPECIAL, PUNITIVE, OR EXEMPLARY DAMAGES EVEN IF EMIRATES NBD HAS BEEN ADVISED SPECIFICALLY OF THE POSSIBILITY OF SUCH DAMAGES, ARISING FROM THE USE OF THE PUBLICATION, INCLUDING BUT NOT LIMITED TO, LOSS OF REVENUE, OPPORTUNITY, OR ANTICIPATED PROFITS OR LOST BUSINESS. The information contained in the publication does not purport to contain all matters relevant to any particular investment or financial instrument and all statements as to future matters are not guaranteed to be accurate. Anyone proposing to rely on or use the information contained in the publication should independently verify and check the accuracy, completeness, reliability and suitability of the information and should obtain independent and specific advice from appropriate professionals or experts regarding information contained in the publication. Further, references to any financial instrument or investment product is not intended to imply that an actual trading market exists for such instrument or product. In publishing this document Emirates NBD is not acting in the capacity of a fiduciary or financial advisor.

Emirates NBD and its group entities (together and separately, "Emirates NBD") does and may at any time solicit or provide commercial banking, investment banking, credit, advisory or other services to the companies covered in its reports. As a result, recipients of this report should be aware that any or all of the foregoing services may at times give rise to a conflict of interest that could affect the objectivity of this report.

The securities covered by this report may not be suitable for all types of investors. The report does not take into account the investment objectives, financial situations and specific needs of recipients.

Data included in the publication may rely on models that do not reflect or take into account all potentially significant factors such as market risk, liquidity risk and credit risk. Emirates NBD may use different models, make valuation adjustments, or use different methodologies when determining prices at which Emirates NBD is willing to trade financial instruments and/or when valuing its own inventory positions for its books and records. In receiving the publication, you acknowledge and agree that there are risks associated with investment activities. Moreover, you acknowledge in receiving the publication that the responsibility to obtain and carefully read and understand the content of documents relating to any investment activity described in the publication and to seek separate, independent financial advice if required to assess whether a particular investment activity described herein is suitable, lies exclusively with you. You acknowledge and agree that past investment performance is not indicative of the future performance results of any investment and that the information contained herein is not to be used as an indication for the future performance of any investment activity. You acknowledge that the publication has been developed, compiled, prepared, revised, selected, and arranged by Emirates NBD and others (including certain other information sources) through the application of methods and standards of judgment developed and applied through the expenditure of substantial time, effort, and money and constitutes valuable intellectual property of Emirates NBD and such others. All present and future rights in and to trade secrets, patents, copyrights, trademarks, service marks, know-how, and other proprietary rights of any type under the laws of any governmental authority, domestic or foreign, shall, as between you and Emirates NBD, at all times be and remain the sole and exclusive property of Emirates NBD and/or other lawful parties. Except as specifically permitted in writing, you acknowledge and agree that you may not copy or make any use of the content of the publication or any portion thereof. Except as specifically permitted in writing, you shall not use the intellectual property rights connected with the publication, or the names of any individual participant in, or contributor to, the content of the publication, or any variations or derivatives thereof, for any purpose.

YOU AGREE TO USE THE PUBLICATION SOLELY FOR YOUR OWN NONCOMMERCIAL USE AND BENEFIT, AND NOT FOR RESALE OR OTHER TRANSFER OR DISPOSITION TO, OR USE BY OR FOR THE BENEFIT OF, ANY OTHER PERSON OR ENTITY. YOU AGREE NOT TO USE, TRANSFER, DISTRIBUTE, OR DISPOSE OF ANY DATA/INFORMATION CONTAINED IN THE PUBLICATION IN ANY MANNER THAT COULD COMPETE WITH THE BUSINESS INTERESTS OF EMIRATES NBD. YOU MAY NOT COPY, REPRODUCE, PUBLISH, DISPLAY, MODIFY, OR CREATE DERIVATIVE WORKS FROM ANY DATA/INFORMATION CONTAINED IN THE PUBLICATION. YOU MAY NOT OFFER ANY PART OF THE PUBLICATION FOR SALE OR DISTRIBUTE IT OVER ANY MEDIUM WITHOUT THE PRIOR WRITTEN CONSENT OF EMIRATES NBD. THE DATA/INFORMATION CONTAINED IN THE PUBLICATION MAY NOT BE USED TO CONSTRUCT A DATABASE OF ANY KIND. YOU MAY NOT USE THE DATA/INFORMATION IN THE PUBLICATION IN ANY WAY TO IMPROVE THE QUALITY OF ANY DATA SOLD OR CONTRIBUTED TO BY YOU TO ANY THIRD PARTY. FURTHERMORE, YOU MAY NOT USE ANY OF THE TRADEMARKS, TRADE NAMES, SERVICE MARKS, COPYRIGHTS, OR LOGOS OF EMIRATES NBD OR ITS SUBSIDIARIES IN ANY MANNER WHICH CREATES THE IMPRESSION THAT SUCH ITEMS BELONG TO OR ARE ASSOCIATED WITH YOU OR, EXCEPT AS OTHERWISE PROVIDED WITH EMIRATES NBD'S PRIOR WRITTEN CONSENT, AND YOU ACKNOWLEDGE THAT YOU HAVE NO OWNERSHIP RIGHTS IN AND TO ANY OF SUCH ITEMS. MOREOVER YOU AGREE THAT YOUR USE OF THE PUBLICATION IS AT YOUR SOLE RISK AND ACKNOWLEDGE THAT THE PUBLICATION AND ANYTHING CONTAINED HEREIN, IS PROVIDED "AS IS" AND "AS AVAILABLE," AND THAT EMIRATES NBD MAKES NO WARRANTY OF ANY KIND, EXPRESS OR IMPLIED, AS TO THE PUBLICATION, INCLUDING, BUT NOT LIMITED TO, MERCHANTABILITY, NON-INFRINGEMENT, TITLE, OR FITNESS FOR A PARTICULAR PURPOSE OR USE. You agree, at your own expense, to indemnify, defend and hold harmless Emirates NBD, its Suppliers, agents, directors, officers, employees, representatives, successors, and assigns from and against any and all claims, damages, liabilities, costs, and expenses, including reasonable attorneys' and experts' fees, arising out of or in connection with the publication, including, but not limited to: (i) your use of the data contained in the publication or someone using such data on your behalf; (ii) any deletions, additions, insertions or alterations to, or any unauthorized use of, the data contained in the publication or (iii) any misrepresentation or breach of an acknowledgement or agreement made as a result of your receiving the publication.



## Emirates NBD Research & Treasury Contact List

**Emirates NBD Head Office**  
 12th Floor  
 Baniyas Road, Deira  
 P.O. Box 777  
 Dubai

**Aazar Ali Khwaja**  
 Group Treasurer & EVP Global Markets & Treasury  
 +971 4 609 3000  
 aazark@emiratesnbd.com

**Tim Fox**  
 Head of Research & Chief Economist  
 +9714 230 7800  
 timothyf@emiratesnbd.com

### Research

**Khatija Haque**  
 Head of MENA Research  
 +9714 230 7803  
 khatijah@emiratesnbd.com

**Jean Paul Pigat**  
 Senior Economist  
 +9714 230 7807  
 jeanp@emiratesnbd.com

**Aditya Pugalia**  
 Analyst  
 +9714 230 7802  
 adityap@emiratesnbd.com

**Anita Yadav**  
 Head of Fixed Income Research  
 +9714 230 7630  
 anitay@emiratesnbd.com

**Athanasios Tsetsonis**  
 Sector Economist  
 +9714 230 7629  
 athanasiost@emiratesnbd.com

**Edward Bell**  
 Commodity Analyst  
 +9714 230 7701  
 edwardpb@emiratesnbd.com

**Mohammed Al-Tajir**  
 Analyst  
 +9714 609 3005  
 mohammedtaj@emiratesnbd.com

**Shady Shaher Elborno**  
 Head of Macro Strategy  
 +9714 2012300  
 shadyb@emiratesnbd.com

### Sales & Structuring

**Group Head – Treasury Sales**  
 Tariq Chaudhary  
 +971 4 230 7777  
 tariqmc@emiratesnbd.com

**Saudi Arabia Sales**  
 Numair Attiyah  
 +966 11 282 5656  
 numaira@emiratesnbd.com

**Singapore Sales**  
 Supriyakumar Sakhalkar  
 +65 65785 627  
 supriyakumars@emiratesnbd.com

**London Sales**  
 James Symington  
 +44 (0) 20 7838 2240  
 james@emiratesnbd.com

**Egypt**  
 Gary Boon  
 +20 22 726 5040  
 garyboon@emiratesnbd.com

### Group Corporate Affairs

**Ibrahim Sowaidan**  
 +9714 609 4113  
 ibrahims@emiratesnbd.com

**Claire Andrea**  
 +9714 609 4143  
 clairea@emiratesnbd.com

### Investor Relations

**Patrick Clerkin**  
 +9714 230 7805  
 patricke@emiratesnbd.com