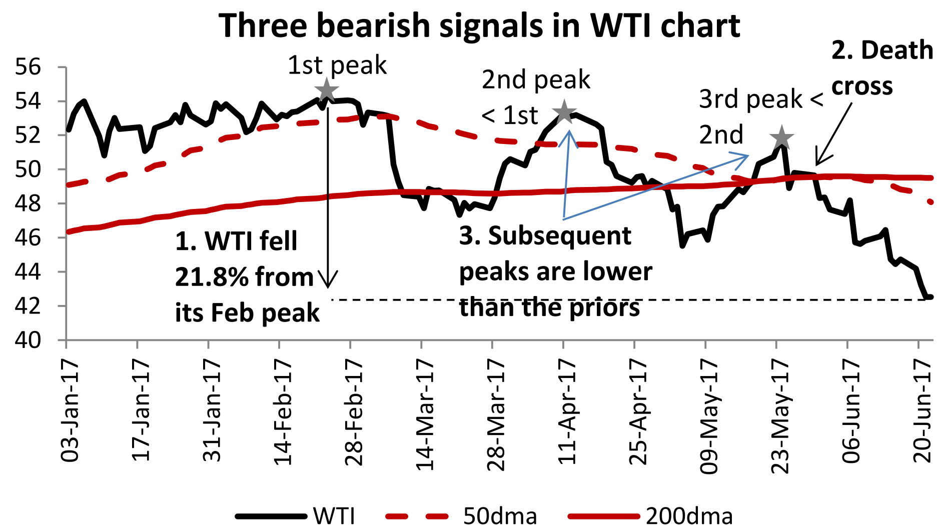
OCBC Bank

Crude Oil

Price history to repeat itself?

23rd June 2017

The headline, "Oil has entered a bear market", caught many market-watchers in the early trading hours of 21st June. Cited by mainstream media, the fact that the West Texas Intermediate (WTI) fell by over 20% from its February's peak likely discouraged the bulls while giving the bears more reasons to short the sticky liquid. Other technical indicators are signalling similar bearish indicators, including the death cross (more commonly defined as the 50-day moving average (MA) crossing the 200-day MA support line) earlier in late May, as well as having the last two peaks (and troughs to be exact) being lower than the previous one. With these bearish signals, many market-players would have surely rid any hopes of an oil rally. Afterall, as explained by the tenet of technical analysis, all information, including past, current and even future ones, are reflected in the price movement.



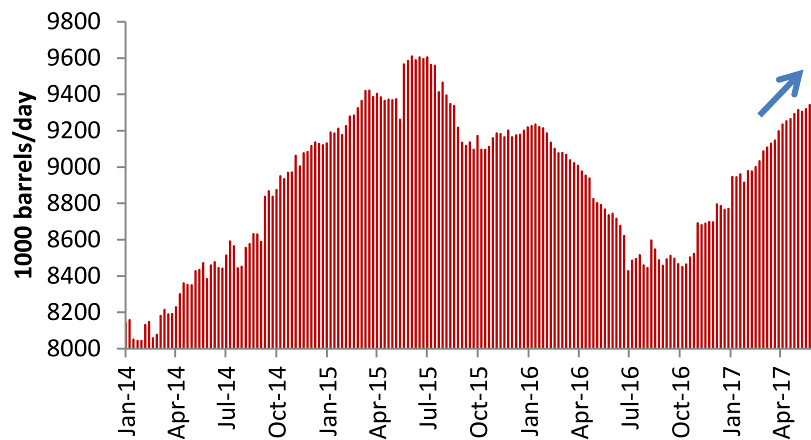
Source: Bloomberg, OCBC Bank

Unfortunately for the bulls, oil fundamentals are also suggesting a prolonged period of supply glut. US oil production gained to 9.35 million barrels per day (bpd) for the week ended 16th June, marking the 16th consecutive month of gains on a year-on-year basis and the highest production level since August 2015. Moreover, US oil rig counts have gained for its 22nd consecutive months, clocking 747 rigs in mid-June, highest since April 2015. Coupled with the strong imports into US shores, crude oil inventories remained above its 500 million barrels mark, highlighting the ample crude oil supplies into the driving season. Similarly, as written in our recent Commodities Outlook: A peep into 2H17, OPEC's oil production had also gained into April and May, led by higher Nigeria and Libya's oil production, exacerbating the glut situation. All-in-all, accounting for the gains in crude oil supply of late, global supply glut has expanded to 1.3 million bpd, up from 0.8 million bpd at the start of this year.

Treasury Advisory
Corporate FX & Structured Products
Tel: 6349-1888 / 1881
Interest Rate Derivatives
Tel: 6349-1899
Investments & Structured Products
Tel: 6349-1886

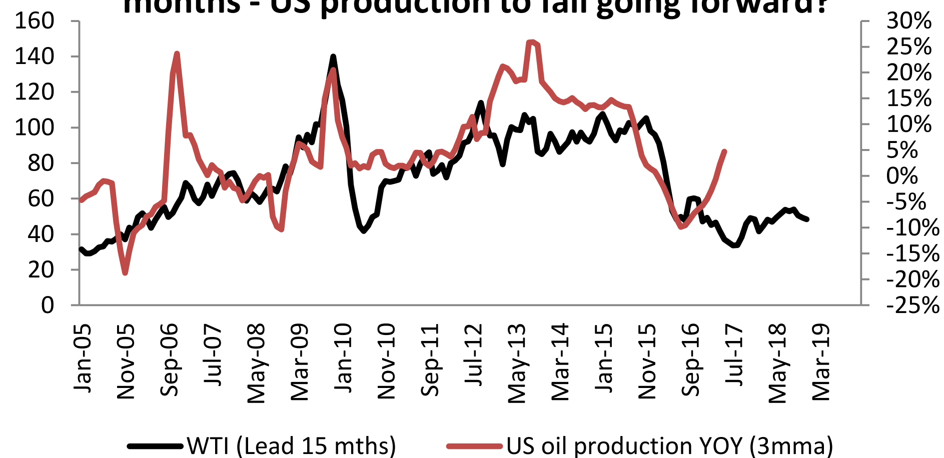
GT Institutional Sales
Tel: 6349-1810

Barnabas Gan
Tel: 6530-1778
BarnabasGan@ocbc.com



Source: Bloomberg, OCBC Bank

Given that the fall in oil prices were largely led by a lob-sided demand-supply matrix, the lower prices should eventually dissuade producers from pumping oil out of the ground. On the contrary to traditional oil wells, the US shale oil industry does faces a relatively higher cost of production per oil barrel, and is generally understood to be grossly sensitive to a quick fall in oil prices. Though the fall in oil prices over the last three years had enabled this industry to adopt efficient methods and lower the cost of production, these oil producers would also need to concentrate on efficient wells. Commonly known as 'high-gearing', the act of pumping oil out of inefficient wells would have to take a pause, thus allowing the high-cost shale producers to stay afloat especially in the current low-price environment. In a nutshell, US production cannot invariably rise especially in a falling oil price environment.

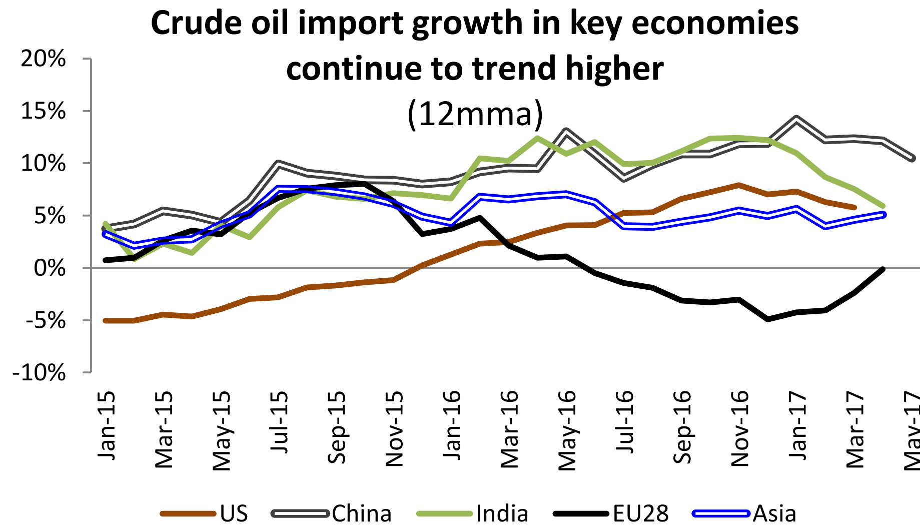


Source: Bloomberg, OCBC Bank

Of course, demand would have to play its part in support oil prices into 2H17. Empirically, crude oil imports in Asia[1] has risen by 10.7% in April 2017, led by China's

[1] Asia includes China, India, Japan, Hong Kong, Taiwan, Indonesia, Korea, Philippines, Thailand and Vietnam

crude petroleum import growth which recently printed a strong 15.4% in May. We opine that Chinese oil imports will continue to expand into the coming months, owing to additional quotas for non-state refiners, while domestic oil production fell for its 12th consecutive month into April this year. Note that China had recently allowed a second batch of crude oil import quotas for independent refiners and some state-owned companies for this year, amounting to full-year quotas at a total of 91.73 million tons, or 1.83 million bpd, according to China's Ministry of Commerce. This quota is higher than the previous stated quota of 87.6 million tons (or 1.75 million bpd), and accounts for 18% of the country's total crude oil imports. Elsewhere, we expect higher US energy demand into the months ahead as the driving season is underway.



Source: Bloomberg, CEIC, OCBC Bank

Still, given the unrelentless increase in oil supplies in the first six months of 2017, the fact remains that the rebalancing scenario could delay into 2018. Importantly, the Joint Technical Committee of OPEC and non-OPEC nations now sees a rebalancing only in 2Q18, should there be any failure to fully implement the agreed supply cuts. Moreover, the International Energy Agency commented for "non-OPEC production to grow… slightly more than the expected increase in global demand" into 2018, suggesting that the oil glut may persist till then. Regardless, we remain bullish on oil prices given that (1) US oil production cannot increase perpetually especially in the face of falling oil prices while (2) demand is likely to stay buoyant into 2H17. Even so, with prices so low, OPEC could well inject another production cut in their next OPEC meeting, an event that would surely reinforce out bullish outlook. In all, our price outlook for WTI and Brent remains at $55/bbl and $57/bbl, respectively, at end-year, underpinned by our hopes for demand to soak up excess supplies into 2H17.

This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC and/or its related and affiliated corporations may at any time make markets in the securities/instruments mentioned in this publication and together with their respective directors and officers, may have or take positions in the securities/instruments mentioned in this publication and may be engaged in purchasing or selling the same for themselves or their clients, and may also perform or seek to perform broking and other investment or securities-related services for the corporations whose securities are mentioned in this publication as well as other parties generally.

Co.Reg.no.:193200032W