Commodities: Crude Oil

OCBC Bank

Crude Oil: Fortunes improving from OPEC cuts

Friday, March 08, 2019

House View				
	1 Week	**1 Month**	**3 Months**	**12 Months**
Latest	Bullish	Bullish	Bullish	Neutral

OCBC COMMODITY FORECAST 2019							
	3Y AVG	Spot	Q1	Q2	Q3	Q4	Annual
Energy							
WTI ($/bbl)	53	56	55	58	62	65	60
Brent ($/bbl)	57	67	65	67	70	73	69

Treasury Research

Tel: 6530-8384

At A Glance:

- Since the OPEC Feb report, WTI and Brent have rallied as much as +8.5% and +9.3% respectively
- Easing of US-China trade tensions, with a possible agreement by end Mar, have raised the support levels for both crude benchmarks
- The energy market is keenly awaiting the OPEC report next week to ascertain the depth of production cuts from Saudi
- Crack spreads show improved profitability for refiners since the start of 2019
- CFTC net speculative positions suggests much room for bulls to add longs
- High US inventories, Libya restarting Sharara fields, are downside risks

The crude market has shifted its attention from the bleak macro backdrop to tightening fundamentals from OPEC. With the US-China trade spat seemingly abating, oil bulls are flexing their muscles – judging from the recent long liquidation, it appears there is more upside space than downside at the moment.

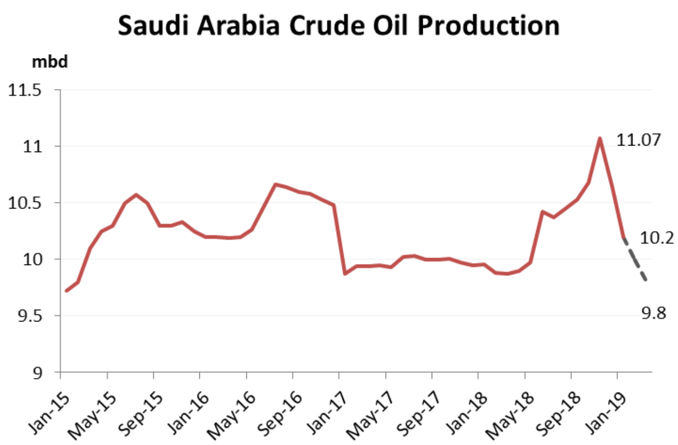
Howie Lee

+65 6530-1778

HowieLee@ocbc.com

OPEC report: Look out for Saudi to cut to 10m bpd; Iraq, Nigeria to comply

Saudi Arabia: All eyes will be on the OPEC report next Thursday, when market participants await to see if Saudi Arabia will keep to its production cut promises. In the February edition, Saudi said that it will curtail production to 9.8m bpd by March from January's level of 10.2mbp. Averaging this difference means Saudi is expected to have produced 10m bpd last month – any amount more than that and the probability of meeting the target of 9.8m bpd production this month will decrease.



Source: Bloomberg, OPEC, OCBC Bank

Libya: the foil to Saudi's production cut is Libya's restarting of its Sharara oil field after it has been resecured, following a 3-month occupation of the site by militants. The Sharara oil field is capable of producing 300k bpd, which will negate Saudi's supply cut of -400k bpd from its January levels. As the oil field has only been recaptured at the start of March, next week's OPEC report will not feature any substantial increase in Libya's oil production, although it will be appropriate to add a further 200-300k bpd supply for forward calculations based off next week's report.

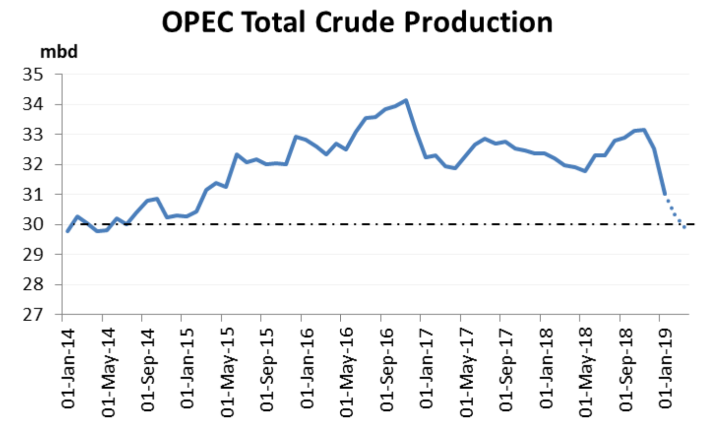
Iraq and Nigeria: among the biggest noncompliance in last month's oil report were Iraq and Nigeria, which overproduced by about 160k and 110k bpd respectively. If these two countries can keep to the OPEC+ deal quota and bring down supply by a combined 270k, then overall OPEC is likely to see a month on month decline in production, even after factoring the restarting of Libya's Sharara oil field.

OPEC overall: we are estimating OPEC production in Feb at 30.35m bpd, down -450k bpd from Jan. We then expect this production level to persist through in March as the restarting of Libya's Sharara oil field should offset further declines in Saudi production, with marginal declines coming from Venezuela and Iran.

OPEC Production ('000 bpd)										
Month	**Saudi**	**Iraq**	**Iran**	**Kuwait**	**Nigeria**	**Venezuela**	**Libya***	**Other**	**Total**	**MoM**
Jan-19	10,213	4,669	2,754	2,710	1,792	1,106	895	6,670	30,809	-795
Feb-19 Est	10,007	4,591	2,740	2,710	1,739	1,073	820	6,670	30,809	-461

* does not include the reopening of the Sharara oil field

Source: OPEC, OCBC Bank



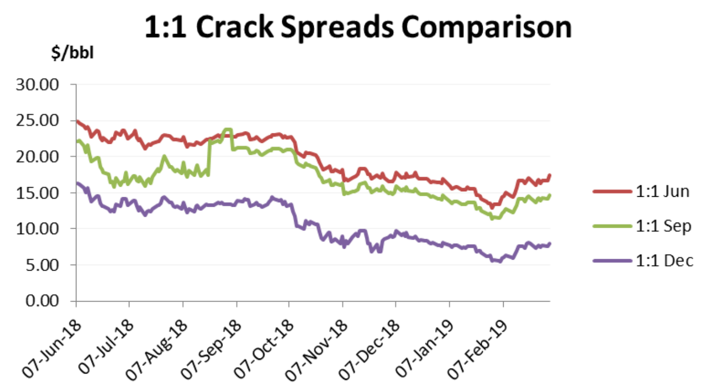
Source: OPEC, Bloomberg, OCBC Bank

Demand: US-China potential resolution to give demand a boost

Over the weekend, headline news reported that the US and China are nearing an agreement regarding the ongoing trade spat. It is far from given that the trade tensions are coming to an end, until President Trump and President Xi meet to sign an official agreement. Trump has shown he can and will walk away if the deal is not right, as North Korean leader Kim Jong-un can attest. The uncertainty of whether the Trump-Xi summit will take place, plus Trump's volatile character, mean the crude market has yet to fully price in a complete US-China trade agreement. Prices are expected to rally further on the official confirmation, but till then we expect any upside prices to be capped.

Crack spreads: gradually increasing but still a far cry from last year's levels

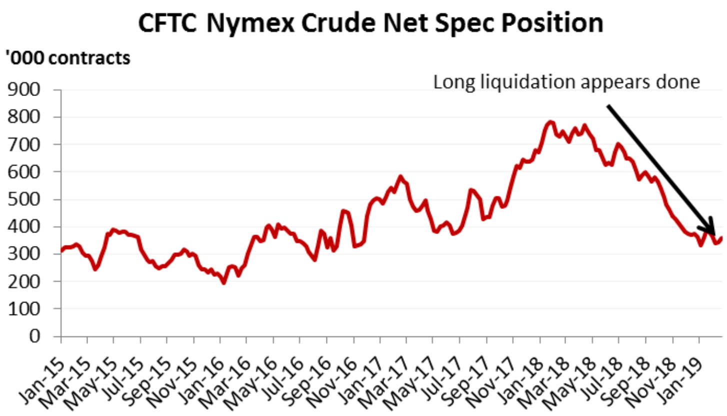
Crack spreads – a measure of refiner's profitability – has improved since the start of the year. The June 1:1 crack spread has increased to about $17/bbl from a low of $12/bbl at the start of January, but is still a considerable gap from the $23/bbl level as recent as last October. WTI prices were unable to rally past the $55/bbl at the start of the year on several factors, one of which was the poor refiner's margin on offer. With the profitability of refining now having improved, demand for crude is expected to increase and the floor in which crude prices can fall to now appears higher.



Source: Bloomberg, OCBC Bank

Spec positions: long liquidation is done, further shorts may have limited space

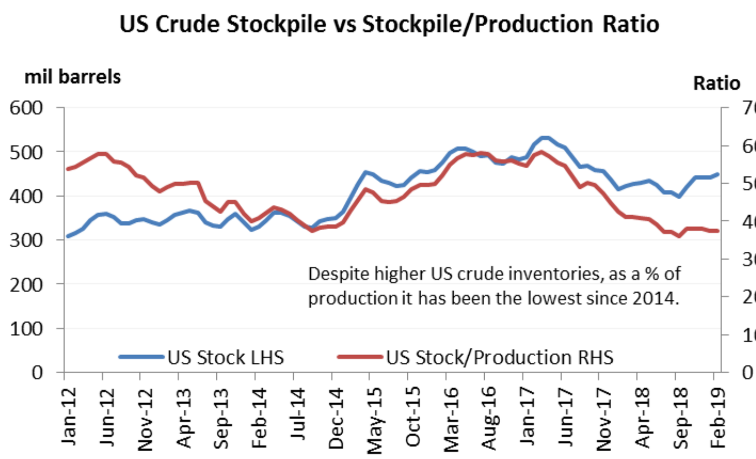
The latest CFTC report shows the net speculative position at 360k contracts, less than half the recent high of 784k contracts reached in January 2018. At such levels, it appears that the massive liquidation of crude beginning 2H last year is done. The net spec position is also unlikely to fall further than 250k contracts, which was the level set during the 2015 oil supply glut. With most of the long specs having been forced out during last year's oil rout, there is considerable space for longs to be added again. Net spec position has an upside of at least 360k contracts, and a downside of -100k contracts – this gives the confidence for bulls to add more longs to the book as the possibility of further long liquidations are now much reduced compared to a quarter ago.



Source: Bloomberg, CFTC, OCBC Bank

Key downside risk: burgeoning US oil inventories

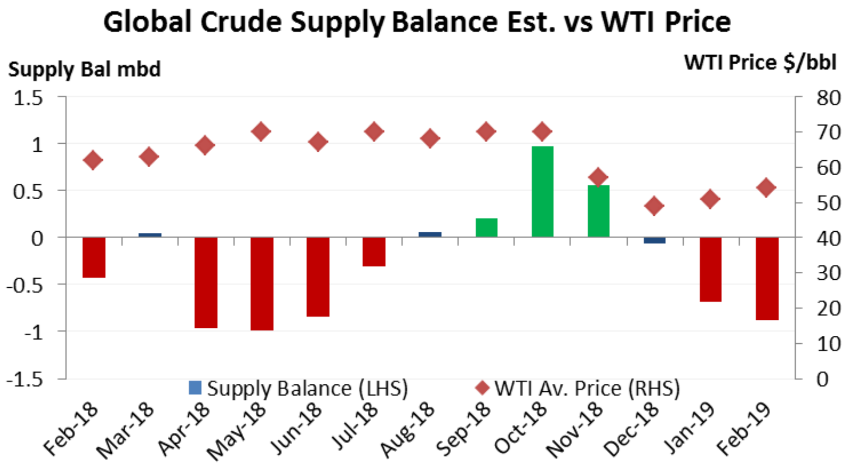
US oil inventories have not fallen below 445m barrels since mid-Jan, which is the highest since Jan 2017. While oil inventories are typically a bearish signal for commodity prices, the increasing warehouse stocks in the US is also a function of increasing US crude production. As such, while high US crude inventories could potentially act as a dampener to any price rally, we do not necessarily see the high stock levels as a bearish play.



Source: Bloomberg, EIA, OCBC Bank

Conclusion: OPEC production is key to further price movements

The market has increasingly shifted its focus from the bleak macro backdrop to OPEC's tightening supply. We expect OPEC to show a decline of -450k bpd in next week's report, which could potentially spark a rally in WTI to $58/bbl and Brent to $67/bbl. Positive developments on the US-China trade front, coupled with the OPEC supply cuts, may even take WTI above $60/bbl and Brent above $70/bbl by Q3. Bulls have plenty of space to add further longs with a lower risk of long liquidation than a quarter ago. Libya will provide some downside risk to prices as it is expected to add a further 300k bpd with the restarting of the Sharara oil field, but that should be negated by Saudi's production cut.



Source: Bloomberg, OPEC, OCBC Estimates

Co.Reg.no.:193200032W