OCBC Bank

It's already rebalanced!

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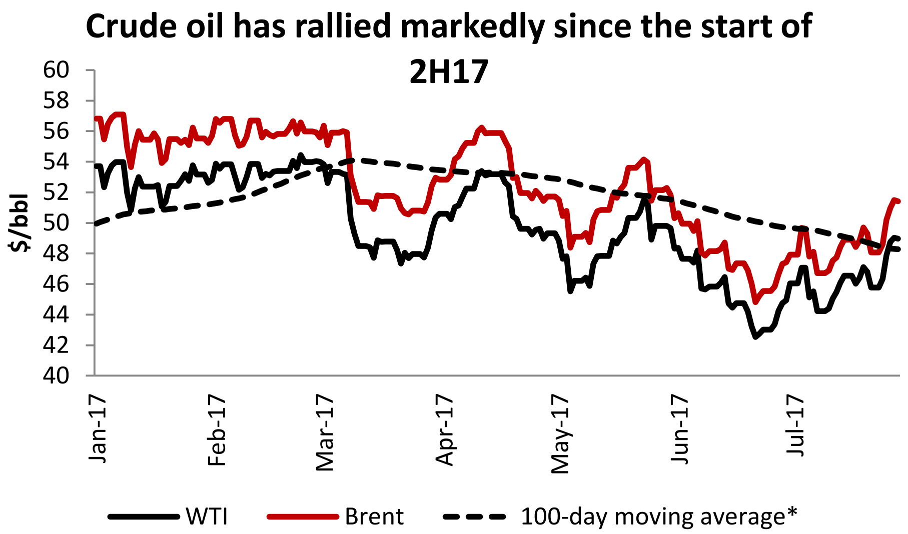
Highlights

- Crude oil fundamentals are already rebalanced as of April 2017. Still, crude oil rally was only arguably started at the start of the second half. Importantly, demand growth had outpaced supply in April and May.
- Demand remains robust, led by Asia and Europe, on top of the markedly higher US energy consumption given the on-going driving season. Moreover, supplies may see further downside risk, especially if OPEC's promise over the production and export cut made of late materialises.
- Our crude oil outlook for both WTI and Brent to touch $55/bbl and $57/bbl, respectively, remains intact. Moreover, given the strong rally of late, our outlook may even have further upside risk if the rebalanced environment sustains into 4Q17.

Fundamentals First

Concerns on crude oil's oversupply environment have been plaguing oil futures lower in the first half of 2017. Statistically, both WTI and Brent had fallen to its sub-$45/bbl handle into June, before rallying markedly year-to-date. Importantly, the recent rally has lifted both WTI and Brent above their 100-day moving average levels earlier this week, with the latter currently sitting squarely above its critical $50/bbl handle.



Source: Bloomberg, OCBC Bank
* Average WTI and Brent prices, over a 100-day moving average

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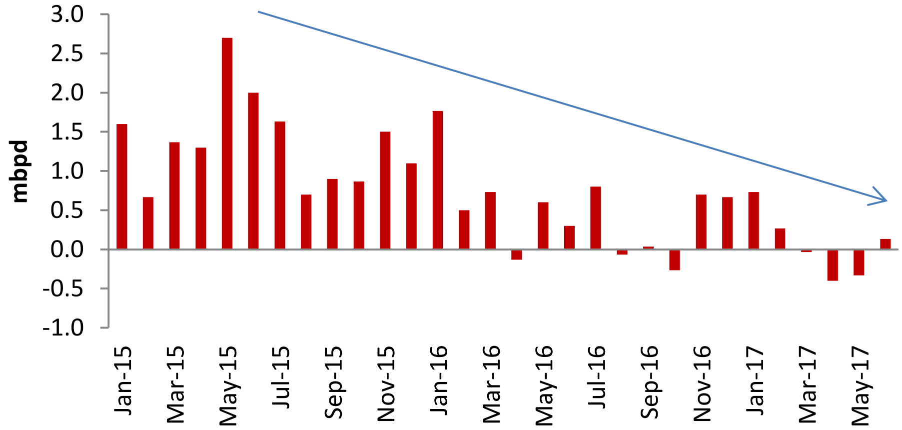
The stark increase since the beginning of the second half is not surprising. Should we look at the global demand and supply numbers, the oil glut has been narrowing steadily since 2015. Data-wise, the oversupplies have fallen from some 2.7 million barrels per day (mbpd) to June's print of a mere 0.1 mbpd. Moreover, demand volume has actually outpaced supplies in April and May 2017, according to the data by

Energy Intelligence Group. As written in our past Commodity Outlooks, global demand has been stellar, led by higher import levels by Europe and Asia, while the ongoing US driving season should continue to buoy demand into 3Q17.

Crude oil glut has narrowed substantially since 2015



Source: Bloomberg, Energy Intelligence Group, OCBC Bank

Is the rebalancing act sustainable?

However, more often than not, the rally in oil prices have been met with profit-taking, a behavior exacerbated on oversupply woes. But things may be different this time around: some comfort can be seen OPEC's recent calls to limit export levels, seen from Saudi Arabia's announcement to export up to 6.6 mbpd (-1.0 mbpd) beginning next month. Moreover, recent official rhetoric highlighting Kuwait's and UAE's promise to cut export volume in a bid to curtail the glut added more lift to crude oil prices of late. Nigeria as well, praised in the recent OPEC JMMC report for its flexibility and willingness to limit production at 1.8 mbpd (currently at around 1.6 mbpd).

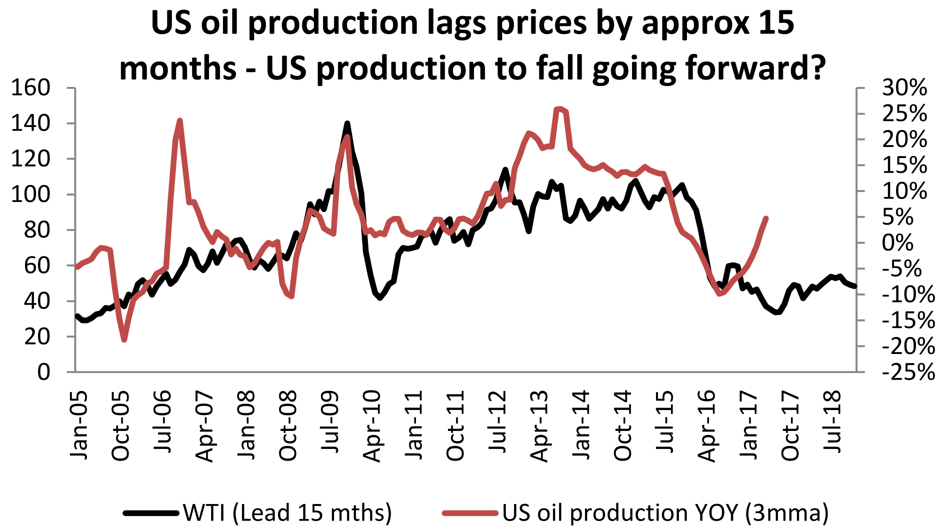
thousand barrels per day	Reference Production Levels	Targeted production level	Production (June 2017)	Proposed Cuts	Actual Cuts (June 2017)
	a	b		(h): (b) - (a)	(l): (g) - (a)
Algeria	1,089	1,039	1,071	-50	-20
Angola	1,751	1,673	1,662	-78	-158
Ecuador	548	522	527	-26	-19
Equatorial Guinea**	-	-	170		
Gabon	202	193	197	-9	+3
Iran	3,975	3,797	3,880	-178	-82
Iraq	4,561	4,351	4,550	-210	+3
Kuwait	2,838	2,707	2,705	-131	-123
Libya**	-	-	852	-	
Nigeria**	-	-	1,663	-	
Qatar	648	618	611	-30	-54
Saudi Arabia	10,544	10,058	10,070	-486	-664
UAE	3,013	2,874	2,898	-139	-32
Venezuela	2,067	1,972	2,156	-95	+122
Total	**31,236**	**29,804**	**33,012**	**-1,432**	**-1024**

Source: OPEC, Bloomberg, OCBC Bank
** Excluded from OPEC production cut agreement
Note: Black prints are official numbers, while Blue prints are from secondary sources

But all these are just talks, for now. For those keeping a close tap on production levels, the OPEC members appear to have been walking the talk. The cartel members (save for a few) have been diligently keeping to their word in complying with the previous production cut levels. Compliance rate has been suggested at 98% in the said JMMC report, though our calculation merely put at 71.5% (see the above table) as of June 2017. Importantly, only Saudi Arabia and Angola have seen 100% compliance, while Venezuela, Gabon and Iraq have repeatedly increased production above their reference production levels.

Crude Oil outlook is still hazy however
Despite the relatively hazy environment into 2H17, the one thing that market-watchers would likely agree on, is the fact that every OPEC members needs higher oil prices. IMF estimates suggest that current oil prices remain too low for every OPEC member; fiscal breakeven oil prices for Saudi Arabia is estimated at $70.2/bbl, and Iran is slated to face the lowest breakeven oil price at $55.8/bbl. Interestingly, Libya and Yemen are the countries that face the highest fiscal breakeven oil prices at $149.3/bbl and $125/bbl, respectively. The need for higher oil price would mean little incentive for any OPEC oil producer to be seen as non-compliant, and a collective team effort to suggest a unified goal to limit production in hope for higher oil prices would be a wise move (and likely adhered to!)

Of course, skeptics over the sustainability of the current rebalanced environment may finger-point at US oil production and its rising production trend since the start of the year. However, US oil production growth is seemingly plateauing at this juncture. Moreover, US oil rig counts, a key forward indicator to suggest production growth in the future, has been adding oil rigs at a decreasing rate. Importantly, our OCBC US oil production model suggests that US oil production will likely see further downside into 2H17 given the relatively low oil prices seen in 1H17.



Source: Bloomberg, OCBC Bank

With the rally seen at the start of 2H17, coupled with promises of tapering in OPEC export volume into 2H17, it seems that the rally will have plenty of steam to continue. Moreover, demand trends from Europe and China have been encouraging, and should continue to buoy oil prices in the foreseeable future. In a nutshell, market-watchers should content with the fully rebalanced oil fundamentals in the last three months, in line with our estimates for a rebalanced environment to occur this year. All-in-all, our bullish call for WTI and Brent at $55/bbl and $57/bbl, respectively, remains intact, and may have upside risk into end-2017 especially if more evidences over a sustained rebalanced environment are seen then.