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Crude Oil: A bullish feel at the moment

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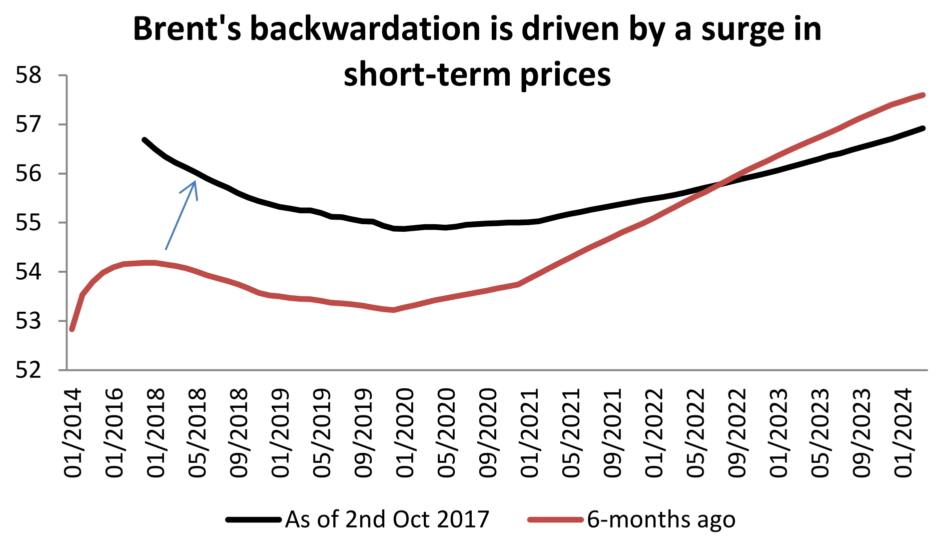
Crude oil prices have arguably rallied for almost a month now, with peak September levels of both WTI and Brent touching their highs since April 2017. The many events that occurred since then had largely revolved around crude oil's improving fundamentals, which naturally led to the sticky liquid's advance. These had included the improved demand outlook from oil think-tanks (OPEC, IEA), as well as shrinking supplies from OPEC's diligence in adhering to their production cut plans. Importantly as well, market-watchers likely cheered on comments by some OPEC producers which included a potential extension of its oil production cut period by another three months to June 2018. The relatively calmer geopolitical climate now that N. Korea is facing sanctions by China itself could have depressed risk-off sentiments as well, which then led to oil's advance given crude oil's characteristic as a growth-related commodity.

More starkly perhaps, is the rather quick initial flattening to recent backwardation of the Brent forward curves of late. Note that Brent's backwardation curve has extended to mid-2020, or for short, means that Brent futures for near-term delivery is now starkly more expensive than those for delivery at a much later date. On the surface, it does mean that crude oil prices are priced to fall into the coming months ahead, but careful investigation reveals that the backwardation is caused by a strong surge in short-term prices, rather than a deterioration in Brent's price outlook.

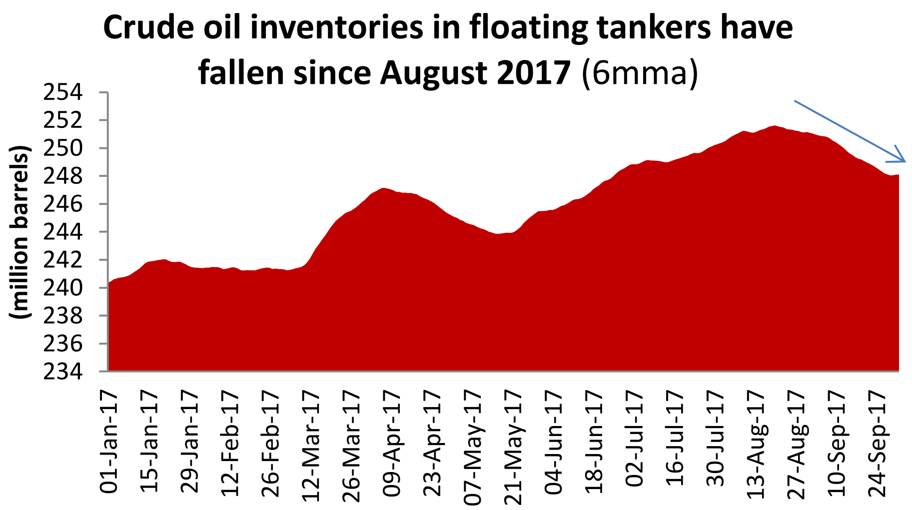


Source: Bloomberg, OCBC Bank

The backwardation of the Brent forward curve tells us a couple of things.

Firstly, the distinguishable upward shift of the Brent forward curve to-date suggests that there is a bullish feel at this juncture. This is evident from the quick climb in the immediate tenor of the forward curve versus the behaviour seen in the longer-end of the curve, likely given potential short-term supply shock given recent Kurdish independence referendum and the uncertainty surrounding Iraq's oil supplies.

Secondly and more importantly, the backwardation suggests that it is becoming more costly to store crude oil supplies, given that prices are expected to dip into the coming months. As such, the downward sloping forward curve does not make is very attractive to keep oil in storage, and gives an incentive to reduce stocks. Empirically, global crude oil inventories in floating tankers have fallen considerably to 248 million barrels as of end September, though there exists more room for inventories to fall further should destocking occurs into the immediate months ahead.



Source: Bloomberg, OCBC Bank

Our immediate price outlook for the rest of 2017 remains unchanged; we continue to maintain our crude oil outlook for WTI and Brent to touch $55/bbl and $57/bbl, respectively. As written in our past outlooks, our bullish call is chiefly underpinned by the recovering global oil demand, led especially by Asian and European demand. Prices have already risen to their multi-month high given the rosy economic backdrop amid the equivalent support for oil demand. Sustained risk appetite amid an improving oil fundamental should lift oil prices to our 2018 forecast of $65/bbl for both WTI and Brent.

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