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Market Insights & Strategy
Global Markets

09 November 2017

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Oil Barrels Along

Those of you who have been following our oil market commentaries for the past 12 to 18 months will already be aware of our optimistic outlook for crude prices since WTI dipped briefly below US$30 a barrel back in February 2016, and which we suggested was likely to be the bottom for this latest major cycle. Since then the market has staged a pretty respectable recovery, although on a very short-term technical basis the most recent shift above US$60 a barrel for Brent has basically filled our near-term target, and whilst the latest regional geopolitical events could still trigger a test of US$70 we expect to see a minor retracement from these current levels take place over the next few weeks.

Further out we believe the market in general will remain supported by fundamentals, namely the ongoing recovery in demand which is finally having an impact on global crude stocks, supported in part by the OPEC/NOPEC output reduction agreement that has seen a better than expected compliance rate, and which may well be extended for at least a further six months when the current accord expires in March 2018. The likelihood of this extension is enhanced by the fact that Moscow and Riyadh remain the prime drivers of the deal, and aside from trying to ensure that the market rebalancing process continues, both have other specific key domestic reasons to support an extension of the output cap in 2018, such as the impending IPO of Saudi Aramco and Russian elections.

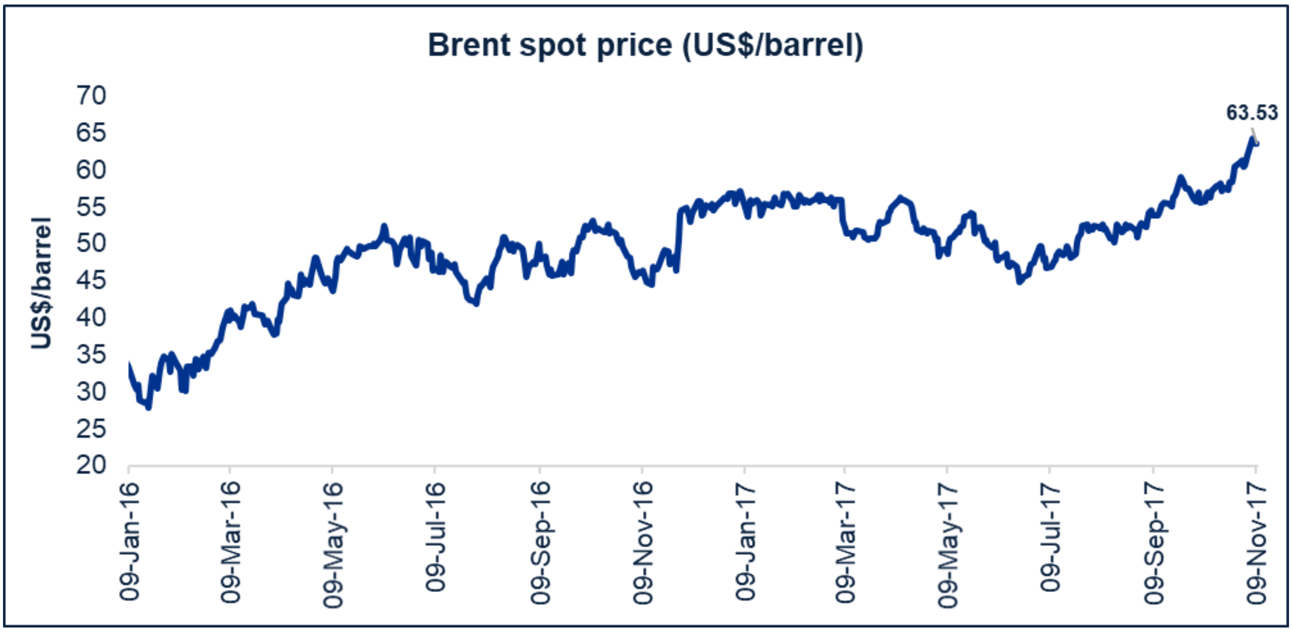
Of course we cannot ignore the threat of US shale production, noting too that it has rebounded in line with this year's price recovery, and will likely continue to provide a cap on a sharper move higher in oil prices over the next 12 months or so. However as we have outlined in our previous articles (eg: Oil which way is up? – Sept 2016) we believe that this particular sector has been somewhat over-hyped, particularly with regards to its actual percentage contribution to total oil supply, and its questionable long-term geological sustainability, the latter being too detailed a discussion to enter into here. This narrow focus has also ignored the 'elephant in the room' which is the dramatic fall in capital expenditure on conventional field development and exploration since 2014, a situation underlined again by recent data showing that the number of newly approved conventional projects are at their lowest level in 60 years, and that potential fresh oil reserve discoveries last year totaled just 2.4 bio barrels compared to a historical annual average of 9 bio barrels. For us this is something that might just create another crude supply crunch within the next 3-5 years.

Renewables is another topic that continues to receive plenty of media coverage, and we agree that this will be the primary game changer for the market in the long-term, but its actual impact on the demand for oil remains very limited for now, and this will only change once the vast network of infrastructure required to support such alternative sources of energy is in place. Electric cars still only make-up just 2% of the global market and over 80% of global energy consumption still comes from fossil fuels, whilst bio-fuel production in the US appears to be running into headwinds highlighted by Du Pont's decision just last week to shut the world's largest cellulosic ethanol plant in Iowa just two years after it opened.

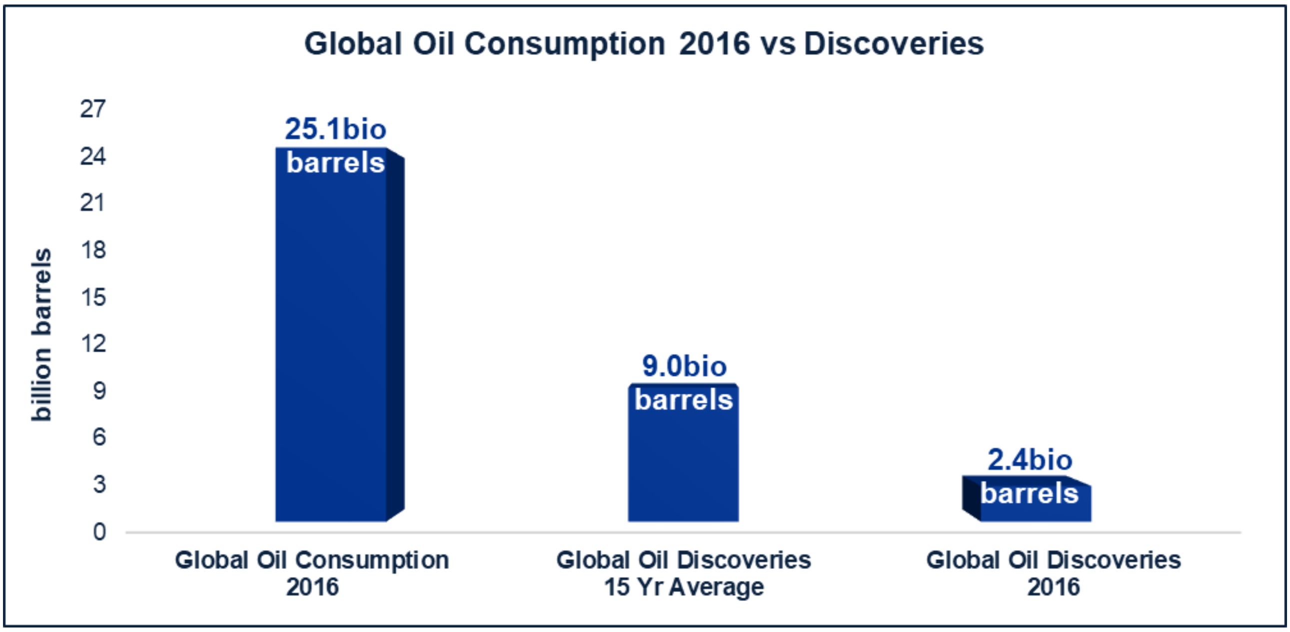
Finally there are the imponderables or the aptly named 'black swan' events which are difficult to predict, although looking at the current global geopolitical environment the risk of such events occurring appears to be growing.

Venezuela a country with the world's largest proven oil reserves is still undergoing a social and economic meltdown which in turn continues to reduce both the quality and quantity of Venezuela's crude output. In Africa, ongoing militant activity in Libya and the potential for a resumption of similar activity and/or protests in Nigeria's oil rich Niger delta region next year could further threaten supplies, while in the US much promised changes to domestic energy policies have yet to even be drafted, with tax reform, trade talks and Obamacare still likely to be the near-term focus for the Trump administration. Closer to home, US moves to pressure Iran over its missile activity and the decision by President Trump not to certify Iranian compliance with the JCPOA agreement last month may even put the nuclear accord at risk of collapse, this combined with the consequent threat of fresh US sanctions could potentially reverse at least some of the sharp recovery in Iranian crude exports seen over the past year.

In conclusion we remain positive in our outlook for crude especially further out, while in the interim and barring any unforeseen events we expect prices to hold onto their gains made this past year and for the average price of Brent to rise to US$57-60 per barrel over the next 12 months, compared to US$53 so far this year and US$44 in 2016.



Source: Bloomberg; FAB



Source: SRSrocco Report; International Energy Agency (IEA); FAB

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