Oil markets

OPEC extends output cuts for 9 months but oil prices remain in the doldrums

> Omar Al-Nakib
Senior Economist
+965 2259 5360, omarnakib@nbk.com

Highlights

- **Oil prices back below $50/bbl as markets remain unfazed by 9-month OPEC output cut extension, and reiteration of Saudi-Russian oil supply management in 2018.**
- **Sentiment remains bearish and focused on US shale gains, despite signs that global and US crude stocks are declining, albeit slowly.**
- **US crude production reached 9.3 mb/d at the end of May, up 6.5% in 2017.**
- **Market is currently in supply deficit territory, according to the IEA.**

Oil prices on the back foot despite OPEC output cut extension

Surveying the oil markets at the start of May, when prices were under pressure and ranging between $49-$51 per barrel (bbl), OPEC ministers could be forgiven for believing that a decision to extend their 6-month production cut agreement for an additional 9 months, to March 2018, would be just the prescription to boost the oil price. After all, the agreement achieved a surprisingly high level of compliance, removing almost 1.8 mb/d of crude from the oil market as it nudged it towards a new balance. By the end of the month, however, it was clear that the markets were following a different script, oil prices were on the back foot and OPEC was looking vexed.

Brent dipped below the symbolic $50 floor to $49.75/bbl on 2 June, while WTI dropped to $47.7/bbl. Both price markers have just posted 2 consecutive weeks of losses and were down by around 12% year-to-date. (Chart 1.)

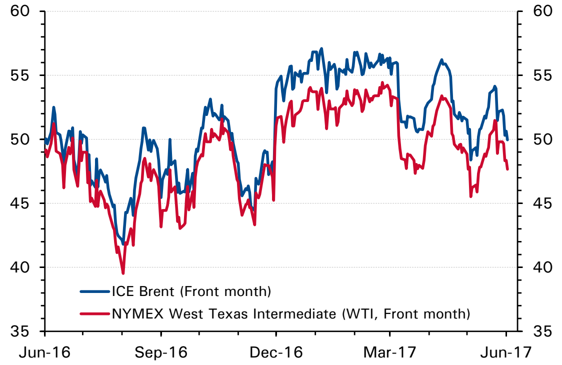
Oil's reversal prompted the Saudi and Russian ministers recently to reaffirm their pledge to bring global crude stocks down to 5-year average levels and to reiterate their commitment to further manage the oil supply after the expiration of their current output cut agreement, in March 2018. But the markets appear immune to the bullish rhetoric, even while supplies are tightening and global and US crude inventories, whose stubbornly high levels were the source of much of the markets' anxieties, are indeed finally beginning to fall. OECD commercial crude and petroleum products stocks declined for the second consecutive month in March, by 32.9 million barrels to 3.03 billion barrels, the International Energy Agency (IEA) estimated in its May report. (Chart 2.)

While over in the US, commercial crude inventories recorded their steepest decline since December 2016 last week in late May, falling by 6.4 million barrels amid record refinery runs and lower US imports. (Chart 3.) Indeed, crude stocks in the US have been declining for 8 consecutive weeks, but markets are paying little attention.

Instead, they appear to be primarily focused on the US shale story and the reality that whatever OPEC removes from the markets, shale

Chart 1: Crude oil prices

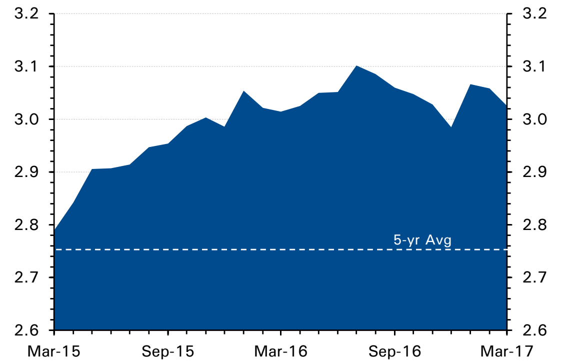
($/bbl)



Source: Thomson Reuters Datastream

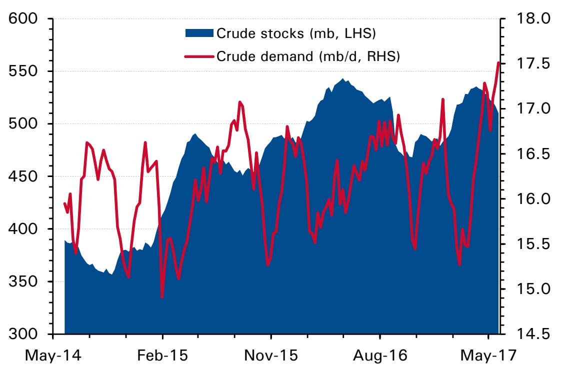
Chart 2: OECD commercial crude and product stocks

(billion barrels)



Source: International Energy Agency (IEA)

Chart 3: US commercial crude stocks and refinery runs



Source: US Energy Information Administration (EIA) producers are slowly putting back. The head of Russia's largest oil producer, Rosneft, conceded as much last week when he raised the prospect of US oil companies adding as much as 1.5 mb/d to global supplies within the next year. If realized, this increase would offset more than two thirds of the crude that OPEC and non-OPEC producers are clearing from the market—a sobering thought.

Such is the resurgence of US crude output—production reached 9.3 mb/d by the end of May, 11% higher than the low recorded last July—that both OPEC and the IEA have had to repeatedly revise their own estimates of US growth upwards for this year. (Chart 4.) The IEA's latest forecast has US crude supply increasing by an average of 790,000 b/d in 2017, up 100,000 b/d from its previous report, while OPEC projects US crude rising by 600,000 b/d by the end of the year.

OPEC achieves a commendable compliance rate as production cuts are extended for an additional 9 months

OPEC, for its part, has tried its best to reassure the markets, promising to do "whatever it takes" to accelerate the drawdown of excess global crude stocks and bring the market to a swift balance. OPEC production in April, according to secondary sources, fell below its target level of 31.75 mb/d to 31.73 mb/d for the first time, achieving a compliance rate of 107%. (Charts 5 & 6.) While the UAE finally met its output cut pledge in April, and Iraq inched closer to its quota, declines in Libya and modest supply gains in Nigeria, two countries exempt from the output cut accords, have undoubtedly helped the group attain its aggregate production target. Things may be more complicated over the coming months, with both those countries expected to raise production.

This, along with the above mentioned US shale gains, is part of the reason why the markets were underwhelmed by the 9-month extension; deeper cuts would have had, in hindsight, a more profound effect on market sentiment.

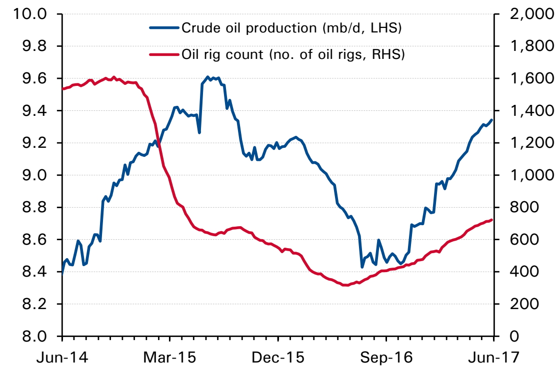
Market rebalancing firmly underway

Nevertheless, market rebalancing is underway, with the IEA reporting that the demand/supply balance is expected to end 2Q17 firmly in supply deficit territory. (Chart 7.) Crude demand is expected to peak in 3Q17, which should see surplus crude stocks drawn down at a faster rate.

For 2017 as a whole, the IEA sees demand growing by 1.3 mb/d to 97.9 mb/d, which is a slower rate of growth than 2016's increase of 1.7 mb/d.

In the end, while the market's attention has been focused almost exclusively on the supply side of the equation, demand will need to remain robust for oil prices to firm up.

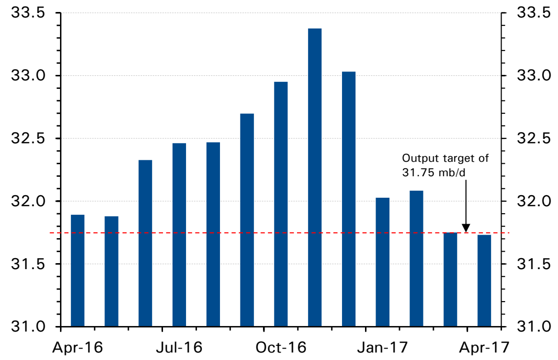
Chart 4: US crude oil production and rig counts



Source: US Energy Information Administration (EIA), Baker Hughes

Chart 5: OPEC crude oil production

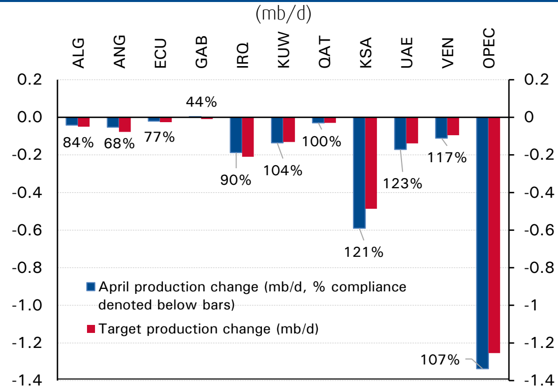
(mb/d)



Source: OPEC (secondary sources)

Chart 6: OPEC member* output change in April vs. target

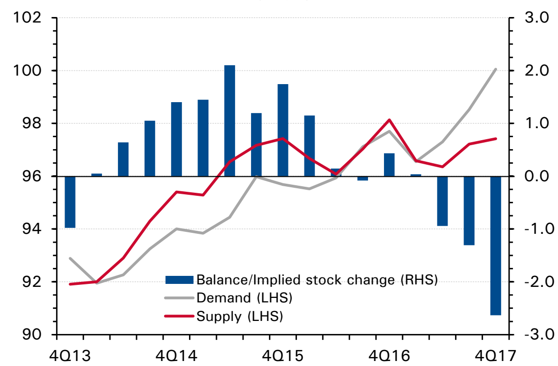
(mb/d)



Source: OPEC; * those members required to cut output

Chart 7: Balance of crude supply and demand

(mb/d)



Source: IEA; *assumes OPEC production cut target attained and extended

Head Office

Kuwait
National Bank of Kuwait SAKP
Abdullah Al-Ahmed Street
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAKP
Zain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait SAKP
Bahrain Head Office
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAKP
Dubai Branch
Latifa Tower, Sheikh Zayed Road
Next to Crown Plaza
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait SAKP
Abu Dhabi Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAKP
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

Jordan
National Bank of Kuwait SAKP
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300
Fax: +20 2 26133978

United States of America
National Bank of Kuwait SAKP
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait
(International) Plc
Paris Branch
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAKP
Singapore Branch
9 Raffles Place # 44-01
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAKP
Shanghai Representative Office
Suite 1003, 10th Floor, Azia Center
1233 Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
NBK Capital
38th Floor, Arraya II Building, Block 6
Shuhada'a street, Sharq
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

United Arab Emirates
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial Center
Sheikh Zayed Road
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Associates

Turkey
Turkish Bank
Valikonagl CAD. 7
Nisantasi, P.O. Box. 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353