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Oil price trends, forecasts and their implications for developing economy

By

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Natixis Oil Outlook - 2016

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Oil Price Drivers

Fundamentals

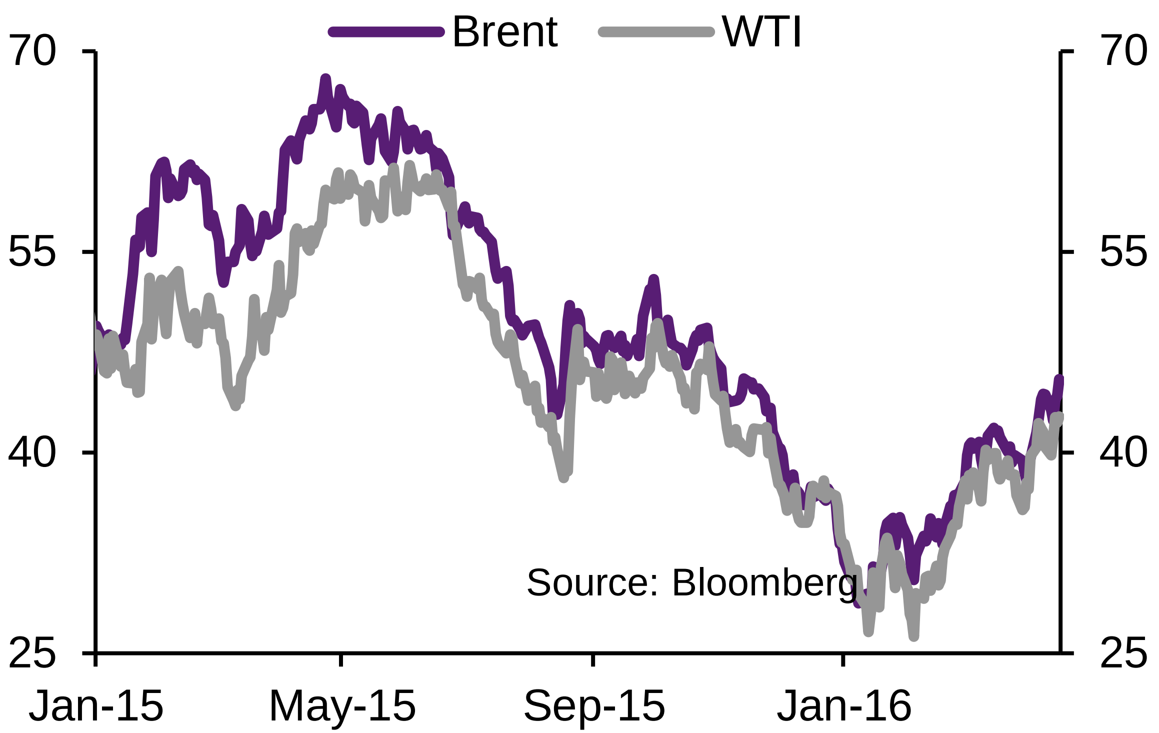
- Supply
- Demand

Geo-politics

Financial Markets

Dollar

Benchmark crude prices ($/bbl)

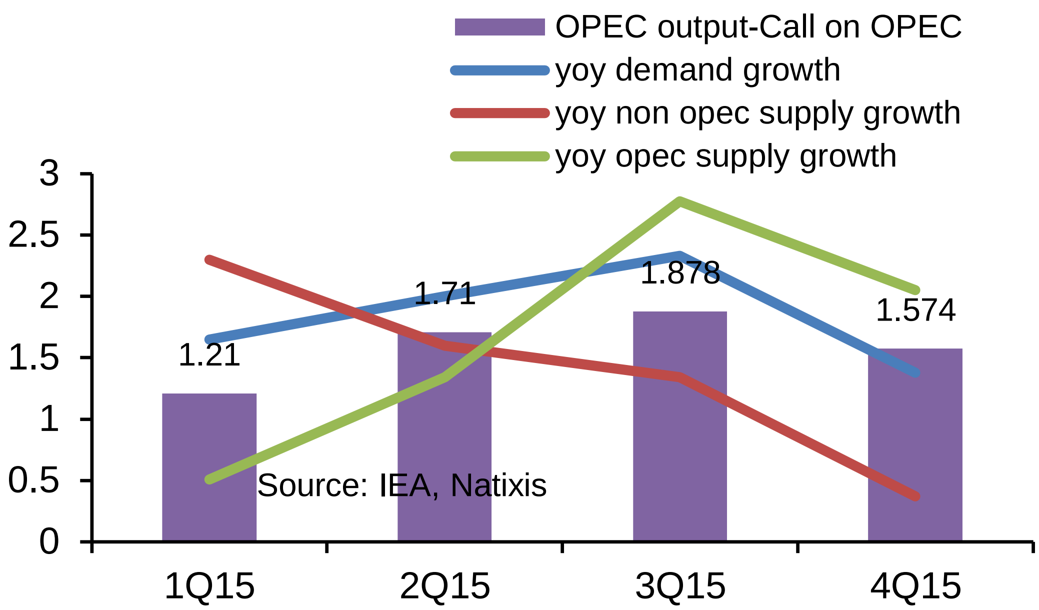


What caused the nose dive?

Fundamentals in 2015

- **Weak fundamentals for last 18 months**
- **Paradigm shift in OPEC (Saudi Arabia) policy**
- **Lifting up of Iranian sanctions**

Global physical balances for oil in 2015 (mn b/d)



Source: IEA, Natixis

Oil and Oil Product Inventories

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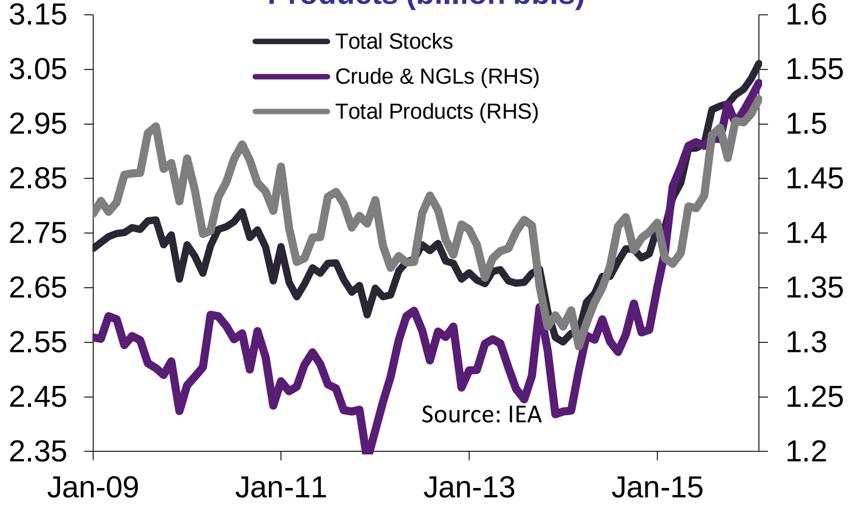
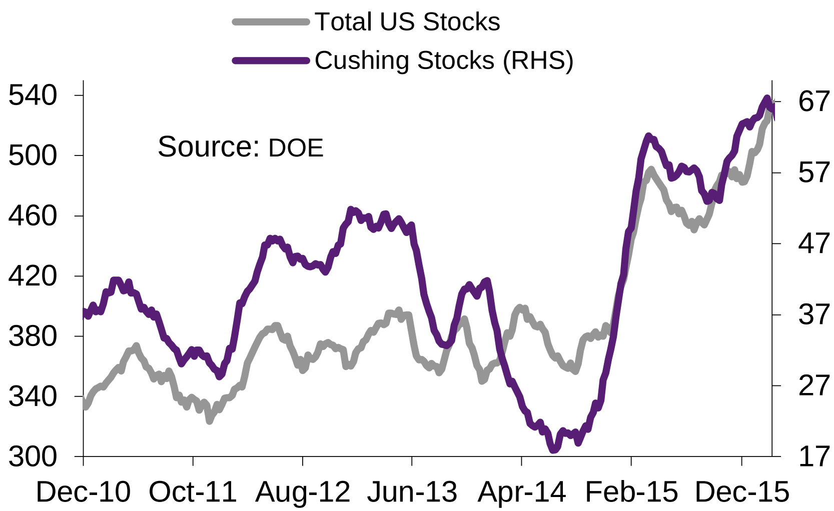
Apart from markets taking longer to balance perhaps by early 2017, stock builds will continue for another year.

- **Oil and oil products stocks in OECD countries are currently in excess of 3bn bbl.**
- **With stock builds expected to be higher in 2016Q1 and 2016Q2 vs 2015Q4, crude storages capacities in the OECD and globally are expected to be tested. Cushing is already over 85% of total shell capacity.**
- **Monthly crude oil and oil products additions to the existing inventories has increased once again since Jan16 in OECD**

Total OECD Stocks Vs Crude, NGLS and Products (billion bbls)



US Crude oil stocks (mn bbl)



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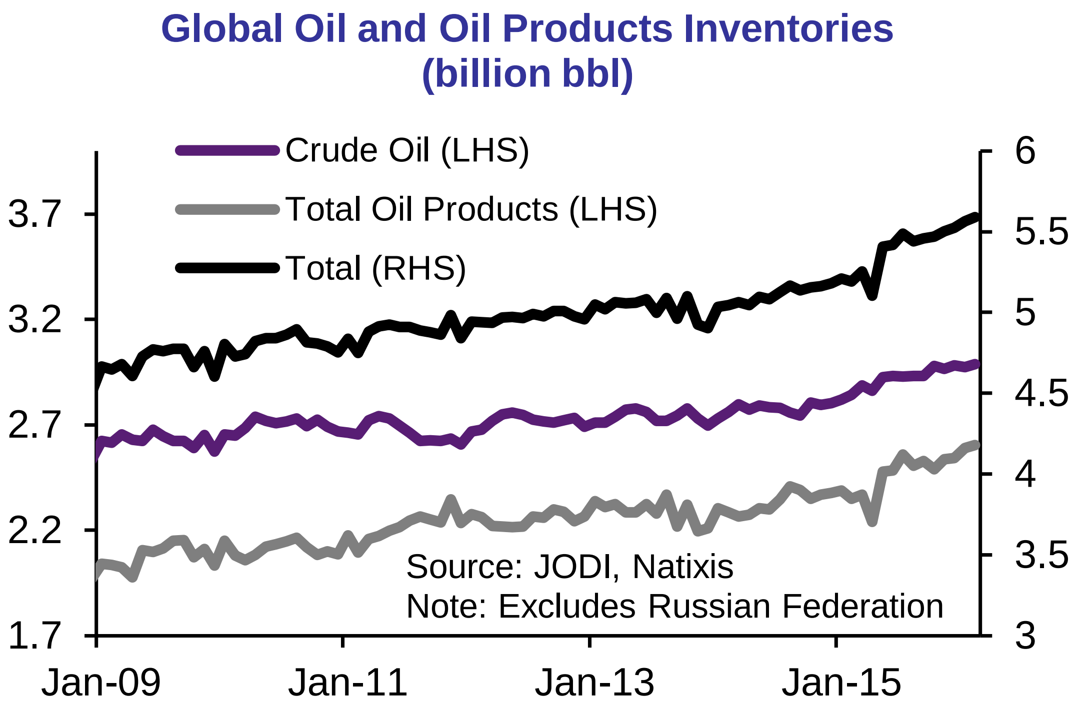
Oil and Oil Product Inventories

Global oil and oil product inventories (excluding Russian Federation) were in excess of 5.6bn bbl in Feb16; +1bn bbl compared to the same month in 2009.



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Where is the latest support coming from??

Geopolitics providing some support..

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Frozen

Talk about an oil production freeze has supported oil prices in the past two months but some market watchers are skeptical whether an agreement will be reached when the producers meet in Doha on April 17.

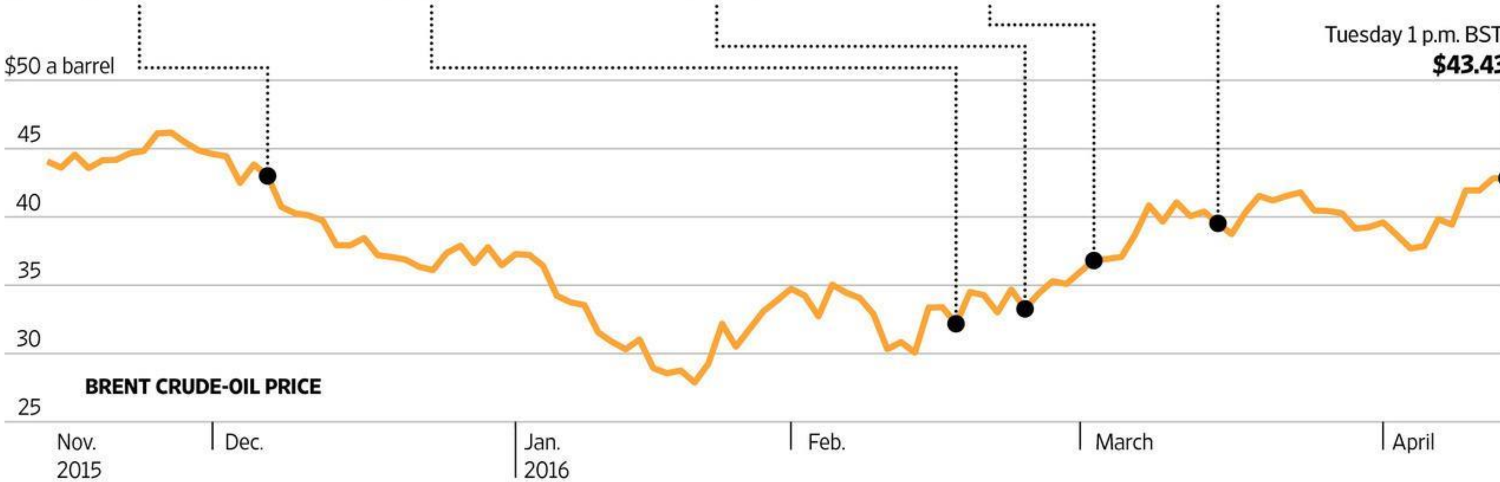
Dec. 4, 2015: OPEC ends a contentious meeting without agreement to restrain production, sending prices spiraling downwards

Feb. 16, 2016: Saudi Arabia, Russia, other OPEC members reach agreement to freeze output, provided other suppliers follow suit

Feb. 23, 2016: Iran's oil minister Bijan Zanganeh calls the plan 'a joke,' says Tehran plans to increase output

March 1, 2016: Russian energy minister Alexander Novak says a 'critical mass' of oil producers agree to freeze output

March 14, 2016: Negotiations hit obstacles, freeze meeting postponed to April 17 from March 20



Sources: Staff Reports; WSJ Market Data Group (price) Photos: Associated Press; Reuters (2); European Pressphoto Agency (2)

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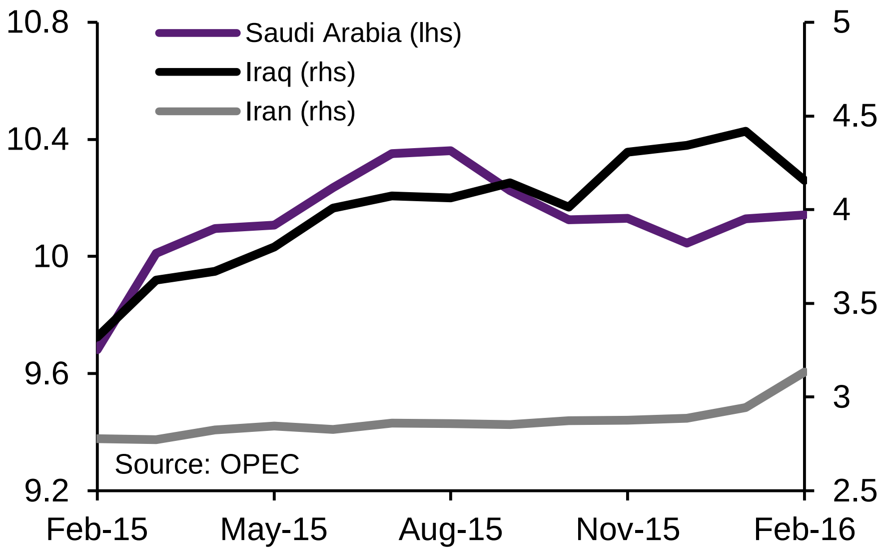
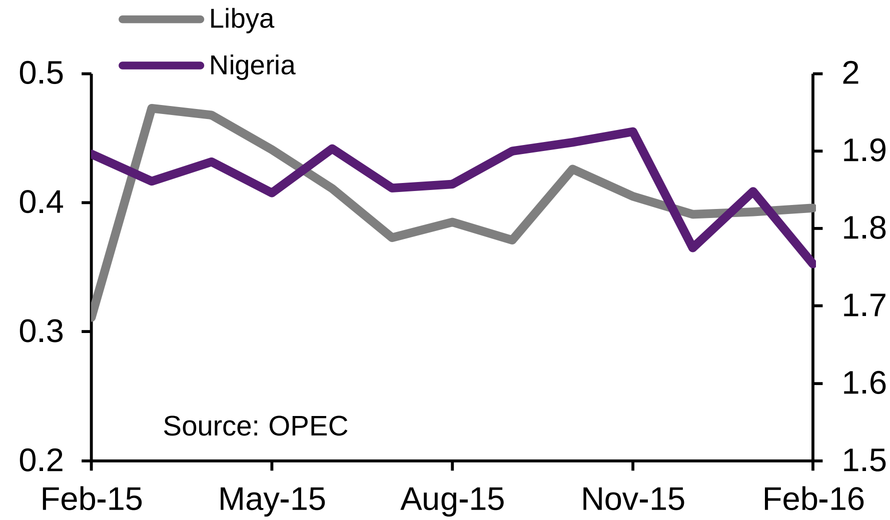
Geopolitics providing some support..

- Supply disruptions in Libya, Nigeria and Iraq recently have helped take away over 380,000b/d in 2016Q1.
- Outages in Kuwait led to a drop I Kuwait's production by over 50% to 1.1mn b/d for 3 days.
- Talks on OPEC and non-OPEC freeze since early Feb had brought together key oil producers to discuss the current glut and find a sustainable solution

Production of various OPEC countries- Middle East (mn b/d)

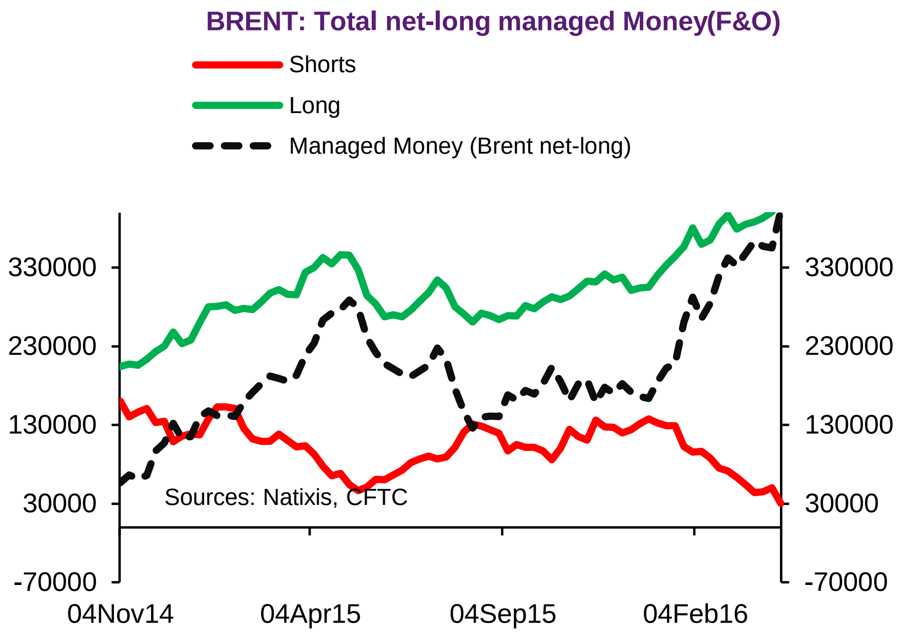


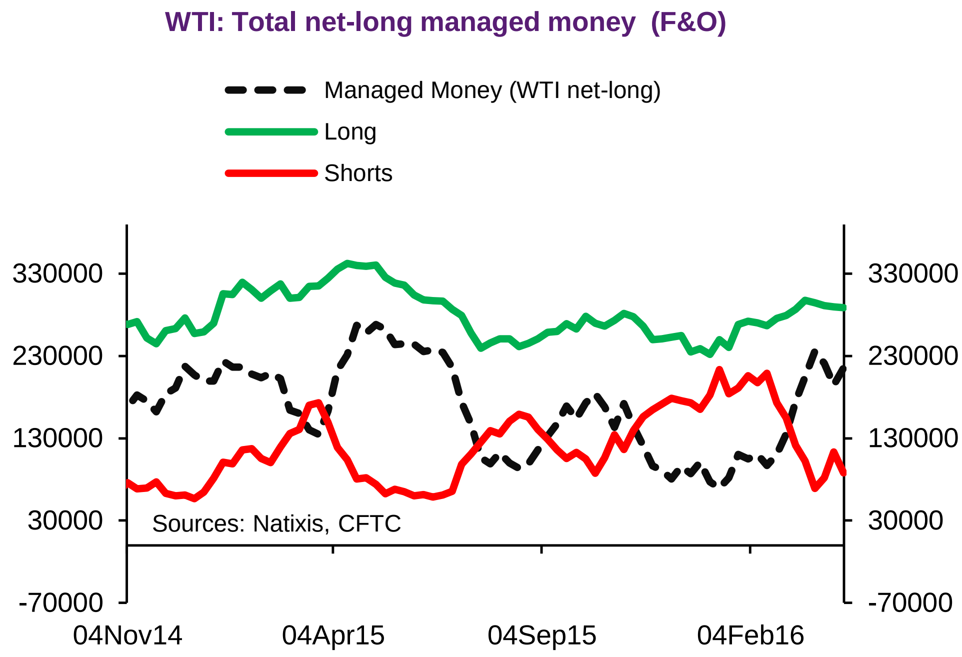
Production of various OPEC countries - North West Africa (mn b/d)



Hot money net flows

- Speculative positions have increased significantly as investors are calling it a bottom based on:
  - Expectation that US oil production will slow down significantly this year, thanks to the latest production guidance given by oil companies in addition to the Capex cuts
  - Freeze talks between OPEC & non-OPEC since Feb16

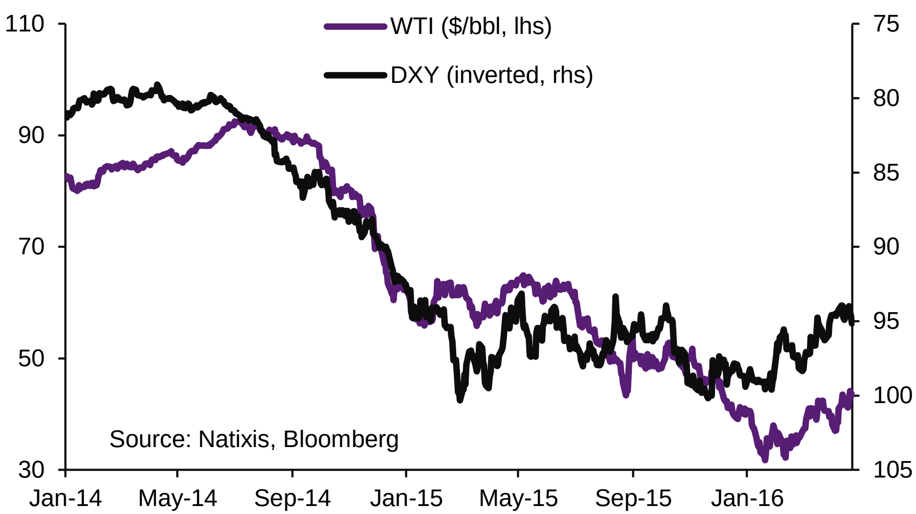




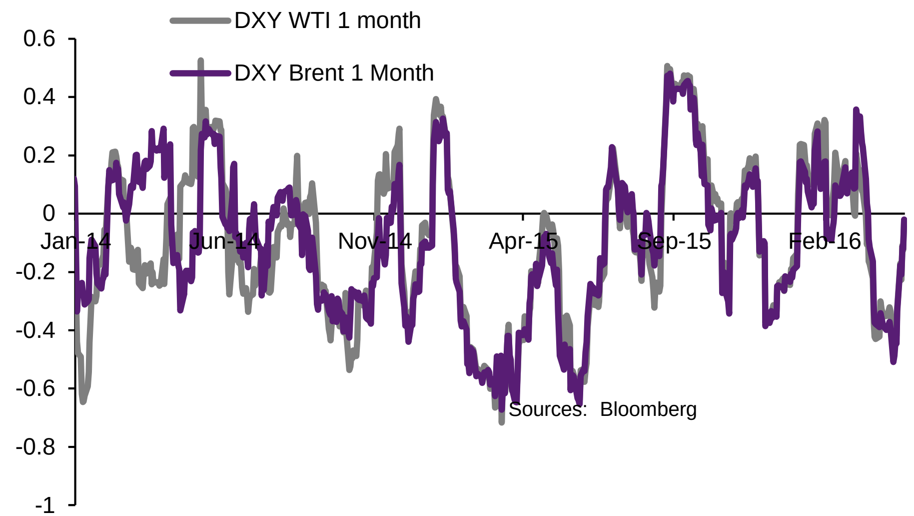
Oil-Dollar Correlation

- From time to time there is a strong correlation between dollar and oil prices, but it's not always the case.
- With fed pushing back interest rate hikes recently has led to weakness in dollar which could be taken as some temporary support to oil prices

Oil price vs US dollar



1 month rolling correlation with daily returns



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Going forwards….

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Global Demand

- **Global demand revised down for 2016 due to global uncertainties**
- **Demand being driven mainly by non-OECD countries but some OECD countries as well**
- **US, India the key demand drivers, Chinese demand is softening rapidly**
- **Increased demand from Strategic Petroleum Reserves (SPR) and commercial builds**

Demand (yoy growth, 1000 b/d) - 2016

Region	OPEC	IEA	Natixis
OECD	+180	-20	+170
China	+290	+340	+150
South America (excl. Chile)	+10	-10	-10
Other Asia (Incl. India)	+390	+550	+560
Middle East	+150	+110	+100
Net growth	+1200	+1160	+1100

Source: Natixis, IEA, OPEC

Non-OPEC Supply

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- **Non-OPEC supply to decline aggressively in 2016**
- **US crude production will be the main contributor**
- **Supply has also dropped in China, Latin America, Kazakhstan, Azerbaijan**

Non-OPEC Supply (yoy growth, 1000 b/d) - 2016

Region	OPEC	IEA	Natixis
North America	-460	-470	-500
OECD Europe	-90	-50	+20
South America (excl. Chile)	+10	-60	-20
Africa	-30	-20	-20
FSU	-120	+20	-80
Net growth	-730	-710	-760

Source: Natixis, IEA, OPEC

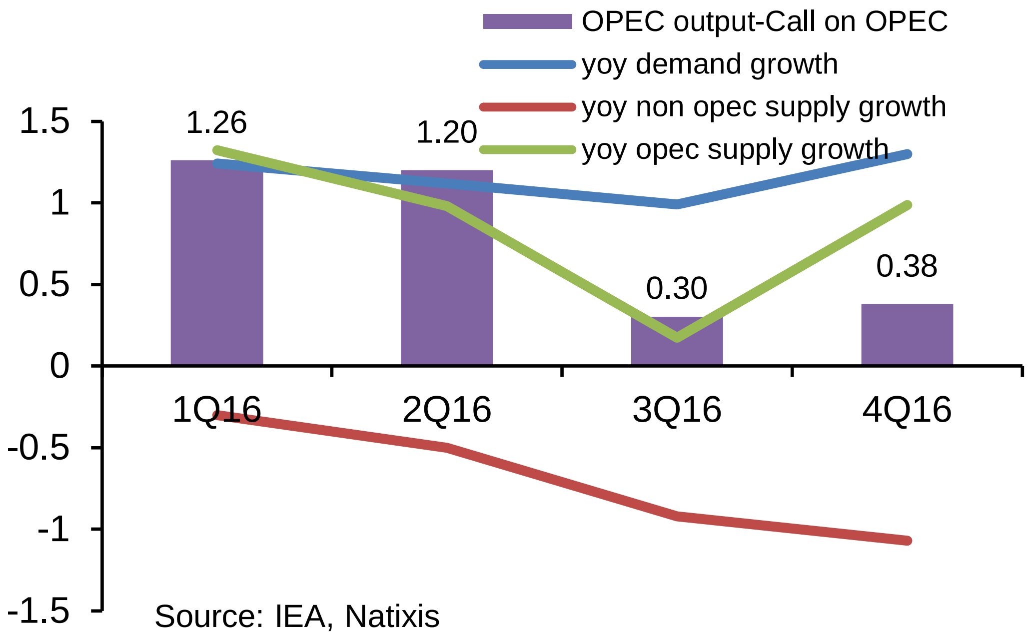
Will markets balance by end of 2016??

Global crude oil supply continues to outpace demand all the way into 2016 and possibly 2017.

Assuming OPEC sticks to its current strategy of maintaining market share,

- **In 2016 we expect the excess to average around 0.8-1mn b/d.**
- **We expect Iran to add 800,000b/d after sanctions were lifted. Currently Iran is producing 3.2mn b/d, +400,000b/d since Dec15.**

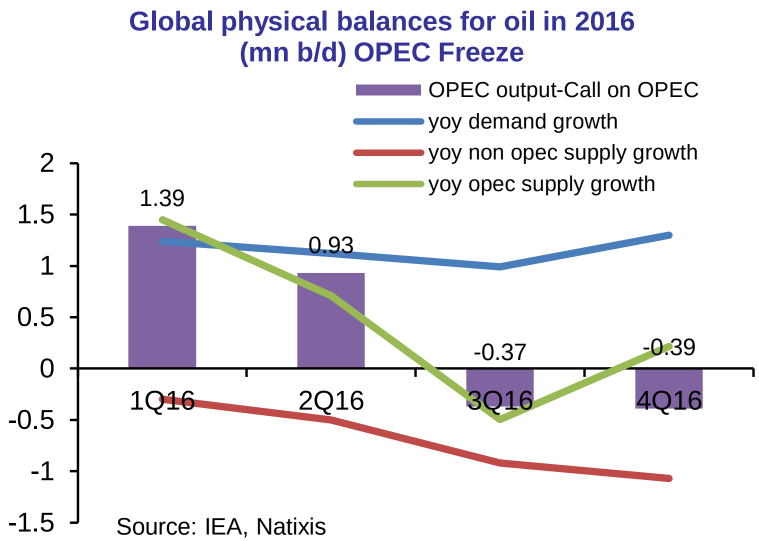
Global physical balances for oil in 2016 (mn b/d)

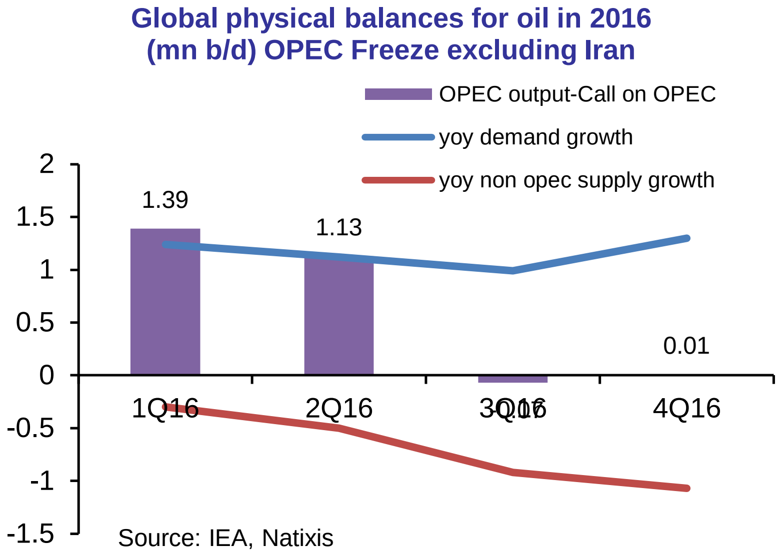


Source: IEA, Natixis

In the event of a production freeze..

- **Indeed, freezing output at 11Jan levels which were 32.4mn b/d including Indonesia, (31.63mn b/d excluding) could have helped balance the markets as early as the third quarter of this year.**





- **And excluding Iran would tighten the markets but unlikely to cause major withdrawals.**

Forecasts for 2016

- ***We do expect oil prices to trend slowly upwards but w*****e are cautiously bearish as current support in the oil prices is due to significant transitional outages and increased net long positions by investors who are seeking to increase their exposure to the energy sector.**

- **As the DOHA talks failed to secure any freeze in output, we see no reason to believe why OPEC and some of the non-OPEC producer will not increase their production capacity as planned and output as market share strategy becomes increasingly important and this should push back the markets to balance into 2017.**

- **Hence pressure to remain on oil prices from:**
  - **the large inventories already in place,**
  - **oil markets likely to take longer to balance,**
  - **any immediate increase in oil production only helping North American shale producer,**
  - **rapid increase in crude prices reduces refining margins which could results in reduced processing rates,**
  - **weak apparent demand from key drivers such as China, Europe, especially if the global growth were to remain tepid**
  - **strength in dollar is also bearish for oil.**

- **Support to come from:**
  - **rapid fall in US oil production**
  - **decline in other non-OPEC production**
  - **planned and largely unplanned outages**
  - **investors overly bullish**

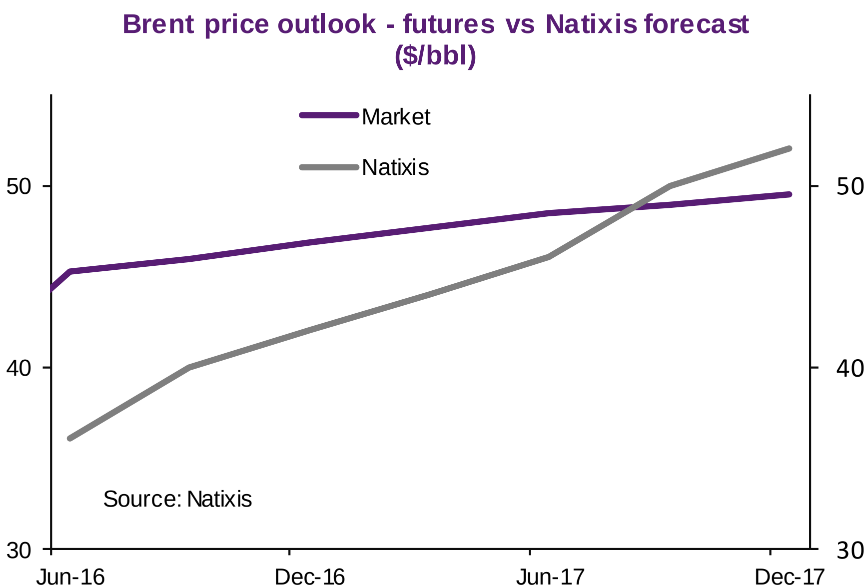
- **Our central scenario for oil is based on Iran's return of 800,000b/d of crude.**

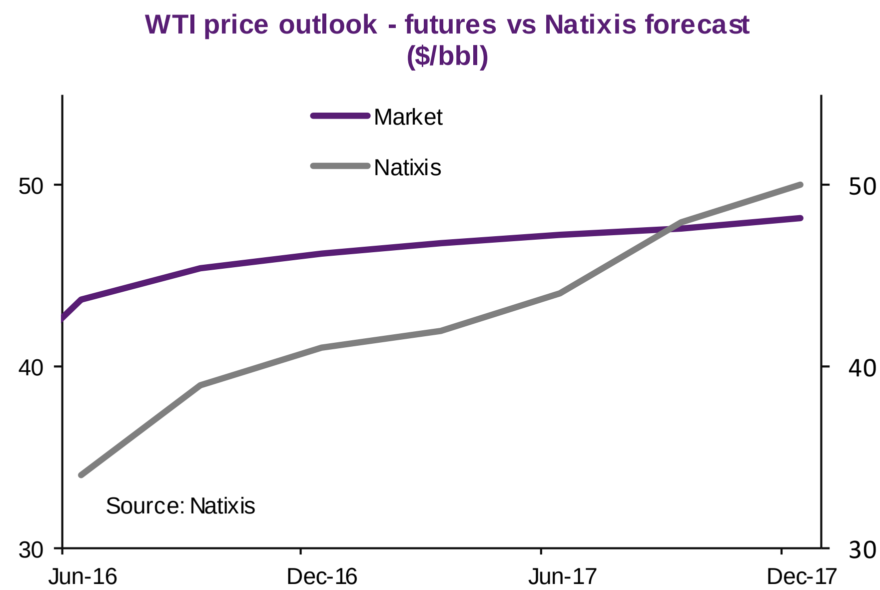
Forecasts for 2016

Base scenario	2014	2015	2016				
			Q1	Q2	Q3	Q4	Annual
Crude prices ($/bbl)							
- WTI (average)	**93.6**	**48.8**	**32.5**	**34.0**	**39.0**	**41.0**	**36.6**
t/t-1 (%)	-5.2%	-47.9%	-22.7%	4.6%	14.7%	5.1%	-24.9%
- BRENT (average)	**99.8**	**53.5**	**34.5**	**36.0**	**40.0**	**42.0**	**38.1**
t/t-1 (%)	-7.2%	-46.4%	-22.8%	4.3%	11.1%	5.0%	-28.7%

Base scenario	2015	2016	2017				
			Q1	Q2	Q3	Q4	Annual
Crude prices ($/bbl)							
- WTI (average)	**48.8**	**36.6**	**42.0**	**44.0**	**48.0**	**50.0**	**46.0**
t/t-1 (%)	-47.9%	-24.9%	2.4%	4.8%	9.1%	4.2%	25.6%
- BRENT (average)	**53.5**	**38.1**	**44.0**	**46.0**	**50.0**	**52.0**	**48.0**
t/t-1 (%)	-46.4%	-28.7%	4.8%	4.5%	8.7%	4.0%	25.9%

Forecasts for 2016





Risks to Oil Price

Mainly upside as low price scenario is already captured in our central scenario.

Upside:

- **Unprecedented unplanned outages especially in 2016Q3 and 2016Q4 when balances are much tighter than in 2016Q2.**
- **US oil producers and any other non-OPEC producer cutting back aggressively on rigs and wells**
- **North American oil companies file for bankruptcy; increased consolidation in oil companies, focusing on the economical wells and basins post restructuring.**
- **OPEC agreeing on an oil production quota/freeze in next OPEC meeting.**
- **Increased geopolitical risk in the Middle East e.g. Saudi Arabia, Iran, strikes in Kuwait**
- **Instability and bankruptcy of OPEC oil producing states such as Venezuela on the brink.**
- **Unprecedented Capex and OPEC cuts resulting in lower output by as early as 2017**

Downside:

- **Global economy slowing down further.**
- **A Unity Government in Libya could lead to a boost in production as the country stabilises. This could add 500,000b/d of production to the market.**
- **Increased production from OPEC and some Non-OPEC members such as Russia as they intensify the market share strategy.**

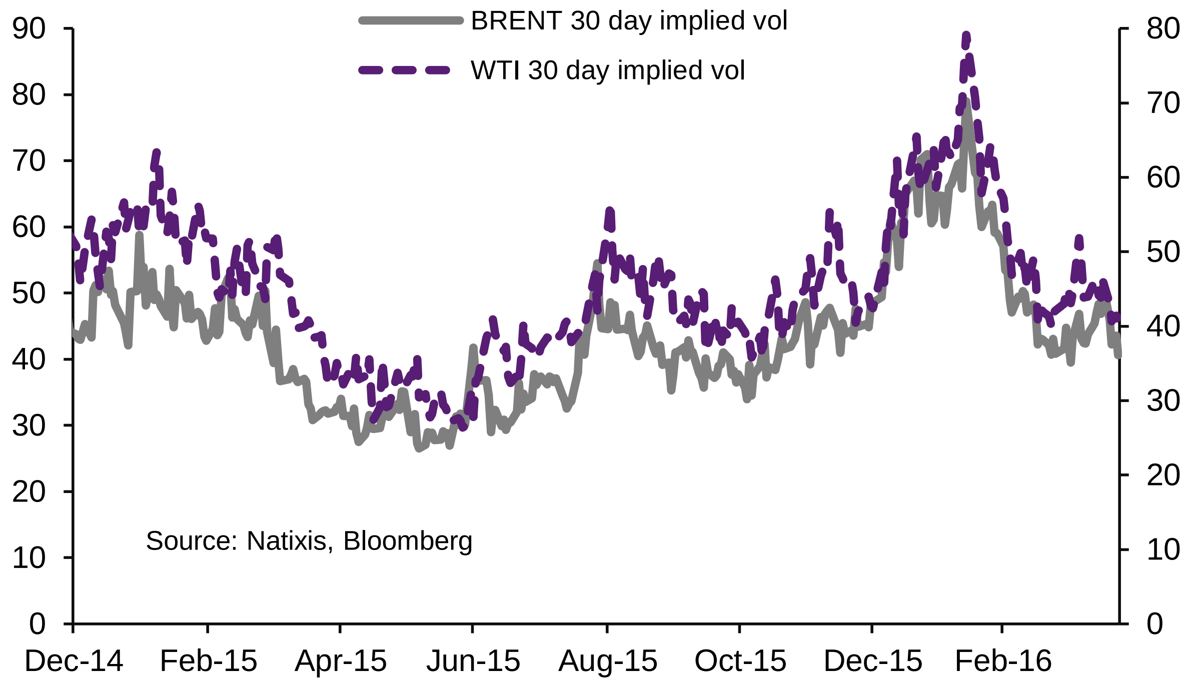
Risks to Oil Price

Forecasts ($/bbl)		31-Mar-16	30-Jun-16	30-Sep-16	31-Dec-16	31-Mar-17	30-Jun-17	30-Sep-17	31-Dec-17
Low Case Scenario	**WTI**	31.5	30	34	36	38	40	42	44
	Brent	33.5	33	36	38	40	42	44	46
Base Case Scenario	**WTI**	32.5	34	39	41	42	44	48	50
	Brent	34.5	36	40	42	44	46	50	52
High Case Scenario	**WTI**	34	43	45	47	50	52	54	56
	Brent	35.5	44	46	48	52	54	56	58

Volatility in oil to remain high

- **Expect high volatility in the next 12 months**

30-day Implied Volatility (%)



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