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Near-Term Oil Outlook - 2015

By

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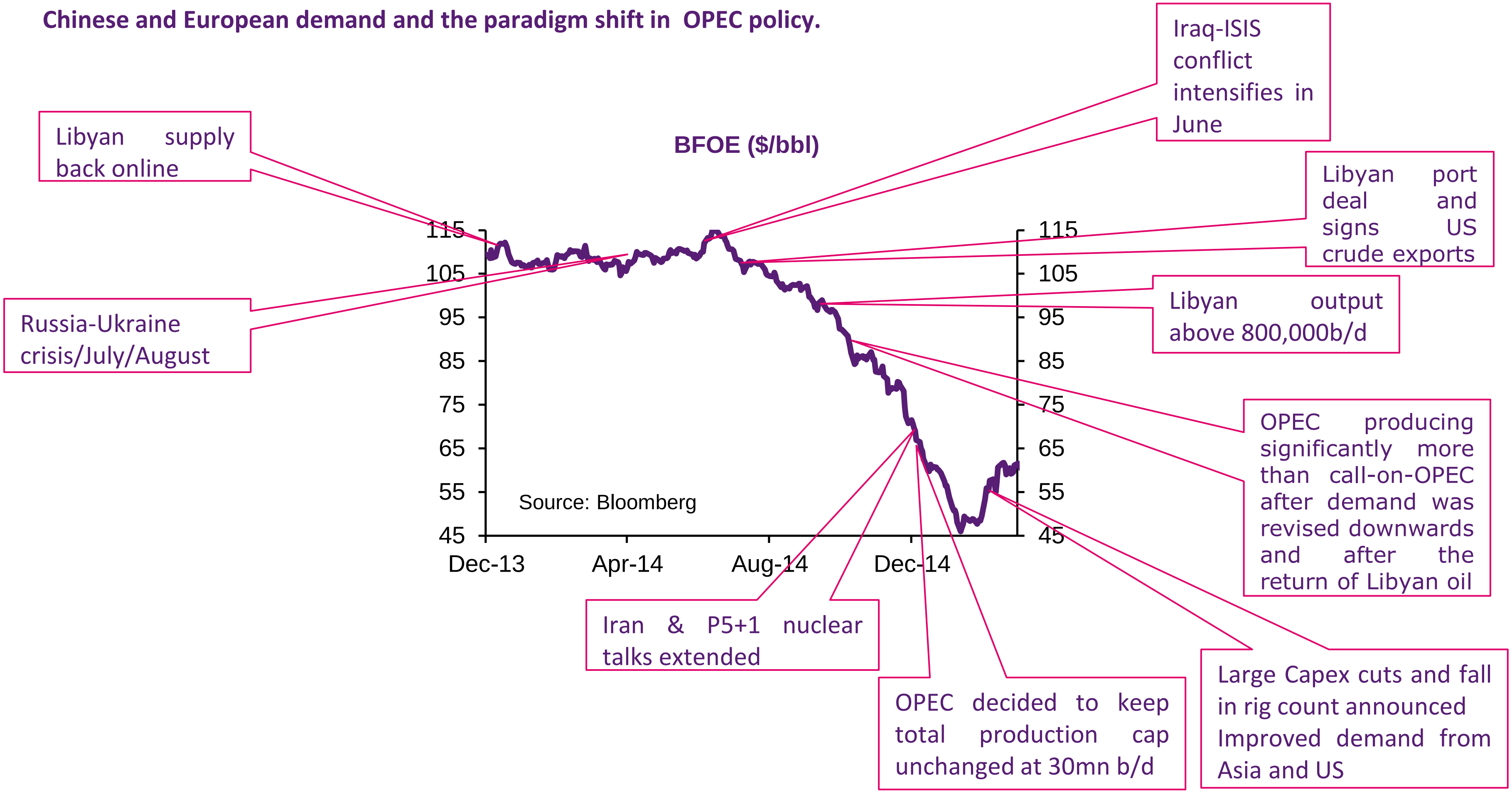
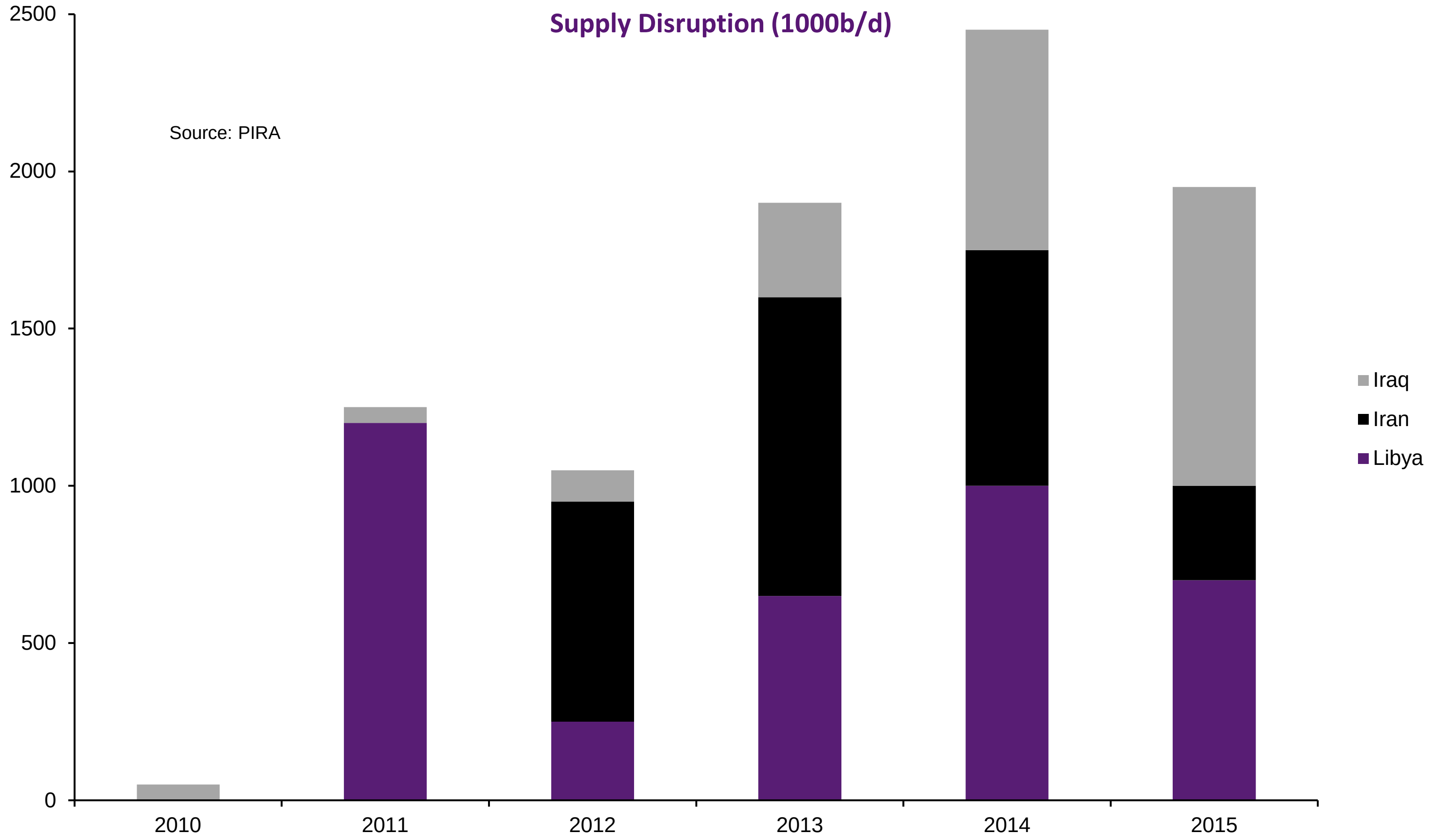
Oil in 2014-15

- **Physical balances had started to weaken slowly in the first half of 2014, however prices were supported by geopolitical tensions. Supply-demand fundaments weakened further with the unprecedented increase in non-OPEC supply, further weakness in Chinese and European demand and the paradigm shift in OPEC policy.**

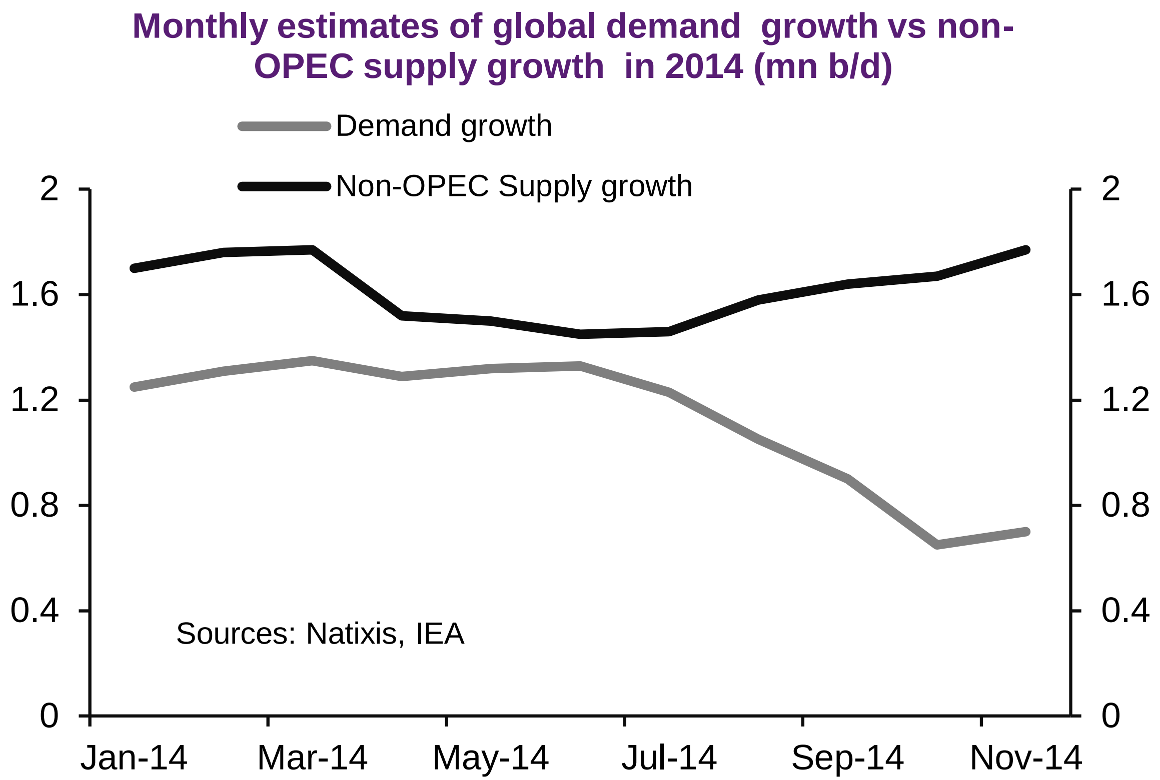


Supply disruptions



Weak fundamentals

- Since the start of 2014, the fundamentals in the global oil industry have deteriorated markedly.



OPEC policy results in increase in inventories!

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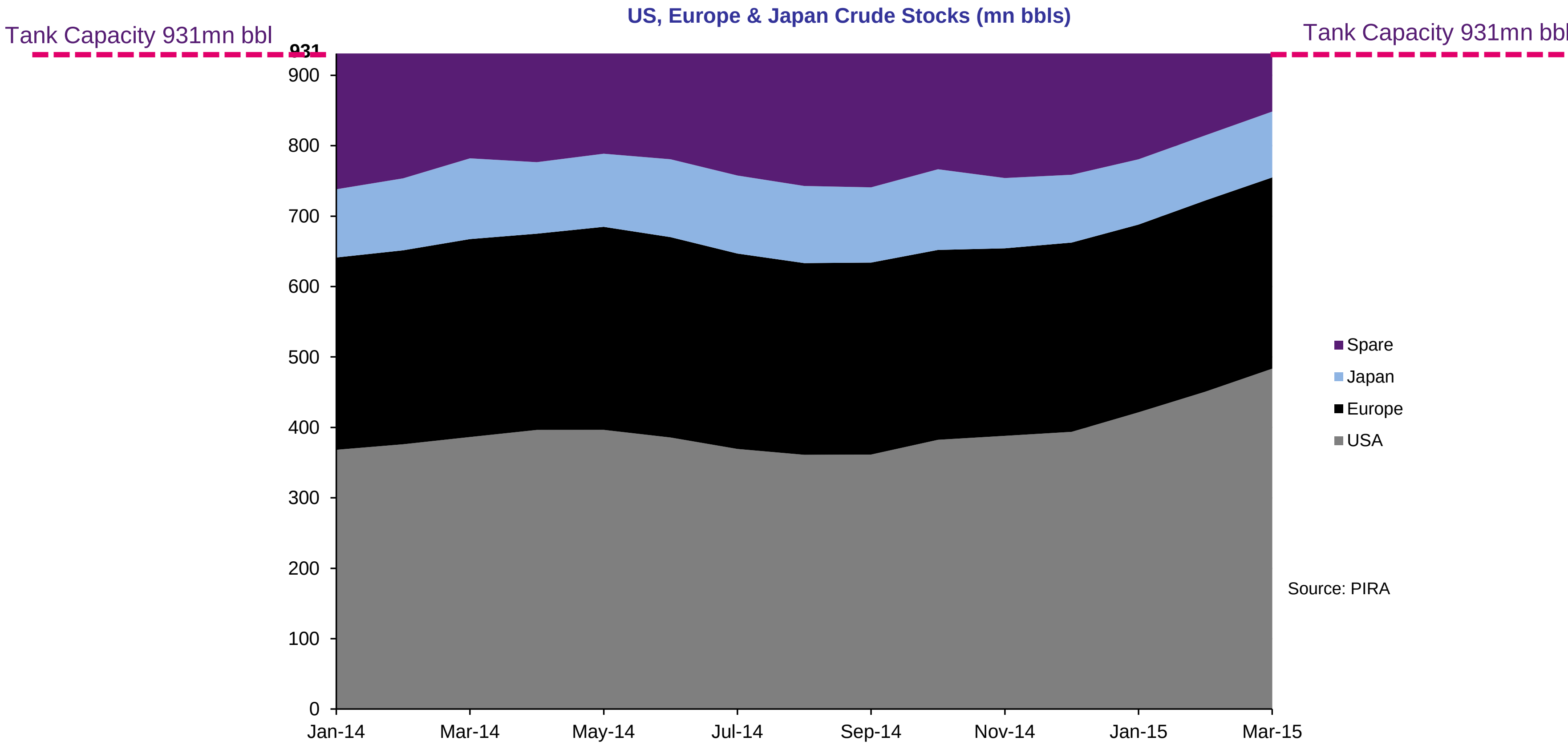
- **OPEC's (mainly GCC allies) refusal to cut production and let markets balance by itself - a paradigm shift in policy to maintain market share and put pressure on marginal producers worldwide. Result: increase in crude inventories.**



- **Crude and NGL inventories were on average 1.1% higher in 2014 than 2013-IEA**
- **Crude inventory expected to be up 7.3%yoy in Feb15 - PIRA**

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New era in oil market or just a temporary phase?

- **Will demand pick up and will the growth be similar to the one seen in the last decade?**

- **What about global crude oil supply growth? Will it continue to outpace growth in demand**
  - ***Is US becoming the new marginal producer?***

- **If so then what happens to OPEC? Will OPEC continue to maintain its output over 30mn b/d or will it be the first to blink?**

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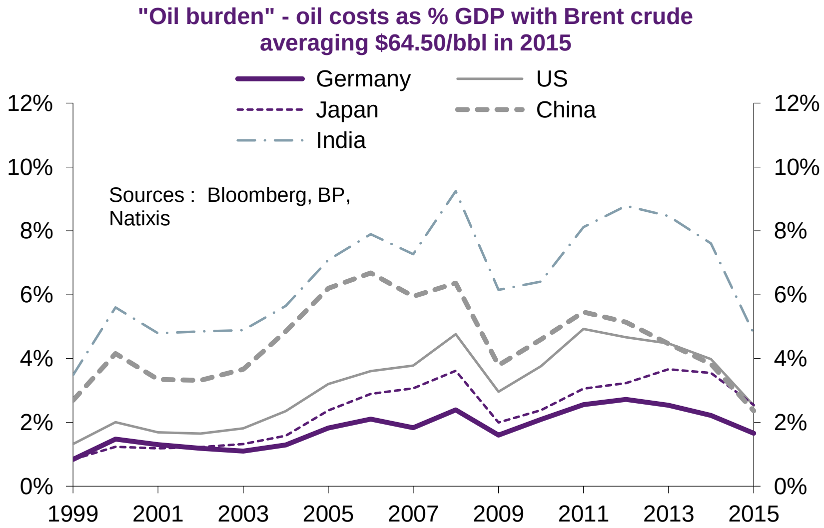
OIL DEMAND

Lower oil prices are positive for global growth

- **Similar to 2009, lower oil prices should help to boost global growth**
- **Oil consuming nations will benefit from a rise in household disposable income and/or improving government finances**
  - **Improvement of terms of trade means improvement in current balances and currencies**
- **Falling income in oil producing countries will reduce saving more than it cuts consumption**
  - **A slightly positive-sum game for global growth (Keynesian balanced budget multiplier effect)**
- **Over time, the resultant boost to global growth should stimulate demand for oil, even where price elasticity of demand appears to be low**
- **IMF estimates that a 10-20% fall in oil lifts world GDP by 0.05%**



Natixis near term oil demand forecasts

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- **Consumption of oil grew by around 700,000b/d in 2014. Demand is expected to increase by around 1mn b/d in 2015, boosted by low oil prices.**

Demand (yoy growth, 1000 b/d) - 2015

Region	OPEC	IEA	Natixis
OECD	-10	+20	+20
China	+310	+280	+280
South America (excl. Chile)	+200	+110	+130
Other Asia (Incl. India)	+250	+430	+360
Middle East	+280	+180	+200
Net growth	+1170	+990	+1000

Source: Natixis, IEA, OPEC

Note: Numbers above do not add up as the total includes other regions

Non-OPEC OIL SUPPLY

Non-OPEC oil supply: near-term drivers

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➢ On the upside:

- US oil production is expected to rise by close to 0.74mn b/d in 2015. Output growth is expected to be greatly affected by low oil prices in 2015, given the steep decline in rig count as producers are idling rigs and capex cuts. But oil production could easily bounce back given the declining break-evens in the US.
- US NGL output is expected to rise to more than 3.8mn b/d by 2020 from current 3.07mn b/d, although growth is likely to be impacted
- Brazilian oil output expected to rise by up to 100k b/d in 2015 due to ramp up at pre-salt fields

➢ On the downside:

- Russian oil output is expected to fall by 100k-110k b/d in 2015 due to sanctions and limited investments
- Kashagan will not restart until 2016
- Lower output is expected from Middle East (Yemen) and Africa (especially Egypt, Ghana and Sudan) in 2015
- Mexican oil output is expected to decline further in 2015 by 160kb/d

➢ **Low oil prices will reduce investment in North Sea, Brazil, Canada, US and Asia, with the impact on output/growth felt as early as second half of 2015 in some regions.**

➢ **We are expecting most of the non-OPEC reductions to come from North American unconventional oil supply. This supply, unlike conventional supply, also has the ability to spring back very quickly if prices are above the required break-evens.**

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Global Capex

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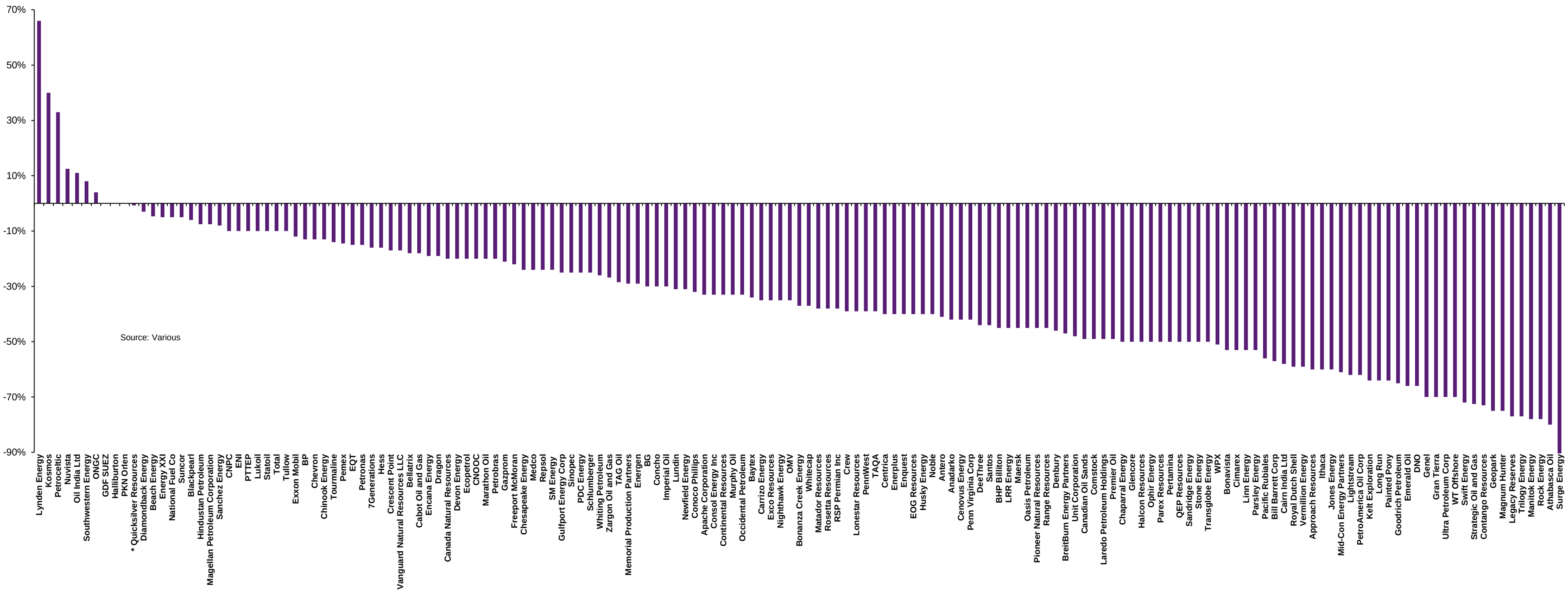
- **Total global Capex cuts identified in excess of $135bn**



Source: Various

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Natixis non-OPEC supply forecasts

- Non-OPEC supply of oil grew by 1.9mn b/d in 2014. Non-OPEC supply is expected to increase by around 760,000 b/d in 2015.

Non-OPEC Supply (yoy growth, 1000 b/d) - 2015

Region	OPEC	IEA	Natixis
North America	+860	+720	+700
OECD Europe	-40	0	+20
South America (excl. Chile)	+60	+60	+100
Africa	0	-10	0
FSU	-130	-70	-110
Net growth	+850	+740	+760

Source: Natixis, IEA, OPEC

Note: Numbers above do not add up as the total includes other regions

The Key Equation:

Global demand

– non-OPEC supply

=

Implicit call on daily OPEC production

Uncertainty in physical balances

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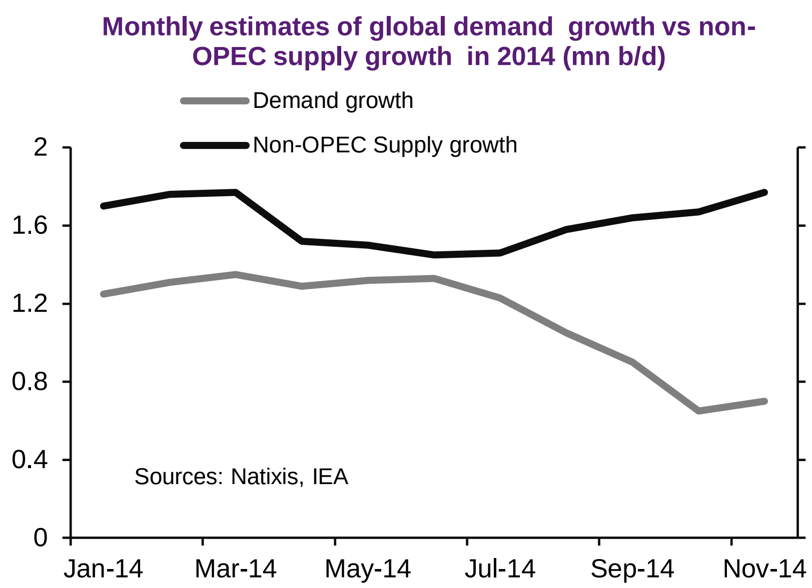
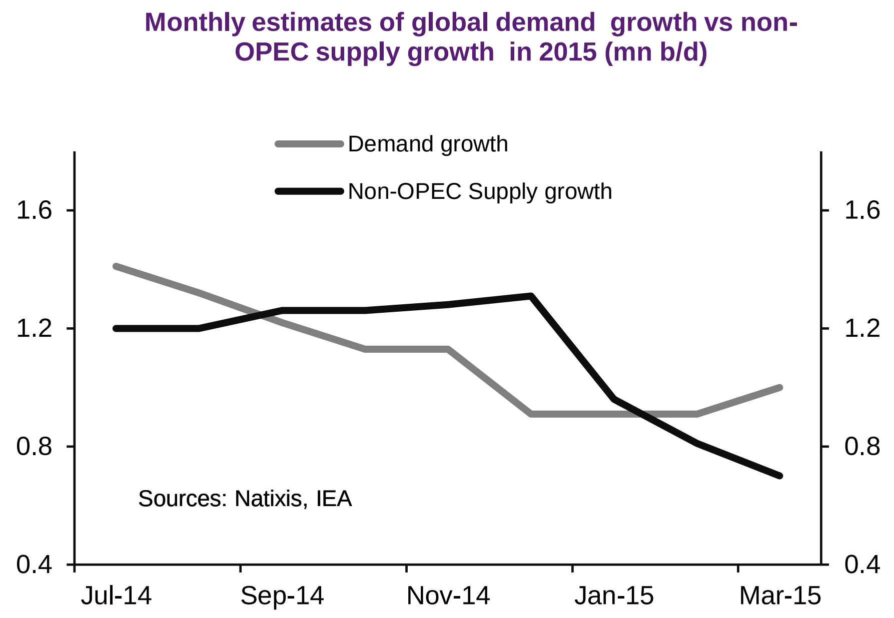
➢ **With the outlook for fundamentals discussed earlier we could very well see growth in global demand exceeding growth in non-OPEC supply by the end of 2015. However this could easily change if US output were to bounce back on high oil prices and lower break-evens.**





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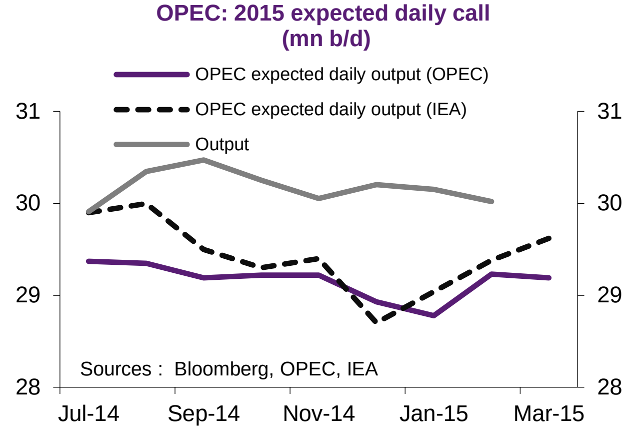
OPEC production > call-on-OPEC

- **With global demand expected to grow at a faster pace than non-OPEC supply , we expect the average call-on-OPEC to remain broadly unchanged at 29.4mn b/d in 2015, as compared to 2014.**

Call-on-OPEC (mn b/d)		
	2014	**2015**
OPEC	29.36	29.19
IEA	29.5	29.62
EIA	29.3	29.13
Sources: IEA, OPEC, EIA, Feb data		

- **OPEC and IEA estimates for the 2015 call-on-OPEC (reported in Mar15 monthly reports) are around 0.6-0.8mn b/d below expected average OPEC crude production for 2015. As demand exhibits seasonal weakness in 2015H1, this gap could be as high as 1.5-2mn b/d and as low as -0.4mn b/d in 4Q15.**



Fiscal break-evens and "reasonable" oil price

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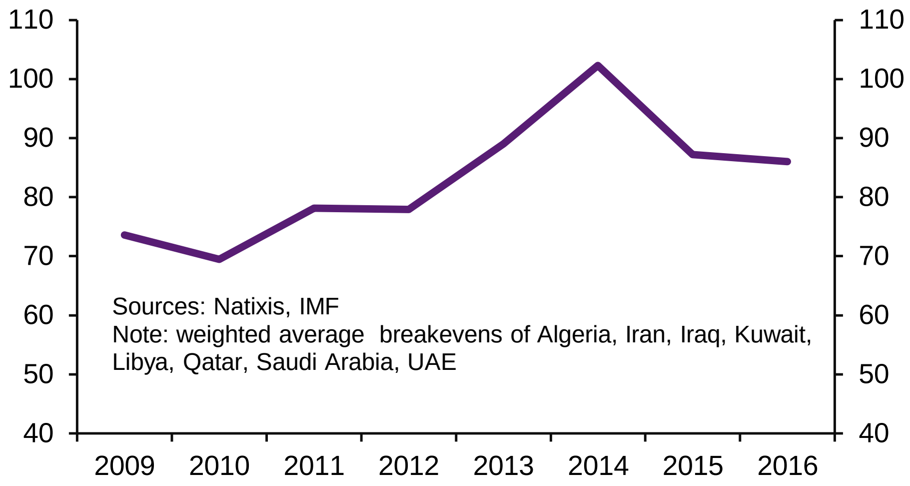
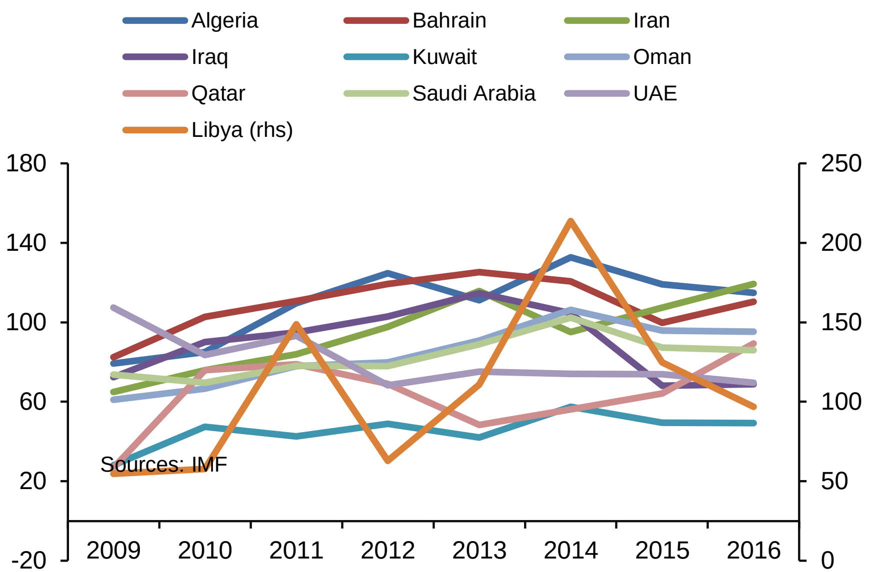
- **Our estimate for Saudi Arabia's fiscal break-even oil price stands at around $90/bbl for 2014 and is expected to be higher in 2015. Surpluses prior to 2014 are therefore shifting to deficits.**

- **Saudi Arabia has acknowledged the possibility of fiscal deficits as it contemplates a period of lower output and restrained oil prices due to increased non-OPEC supply.**

Weighted average oil fiscal breakevens ($/bbl)



Oil fiscal breakevens ($/bbl)



- **To reduce fiscal break-evens would require key OPEC countries to reduce expenditure (hence subsidies)**
- **Middle Eastern crude exporting countries have been revising their budgetary expenditures to help them adapt in a lower cost environment. Despite these reductions all but Kuwait will be feeling pressure with current low oil prices based on recent data provided by IMF**
- **Further price war possible with return of Iranian oil**

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NATIXIS OIL PRICE FORECAST

Possible scenarios

- **There are four plausible scenarios for the global oil market. Each would have a materially different outcome:**

  - No change in OPEC production. Low oil prices reduce investment in future output, but have relatively little effect on near term volumes supplied. Oil market remains oversupplied. Prices remain low.

  - Low oil prices lead to reduced investments worldwide in oil production which has a significant impact on near term oil production growth. Prices are supported depending on the volume of global production affected.

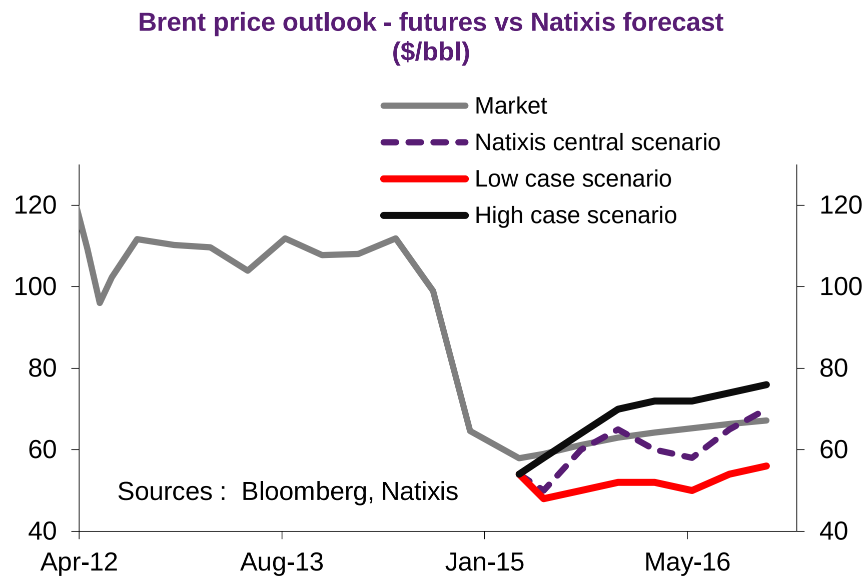
  - Saudi Arabia and its OPEC allies begin to cut output in response to an actual or perceived slowdown in oil production. Prices recover in response, drifting up towards new OPEC target.

  - One or more major defaults result in a material slowdown in oil production, eg as civil unrest damages infrastructure. Oil prices begin to recover, but without OPEC action result remains unclear.

- **In the first two quarters, we have taken scenario 1 but third and fourth quarter we are looking at either scenario 2 OR 3.**

- **Return of Iranian oil, if sanctions are lifted, could keep oil prices low for next couple of years especially if OPEC does not agree on any production cuts. In which case scenario 1 will become our central scenario for next two years.**

Oil price outlook



- **Volatility in oil prices to remain high in 2015**
- **Our forecasts assume increased demand due to lower oil prices, higher seasonal demand in 2015H2, SPR demand from China and India and a cut in oil production from OPEC or a higher than expected reduction in non-OPEC oil output growth.**
- **Return of Iranian oil (in the absence of OPEC cuts), would keep pressure on oil prices for longer.**
- **If fundamentals remain weak, we would expect oil in storage to test storage capacities - even in the US. Oil prices would come under pressure if stocks worldwide continue to rise at current pace. Prices will have to fall further to price in floating storage.**
- **The more oil goes into the storage, the longer it might take for oil prices to recover.**

New era in oil market or just a temporary phase?

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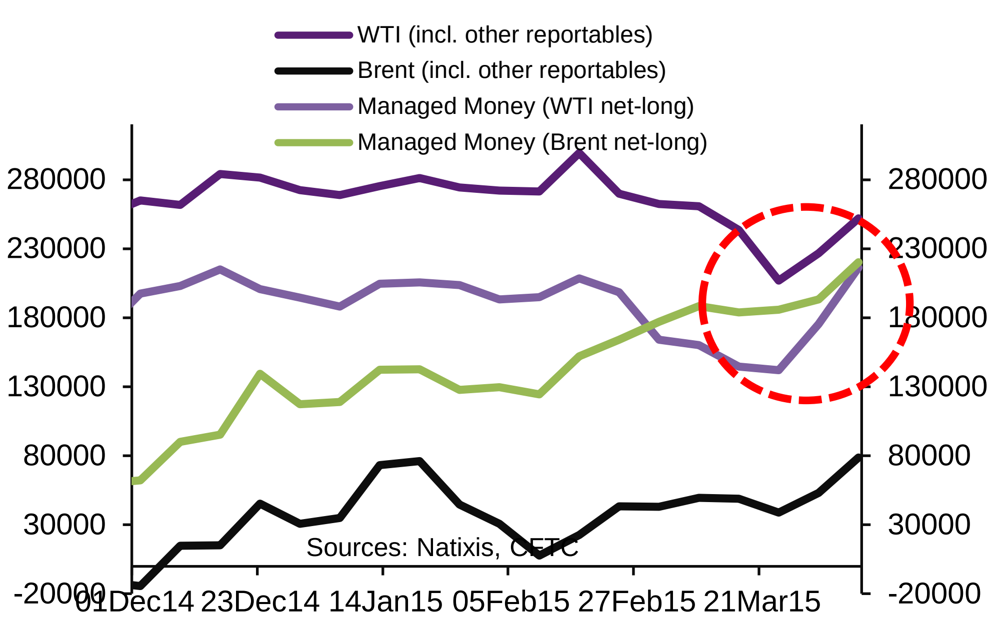
- Near term: Growth in global demand for oil expected to rise due to low oil prices.
- Non-OPEC supply growth will depend largely on the "new marginal producer" US supply growth. Although the current idling of rigs suggest that US oil output is likely to reduce by end of 2015, but given the reduced break-evens and quick turn around if prices are supported could see a rebound in US supply and hence putting a cap on prices.
- OPEC's paradigm shift in policy in maintaining their output at around 30mn bbl is likely to stay in place at least for first half of this year as Saudi Arabia is looking for a sustainable solution to the over supply in the market which would require a non-OPEC and OPEC coordination as per their latest statements.
- Medium-Long term: Growth in global demand for oil expected to rise but increase could be limited thanks to regulations, efficiency gains and diversification.
- Reduced capex is likely to reduce supply growth in fields outside of US.
- Markets likely to be more balanced and OPEC could once again regain its position as the marginal producer

HOT MONEY NET FLOWS

Hot money net flows

- **Speculative length has increased in Brent since February.**
- **After cutting bullish positions for WTI, thanks to rising inventoriess in the US, net long positions have once again increased for the light crude contract.**

Total net-long non commercials



Analyst Biography

Dr Abhishek Deshpande leads the oil and oil products research at Natixis, providing oil strategies, price forecasts and analysis of developments across the global oil and oil product markets. Abhishek has a doctorate in Chemical Engineering from Cambridge University and holds Chartered Engineer status with the Institute of Engineers, UK. While pursuing his degree, he spent time working for Indian Oil Corporation Limited.

Abhishek has appeared on BBC, CNBC, Bloomberg TV, presented at Oil & Gas conferences and is quoted regularly by financial media globally. He has also published articles in financial journals such as Petroleum Economics and O&G Journal. He is invited regularly to talk at international conferences.

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