

# OIL MARKET OUTLOOK: CAUTIOUS IN 1H19, BULLISH IN 2H19... IF DEMAND HOLDS



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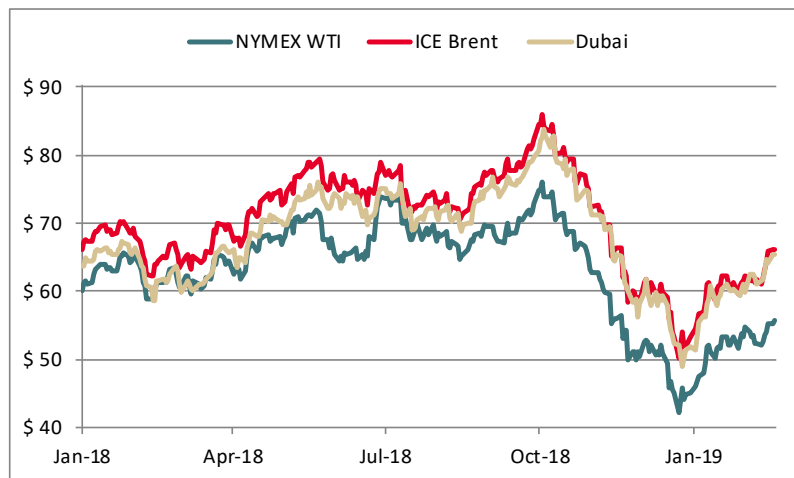
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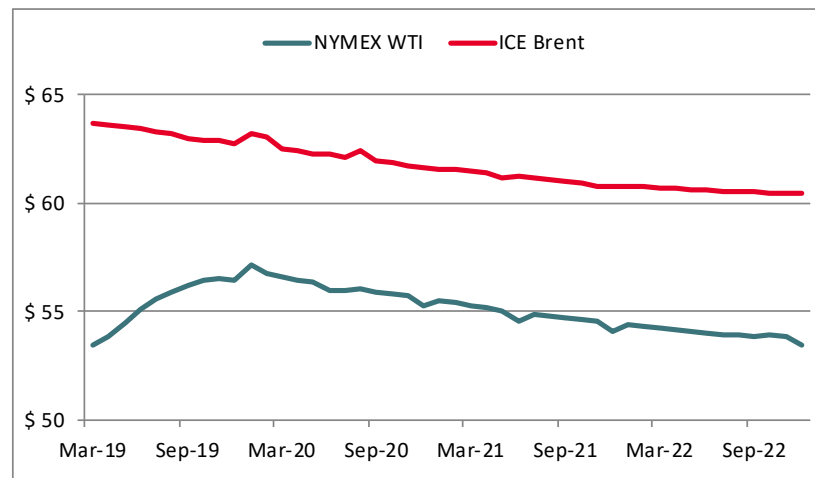
# PRICE REBOUND: RETURN OF RISK APPETITE (MACRO), SAUDI/OPEC+ CUTS, IRAN / VENEZUELA / OTHER DISRUPTIONS, STABILIZATION / RECOVERY IN INVESTOR FLOWS

**World crude oil benchmarks (\$/bbl)**



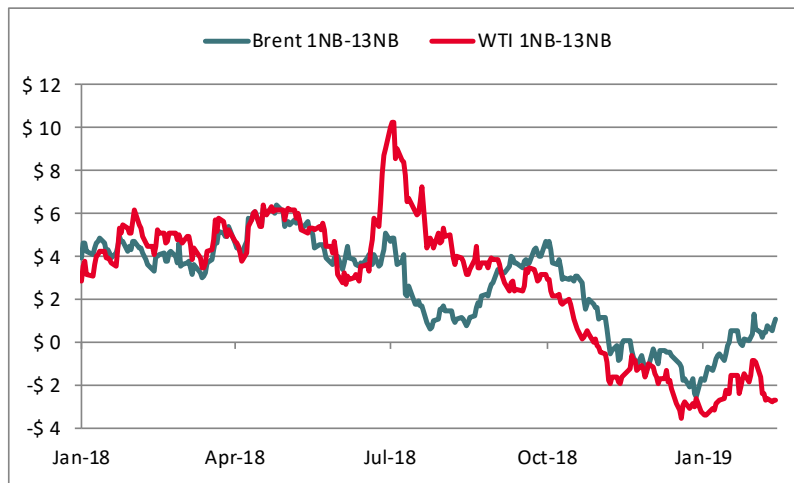
Source: Bloomberg, SG Cross Asset Research

**ICE Brent and NYMEX WTI forward curves**



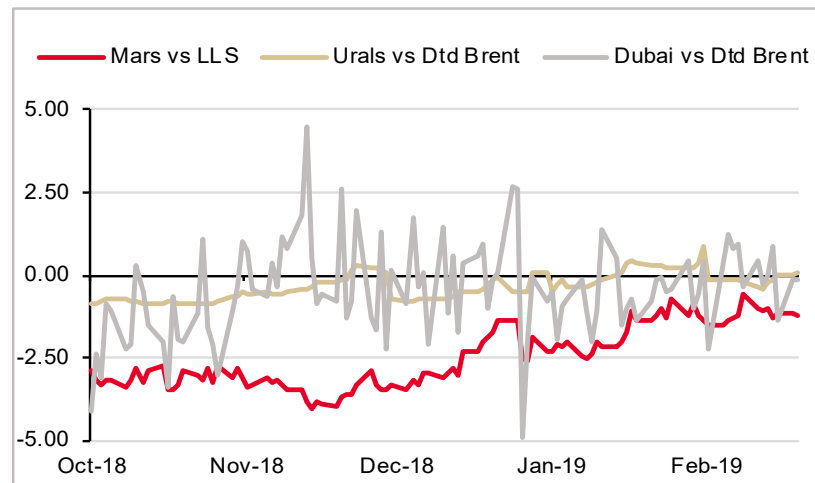
Source: Bloomberg, SG Cross Asset Research

**ICE Brent / NYMEX WTI front month vs. 1-yr fwd timespreads**



Source: Bloomberg, SG Cross Asset Research

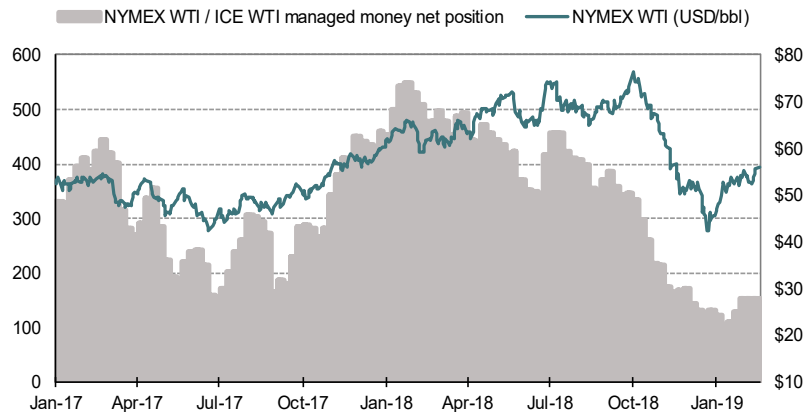
**Sweet vs. sour crude price differentials**



Source: Bloomberg, SG Cross Asset Research

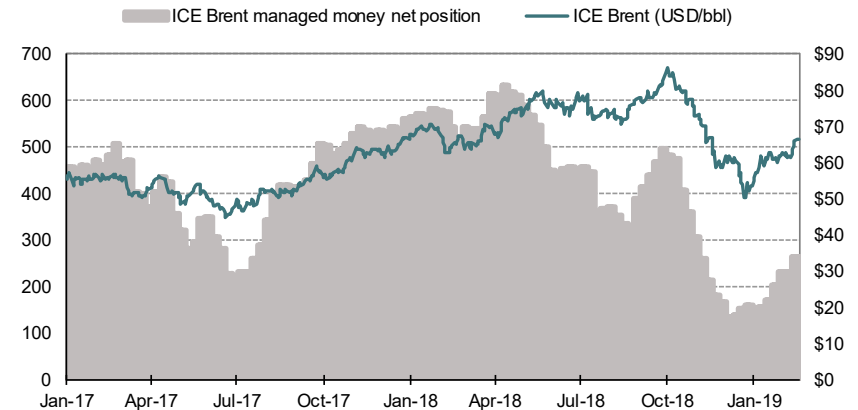
# COMPARED TO RECORD HIGH LEVELS IN 1H18, MANAGED MONEY NET LENGTH FELL TO BOTTOM OF RANGE IN 4Q18. NOW A BULLISH RISK: WHAT WILL CATALYST BE?

## NYMEX WTI / ICE WTI managed money net position (Mb)



Source: Bloomberg & SG Cross Asset Research

## ICE Brent managed money net position (Mb)

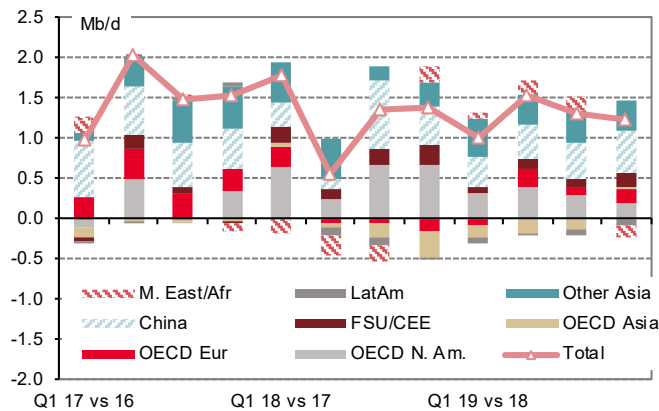


Source: Bloomberg & SG Cross Asset Research

# FUNDAMENTALS

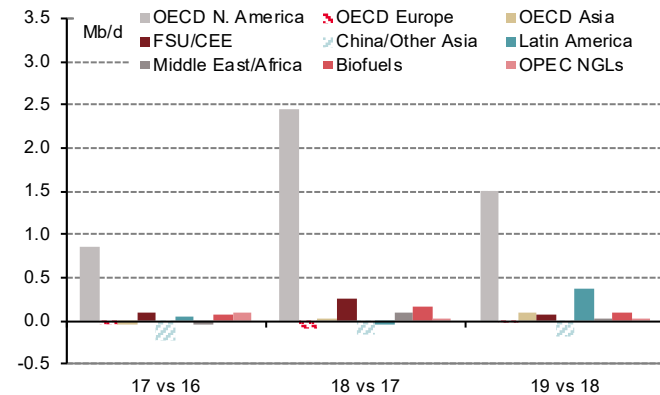
# FOR 2019, SOLID GLOBAL DEMAND GROWTH VS. STRONG GROWTH IN NON-OPEC SUPPLY

**Global demand growth 2017-2019 (quarterly)**



Source: IEA (history), SG Cross Asset Research (forecast)

**Non-OPEC supply growth (incl. OPEC NGLs) 2017-2019**



Source: IEA (history), SG Cross Asset Research (forecast)

## ■ Global demand growth:

- SG forecasts global GDP growth edging lower, from 3.8% in 2018 to 3.6% in 2019. The risk is to the downside (escalating trade war).
- Growth in 2018-2019 led by emerging markets (0.9 Mb/d in 2018, 1.0 Mb/d in 2019).
  - ▶ 0.8 Mb/d in 2018 and 0.85 Mb/d in 2019 from China, India, and other emerging Asia (63-67% of global growth)

**1.3 Mb/d 2018, 1.3 Mb/d 2019**

## ■ Non-OPEC supply growth (incl. OPEC NGLs):

- By country: Growth led by the US, but the pace expected to slow from 2.2 Mb/d in 2018 to 1.7 Mb/d in 2019 (crude plus NGLs). Also significant gains of 0.3 Mb/d from Brazil. Worthy of note: mandatory output cuts in Alberta, Canada to reduce local oversupply.

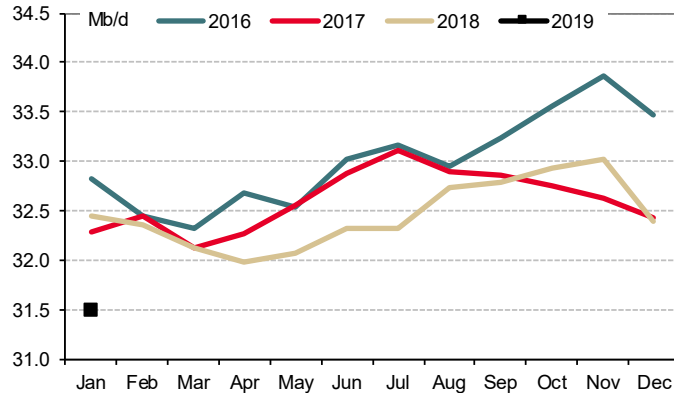
**2.7 Mb/d 2018, 2.0 Mb/d 2019**

# OPEC SUPPLY AND GEOPOLITICS



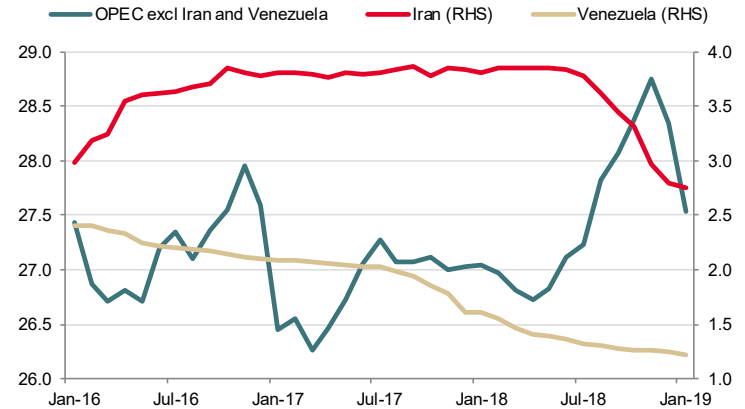
# TOTAL OPEC CRUDE OUTPUT WAS CUT BY 1.5 MB/D FROM NOV 2018 TO JAN 2019, LED BY SAUDI ARABIA.

OPEC Crude Production 2016-2019



Source: IEA, SG Cross Asset Research

OPEC Crude Production 2016-2019: focus Iran and Venezuela

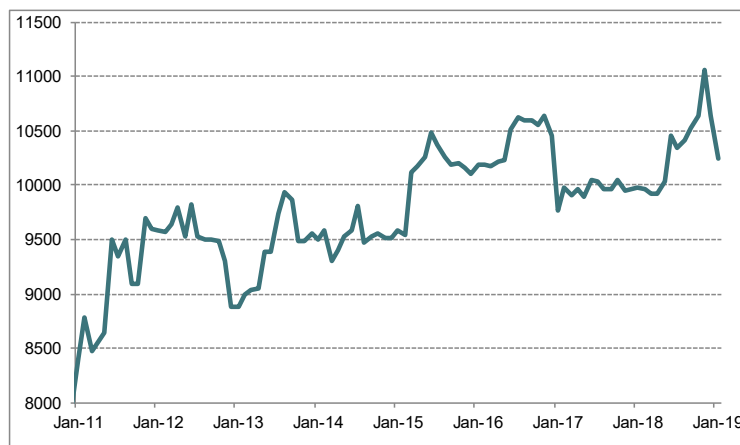


Source: IEA, SG Cross Asset Research

- OPEC+ (Saudi Arabia and Russia) announced a 1.0 Mb/d increase in June 2018
- From May to Nov 2018, total OPEC crude output increased by 0.9 Mb/d, including a drop of 0.8 Mb/d from Iran. Saudi Arabia increased by 1.0 Mb/d. Russia increased by 0.4 Mb/d.
- Cuts of 1.2 Mb/d agreed at OPEC+ meeting on 6 December: 0.8 Mb/d from OPEC and 0.4 Mb/d from non-OPEC. Iran, Venezuela, and Libya are exempt from the cuts.
- From Nov 2018 to Jan 2019, total OPEC crude output was cut by 1.5 Mb/d. Saudi Arabia cut by 0.8 Mb/d. The UAE cut by 0.25 Mb/d. Iran dropped 0.25 Mb/d.
- Key assumptions: strong OPEC+ compliance; OPEC+ cuts will be extended through 2019 (possibly with adjusted output targets); Saudis will produce 10.2 Mb/d in 2H19.

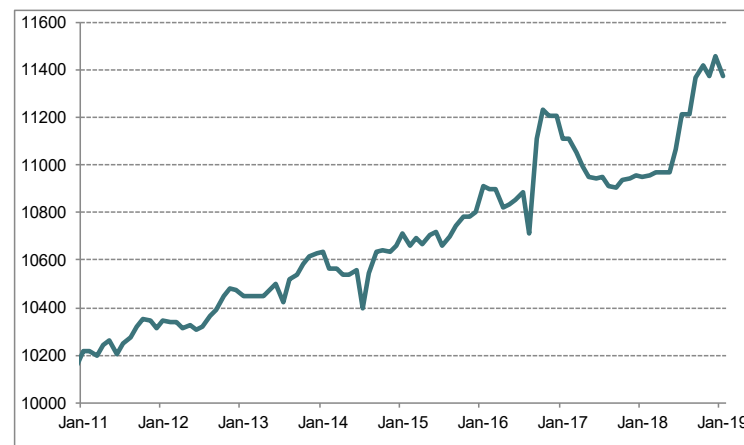
## FROM NOVEMBER TO MARCH, SAUDI ARABIA WILL CUT BY 1.3 MB/D

Saudi Arabia crude production 2011 – 2019 (kb/d)



Source: IEA, SG Cross Asset Research.

Russia crude production 2011 – 2019 (kb/d)



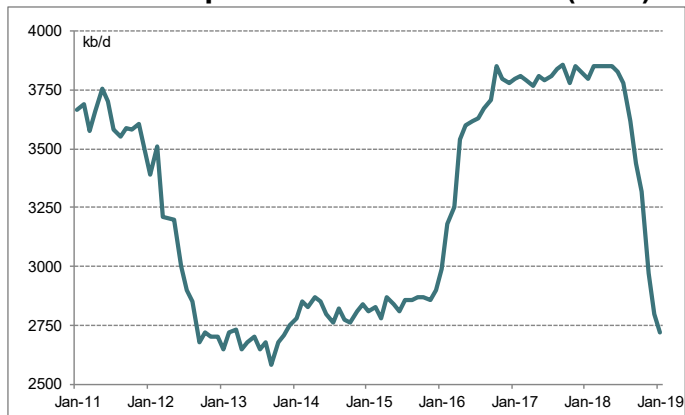
Source: IEA, SG Cross Asset Research.

- Saudis are aggressively leading the OPEC+ cuts. They did not wait for January.
- From peak of 11.1 Mb/d in Nov, crude output cut to 10.6 Mb/d in Dec and 10.2 Mb/d in Jan. Planned output of 10.1 Mb/d in Feb and 9.8 March (which is 0.5 Mb/d below their target).
- Overall cut of 1.3 Mb/d from Nov to March. A signal that the Saudis are not in any hurry to replace Iranian and Venezuelan losses – especially the March cut. Also refinery maintenance.
- Saudis appear to favor a price range of \$70-80 Brent.
- No severe squeeze on Saudi spare capacity seen for 2019. Immediately available capacity is 11.0-11.5 Mb/d. Saudi can reach 12.0 Mb/d, but they say that would take 3-6 months.
- Spare capacity tight by historical standards, but markets are relaxed due to comfortable stocks.
- Russia will cut, but only at a gradual pace, as they said in Dec – and as they did 2 years ago.



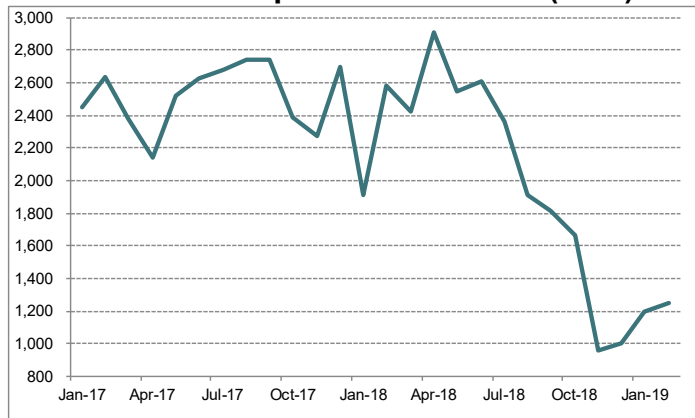
# IRAN: COMPARED TO 1H18, EXPORTS DOWN BY 1.5 MB/D IN NOV/DEC. JAN - APRIL EXPORTS EXPECTED TO BE 1.2-1.3 MB/D (SANCTIONS IMPACT OF 1.25 MB/D).

Iran crude production 2011 – 2019 (kb/d)



Source: IEA, SG Cross Asset Research.

Iran crude exports 2017 – 2019 (kb/d)



Source: Platts, Reuters, SG Cross Asset Research.

Imports of Iran crude (Mb/d)

		actual imports 1H18	actual last 3 months*	sanctions estimate Nov 18 - May 19	cut (%)	cut (Mb/d)
<b>Europe</b>						
	EU	0.51	0.41	0.08	85%	0.43
	Turkey	0.17	0.17	0.06	66%	0.11
	<b>subtotal</b>	<b>0.68</b>	<b>0.58</b>	<b>0.14</b>		<b>0.54</b>
<b>Asia</b>						
	China	0.64	0.52	0.36	44%	0.28
	India	0.59	0.27	0.30	49%	0.29
	South Korea	0.27	0.09	0.20	26%	0.07
	Japan	0.15	0.15	0.07	50%	0.07
	<b>subtotal</b>	<b>1.65</b>	<b>1.04</b>	<b>0.93</b>		<b>0.72</b>
<b>Total</b>		<b>2.33</b>	<b>1.61</b>	<b>1.07</b>		<b>1.26</b>
<b>Total incl. UAE</b>		<b>2.43</b>	<b>1.71</b>	<b>1.17</b>		

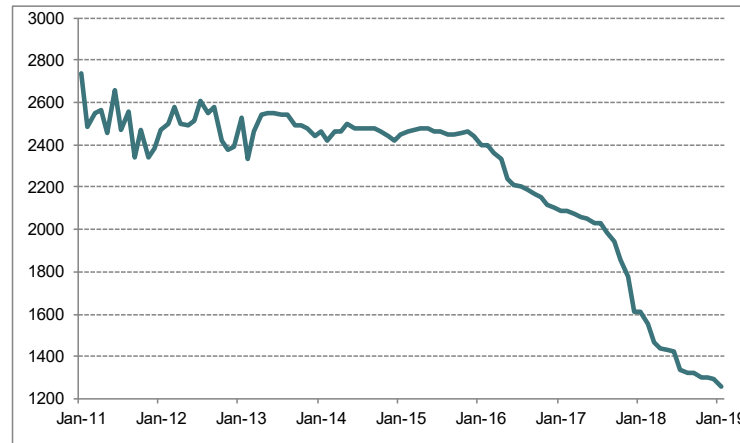
Source: IEA, Bloomberg, SG Cross Asset Research.

Note: Last 3 months is Oct-Dec for China and India., and July-Sept for all others.

- Last November, allowable Iranian flows under US waivers were more generous than expected.
- Compared to 2.5 Mb/d in 1H18, Iranian exports were down by 1.5 Mb/d to under 1.0 Mb/d in November/December. Going forward, estimated exports of around 1.2-1.3 Mb/d through April.
- For the next 6-month phase beginning early May, allowed imports will be influenced by markets.

# VENEZUELA

Venezuela crude production 2011 – 2019 (kb/d)

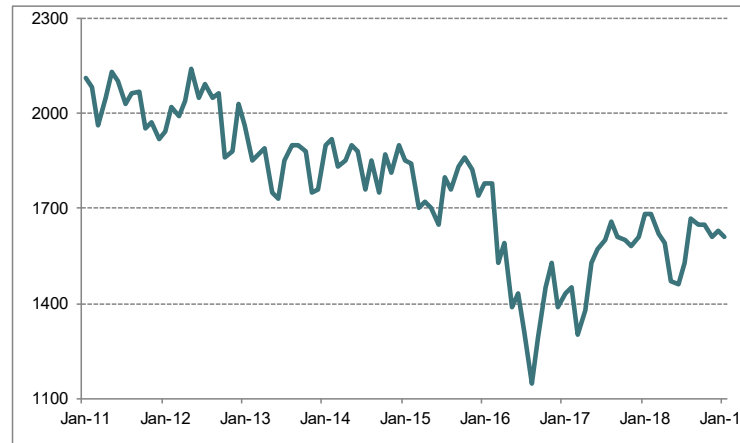


Source: IEA, SG Cross Asset Research.

- **US sanctions: a de-facto embargo on US crude imports from Venezuela (500 kb/d) and US product exports to Venezuela (120 kb/d, incl. 50 kb/d of naphtha used as diluent for x-heavy crude output)**
- **Starting on 28 April, non-US buyers/sellers will not be able to transact with PDVSA in US dollars.**
- **Venezuela exported 1.1 Mb/d in 2018. 3 main buyers: US 0.5 Mb/d, India 0.3 Mb/d, China 0.3 Mb/d.**
- **US will buy sour crude elsewhere (Latin America, Middle East). Venezuela will sell sour crude elsewhere (at a discount). Venezuela will buy diluent elsewhere (at a premium).**
- **Our initial reaction: temporary market disruption, but price differentials and trade flows should adjust, without much overall loss of supply. However: loss of diluent expected to cause a drop of 300-400 kb/d by end of Feb; India/China may not take full 500 kb/d from US; steeper decline rates.**
- **Markets relaxed: refinery maintenance; comfortable commercial stocks; strategic reserves.**
- **Also, many believe that Maduro cannot last. Key date: 23 Feb humanitarian aid delivery.**
- **We forecast output drops to 0.8-0.9 Mb/d in 2Q19; recovers to 1.1 Mb/d in 3Q19; drops to 1.0 by year-end.**

# NIGERIA

**Nigeria crude production 2011 – 2019 (kb/d)**

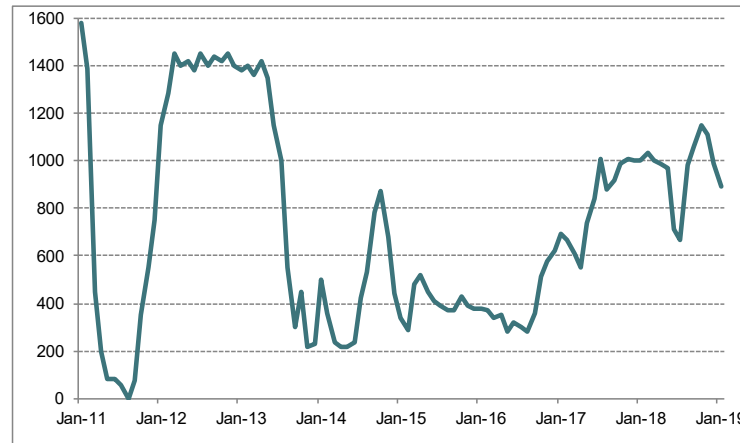


*Source: IEA, SG Cross Asset Research.*

- **Presidential election (first round) delayed until Feb. 23rd. President Buhari is still a slight favorite but he has been losing ground rapidly to his opponent, Atiku Abubakar. Buhari recently suspended Nigeria's top supreme court justice. The supreme court would play a role in deciding a disputed election.**
- **In the past, campaigns have involved violence in the Niger Delta region, often coordinated and targeted against oil fields and pipelines.**
- **This time, the leading militant group, the NDA, has been quiet and apparently happy with its amnesty payments; however, the NDA resurfaced on 14 Feb. The NDA supports the challenger, Abubakar, and threatened oil attacks if Buhari wins.**
- **Risks to oil infrastructure may rise after the elections, as militant groups and regional players position themselves for a new round of amnesty payments.**
- **We forecast production flat at 1.65 Mb/d in 2019, similar to recent levels.**

# LIBYA

Libya crude production 2011 – 2019 (kb/d)



Source: IEA, SG Cross Asset Research.

- We forecast steady production at 1.0 Mb/d in 2019, somewhat higher than recent levels, which have been affected by disruptions. However, the ongoing civil war creates significant downside risks.
- In southwest Libya, 300 kb/d has been shut-in since 09 Dec, due to a militia blockade and fighting at the El Sharara field. This can also affect the Elephant field, which gets electricity from El Sharara.
- Almost all other output is in eastern Libya, under control of eastern general Khalifa Haftar.
- There has been fighting between Haftar's forces and militias controlled by Ibrahim Jathran – who had previously controlled and shut down the eastern terminals from Sept 2014-Sept 2016. He briefly captured them again in June 2018. Haftar appears to have won; he wants to turn the field over the NOC.
- UN-backed elections planned for spring 2019, delayed from Dec. 2018. Militias could be trying to capture oil infrastructure and gain power ahead of the elections. In addition, ISIS and al Qaeda are taking advantage of the chaos and instability to regroup throughout Libya.

## OTHER RISKS

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- Iran vs. Saudi Arabia in Yemen:

- In 2018, Houthi attacks against Saudi Arabia widened to include oil targets, including refineries and tankers. In one instance, Saudi Arabia briefly (for less than a week) halted their own tanker traffic through the Bab el-Mandeb Strait, which connects to the Red Sea and then the Suez Canal and the Sumed pipeline. Flows through the Bab el-Mandeb Strait are around 4.8 Mb/d.

- Iran vs. Israel in Syria / US withdrawal from Syria:

- Most Middle East powers are involved in Syria, including Iran, Israel, Turkey, Russia, and the US, which is withdrawing gradually. The risk is that an escalation in the conflict in Syria could spill over into northern Iraq. In the past, Turkish fighting with the Kurdish PKK has resulted in attacks on northern pipelines to Turkey. Turkey will probably get more aggressive again, and this puts up to 0.5 Mb/d of northern production and exports at risk. Northern flows still recovering after Sept. 2017 fighting between Iraqi and Kurdish forces.
- This is not a comprehensive list of geopolitical risks for oil – just some prominent examples.

# SHORT-TERM CRUDE OIL PRICE OUTLOOK



# PRICE OUTLOOK: CAUTIOUS IN 1H19 AND BULLISH IN 2H19.

## 1Q/2Q19: BRENT \$60/\$62. 3Q/4Q19: BRENT \$65/\$70. ANNUAL 2019: BRENT \$64

- Given our solid macro outlook, fundamentals remain supportive. Global supply / demand are forecast to be nearly balanced in 2019, with small global stockbuilds and small OECD stockdraws.
- A significant global stockbuild in 1Q19 will limit near-term upside.
- Although the Saudis are cutting 1.3 Mb/d from Nov to March, the markets want to see how OPEC+ as a whole implements the cuts, which only began in Jan. More importantly, the markets want to see the OPEC+ cuts have an impact on stocks, first stabilization, then stockdraws.
- In 2Q19 and 3Q19, lower OPEC and seasonally stronger global demand should draw down OECD stocks and provide more price support. Also, IMO 2020 should provide broad uplift in 2H19.
- Based on OECD days fwd cover, 1-yr fwd Brent timespreads should be in backwardation in 2019. Expected to be relatively weak through 1H19; then strengthen to around \$5 in 2H19.
- Key variables: economy/oil demand; US shale production; OPEC+ cuts; US oil sanctions on Iran and Venezuela; other geopolitical risks; IMO 2020; investor flows.

### SG Supply/Demand Forecasts

Mb/d	2017	1Q 18	2Q 18	3Q 18	4Q 18	2018	1Q 19f	2Q 19f	3Q 19f	4Q 19f	2019f
OECD demand	47.4	47.9	47.2	48.1	48.2	47.8	48.0	47.6	48.4	48.6	48.2
Non-OECD demand	50.5	50.5	51.5	51.7	51.8	51.4	51.4	52.6	52.7	52.7	52.3
<b>World demand</b>	<b>97.9</b>	<b>98.4</b>	<b>98.7</b>	<b>99.8</b>	<b>100.1</b>	<b>99.2</b>	<b>99.4</b>	<b>100.2</b>	<b>101.1</b>	<b>101.3</b>	<b>100.5</b>
*Non-OPEC supply	59.9	61.0	62.0	63.3	64.0	62.6	63.7	64.2	65.0	65.4	64.6
*OPEC NGLs	5.5	5.5	5.5	5.5	5.6	5.5	5.6	5.6	5.6	5.6	5.6
*OPEC crude	32.0	31.7	31.6	32.0	32.2	31.9	30.6	30.3	30.7	30.7	30.6
<b>World supply</b>	<b>97.4</b>	<b>98.3</b>	<b>99.1</b>	<b>100.9</b>	<b>101.7</b>	<b>100.0</b>	<b>99.9</b>	<b>100.1</b>	<b>101.3</b>	<b>101.7</b>	<b>100.7</b>
Stock change	-0.6	-0.1	0.4	1.1	1.6	0.8	0.5	-0.1	0.2	0.4	0.2
<b>NYMEX WTI (\$/bbl)</b>	<b>50.95</b>	62.87	67.88	69.50	58.81	<b>64.77</b>	52.00	55.00	59.00	63.00	<b>57.25</b>
<b>ICE Brent (\$/bbl)</b>	<b>54.83</b>	67.18	74.90	75.97	68.08	<b>71.53</b>	60.00	62.00	65.00	70.00	<b>64.25</b>

*Source: Historical data – IEA; Forecasts – SG Cross Asset Research*

## UPSIDE RISKS

- Key upside risks include the following:

- **US oil sanctions on Iran**: when the next six-month phase begins in early May, the US could severely tighten/reduce allowable Iranian crude exports, using the mechanism of sanctions waivers for importers; this could happen if prices are relatively low and markets are perceived to be well-supplied. The US does not want sharply higher prices, but they could get it wrong and over-tighten at the wrong time, just ahead of peak summer crude and product demand. *\$10 crude price impact.*
- **US oil sanctions on Venezuela**: Starting on 28 April, non-US companies will not be able to transact with PDVSA in US dollars. The US could reduce flows further by imposing secondary sanctions on non-US companies/countries, banning them from using the US financial system (similar to oil sanctions on Iran). *\$5-10 crude price impact.*
- **Big picture**: the US essentially has a new policy lever to adjust Iranian and Venezuelan flows, with a potentially large impact on oil supply and prices. This is a relatively new - and complicating - factor for the oil markets. The US goals for oil markets are not the same as for the Saudis. The US price target is lower than the Saudis. The level of future coordination between the US and the Saudis is not clear. From a Saudi perspective, last autumn (when the US asked the Saudis to increase output) did not work out well at all.
- **Investor flows**: could provide pronounced uplift; current managed money positioning is extremely oversold (net length is near the bottom of the range). This means that the price risks are strongly to the upside. *\$10 crude price impact.*
- **Geopolitics**: upside risk from disruptions and increasing tensions, both in existing hot-spots and from new/unanticipated areas of instability. *\$10 crude price impact.*



## DOWNSIDE RISKS

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- Key downside risks include the following:

- The health of the global economy and global oil demand: growth could be significantly slower than expected. This could be caused by various issues, but our most serious concern is the US-China trade war, which could potentially have a significant global impact. *\$15 crude price impact.*
- OPEC+ cuts: we assume strong compliance with the cuts, and further project they will be extended through all of 2019 (possibly with adjusted output targets). If OPEC+ supply management is less effective than expected, or if the cuts are not extended, there is downside. *\$10 crude price impact.*

## OTHER WILDCARDS (BOTH UPSIDE AND DOWNSIDE RISKS)

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- Other wildcards could be either bullish or bearish. These include the following:
  - US shale production growth could be slower (bullish) or faster (bearish) than expected. *\$5-10 crude price impact.*
  - IMO 2020 could result in a bigger (bullish) or smaller (bearish) impact on distillate demand than expected. Refineries may find it more difficult (bullish) or less difficult (bearish) to supply the necessary incremental distillate. *\$5 crude price impact.*

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