جدوى للإستثمار
Jadwa Investment

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Quarterly Oil Market Update (Q3 2014)

Summary

- The combination of accelerating US supply, weaker than expected global demand, stabilization in geopolitics, and an appreciation of the dollar, led to oil prices dropping by 7.3 percent in Q3 2014, to an average of $102 per barrel.

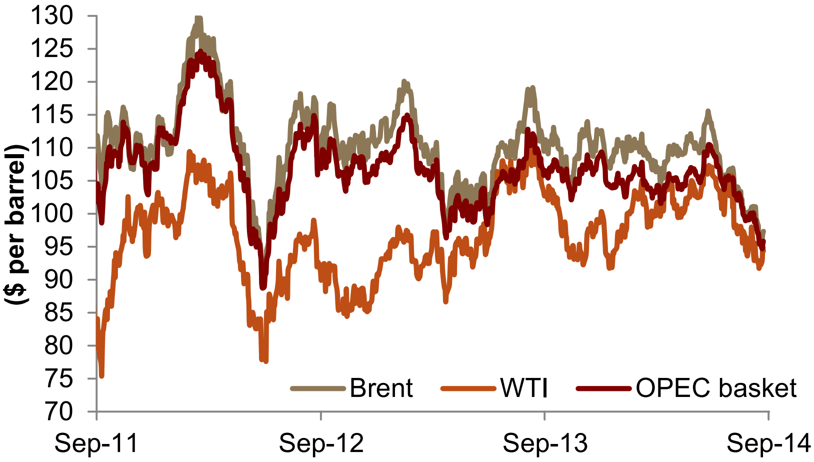
- Weak economic growth, especially in the EU and Japan, continues as a drag on oil consumption amongst OECD countries, but an uplift in economic activity in the US and a rise in demand during the winter months will result in higher consumption during the final quarter of 2014. This will also help oil prices recover slightly, but ample supply from non-OPEC sources will prevent prices from rising too far beyond $100 per barrel, unless there is a significant deterioration in geopolitics in Iraq, Libya or Russia/Ukraine.

- We expect continued domestic economic growth and the staggered start-up of the Yasref refinery to sustain Saudi oil demand in Q4 2014 and 2015. Saudi production will fall to an average of 9.5 mbpd in Q4 2014, resulting in 9.7 mbpd average for 2014. Saudi production will average 9.6 mbpd in 2015 as the global economy recovers and oil demand picks up.

Oil Prices Review Q3 2014

Q3 2014 was marked by a sudden decline in oil prices, with the Brent benchmark dropping by 7.3 percent in Q3 2014, to an average of $102 per barrel, down from $110 in Q2 2014 (Figure 1). We see this decline coming about from a combination of accelerating US supply, resulting in a glut of light sweet crude in the Atlantic Basin, weaker than expected global demand, stabilization in geopolitics, and an appreciation of the dollar.

Figure 1: Oil Prices Fell 7.3 percent in Q3 2014 vs. Q2 2014



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We see the decline in Q3 2014 oil prices coming about from a combination of...

...accelerating US supply, resulting in a glut of light sweet crude in the Atlantic Basin…

...weaker than expected global demand….

...stabilization in geopolitics…

...and an appreciation of the dollar.

Although the growth of light, sweet US crude oil production has been accelerating in the last few years, global production outages in a number of countries have delayed the impact of US supply rises on oil prices. US production increased by 3 mbpd in the five years since Q3 2009, but outages in five countries (Libya, Iran, Yemen, (South) Sudan and Syria), totaling 2.4 million barrels per day (mbpd), meant oil supplies that were no longer going to the US found alternative markets quite easily. Since 2012, however, rising US oil production has been backing out imports of West African crude, mainly Nigerian crude. Nigerian exports, which are of the light sweet type too, totaled 1.1 mbpd to the US in 2007, but dropped to an average of 140 thousand barrels per day (tbpd) in H1 2014 and the US imported no crude oil from Nigeria between June 27 and August 8 2014 (Figure 2). As a result, a large portion of this unwanted Nigerian crude has contributed to creating a glut of supply in the Atlantic Basin, putting downward pressure on Brent prices.

The glut in West African crude has also come about at a time when concerns over geopolitics issues, which had previously maintained a floor on prices, receded. In Q3 2014, we saw no major additional damage to oil infrastructure in Iraq as violence did not spread to the oil exporting areas in the south. The Ukraine-Russian conflict saw sanctions applied by both sides but these sanctions did not impact upon short to medium oil supplies and, although conflict continued in Libya, oil output increased. As these key geopolitical events stabilized, the risk premium attached to oil prices decreased, pushing prices downwards.

Lastly, an appreciation of the dollar in the last two months has seen it reach its highest point in over a year which, in turn, has also contributed to decreasing global demand for oil and added to downward pressure on prices. Oil prices and the US dollar exchange rate have a negative correlation, since the global market for crude oil is generally priced in the dollar (Figure 3). Therefore an appreciation of the dollar is usually accompanied by a decline in global oil prices, due to decreases in demand as it becomes more expensive for non-US consumers, and vice versa. The current dollar strength is a result of the expectations of rising interest rates in the US, as the Federal Reserve (Fed) ceases its asset-purchasing program plus looser monetary policy implemented by both the EU and Japanese central banks, to support their respective economies.

Figure 2: US Imports of Nigerian Crude Near Zero

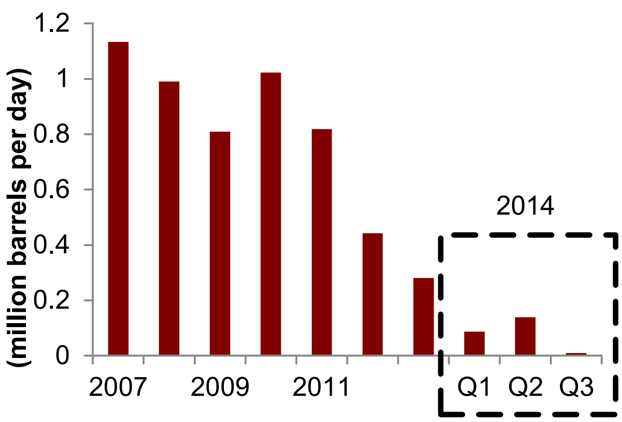
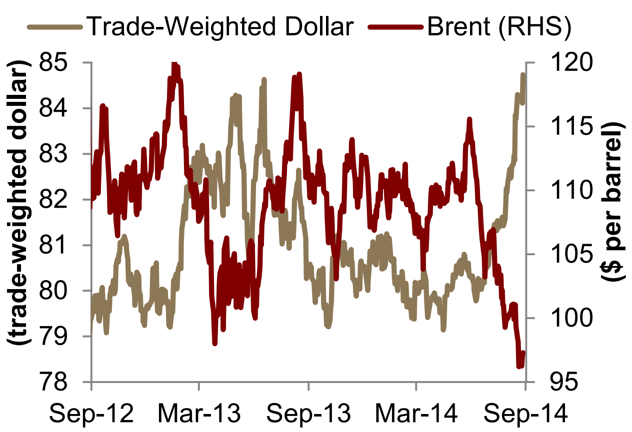


Figure 3: The Dollar and Oil Prices



Oil Demand

Weak economic growth, especially in the EU and Japan, continues as a drag on oil consumption amongst OECD countries...

According to OPEC data, global demand in Q3 2014 increased by 1.4 mbpd, year-on-year, with 1.5 mbpd of increases from non-OECD countries and a drop of 0.1 mbpd in OECD countries. Weak economic growth, especially in the EU and Japan, continues as a drag on oil consumption amongst OECD countries, but an uplift in economic activity in the US and a rise in demand during the winter months will result in higher consumption during the final quarter of 2014. According to OPEC data world oil demand is expected to grow by 1.3 percent in 2015, or 1.1 mbpd, supported by non-OCED rises, with OECD countries only seeing an increase in demand in the final quarter of 2015 (Figure 4).

…but an uplift in economic activity in the US and a rise in demand during the winter months will result in higher consumption during the final quarter of 2014.

The US is the main source of demand growth amongst the OECD countries. US economic growth prospects are increasingly buoyant, with preliminary GDP growth for Q2 2014 at 4.2 percent, year-on-year. Manufacturing PMI's have trended above 58 points in six of the last eight months in 2014 and unemployment is at its lowest rate since the financial crisis. Full year GDP growth is forecast to average 2.8 percent, year-on-year. Historically, US energy demand has followed GDP growth rates. As GDP continues to grow in Q4 2014 and 2015, positive growth in energy consumption will occur too (Figure 5).

The EU is continuing to see improvements in fuel economy standards...

...together with economic fragility, this will result in Q4 2014 and 2015 oil demand declines, year-on year.

EU oil demand growth continues to be weak due to the stuttering economy. In Q3 2014, economic results from two of the largest European economies, France and Germany, disappointed, even before any impact from sanctions imposed by Russia, over Ukraine, kicked in, whilst Italy, the third largest economy, still remains in recession. Persistently low inflation also remains a problem with the European Central Bank (EBC) recently cutting interest rates to record lows and charging banks for deposits held with it. Furthermore, the EU is continuing to see improvements in fuel economy standards which, together with economic fragility, will result in Q4 2014 and 2015 oil demand declines, year-on year. Moreover, the Russian-Ukrainian conflict continues to affect confidence in the EU economy, and a very real risk of escalation exists, especially in the form of further sanctions.

Figure 4: Non-OECD Holding Oil Demand Up

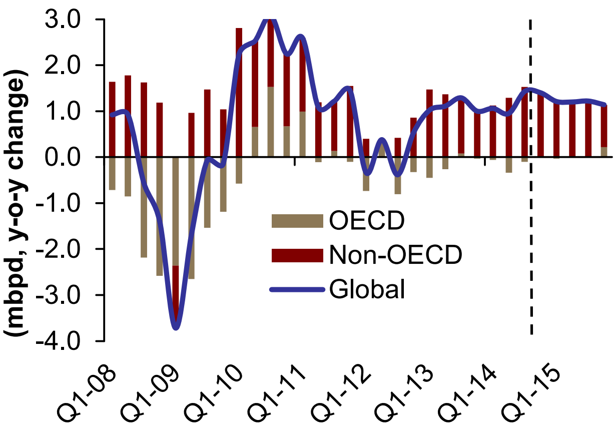
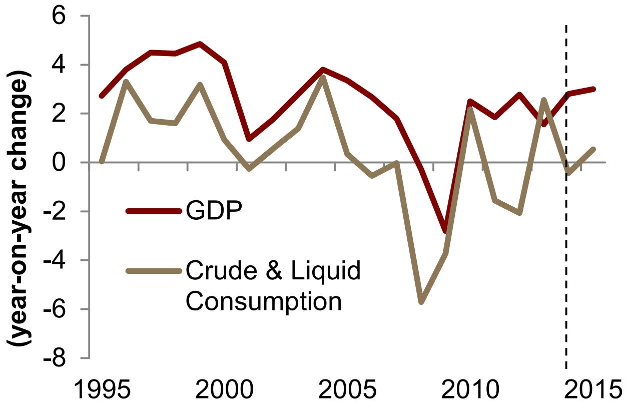


Figure 5: US GDP and Energy Consumption



The combination of closures in refinery capacity and increased use of LNG in power generation saw Japanese crude oil imports decrease in Q3 2014.

The combination of permeant closures in refinery capacity and increased use of Liquefied Natural Gas (LNG) in power generation saw Japanese crude oil imports decrease in Q3 2014 (Figure 6). Ample supply of LNG, in part due to increased US shale gas production, has seen LNG spot prices average their lowest since Q1 2011 (Figure 7). Added to this is the Japanese government led energy-efficiency drive which is forcing domestic crude refiners to cut capacity, with around 0.1 mbpd targeted for the whole of 2014. Looking further ahead into 2015, oil demand is set to continue on a downward trend. The Japanese economy is being weighed down by a sales tax and weak export growth and, more pertinently, the government is also in the process of reactivating nuclear plants, with one reactor given the go-ahead to reopen next year. Although public opinion is still against the restarts, the government is keen to push through further re-activations so to decrease the huge import costs associated with oil & gas reliance.

Latest economic indicators for China point to a moderate slowdown in growth in Q3 2014…

...as a result, oil imports in Q3 2014 were down 19 percent, year-on-year.

Latest economic indicators for China point to a moderate slowdown in growth in Q3 2014, with manufacturing PMI's unchanged in September, from 50.2 in August. Industrial production and retail sales slowed in July and imports dropped further in August. As a result oil imports in Q3 2014 were down 19 percent, year-on-year (Figure 8). Domestically, the economy is being dragged down by a housing correction, whilst externally, export demand is being constrained by weaker recovery in the global economy. China's ability to meet its forecasted annual GDP of 7.5 percent is partly contingent on the strength of overseas demand, and with only tepid growth in key export markets of the EU and a recent upturn in the US, the risk of slower economic growth and, in turn, oil demand, remains. Despite this, we still expect oil demand growth to be above 3 percent for the whole of 2014 since year-to-date oil import were up 7.4 percent, year-on-year, and government infrastructure projects, new refineries and oil stockpiling will help sustain demand over the final quarter of 2014. We also expect to see similar levels of growth in 2015 as a steady pick up in the global economy helps to expand Chinese exports.

The Crimea standoff between Ukraine and Russia continues to add to downside risks on both the demand and supply side of the oil market. Both the US and EU has applied sanctions on Russia and this, in turn, has been countered by Russia's own sanctions. Capital

Figure 6: Japan's Oil Imports Down Year-on-Year

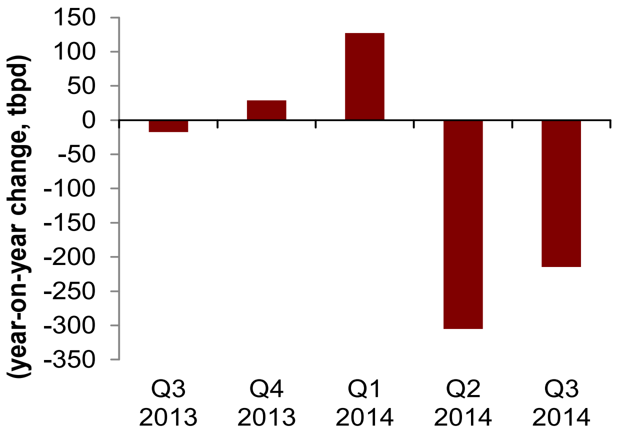
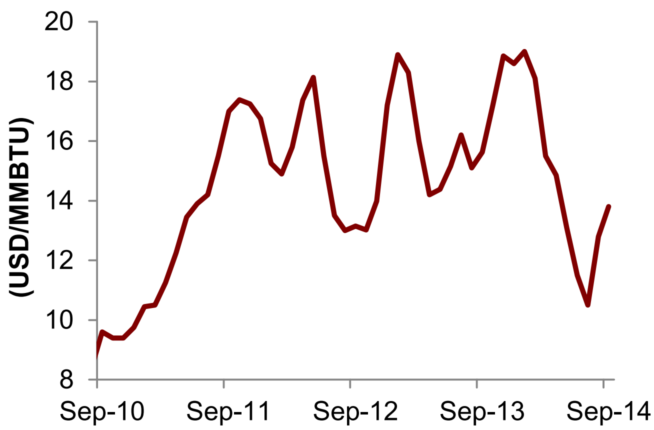


Figure 7: Asian LNG Prices Down in Q3 2014



The Crimea standoff between Ukraine and Russia continues to add to downside risks on both the demand and supply side of the oil market.

outflow from the private sector in Russia totaled $75 billion in the first half of 2014, up from $32 billion, year-on-year. Risks of a further fall in oil demand in 2014 and 2015 remain. The Russian economy is expected to show meagre growth in 2014, which could continue into 2015 if no political resolution with Ukraine is reached.

Indian oil demand will remain at around 2 percent for the next quarter with comparable growth in 2015 too. Demand will be held up by continued expansion in the construction sector but remains open to downside risks through macro-economic uncertainty relating to a large fiscal deficit, and capital outflows due to a lack of economic reform.

Saudi Arabia consumption averaged 2 mbpd in the first half of 2014…

...We expect continued economic growth and the staggered start-up of the 400 tbpd Yasref refinery to push up domestic oil demand.

Saudi Arabia's implied oil consumption averaged 2 mbpd in the first half of 2014, up 37 percent, year-on-year. The sharp rise in oil demand is largely a result of the start-up of the 0.4 mbpd Satorp refinery in Q4 2013, which has pushed up refinery intake levels since the beginning of the year (Figure 9). In Q3 2014, the higher use of oil for domestic generation of electricity pushed Saudi oil production to an average of 9.8 mbpd, compared to H1 2014 average of 9.7 mbpd. We expect continued economic growth to sustain oil demand throughout the remainder of 2014, whilst the staggered start-up of the 400 tbpd Yasref refinery in late 2014 also pushing up domestic oil demand.

Oil Supply

In Q4 2014 there will be continued output increases from non-OPEC sources, led by the US…

Global oil supply grew by 1.7 mbpd, year-on-year, in Q3 2014, with non-OPEC supplies growing by 1.8 mbpd as a result of increased US oil production (Figure 10) . In Q4 2014 there will be continued output increases from non-OPEC sources, led by the US with some increases also recorded by OPEC as a partial resumption of output from Libya contributes to year-on-year increases.

...but some OPEC rises too, as a partial resumption of output from Libya contributes to year-on-year increases.

The shale oil revolution in the US continues apace with production rising by 13 percent in Q3 2014, year-on-year. As economic recovery builds momentum, we expect to see increased investment in both non-conventional and conventional oil resources which will maintain output by 13 percent in Q4 2014. US production will average 8.46 mbpd in 2014 and 9.28 mbpd in 2015 and this will be accompanied by declining oil imports, which will average 7 mbpd in 2014 and 6.2

Figure 8: China's Oil Imports Down Year-on-Year

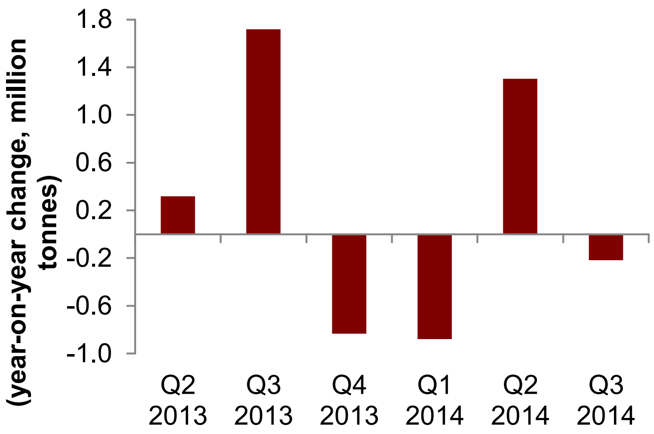
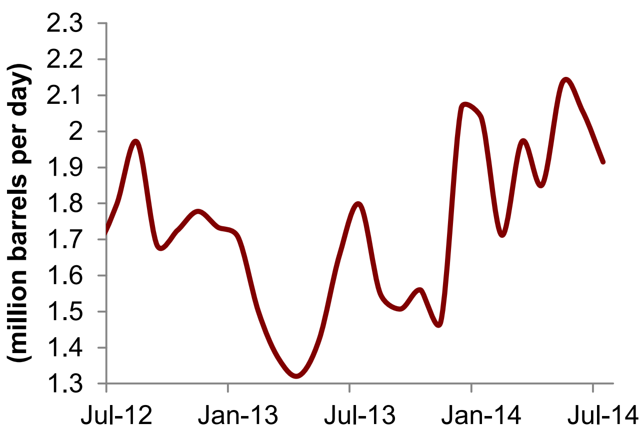


Figure 9: Saudi Refinery Intake Up in 2014



In 2014, total Russian crude production will grow by just under 1 percent….

...although political tensions remain high around Crimea, we see the likelihood of disruption on Russian oil exports as very low.

Total output from OPEC dropped by 5.1 percent in Q3 2014, year-on-year.

Iraqi crude production rose by 0.5 percent, year-on-year, in Q3 2014, to 3.1 mbpd…

...with exports increasing by 6 percent, year-on-year.

mbpd in 2015. By 2015, imports of oil will represent 36 percent of total US energy consumption, compared to 58 percent in 2010 (Figure 11).

In 2014, total Russian crude production will grow by just under 1 percent. Russian oil output growth has been on a downward trend in recent years as many of the western Siberia oil fields, which yield two-thirds of total production, are maturing and require more capital intensive investment to maintain output levels. In addition, new US and EU sanctions, at the beginning of September, are likely to further impact long term oil exploration and make financing for all the major Russian energy companies more difficult. At the same, even as political tensions remain high around Crimea, we see the likelihood of disruption on Russian oil exports, amounting to roughly 5 mbpd, as very low. Energy trade between EU and Russia is too important for both sides and will only be affected if there is a significant deterioration in the current geopolitical situation.

Total output from OPEC dropped by 5.1 percent in Q3 2014, year-on-year. OPEC continues to be affected by sizable falls in Libyan output despite some improvement in output recently. Other sizable drops in Q3 2014, year-on-year, were seen in Iran (-17.7 percent), Nigeria (-5.5 percent) and Saudi Arabia (-3.1 percent).

Latest OPEC data shows that Iraqi crude production rose by 0.5 percent, year-on-year, in Q3 2014, to 3.1 mbpd. Southern Iraqi oil fields and infrastructure have been unaffected by civil strife in Iraq, resulting in exports increasing by 6 percent in Q3 2014, year-on-year (Figure 12). The loss of control of oil fields and infrastructure in the north of the country is keeping overall output broadly flat. Since an attack on the Kirkuk-Ceyhan oil pipeline in early March there have been no exports out of the north, with production from northern fields dropping to around 160 tbpd from highs of 620 tbpd in February. We believe that the current civil strife in Iraq will not further impact oil output going forward but the main threat is likely to come from small scale attacks that add to negative market perception which, in turn, have a short term impact on oil prices. We therefore forecast that Iraqi oil production will remain around current levels for the foreseeable future.

An agreement between the government and rebel groups in Libya

Figure 10: Non-OPEC Supply Prominent

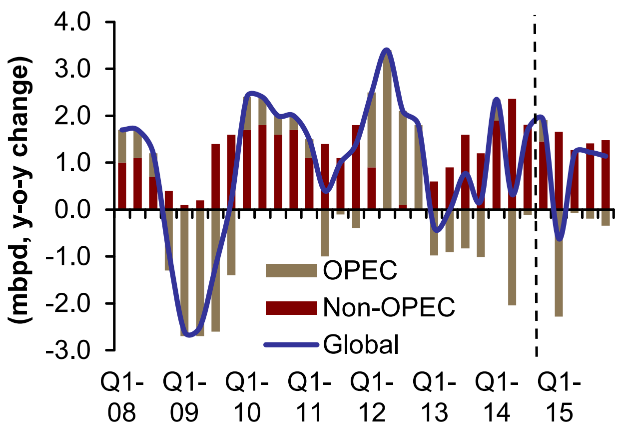
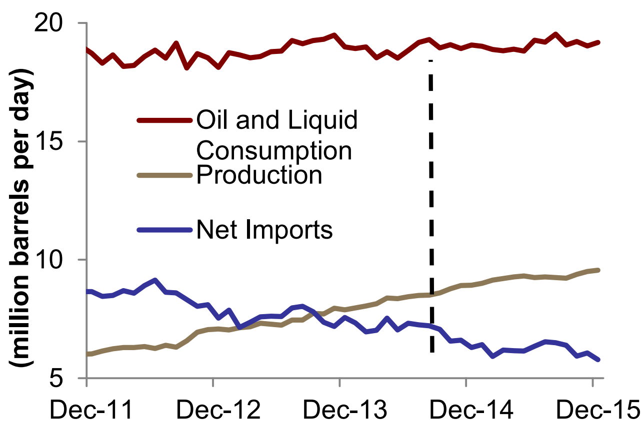


Figure 11: US Production Up, Imports Down



The opening of two export terminals helped push up Libyan production to an average of 0.4 mbpd in Q3 2014…

...but we expect a slow uptick in oil output going forward due to technical delays.

resulted in the opening of two export terminals which helped push up production to an average of 0.4 mbpd in Q3 2014, 46 percent lower than the same period last year. Although these are welcome positive political developments, we expect a slow uptick in oil output from Libya since much of the oil infrastructure is likely to face technical delays due to damage and neglect. Furthermore, a significant downside risk remains in production relapsing as fighting between various political factions is still ongoing. As such, we expect limited improvement in sustained Libyan production and exports for the remainder of 2014 and early 2015 (Figure 13).

Iran's crude output decreased 17.7 percent year-on-year in Q3 2014, to 3 mbpd, but rising levels of exports are helping to stabilize production.

Iran's crude output decreased 17.7 percent year-on-year in Q3 2014, to 3 mbpd, but rising levels of exports are helping to stabilize production. Under a Joint Plan of Action (JPAO) signed in November 2013 between the US and Iran, exports were to be limited to an average of 1 mbpd through to July 2014. In the first half of 2014, Iran exported an average of 1.2 mbpd, which held steady in Q3 2014. China and India are the largest purchasers of Iranian crude but, most recently, Japan and South Korea have cut back on purchases whereas China has not, and is not expected to do so going forward.

Oil production from Nigeria decreased 5.5 percent during Q3 2014 year-on-year as exports from the country are finding it difficult to compete with light sweet oil produced by the US.

Oil production from Nigeria decreased 5.5 percent during Q3 2014 year-on-year as exports from the country are finding it difficult to compete in the Atlantic basin, which has been oversupplied with light sweet oil produced by the US. The Nigerian oil industry also faces other problems, namely theft, sabotage and a worsening security situation, all of which add to towards increased downside risk to the country's oil output. According to the Nigerian National Petroleum Corporation (NNPC) around 0.3 mbpd of crude was lost to theft and sabotage in 2013. On top of this an insurgency in northern Nigeria is adding to security fears. So far, much of the security problems have been concentrated in the north but any spread of attacks further south could target oil infrastructure which would no doubt contribute to fluctuating and unpredictable output.

Saudi Arabian crude production was down by 3.1 percent in Q3 2014, year-on-year, to 9.8 mbpd, due to softer global demand and rising non-OPEC supplies, in specific, US shale oil.

Saudi Arabian crude production was down by 3.1 percent in Q3 2014, year-on-year, to 9.8 mbpd, compared to 10.1 mbpd over the same period in 2013, due to softer global demand and rising non-OPEC supplies, in specific, US shale oil. Saudi production will fall to an average of 9.5 mbpd in Q4 2014 as non-OPEC output continues to accelerate and global oil demand is subdued due to a weaker than

Figure 12: Iraqi Oil Exports Up Year-on-Year

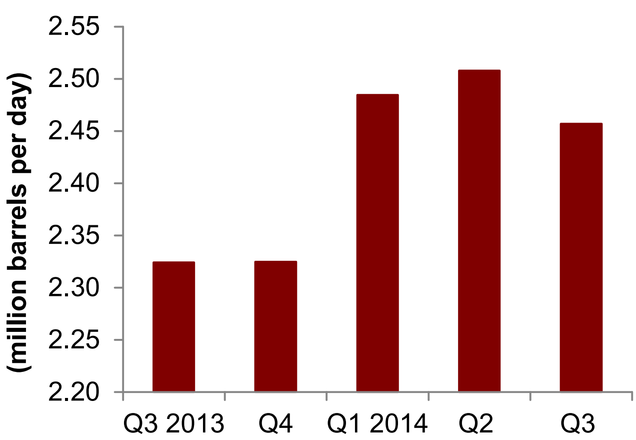
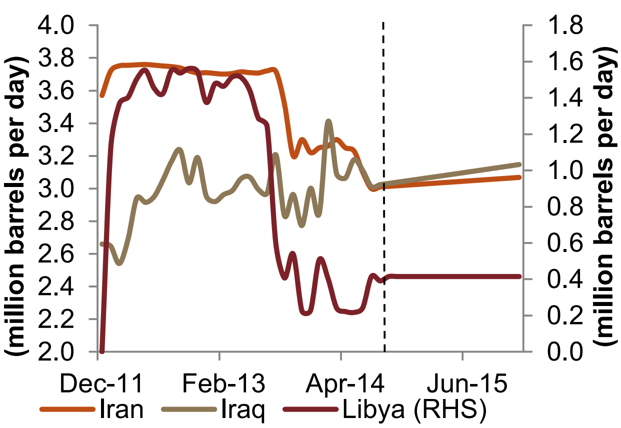


Figure 13: Iraqi, Iranian and Libyan Rises Minimal



We forecast Saudi production to average 9.7 mbpd for 2014, up from 9.6 mbpd in 2013.

As the global economy recovery builds momentum, oil demand should support Saudi production levels at around 9.6 mbpd in 2015.

expected recovery in the global economy. Overall, we forecast Saudi production to average 9.7 mbpd for 2014, up from 9.6 mbpd in 2013. Looking ahead into 2015, we see Saudi production declining slightly, but not dramatically. As the global economy recovery builds momentum in 2015, especially in the H2 2015, global oil demand should also pick up, supporting Saudi production levels at around 9.6 mbpd for the year. We also expect Saudi Arabia to maintain its current share of total OPEC production, at around 32 percent, because, as pointed out earlier, we do not see Libyan supply returning to normal levels for the short to medium term, whilst security and infrastructure issues in Iraq will prevent production from rising beyond current levels for the remainder of the year and hamper efforts to increase output in 2015 (Figure 14).

Oil Prices

In Q4 2014 we see oil prices recovering slightly (to around $100 per barrel) on the back of an uptick in demand during the winter seasons…

...but any deterioration in geopolitics of Iraq, Russia/Ukraine and Libya will push up oil prices above $105 per barrel.

Looking ahead to Q4 2014, we see oil prices recovering slightly on the back of an uptick in demand during the winter seasons, but ample supply from non-OPEC sources will see global oil surplus reaching 1.73 mbpd in 2014, therefore preventing prices from rising too far beyond the $100 per barrel mark. Furthermore, there is likely to be no let-up in the strength of the US dollar, which will hold its elevated value, and we do not foresee any significant cuts in OPEC production taking place. However, we see any deterioration in geopolitics of Iraq, Russia/Ukraine and Libya resulting in oil prices recovering to above $105 per barrel (Figure 15).

Figure 14: Saudi Output Down Slightly in 2015

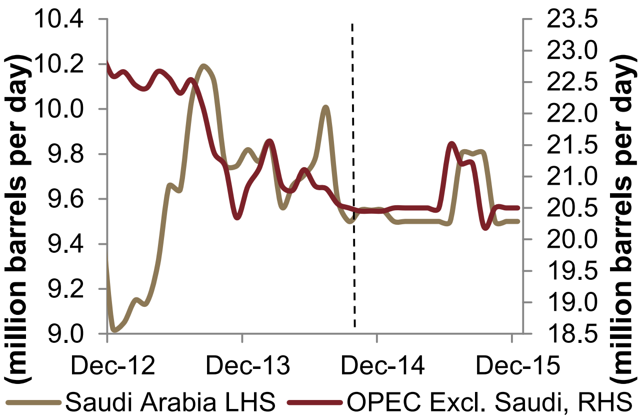
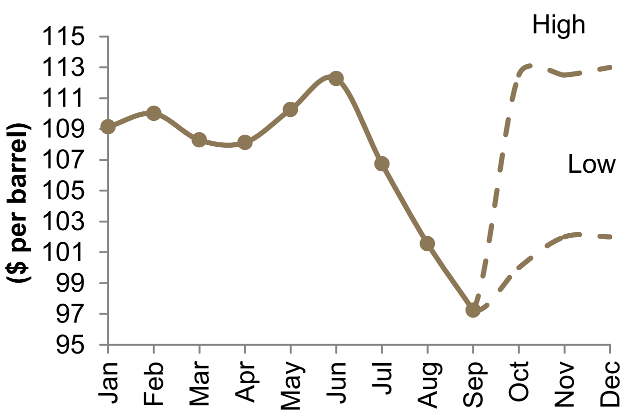


Figure 15: Oil Prices Will Recover in Q4 2014



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