COMMERZBANK

Commodity Spotlight Energy

11 February 2014

OPEC faces big challenges

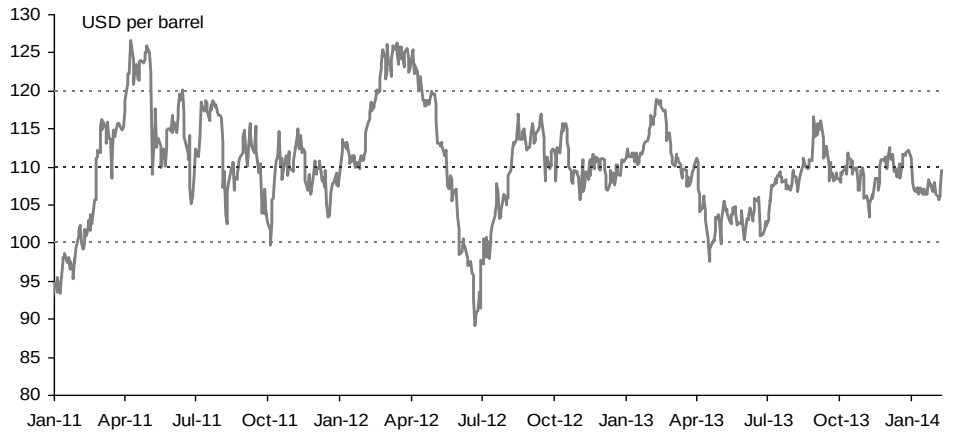
So far, any decline in the oil price has been precluded by the cold winter in the US and major unscheduled production outages. The coming months could see oil supply from Libya and Iran returning to the market, in which case OPEC would be producing much more oil than is needed. We anticipate that Saudi Arabia will scale back its oil production so as to prevent any price fall, meaning that the oil price is likely to remain within its familiar trading band.

Despite the oil market having been amply supplied, Brent in recent months has been trading predominantly in a corridor of between $100 and $110 per barrel (chart 1). Even the latest currency turmoil in the emerging economies and the resulting increase in risk aversion were hardly able to drag the oil price out of its lethargic state. There are two reasons above all why the price has not been falling: first, the increased heating oil demand generated by the unusually cold winter in the US, as a result of which the supply of middle distillates has tightened noticeably on both sides of the Atlantic. Distillate stocks on the US East Coast have meanwhile fallen to 48% below the long-term average and are at their lowest level since the spring of 2008. Recently, the US was even forced to import distillates from Europe. Partly because of this, gasoil stocks in Western Europe are 20% below their usual level for the time of year and at the lowest level at this time of year since 2008.

Second, we have unscheduled oil production outages: according to the US Energy Information Administration, these totalled approx. 3 million barrels per day at the end of 2013 (chart 2, page 2). A good 80% of this amount was attributable to OPEC countries, half of which in turn was due to Libya. Since mid-2013, oil production in the east of Libya has been largely paralysed by protests and strikes at the oil terminals. At the end of last year, the protests also spilled over into the west of the country, causing Libyan oil production in November and December to collapse to its lowest level since the civil war 2½ years ago. Nigeria and Iraq have also suffered unscheduled outages due to the difficult security situation. What is more, oil shipments from Iran are still suspended as a result of the sanctions.

The price support lent by the cold winter in the US should come to an end in two months' time at the latest. The unscheduled production outages also look set to decline noticeably in the coming months. Following the resumption of production at an oilfield in the west of the country, Libya was already able to increase its oil production in January by approx. 300,000 barrels per day. If the still-closed oil terminals in the east of the country were to reopen, the oil supply from Libya would grow by a further 600,000 barrels per day.

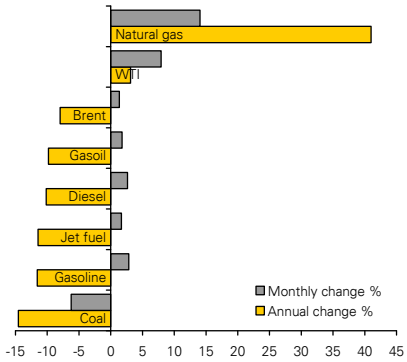
CHART 1: **Brent has been moving in a narrow trading corridor for months now**



Source: Bloomberg, Commerzbank Corporates & Markets

Commerzbank Forecasts

	Q1 14	Q2 14	Q3 14
Brent Blend	108	105	105
WTI	97	99	100
Diesel	950	920	910
Gasoline (95)	940	950	970
Jet fuel	990	970	960
Natural gas	4.2	3.5	4.0
Coal (API #2)	84	85	90
EUA (€ per t)	5.0	5.5	6.0



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Libya likely in mid-term to offer more crude oil on world market again

Armed rebels have been occupying the ports for months and demanding greater autonomy. So far, however, the rebels have not succeeded in selling oil on their own account, which means they do not have the income to maintain the blockade for much longer. It is therefore probable that we will see an end to the occupation of the ports within the next few months. Over the next six months, Libya should thus be able to offer more crude oil on the world market than in the previous six months. It will be difficult for the country to return to its original production level, however, given that the demands and interests of the protesters vary considerably in some cases, so we may repeatedly see renewed protests which will hamper the oil supply from Libya. On the other hand, any forced evacuation of the occupied oil terminals by the army – a possibility alluded to by the Libyan prime minister – would make any peaceful and long-term resolution of the conflict impossible, and would thus pose a risk to the aforementioned scenario.

Sanctions against Iran could be lifted during the course of the year

Supply from Iran could also return to the market during the course of this year. The sanctions imposed by the West have driven Iranian oil exports down to approx. 1 million barrels per day (chart 3). Sanctions were already eased slightly in January – European insurance companies are now allowed again to insure oil shipments from Iran. What is more, the US have refrained from urging consumers of Iranian oil to further reduce their imports. Initially, the eased sanctions will apply for a period of six months. The immediate impact on oil supply from Iran is limited because the EU's oil embargo remains in place. During the next few months, however, the aim is to find a comprehensive solution to the nuclear dispute, with negotiations due to begin in mid-February. If the outcome of the talks were to prove positive, the sanctions that have been in place since mid-2012 could be lifted. Iran has already called upon western oil companies to invest in Iranian oil production facilities – something that is essential if Iran is to expand its oil production to 4 million barrels per day as it plans. The IEA estimates Iran's current production capacities at just 2.9 million barrels per day – prior to the sanctions, Iran was still producing between 3.5 and 4 million barrels of crude oil per day.

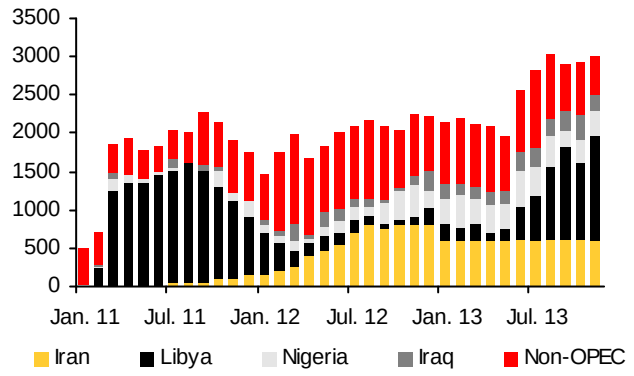
Up to 1.6 million barrels per day of crude oil could then return to the market

In the best case scenario, up to 1.6 million barrels of crude oil per day could thus return to the market from Iran and Libya combined in the second half of this year. Then there is the possibility of growing oil supply from Iraq if the security situation there were to improve sufficiently. In this case, OPEC would be producing considerably more than is needed. In January, OPEC production amounted to just shy of 30 million barrels per day. Based on the above assumptions, OPEC supply would grow to at least 31.5 million barrels per day, which would be approximately 2 million barrels per day above the average estimate for call on OPEC in 2014 and would therefore exert pressure on the oil price.

Demand unlikely to be positive surprise

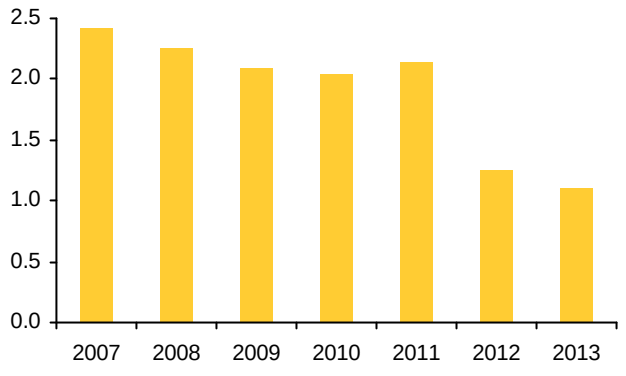
There are three ways in which the oversupply could be reduced: demand might grow more sharply than envisaged, thus also causing the call on OPEC to increase. This hardly appears realistic, however, for the IEA's growth forecast for global oil demand is already for 1.3 million barrels per day, which is slightly above the average increase over the past ten years. Admittedly, industrialized countries could be a positive surprise this year: the US economy this year is likely to grow significantly more strongly than in previous years, while the eurozone economy is expected to show a positive growth rate again for the first time in three years.

CHART 2: **High unscheduled production outages up until recently** in thousand barrels per day



Source: EIA, Commerzbank Corporates & Markets

CHART 3: **Marked decline in oil exports from Iran due to sanctions** in million barrels per day



Source: IMF, Bloomberg, Commerzbank Corporates & Markets

This could be offset by reduced growth in oil demand in the emerging economies, however, because growth there is likely to be slower due to the recent currency turmoil and the resulting interest rate hikes. China has also seen oil demand growth cool of late.

Negative surprise in non-OPEC supply likewise unlikely

The other two possible ways to reduce the oversupply are to be found on the supply side. For one thing, non-OPEC supply might grow less sharply than anticipated, which would also serve to increase the call on OPEC. The lion's share of the expected non-OPEC supply growth comes from North America. According to the IEA, oil production in North America this year looks set to grow so strongly that it will be almost completely able to cover the anticipated increase in global oil demand. Given the experience of recent years, it is hardly likely that the shale oil boom in the US or the oil sand production in Canada will suddenly falter. As far as the other major Non-OPEC suppliers are concerned, Russia is likely to produce much the same amount of crude oil as it did last year. Only Latin America might disappoint since the IEA predicts a slight increase in oil production there. This alone is hardly likely to be enough to produce a negative surprise in terms of non-OPEC supply, however.

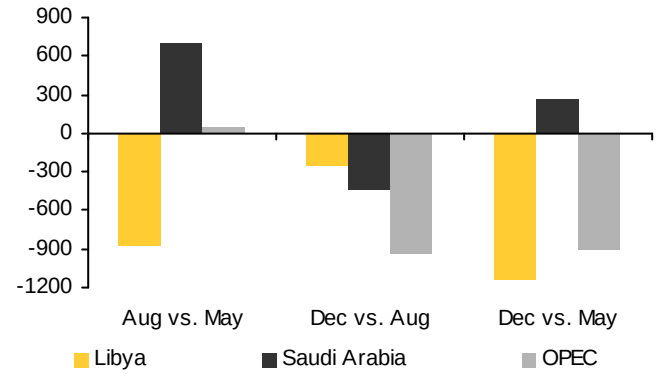
Saudi Arabia has largely reversed its supply increase again

Consequently, the oversupply must be offset first and foremost by production being cut accordingly in other OPEC countries. Saudi Arabia in particular will need to do its bit here. In the summer of 2013, Saudi Arabia stepped up its oil production by 700,000 barrels per day in a bid to cushion the outages in Libya. Thus OPEC production initially remained stable despite the outages (chart 4). Since September, the largest OPEC producer has reversed its increased production again by 60%, while oil production in Libya (and Iraq) has continued to decline. As a result, OPEC production had fallen to 29.6 million barrels per day by the end of 2013, which largely diminished the oversupply that had been in place up to that point. January, on the other hand, saw OPEC production expanded again to 29.9 million barrels per day because, as mentioned above, Libya was able to increase its production again slightly (chart 5).

Supply from Libya and Iran likely to be offset by further cuts

The question then will be whether Saudi Arabia and the other OPEC countries will be prepared to make further production cuts when supply from Libya and Iran returns to the market. After all, this would entail a corresponding loss of revenues for them. On the other hand, Saudi Arabia generated additional revenue by previously stepping up its production. What is more, oil prices in recent years have significantly exceeded the level assumed in the national budget. Saudi Arabia should therefore be able to cope with somewhat lower revenues without immediately having to adjust its expenditure. Furthermore, Saudi Arabia and the other OPEC countries will be aware that the oil price would come under pressure unless oil production is lowered. The revenue losses would be even bigger if at a later date production also needed to be curbed in order to defend the price. We therefore anticipate that Saudi Arabia and the other OPEC countries will sufficiently reduce their supply in terms of time and quantity so as to offset the additional supply from Libya and Iran. As a result, the oil price should remain within its familiar trading band. For 2014, we continue to envisage an average Brent price of $106 per barrel.

CHART 4: **Saudi Arabia decides about OPEC supply**
Change in oil production in thousand barrels per day, 2013



Source: Reuters, Commerzbank Corporates & Markets

CHART 5: **OPEC must further reduce production**
in million barrels per day

Source: Reuters, IEA, Commerzbank Corporates & Markets

At a glance

TABLE 1: **Our Forecasts**

		Forecasts								Yearly Average		
	10-Feb	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	2013	2014	2015
Brent Blend ($/bbl)	108.6	108	105	105	107	107	109	111	113	109	106	110
WTI ($/bbl)	100.1	97	99	100	102	102	106	108	108	98	100	106
Diesel ($/t)	934	950	920	910	960	970	960	970	1010	938	930	980
Gasoline (95 ARA) ($/t)	949	940	950	970	940	940	980	1020	980	986	950	980
Jet Fuel ($/t)	985	990	970	960	1000	1010	1010	1020	1050	989	980	1020
Natural Gas HH ($/mmBtu)	4.58	4.2	3.5	4.0	4.5	4.0	4.0	4.5	5.0	3.7	4.0	4.5
Coal (API #2) ($/t)	78.1	84	85	90	90	90	95	95	100	82	87	95
EUA (€ /ton)	6.4	5.0	5.5	6.0	6.5	6.5	6.5	7.0	7.0	4.5	5.5	6.8

Source: Commerzbank Corporates & Markets, Bloomberg

TABLE 2: **Inventories and imports**

		Net change			% change		Comment
		1 month	1 year	vs. 5 -year-Ø	year	vs. 5 -year-Ø	
US inventories (mm barrels)							
Crude oil	358.1	-2.5	-13.6	10.4	-3.7	3.0	Extrem cold winter in the US leads to strong inventory reductions in distillates and natural gas, their inventory levels are well below the 5-year average
of which: Cushing	40.3	0.7	-11.1	3.0	-21.6	8.1	
Gasoline	235.0	14.2	0.9	4.1	0.4	1.8	
Distillates	113.8	-5.4	-15.8	-32.6	-12.2	-22.2	
Natural gas (bn cubic feet))	1923	-1051	-761	-410	-28.4	-22.4	
ARA inventories ('000 tons)							
Gas oil	2045	231	-305	-483	-13.0	-19.1	Gasoil stocks in Western Europe well below the seasonal usual level
Gasoline	1046	202	312	174	42.5	19.9	
Imports and production (mm bpd)							
US imports	6.9	-0.6	-0.7	-1.7	-9.0	-20.2	US oil production exceeds US oil imports, Chinese imports increase to new record high
US production	8.0	-0.1	1.0	2.2	15.0	37.4	
Imports China	6.3	0.6	0.7	1.6	13.1	33.5	
Refinery activity (mm bpd)							
Processing USA	15.0	-1.2	0.6	0.8	4.3	5.8	US crude oil processing extraordinary high
Processing China	9.9	0.1	-0.3	1.3	-2.6	14.9	

Source: Commerzbank Corporates & Markets, Bloomberg, US Energy Information Administration

TABLE 3: **Historic prices of energy commodities**

Energy	Latest	% change				1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13
		1 Week	1 Month	ytd	year ago								
Brent Blend ($/bbl)	108.6	2.8	1.4	-1.9	-8.0	118	109	109	110	113	103	110	109
WTI ($/bbl)	100.1	3.0	7.9	1.7	3.1	103	93	92	88	94	94	106	97
Diesel ($/t)	934	2.0	2.6	-2.7	-10.2	1010	943	979	984	974	889	949	942
Gasoline (95 ARA) ($/t)	949	4.1	2.8	-0.9	-11.6	1053	1034	1061	982	1029	963	1010	944
Jet Fuel ($/t)	985	2.0	1.7	-3.7	-11.5	1062	995	1027	1025	1038	931	992	996
Natural Gas HH ($/mmBtu)	4.58	-14.0	14.1	9.3	41.0	2.5	2.3	2.9	3.5	3.5	4.0	3.6	3.9
Coal (API #2) ($/t)	78.1	-1.7	-6.2	-5.0	-14.6	101	91	91	89	86	80	77	84
EUA (€/t)	6.4	9.6	41.3	31.7	44.1	7.7	6.9	7.6	7.3	4.6	3.9	4.6	4.8

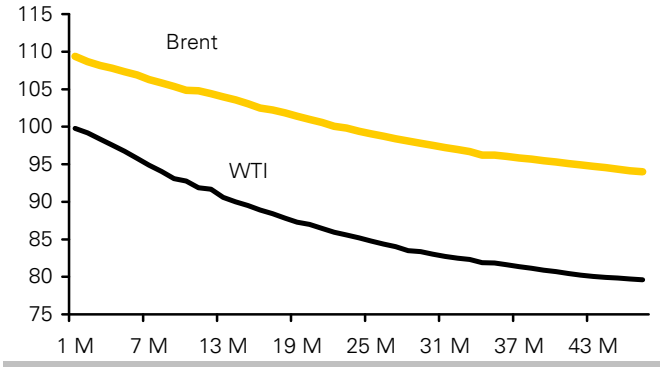
Source: Commerzbank Corporates & Markets, Bloomberg

TABLE 4: **Upcoming events**

12. / 20. / 26. February	USA	US EIA oil inventory data
13. / 20. / 27. February	USA	US EIA gas inventory data
11. Feb / 11. March	INT	EIA Short term energy outlook
12. Feb / 12. March	USA	OPEC oil market report
13. Feb / 14. March	INT	IEA oil market report
11 June 2014	INT	OPEC meeting in Vienna, Austria

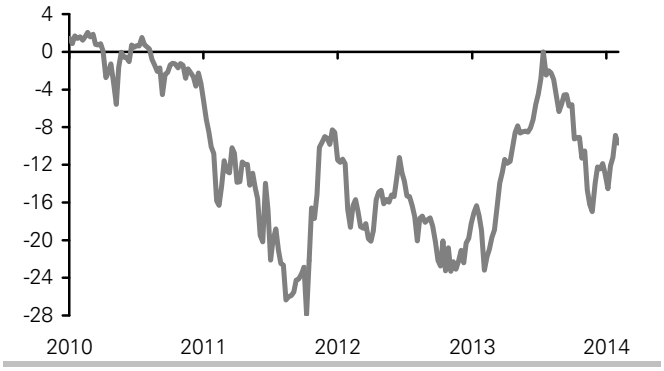
Source: EIA, IEA, OPEC, Bloomberg, Commerzbank Corporates & Markets, Bloomberg

CHART 6: **Crude Oil - Forward Curves in US$ per barrel**



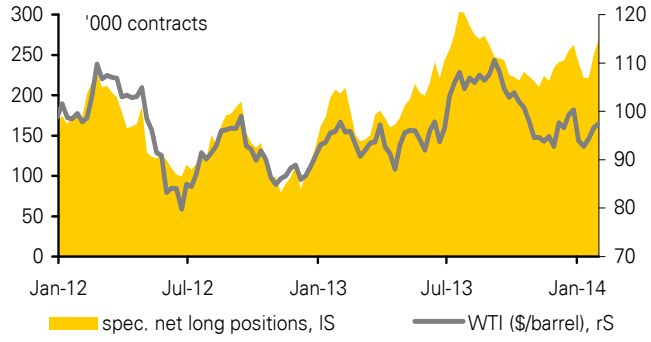
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 7: **Price spread WTI and Brent Blend in US$/bbl**



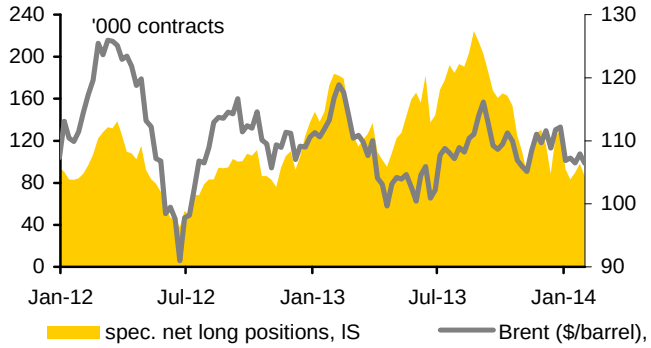
Source: Commerzbank Corporates & Markets

CHART 8: **WTI: managed money net-long positions**



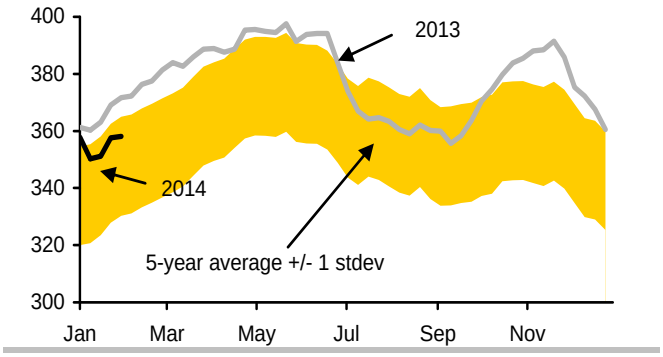
Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

CHART 9: **Brent: managed money net-long positions**



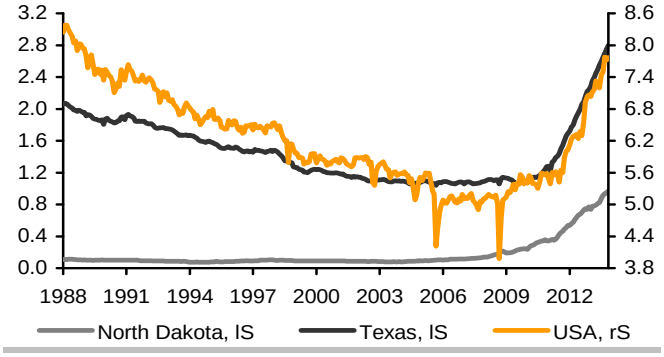
Source: ICE, Bloomberg, Commerzbank Corporates & Markets

CHART 10: **Crude oil: US inventories in mm barrel**



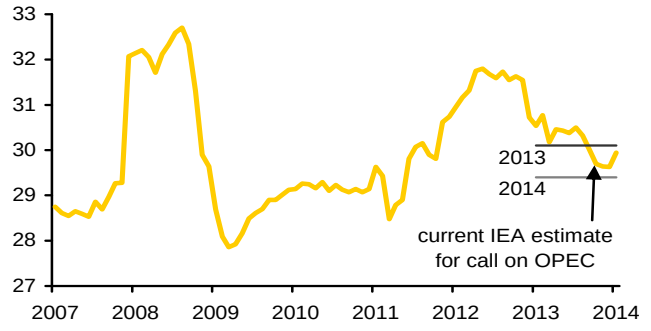
Source: EIA, Bloomberg, Commerzbank Corporates & Markets

CHART 11: **US oil production in mm bpd**



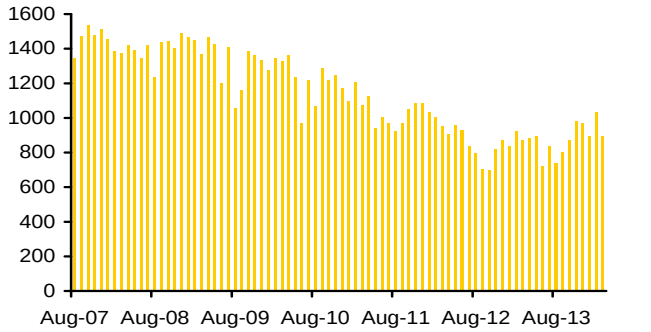
Source: EIA, Bloomberg , Commerzbank Corporates & Markets

CHART 12: **OPEC oil production in mm bpd**



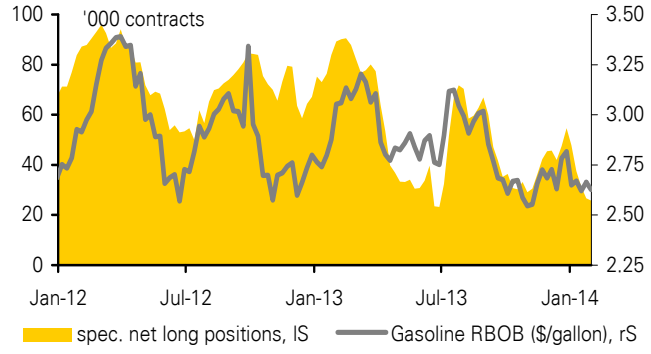
Source: Reuters, Bloomberg, IEA, Commerzbank Corporates & Markets

CHART 13: **Monthly loadings of North Sea crude oil (Brent, Forties, Oseberg and Ekofisk) in '000 bpd**



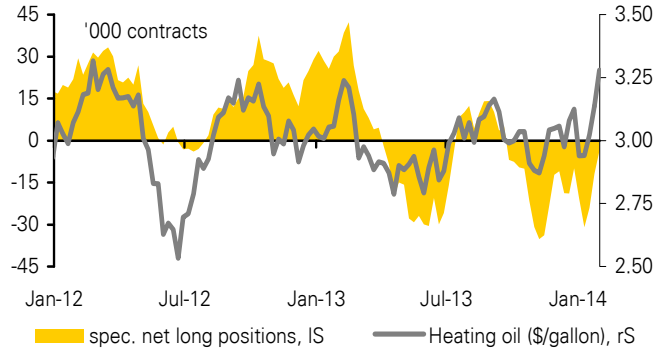
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 14: **Gasoline: managed money net-long positions**



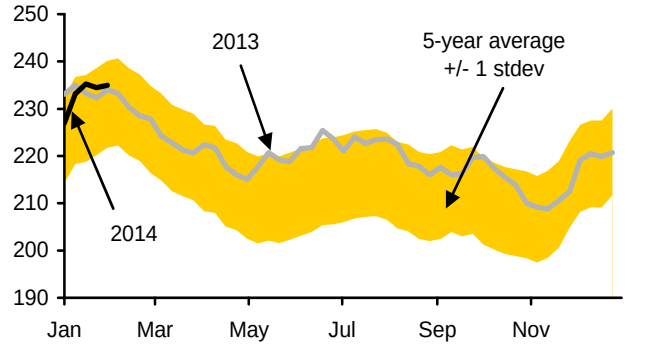
Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

CHART 15: **Heating oil: non-commercials' net-long positions**



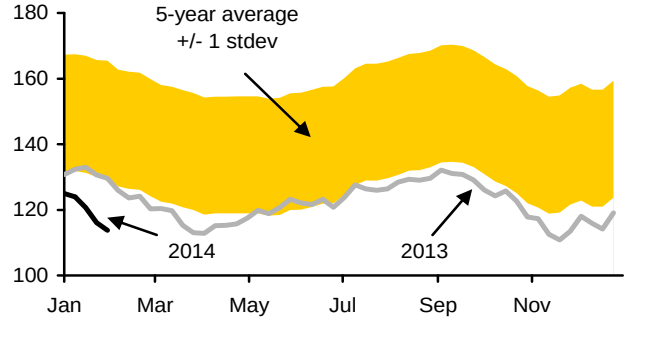
Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

CHART 16: **Gasoline: US inventories in mm barrel**



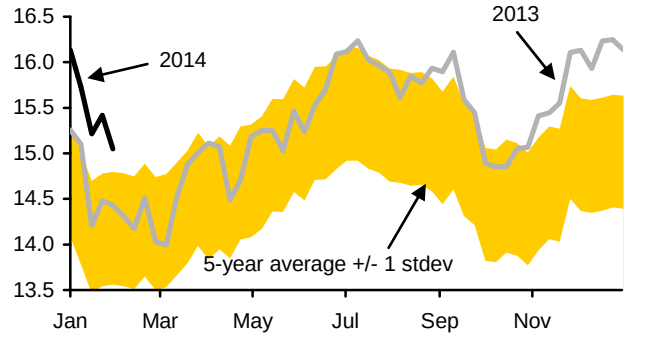
Source: EIA, Bloomberg, Commerzbank Corporates & Markets

CHART 17: **Distillates: US inventories in mm barrel**



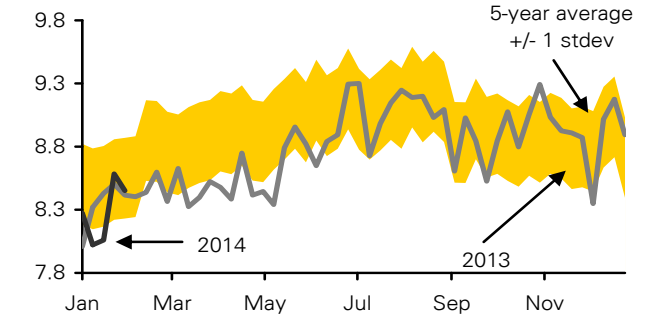
Source: EIA, Bloomberg , Commerzbank Corporates & Markets

CHART 18: **US crude oil processing in mm bpd**



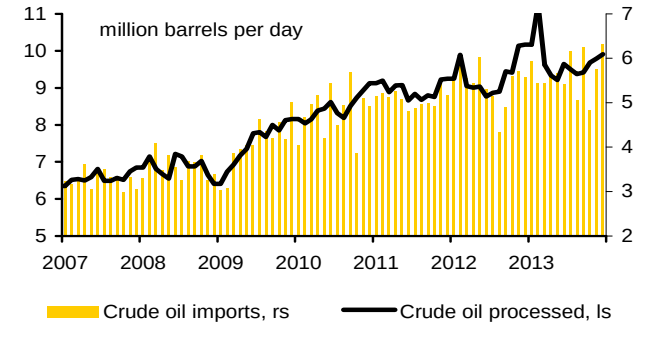
Source: EIA, Bloomberg, Commerzbank Corporates & Markets

CHART 19: **US gasoline demand in mm bpd**



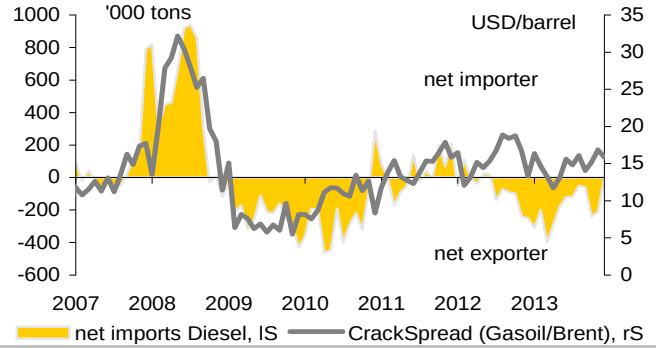
Source: EIA, Bloomberg, Commerzbank Corporates & Markets

CHART 20: **China: crude oil processed and imports**



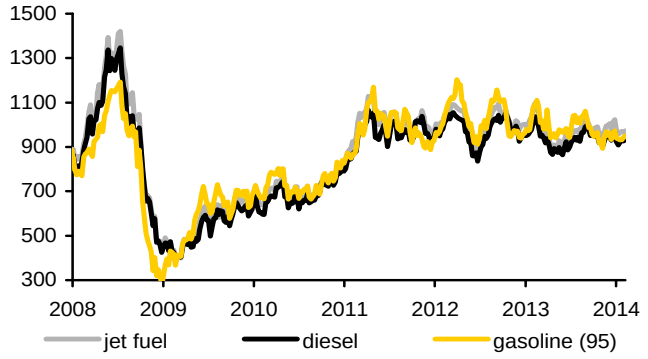
Source: China NBS, Chinese Customs, Commerzbank Corporates & Markets

CHART 21: **China: Diesel imports and gasoil crackspread**



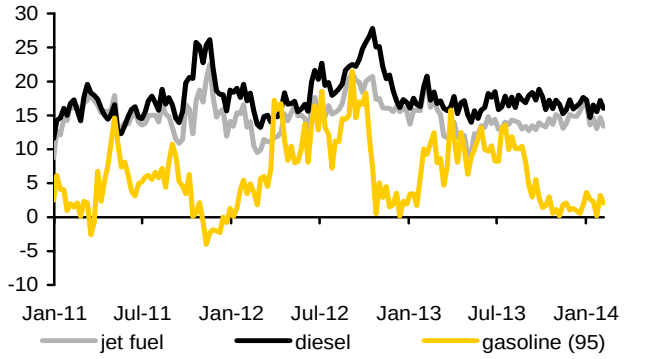
Source: Chinese Customs, Commerzbank Corporates & Markets

CHART 22: **Prices of oil products in US$ per ton**



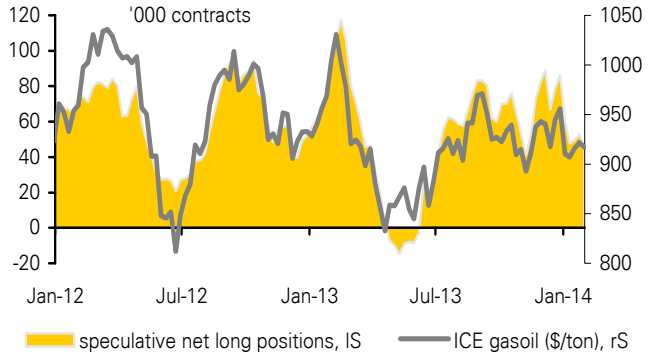
Source: Commerzbank Corporates & Markets

CHART 23: **Price spread products to Brent in $ per barrel**



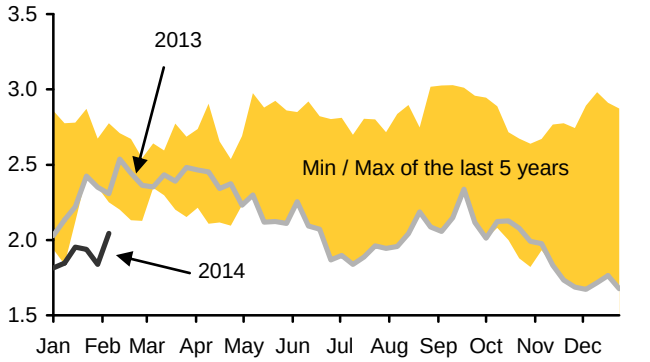
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 24: **Gasoil: managed money net-long positions**



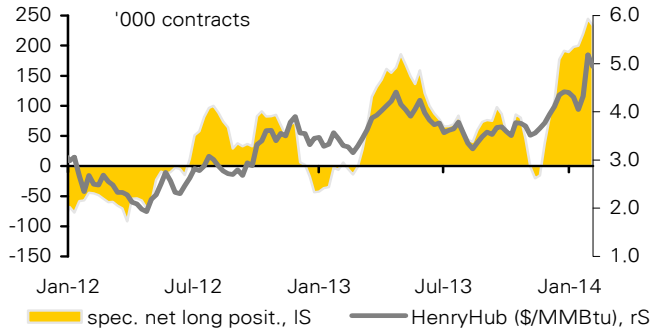
Source: ICE, Bloomberg, Commerzbank Corporates & Markets

CHART 25: **ARA Gasoil inventories in million tons**



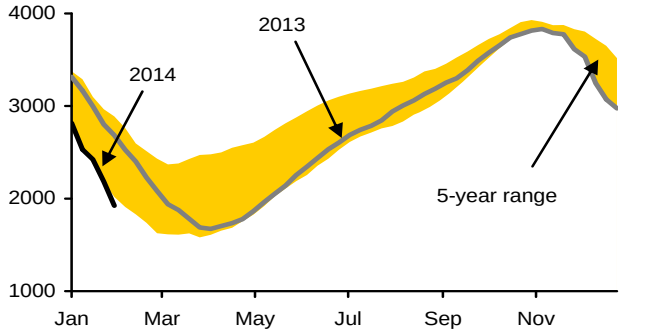
Source: PJK International, Bloomberg, Commerzbank Corporates & Markets

CHART 26: **Nat. gas: non-commercials net-long positions (Futures and swaps)**



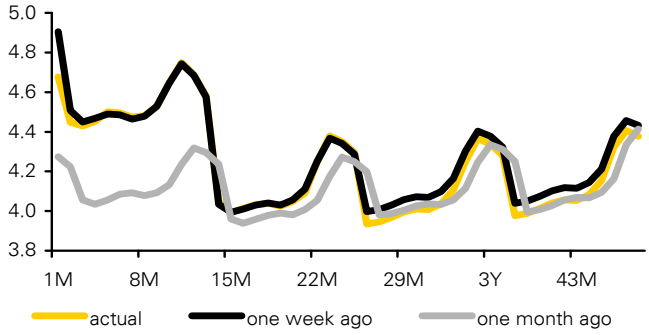
Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

CHART 27: **Natural gas: US storage in bn cubic feet**



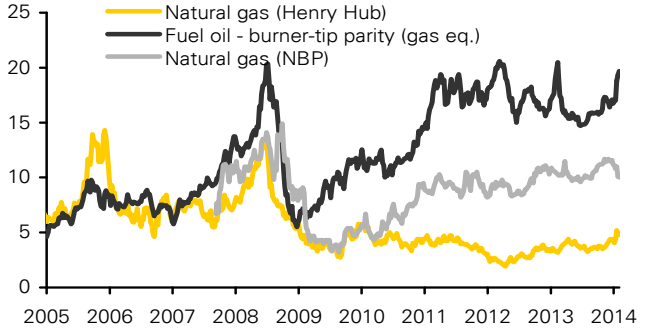
Source: EIA, Bloomberg, Commerzbank Corporates & Markets

CHART 28: **Natural gas – forward curve (Henry Hub) in USD per mmBtu**



Source: Bloomberg, Commerzbank Corporates & Markets

CHART 29: **Burner-tip parity (natgas vs. fuel oil no.6) in USD per mmBtu**



Source: Bloomberg, Commerzbank Corporates & Markets

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