Oil markets

Oil prices retreat in March on crude stock buildups and oversupply concerns

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Highlights

- **Oil prices retreated in March, weighed down by continued crude inventory buildups and the prospect of Iranian crude rejoining already oversupplied crude markets; Brent prices declined by 13% in March to close at $53.9/bbl.**
- **OECD commercial stocks continue to increase above seasonal average levels; US stock levels in particular are at record highs.**
- **The IEA has revised up its forecast for global demand growth in 2015 by 75,000 b/d to 1 mb/d, in line with an improving outlook.**
- **OPEC production slipped in February to 30.2 mb/d on supply outages in Libya and Iraq; at the same time, non-OPEC supply was up by 1.4 mb/d to 57.3 mb/d.**

Prices retreat in March on continuing crude inventory buildups and the prospect of Iranian crude returning to oversupplied markets

March saw oil prices pare back some of their gains from February's rally as concerns over rising commercial crude stocks began to weigh on market sentiment. The International benchmark Brent crude (dated) was down almost $8 per barrel (bbl), or 13%, to $53.9/bbl by the end of March. West Texas Intermediate (WTI), the US marker, also retreated, by $2.0/bbl during the month to settle at $47.7/bbl. (Chart 1.) Similarly, local crude, Kuwait Export Crude (KEC), declined by $5.8/bbl to close at $49.2/bbl on 31 March.

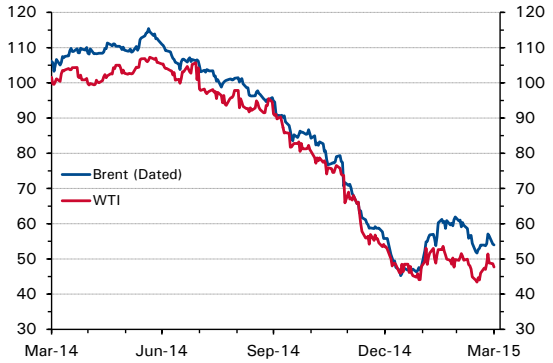
March was also notable for the return of geopolitics as a factor influencing oil prices, first with Saudi Arabia's military intervention in Yemen, and second, with the Wests' potential nuclear deal with Iran.

In the former, the price of Brent crude rose almost 6% after Saudi Arabia launched airstrikes on rebel Houthi positions in Yemen on 25-26 March. Markets were initially concerned that the fighting would impact regional oil supply, both through the loss of Yemeni crude and, more importantly, via disruption of the vulnerable Bab-el-Mandeb straight between Yemen and Djibouti. The straight sees almost 4 million barrels of mostly Gulf oil pass daily en route to the Suez Canal and western markets. The risk premium narrowed, however, after Saudi-led forces moved to secure the shipping lanes.

Meanwhile, as the 31 March deadline approached for an agreement between the P5+1 and Iran on the latter's nuclear program, oil traders were anxiously contemplating the prospect, should sanctions be lifted, of increased quantities of Iranian crude coming back onto already oversupplied markets. Iran's exports are currently at half their 2011 levels, at around 1.1 million barrels per day (mb/d), and the expectation is that anywhere between 500,000 to 750,000 b/d of Iranian crude could

Chart 1: Crude oil spot prices

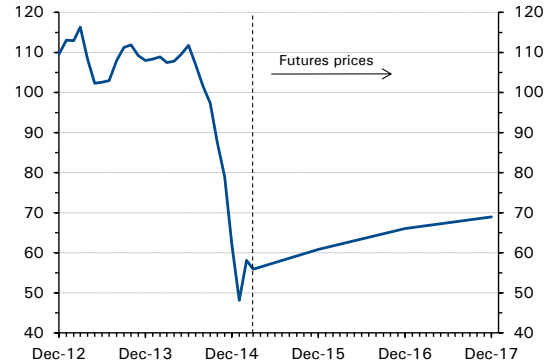
($/bbl)



Source: Thomson Reuters Datastream

Chart 2: Brent crude futures

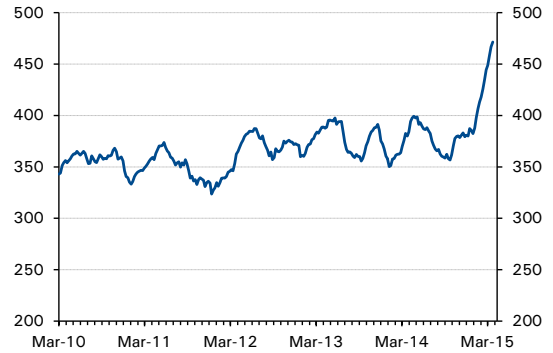
($/bbl)



Source: Thomson Reuters Datastream

Chart 3: US commercial crude stocks

(million barrels)



Source: EIA

be back on international markets within a year of a permanent agreement being signed in June.

Supply glut sees OECD and US commercial crude stocks continue to rise

The buildup in commercial crude inventories continued through March, depressing both near and long-term oil prices. Brent futures were ranging between $60.8-68.9/bbl for deliveries in December 2015-17 on 31 March (Chart 2.), down from the $68-74/bbl range they were trading in at the end of February. While the rise in OECD stocks, to 2,791 million barrels in February (using data from the US Energy Information Agency EIA) continues to be in excess of the seasonal average, the buildup in US commercial inventories has been especially acute. US stocks hit 471 million barrels on 27 March, an increase of more than 24% y/y. (Chart 3.) Stock levels at Cushing, Oklahoma, the storage and pricing point for WTI, are at record highs of above 54.4 million barrels. US stocks have soared as a result of a drop in refinery throughputs, strong domestic production growth and continuing US imports. The onset of the Spring refinery maintenance season, when crude stocks traditionally build up, should see inventory levels and downward pressure on oil prices, especially WTI, increase further.

Accelerating global growth to underpin a recovery in global oil demand in 2015

The International Energy Agency (IEA) has revised upwards its demand growth forecast for 2015 by 75,000 b/d to 1.0 mb/d. (Chart 5.) This comes after oil demand came in better than expected during 4Q2014 and 1Q2015, which was likely a reflection of improving macroeconomic conditions and 'one off' factors such as the impact of colder weather in the northern hemisphere and a base effect boost from 2013. The International Monetary Fund (IMF) expects the global economy to expand further in 2015, by 3.7%, which should help oil demand reach 93.5 mb/d in 2015, an increase of 1% on 2014.

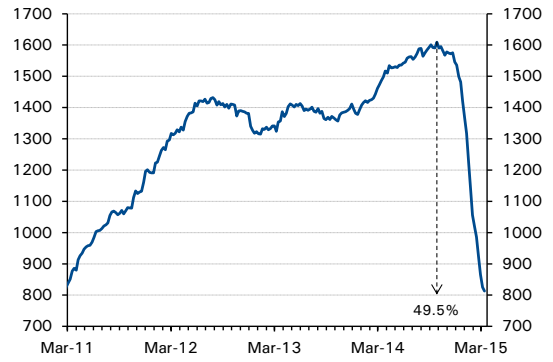
OPEC production slips in February on supply outages in Libya and Iraq

OPEC output fell to 30.2 mb/d in February, its lowest level in two years, according to OPEC data obtained through direct communication with national sources. (Chart 6.) The drop of 330,000 b/d compared to January was primarily a reflection of outages in Libya and Iraq. Libyan output declined further to 341,000 b/d in February as the conflict between the country's two rival governments continued to impact oil fields and installations. Since last October's high of 900,000 b/d, two thirds of the country's oil production has been taken offline.

In Iraq, meanwhile, storage constraints at the country's southern tank farms and bad weather in the Shatt Al-Arab saw crude production decline by almost 260,000 b/d to 2.7 mb/d during the month. This is the second month in a row since December that production has fallen. Output had reached a 35-year high of 3.6 mb/d last December, according to OPEC secondary sources.

Saudi Arabian production was also down, by 44,000 b/d to 9.6 mb/d during February. Nevertheless, since OPEC's Saudi-led decision in November to hold off on cutting output below the group's official target level of 30 mb/d, the kingdom has steadfastly stuck to its strategy of protecting market share and kept its production relatively steady; even

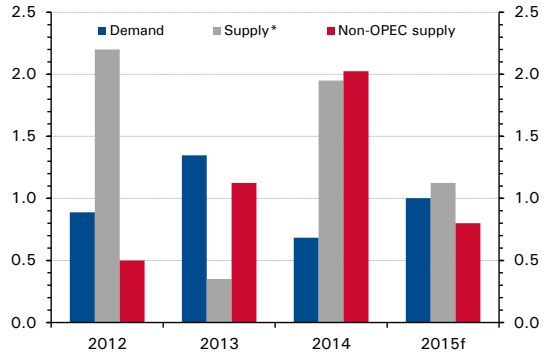
Chart 4: US oil rig count



Source: Baker Hughes

Chart 5: Change in world oil supply and demand

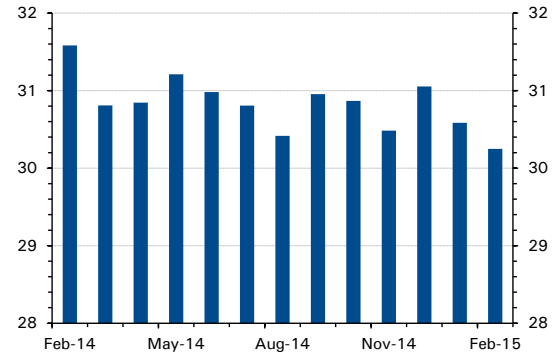
(mb/d)



Source: IEA, *2015 supply growth forecast based on current OPEC output

Chart 6: OPEC crude oil production

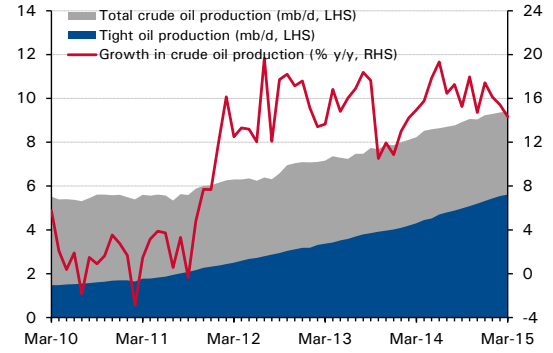
(mb/d)



Source: OPEC

Chart 7: US crude oil production

(mb/d)



Source: EIA

the loss of the 300,000 b/d Khafji oil field in the Neutral Zone, which Saudi Arabia shares 50/50 with Kuwait, was compensated by increasing production from other fields.

While February saw OPEC output exceed the 30 mb/d level for the tenth consecutive month, improving global oil demand this year should help narrow the OPEC supply-demand mismatch to 0.7 mb/d if OPEC maintains production at current levels for the remainder of the year. OPEC would thus need to cut output by 0.7 mb/d to 29.5 mb/d (the "call on OPEC crude and stock change) in order to balance expected demand this year. Often during the second half of 2014, OPEC was producing at least 1.2 mb/d in excess of the "call".

Burgeoning US crude production helped propel non-OPEC supply growth to 1.4 mb/d in February

According to the IEA, non-OPEC supply increased by 1.4 mb/d to 57.3 mb/d in February and was supported by surging North American production which continues to offset supply outages elsewhere. Total US crude production reached 9.4 mb/d, an increase of 15% y/y, according to the EIA. (Chart 7.) Of this, approximately 5.6 mb/d, or 59%, is crude from shale/tight oil formations. Output has, on an aggregate monthly level, shown little sign of slowing down in March despite a 49.5% reduction in the number of active oil rigs (from an all-time high in October, see Chart 4.) and drilling permits. The cutback in capital expenditure is expected to be in the order of 20-40% this year. April may be a slightly different story, however, as preliminary data released by the EIA on 2 April pointed to a 36,000 b/d decline in US production from the previous week. The EIA had earlier indicated in its March Drilling Productivity Report that it expected crude output from three key shale/tight oil producing regions, Eagle Ford, Niobrara and Bakken, to fall during March-April; aggregate production, however, would remain unchanged in April as these declines would be offset by production gains elsewhere. Overall, the IEA expects non-OPEC supply to increase by 800,000 b/d in 2015.

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