Oil markets

Prices fall further as non-OPEC supply growth set to reach record high in 2014

> Omar Al-Nakib
Senior Analyst
+965 2259 5360, omarnakib@nbk.com

Highlights

- **Oil prices continued to trend downwards in December, falling to five-and-a-half year lows.**
- **Weak global demand and rising non-OPEC supplies especially from North America have been the primary catalysts for the fall in prices.**
- **OPEC production was down in November on Libyan crude outages; non-OPEC supply growth is likely to reach a record high in 2014.**
- **The IEA expects global supply growth to outpace demand growth in 2015, with non-OPEC supply increasing by 1.3 mb/d compared to demand of 0.9 mb/d.**

Crude oil prices down by 40-50% in 2014 as OPEC opts to let demand-supply imbalances play out

2014 ended with international oil prices down between 40% and 50% during the year to levels last seen in 2009. Brent crude finished the year at $55.7 per barrel (bbl), a decline of 44%, and US benchmark West Texas Intermediate (WTI) closed at $53.5/bbl, a drop of 46.6%. Meanwhile, Kuwait export crude (KEC) fell by almost 49% during 2014 to settle at $50.5/bbl.

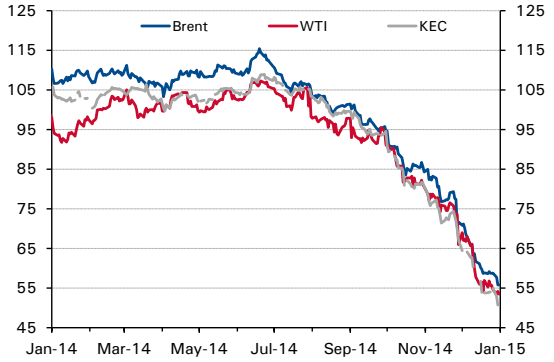
Crude oil's precipitous decline over the last 6 months to five-and-a-half-year lows has been catalysed by a combination of weak global oil demand and rising oil production especially from North America, where US shale/tight oil output had been ramping up at breakneck speed.

The decision by OPEC in November to maintain its output ceiling of 30 million barrels per day (mb/d) in the face of a supply glut of more than 1 mb/d, rather than cut production as many had been anticipating, saw traders respond by a further round of selling which accelerated the price decline. As well as effectively dismissing the notion of an oil producer-orchestrated price floor, OPEC, with Saudi Arabia in the vanguard, has signaled to the market that it is no longer willing to bear the brunt of production cuts unilaterally, preferring to let demand-supply dynamics play out until prices reach levels that become uneconomical for some of the higher cost oil producers, notably the US shale industry, to record further unfettered output gains.

Breakeven costs for the US shale industry are hard to estimate, however; but it is thought that prices would need to be at $50/bbl or below for a sustained period of time for investment and ultimately production at some of the bigger shale plays to be affected in the near term. Nevertheless and for the longer term, signs of a slowdown across the US shale industry may be discerned in the cutbacks in capital spending being announced by private sector oil companies such as Marathon Oil, ConocoPhillips and Continental. These three producers are expecting to

Chart 1: Crude oil spot prices

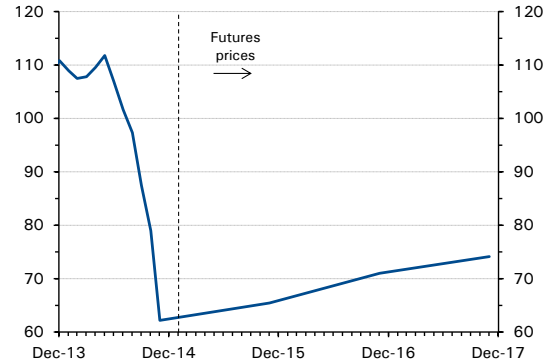
($/bbl)



Source: Thomson Reuters Datastream

Chart 2: ICE Brent futures prices

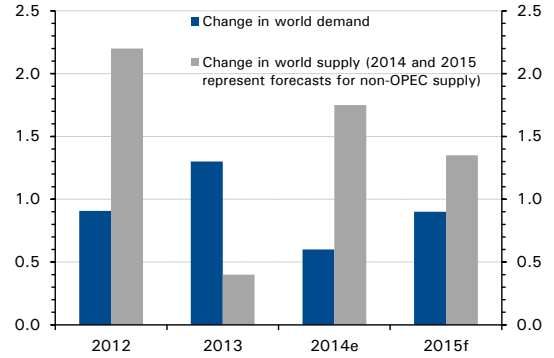
($/bbl, based on monthly averages)



Source: Thomson Reuters Datastream

Chart 3: Change in oil demand and supply

(mb/d)



Source: International Energy Agency

pare back their investments by between 20% and 40% in 2015 which would affect future supply and production.

Going into 2015, markets are not expecting oil prices to rise until the second half of the year when global oil demand growth traditionally rebounds (and world economic growth improves). ICE Brent futures, in contango since mid-2014, are ranging between $65/bbl and $74/bbl for December deliveries over the next two years. (Chart 2.)

World oil demand to rise in 2015 as the global economy improves

In line with forecasts of an improvement in the global economy, world oil demand is expected to rise by 0.9 mb/d to 93.3 mb/d in 2015, from 92.4 mb/d in 2014, according to the IEA. (Chart 3.) This represents a cut of 250,000 b/d from last month's IEA forecast, with the agency expecting demand growth from Russia and other oil-exporting countries to be relatively muted in 2015. Oil demand from OECD Europe and Asia Oceania is actually expected to contract in 2015, by approximately 100-200,000 b/d, a similar amount to the decline witnessed in 2014. World oil demand growth in 2014, at an estimated 0.6 mb/d, is likely to be the slowest growth in 5 years.

OPEC output declines in November on Libya supply outages but rising US oil production has propelled non-OPEC supply growth in 2014 to a record high

OPEC production in November was down by 289,000 b/d on the previous month, to 30.2 mb/d, according to OPEC figures. (Chart 4.) This is the largest monthly decline since March and comes in the wake of supply outages in Libya that took at least 249,000 b/d of crude offline.

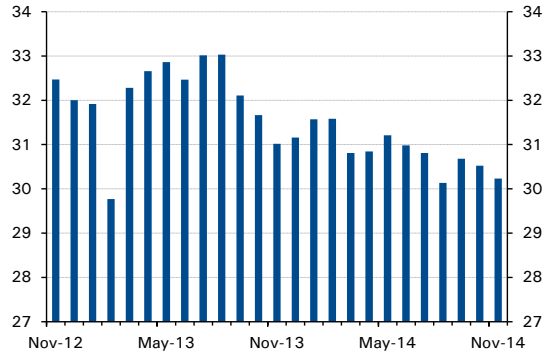
An escalation in the conflict between armed militias loyal to the two rival governments in Libya saw output shut-in at Sharara, one of the country's major fields. Oil production is likely to suffer further after Islamist militias loyal to the government in Tripoli, the National Salvation Government, advanced on two key oil export terminals, prompting the country's national oil company to declare "force majeure". The recent deterioration in security represents a major setback for Libya's oil industry, which had up until early November witnessed five consecutive months of uninterrupted output gains to reach a year-high of at least 900,000 b/d.

Kuwait and Saudi Arabia also recorded output declines, of about 60,000 b/d apiece, to 2.7 mb/d and 9.6 mb/d, respectively. This most probably relates to the cessation of production at the 300,000 b/d offshore Khafji field, which the two countries manage jointly as part of their operations in the Neutral Zone. In the two months since production was shut down on technical and environmental grounds, approximately 100,000 b/d of crude has been taken offline from both countries.

Iraq, Ecuador and Nigeria were the only OPEC members to record an increase in production in November. Iraqi crude output rose by 50,000 b/d to 3.4 mb/d. Significantly, the increase in Iraqi exports includes at least 28,000 b/d of Kirkuk crude handed over to the federal authorities in Baghdad by the Kurdistan Regional Government (KRG) in a deal negotiated between the two parties to end the standoff over oil revenue disbursements. Kirkuk and some of its surrounding oil fields have been under de facto KRG control since June 2014 when the local Peshmerga forces moved in to secure the city against the Islamic State's (IS) offensive. Moreover, it seems that federally-designated crude has been routed through the KRG's own independent pipeline to Ceyhan in

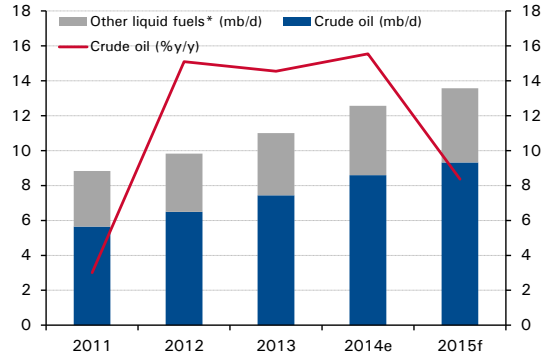
Chart 4: OPEC crude production

(mb/d)



Source: OPEC; *secondary source data used for UAE output in November and for Venezuelan output since August 2014.

Chart 5: US liquid fuels production



Source: US Energy Information Agency (EIA); * includes ethanol, biodiesel and natural gas plant liquids.

Turkey—the source of much acrimony between Baghdad and the KRG—rather than through the federal pipeline which runs through IS-controlled territory and is still out of commission after it was sabotaged in March.

Non-OPEC production, meanwhile, was broadly flat at 57.3 mb/d (including biofuels and processing gains) in November. US production increases continued unabated, however, with total liquid fuels production rising by 140,000 b/d to 12.3 mb/d in November, according to the IEA's estimates. The US Energy Information Agency (EIA) forecasts total liquid fuels production reaching 13.6 mb/d in 2015 and crude output in particular rising by 8.4% to 9.3 mb/d. (Chart 5.)

Burgeoning US production looks set to propel non-OPEC production in 2014 to a record high of 1.9 mb/d. The IEA has also revised its 2015 supply forecast higher, to 1.3 mb/d.

Once again, the 'call on OPEC crude and stock change' for 2015 has been lowered to reflect downward revisions to global demand and the expected increases in non-OPEC supply. OPEC will thus need to reduce production in 2015 by at least 1.1 mb/d from its official 30 mb/d ceiling in order to balance the market.

Head Office

Kuwait
National Bank of Kuwait SAK
Abdullah Al-Ahmed Street
P.O. Box 95, Safat 13001
Kuwait City
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAK
Bahrain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait
Bahrain Branch (H.O)
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAK
Head Office - Dubai
Latifa Tower, Sheikh Zayed Road
Next to Crown Plaza
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait
Abu Dhabi - Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAK
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

Jordan
National Bank of Kuwait SAK
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 178
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300

United States of America
National Bank of Kuwait SAK
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait
(International) Plc
Paris Branch
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAK
Singapore Branch
9 Raffles Place #24-01/02
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAK
Shanghai Representative Office
Suite 1003, 10th Floor, Azia Center
133 Yin Cheng Bei Road, Lujiazui
Shanghai 200120
China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
Watani Investment Company KSC (c)
38th Floor, Arraya II Building
Shuhada'a street, Sharq
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904

United Arab Emirates
NBK Capital Limited
Precinct Building 3, Office 404
Dubai International Financial Center
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Turkey
NBK Capital
Arastima ve Musavirlik AS
SUN Plaza, 30th Floor
Dereboyu Sk. No.24
Maslak 34398, Istanbul
Turkey
Tel: +90 212 276 5400
Fax: +90 212 276 5401

Associates

Turkey
Turkish Bank
Valikonagl CAD. 7
Nisantasi 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353