Oil markets

Amid falling oil prices, OPEC decides against a cut in oil production

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Highlights

- **Oil prices continued their downward trend in November, dropping to four-and-a-half-year lows.**
- **A combination of weak global demand and rising oil supply has been pressuring prices downwards in recent months.**
- **OPEC decided against a production cut and in favor of maintaining the current ceiling of 30 mb/d.**
- **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 growth of 1.1 mb/d.**

Crude oil prices drop to four-and-a-half-year lows

International oil prices continued their downward trend through November, with both Brent crude and West Texas Intermediate (WTI) down by 38% since their peak in mid-June. Brent settled at $70.6 per barrel (bbl) while WTI dropped to $65.9/bbl by the end of November—price levels last seen four and half years ago. (Chart 1.) Kuwait Export crude, (KEC) meanwhile, fell to $67.1/bbl at the end of the month.

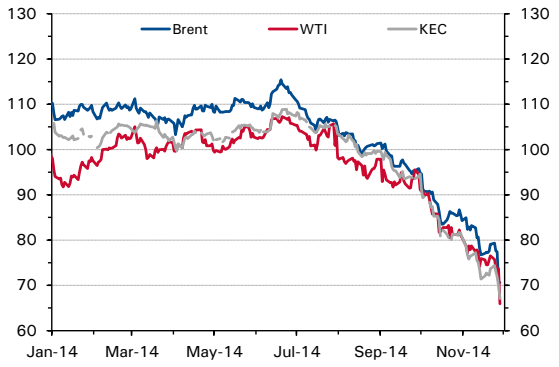
The dramatic drop in oil prices since June when Brent topped $115/bbl amid fears that the IS insurgency would threaten Iraq's oil supplies has largely stemmed from a combination of weakening global demand and surging oil supply. A strengthening US dollar has also been a factor. The return of sizeable Libyan oil supplies after a year-long absence and increasing US light tight oil production has led to a glut of crude on international markets, putting pressure on prices. In recent years, rising production from non-OPEC regions has managed to compensate for supply outages in OPEC countries, for instance, but 2014 has been notable for seeing oil output increase in geopolitical hotspots, such as Iraq and Libya, in spite of prevailing instability and insecurity.

OPEC surprises markets by maintaining its output ceiling

Amid falling prices, expectations were high that OPEC would cut production to prop up prices as it did in late 2008 during the financial crisis. Rather than cut output, the cartel opted to keep production constant at the 30 million barrel per day (mb/d) ceiling (even though average production in 2014 has overshot this level by close to a million barrels per day, according to official sources). Saudi Arabia and the GCC exporters were especially averse to the idea of taking on board unilateral cuts in production without similar cuts being undertaken by non-OPEC producers such as Russia, Mexico and the US; the combined output from these three countries, which is approaching 30% of world crude oil production, is close to OPEC's share of global production (the US currently prohibits exports of its crude under a 1973 moratorium, however).

Chart 1: Crude oil spot prices

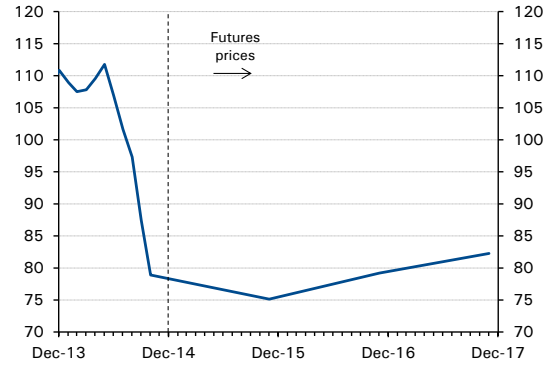
($/bbl)



Source: Thomson Reuters Datastream

Chart 2: ICE Brent Futures prices

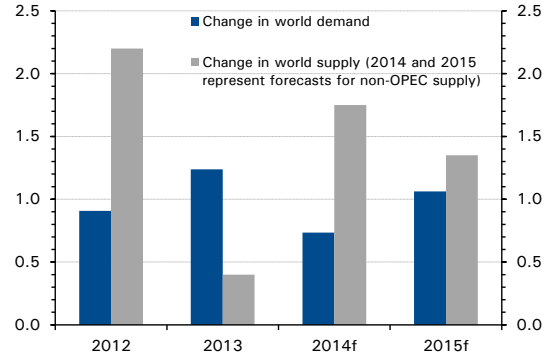
($/bbl, based on monthly averages)



Source: Thomson Reuters Datastream

Chart 3: Change in oil demand and supply

(mb/d)



Source: IEA

Moreover, the thinking goes that by allowing the market to dictate prices, OPEC could be betting on a sustained period of low prices affecting future investment in, and the profitability of, unconventional crude plays, thereby putting the brakes on the North American shale/tight oil revolution. Somewhat concurring with this view, the International Energy Agency (IEA) had earlier in the month opined that investment in US shale/tight oil could drop by 10% in 2015 if prices remained at the $80/bbl level. However, the price of oil needed to significantly affect US shale investment is thought to be much lower than that.

Nevertheless, futures prices were, at the end of November, ranging above spot prices and seemingly pointing to an uptick over the next few years as global macroeconomic conditions improve. ICE Brent for December 2015 and 2016 delivery stood at $75.1/bbl and $79.2/bbl, respectively. (Chart 2.)

World oil demand to rise in 2015 after a subdued 2014

World oil demand is set to rise by only 0.68 mb/d to an estimated 92.4 mb/d in 2014, according to the IEA. (Chart 3.) This is likely to be the slowest growth in 5 years and largely reflects relatively weak Chinese oil demand growth and declines in demand in both OECD Europe and Asia Oceania during the year. Nevertheless, the IEA is predicting an acceleration in demand growth in 2015, by 1.1 mb/d to 93.6 mb/d as the world economy improves. The International Monetary fund (IMF) expects the global economy to grow by 3.8% in 2015 from 3.3% in 2014.

Markets likely to be oversupplied in 2015 on rising non-OPEC output

A glut of crude oil on international markets has been a major factor in the steep fall in oil prices observed in recent months. Increases in OPEC production coupled with record growth in non-OPEC production have pushed global supplies to an average of 93 mb/d in 2014, an excess of almost 500,000 b/d over current levels of demand. While non-OPEC supply growth is expected to slow in 2015, to 1.3 mb/d, from 1.8 mb/d in 2014 (see Chart 3.), the market will still likely be oversupplied in 2015 in view of OPEC's reluctance to rein in output.

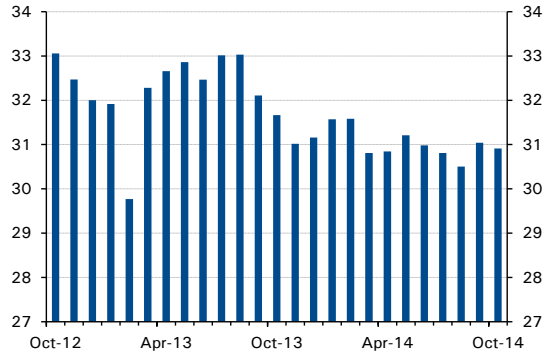
OPEC production in October was down on the previous month, by 130,000 b/d to 30.9 mb/d, according to official data and NBK estimates. The UAE, Iraq and Kuwait recorded the largest declines in output: 150,000 b/d, 140,000 b/d and 50,000 b/d, respectively, while Saudi Arabia, the OPEC member usually expected to bear the brunt of cuts, saw its output drop by just 14,000 b/d. In contrast, Libya recorded OPEC's largest increase, of 140,000 b/d. This is the fifth consecutive month of Libyan output gains since secessionist rebels agreed to end their year-long blockade of ports and oil facilities.

Meanwhile, non-OPEC production continued to surge, increasing by 165,000 b/d in October on the back of output gains in the US and Canada as well as the UK. US crude production reached 8.9 mb/d in October, increasing by 1.2 mb/d year-on-year (y/y), according to preliminary estimates provided by the US Energy Information Agency (EIA). Total crude production is projected to increase by 10% in 2015 to an annual average of 9.4 mb/d (Chart 5.). If realized, this would see US production return to levels last seen in 1972.

In view of weak demand growth and burgeoning supply especially from non-OPEC sources, the 'call on OPEC crude and stock change' for 2015 has been lowered to 29.2 mb/d from 29.6 mb/d in 2014.

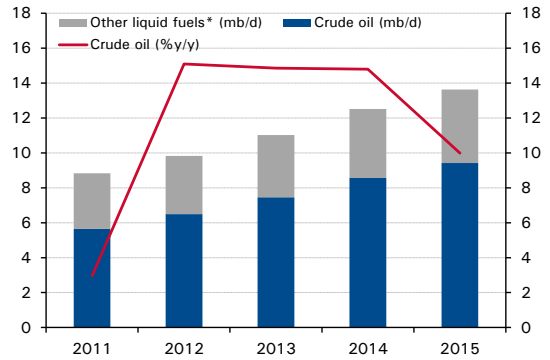
Chart 4: OPEC crude production

(mb/d)



Source: Official sources and NBK estimates

Chart 5: US liquid fuels production



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

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