Oil markets

Elevated OPEC oil output and Iran nuclear deal push prices lower in July

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Highlights

- **Oil prices fell by at least 14% in July as the Iran nuclear deal brought the prospect of more crude hitting oversupplied markets in 2015; concerns over Chinese energy demand was also a factor.**
- **The IEA expects world oil demand to grow by 1.3 mb/d in 2015 after it revised down its projection by 0.1 mb/d.**
- **Record crude output in Saudi Arabia, Iraq and the UAE pushed OPEC supply above 30.4 mb/d in June despite low oil prices.**

Oil prices fall in July on the signing of the Iran nuclear agreement and concerns over falling Chinese energy demand

A turbulent July saw prices for the international crude oil benchmark, Brent, drop by at least 14% and the US marker, West Texas Intermediate (WTI), fall by almost 21%. Dated Brent fell to $52.3 per barrel (bbl) by the end of the month—its worst performance since last December—and WTI declined to $47.1/bbl. (Chart 1.) The last time WTI experienced such a fall was during the financial crisis of October 2008, when the price plummeted by 30%. Kuwait Export crude, meanwhile, closed the month at $50.42/bbl, a drop of 12% on the month.

The price drop was largely triggered by the signing of the nuclear agreement between Iran and the West and the prospect of Iranian crude returning to already oversupplied oil markets once sanctions are lifted. With OPEC production elevated at around 31 million barrels per day (mb/d) and US output from shale resilient so far in the face of lower oil prices, the supply glut that has characterized international markets since the middle of 2014 has shown little sign of unwinding. Further depressing prices in July, was the Chinese stock market sell-off, which raised concerns that energy demand in the world largest energy consumer was beginning to slow down, and the relatively stronger US dollar.

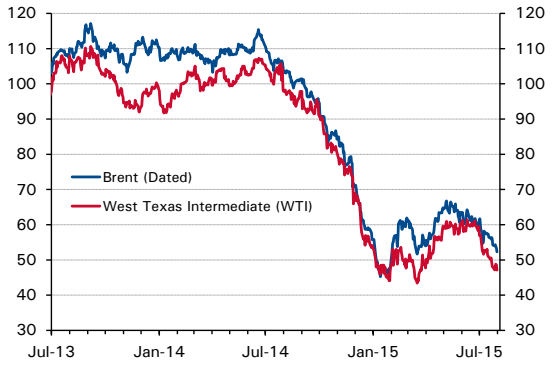
In the futures market, as of 31 July, prices for Brent crude contracts for delivery in December 2015 through to December 2017 fell over the course of the month. But with a contango curve (near-term prices lower than long-term prices) still very much in evidence, the market continues to expect prices to rebound, to $63.8/bbl in December 2017. (Chart 2.)

World oil demand growth in 2Q15 eases after the high of the previous quarter; non-OECD countries to drive demand growth entirely in 2016

According to the International Energy Agency (IEA), world oil demand growth eased to a preliminary estimate of 1.4 mb/d in 2Q15, from 1.8 mb/d in 1Q15. (Chart 3.) Consequently, the IEA has revised down total world demand growth for 2015 by 0.1 mb/d, to an average of 1.3 mb/d. Demand growth may, however, be affected positively by an uptick in Iranian crude demand in the wake of the nuclear agreement and the removal of sanctions and, negatively, by the Greek crisis and its

Chart 1: Crude oil spot prices

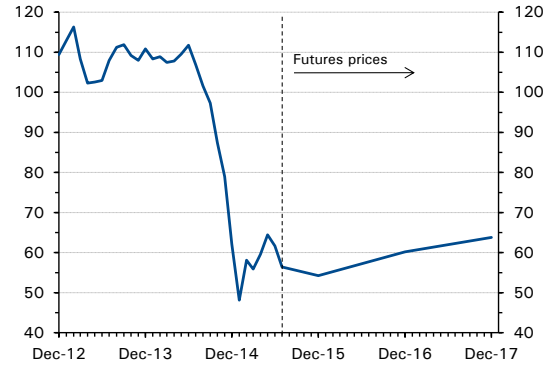
($/bbl)



Source: Thomson Reuters Datastream

Chart 2: Brent futures prices

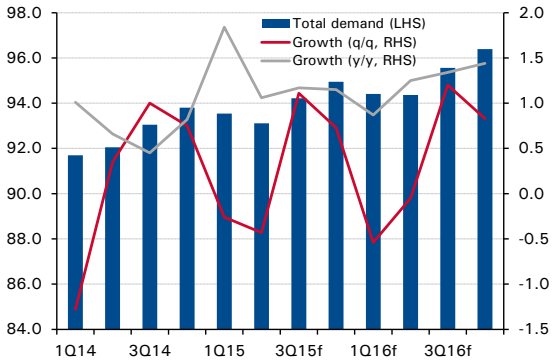
($/bbl)



Source: Thomson Reuters Datastream

Chart 3: World oil demand

(mb/d)



Source: International Energy Agency (IEA)

repercussions; any slide towards a Grexit in the coming months would almost certainly impact domestic demand in Greece and, potentially, other EU countries, were the turmoil to spread.

The agency also included projections for 2016 in its most recent oil market report: for 2016, world oil demand is expected to average 95.2 mb/d, an increase of 1.2 mb/d compared to this year. Demand growth in 2016 is set to be driven almost entirely by non-OECD countries, particularly those in Asia, hence the markets' recent focus on China. For the OECD, the IEA reckons that increasing energy efficiency gains will cancel out potential demand gains attributable to economic growth.

High OPEC crude production of above 31.0 mb/d, and gains in non-OPEC output in June point to still oversupplied markets

Total OPEC crude oil supply increased by 285,000 b/d to 31.3 mb/d in June, according to OPEC figures obtained from secondary sources. (Charts 4 and 5.) Crude output from Saudi Arabia, the UAE and Iraq reached record highs of 10.2 mb/d, 2.9 mb/d and 4.0 mb/d, respectively. Breaking through the 4.0 mb/d barrier was a significant milestone for Iraq, OPEC's second largest producer, and all the more remarkable in light of the prevailing softness in oil prices and the fact that the central government is currently engaged in a costly war against Islamic State (IS), which controls at least a third of Iraq's territory. Tensions with the Kurdistan Regional Government (KRG) over oil rights and revenue sharing are never far from the surface either. On that point, the federal authorities are still unable to produce a comprehensive hydrocarbon law acceptable to the provincial governments (including the KRG). Such a law could have gone some way towards clarifying and resolving some of the oil-related disputes.

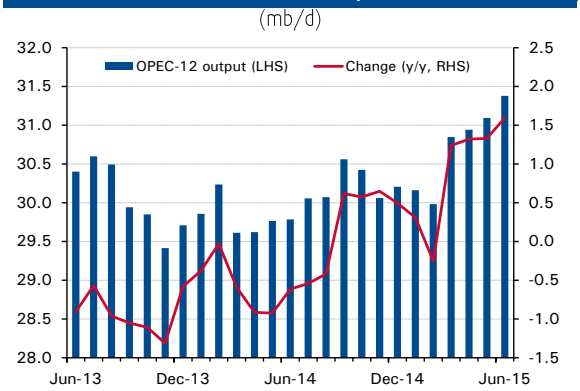
In Kuwait, oil output dropped for the second month in a row in June, to 2.7 mb/d. The closure of the 220,000 b/d Wafra field in the shared Neutral Zone in May due to an operational dispute with Saudi Arabian Chevron was the primary reason. It is not clear how long the field will remain offline, or whether Kuwait has the capacity to boost output from its other fields to compensate for the loss of both Wafra and Khafji in the Neutral Zone. The dispute has gone to international arbitration.

Meanwhile, non-OPEC crude production increased by 200,000 b/d to 58.3 mb/d in June according to the IEA. Returning Canadian and Australian production after outages in May along with higher biofuels production accounted for most of the increase during the month.

US crude oil output, meanwhile, remained steady at around 9.5 mb/d in June, according to preliminary data published by the US Energy Information Administration (EIA). The resilience of US Light Tight Oil (LTO) production in the face of depressed international oil prices has somewhat surprised the markets, although most projections including those of the IEA are for US LTO output growth to slow down over the next few months, as a result of cuts in capital spending. The non-OPEC supply forecast for 2015 remains unchanged at 58.0 mb/d, however, an increase of 1.0 mb/d on 2014.

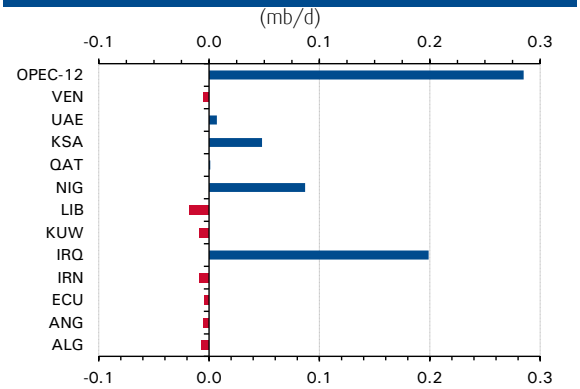
Gains in both OPEC and non-OPEC production in June brought total world oil supply for 2Q15 to 96.3 mb/d, an increase of 1.0 mb/d quarter-on-quarter and a significant 3.4 mb/d increase year-on-year. (Chart 6.)

Chart 4: OPEC crude oil production



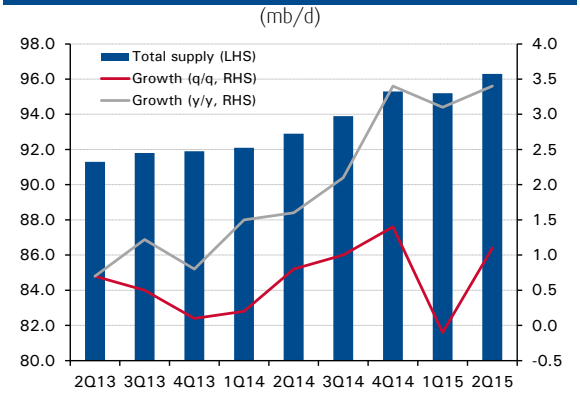
Source: OPEC

Chart 5: OPEC crude production change in June



Source: OPEC

Chart 6: World oil supply



Source: International Energy Agency (IEA)

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