Oil markets

Oil prices rally on stock drawdowns and signs of slowing US crude output growth

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Highlights

- **Oil prices rallied in July back over the $50/bbl symbolic level, paring back losses from the past two months.**
- **In July, Brent and WTI rose 9.9% m/m and 9.0% m/m to $52.7/bbl and $50.2/bbl, respectively.**
- **Sentiment improved on heavy drawdowns in US crude stocks and pledges by OPEC/non-OPEC members to reduce production.**
- **US crude production continues to increase, rising to a high of 9.43 mb/d in July, driven by shale production; growth in US oil rig counts slowed, however.**
- **OPEC output rose in June to 32.44 mb/d, thanks to a ramp-up in Libyan and Nigerian output, while overall compliance fell slightly to 94%.**
- **Markets swung into supply shortfall territory in 2Q17, with the gap expected to widen in 2H17; stock drawdowns should accelerate.**

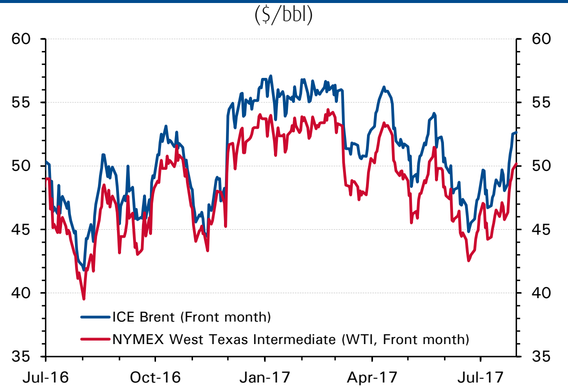
Oil bulls return, weekly US production and stocks figures drive the market

Oil prices made a strong comeback in July, reversing the bear trend of the last couple of months and returning to the symbolic $50 per barrel mark. Markets witnessed a reversal in sentiment in July, sparked by several factors including: OPEC banding together to recommit to production cuts; US inventories declining rapidly; and signs of slowing US production. Crude oil benchmark prices reached their 2-month peak at the end of July, rising to $52.65 per barrel (bbl) for Brent and $50.17/bbl for West Texas Intermediate (WTI). (Chart 1.) By July's close, Brent and WTI had increased by 9.9% and 9.0% month-on-month (m/m), respectively, and by 24.0% and 20.6% year-on-year (y/y), respectively.

US crude oil production has been on the rise since the second half of 2016, threatening the coordinated supply cut efforts of OPEC/non-OPEC. The 4-week moving average of US crude oil production grew 10.9% y/y in the week ending 28 July, with production at 9.4 mb/d. (Chart 4.)

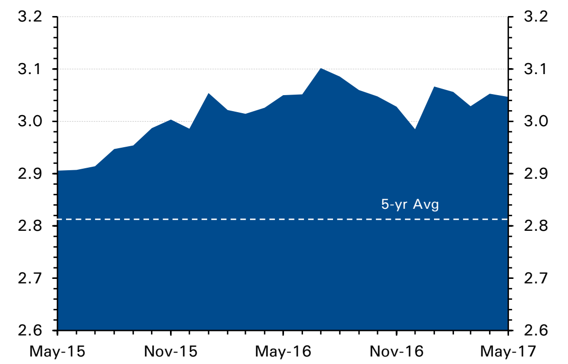
But the outlook for US production has shifted slightly to a more conservative one in recent weeks as the pace of growth in rig counts started to moderate. The total US oil rig count increased by just 2 in the week ending 28 July—well below the 3-month moving average of 5—to bring the total count to 766. But what really sparked the rally in the oil market was the drawdown in US crude stocks. US crude stocks fell dramatically in July by a cumulative weekly total of 24.2 million barrels; crude inventories are now back to January 2016 levels.

Chart 1: Crude oil prices
($/bbl)



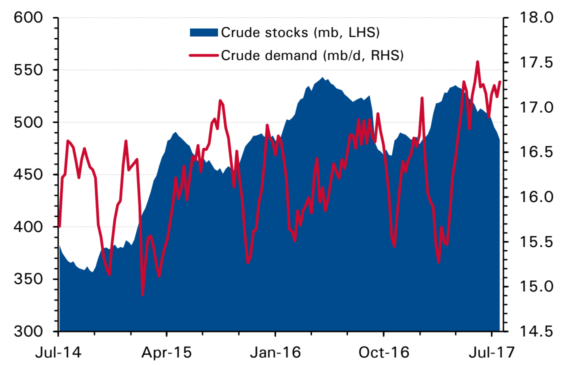
Source: Thomson Reuters Datastream

Chart 2: OECD commercial crude and product stocks
(billion barrels)



Source: International Energy Agency (IEA)

Chart 3: US commercial crude stocks and refinery runs



Source: US Energy Information Administration (EIA)

OPEC and non-OPEC members to reconvene and revisit output cut pledges

Meeting on the 7-8 August, OPEC and non-OPEC members have reaffirmed their commitments to the 1.8 mb/d production cut deal from January 2017 and its recent extension to March 2018.

After meeting in St. Petersburg on 24 July 2017, the Joint OPEC/Non-OPEC Ministerial Monitoring Committee (JMMC) reviewed the first six months since the coordinated cuts pledge in December 2016's "Declaration". Member countries such as Kuwait, Saudi Arabia, and the UAE have promised to cut back crude exports. Saudi Arabia announced that it will limit exports to 6.6 mb/d for August, a million barrels lower y/y. Nigeria, which has been exempt from the cuts, pledged to cap production at 1.8 mb/d this year.

Meanwhile, the Russian oil minister stated that Russia had reduced its output by 310,000 b/d by the end of July compared to October 2016, and that Russia was set to meet its obligation.

The latest OPEC secondary source data showed that the group's total supply increased in June to 32.44 mb/d from May's 32.05 mb/d, driven higher by output increases in Libya and Nigeria, the two non-participants in the OPEC supply cut agreement. This moves the group farther away from its target of 31.75 mb/d, with the overall compliance level dropping from 105% in May to 94% in June. (Chart 6.) The net reduction of OPEC crude production had been closer to 1.0 mb/d earlier in the year, but the increase in production reversed the rebalancing effort, bringing the net change down to approximately 0.5 mb/d.

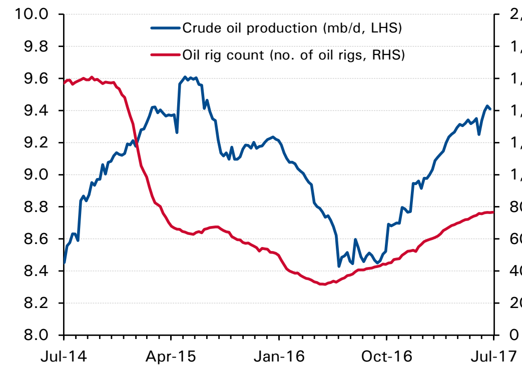
Fundamentals should provide further support to oil prices

US crude stock figures, the most closely tracked indicator by the oil markets, are expected to decline further as we move into August. The International Energy Agency (IEA) expects global demand growth to continue to outpace supply growth, with the deficit supported by further drawdowns on global crude stocks in 2H17. (Chart 7.)

We think that a total draw of approximately 240 million barrels by the end of 2017 is possible. US shale producers are also facing headwinds, as the weakening of oil prices to below the $50 bbl mark has forced them to reduce capital expenditure on drilling projects.

The second half of the year should, therefore, see some of those factors supportive of oil prices, such as stock drawdowns and tighter crude production, increasingly come into play. Markets will be keenly watching for prices to firm up.

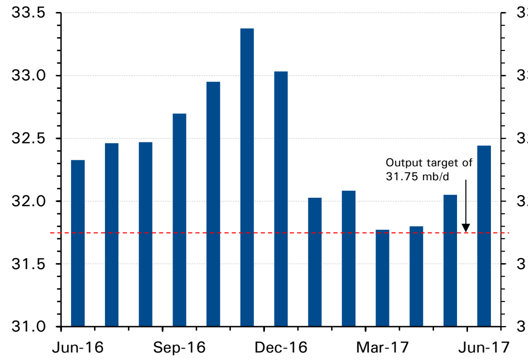
Chart 4: US crude oil production and rig counts



Source: US Energy Information Administration (EIA), Baker Hughes

Chart 5: OPEC crude oil production

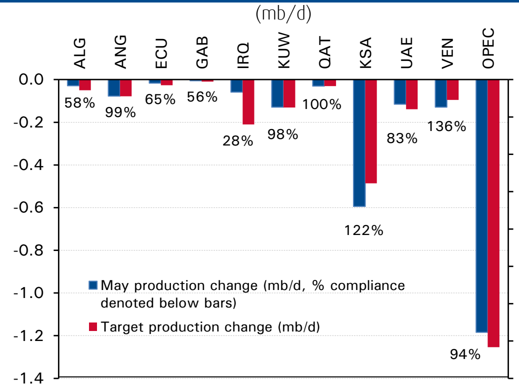
(mb/d)



Source: OPEC (secondary sources)

Chart 6: OPEC member* output change in June vs. target

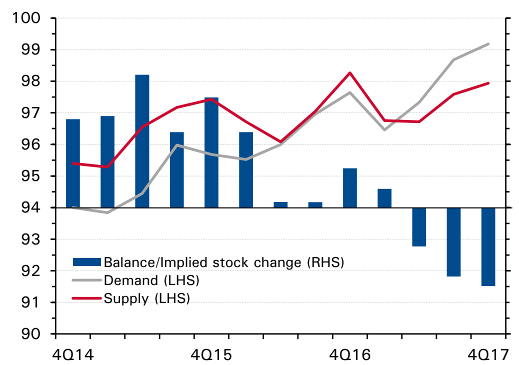
(mb/d)



Source: OPEC; * those members required to cut output

Chart 7: Balance of crude supply and demand

(mb/d)



Source: IEA; *assumes OPEC output at 1H17 average levels

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