Energy Monitor February

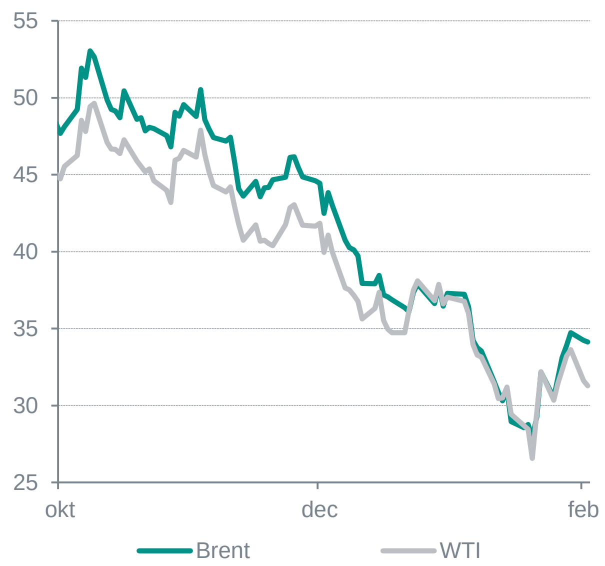
Springtime for oil prices?

Group Economics
Hans van Cleef

5 February 2016

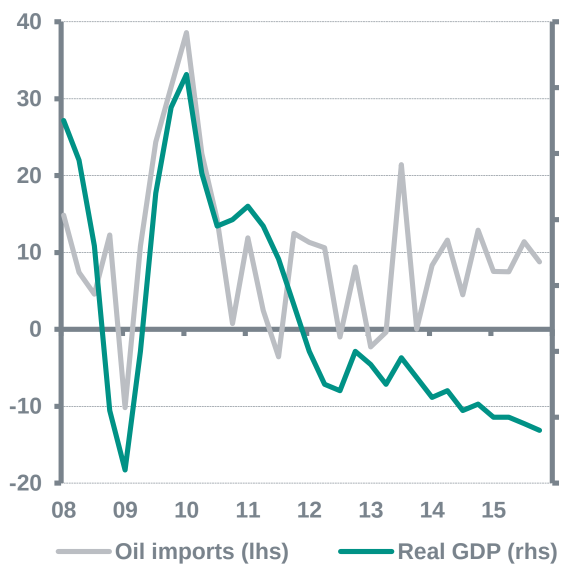
- **Oil prices recovered, but remained within the downward trend**
- **Cooling of the Chinese economic growth does not result in lower oil imports**
- **Coordinated production cut seems unlikely and producers will probably stick to 'verbal intervention'**

Figure 1: Oil prices show strong recovery but downwards trend still intact (in USD/barrel)



Source: Thomson Reuters

Figure 2: Chinese growth (% y-o-y%) slows, but oil imports continue to rise (quarter volume % y-o-y)



Source: International Energy Agency (IEA)

Oil starting to bottom out? Or not yet?

After having touched a provisional low of the Brent oil price on 20 January (USD 27.10/bbl), oil prices recovered strongly. In the eight following days, oil prices gained almost 35% before easing somewhat again. The main reason for the jump in oil prices was speculation of a possible coordinated oil production cut by both OPEC (including Saudi-Arabia) and non-OPEC countries (including Russia) (see also next page). Rumours suggest that it would be a five percent production cut. Although officials from these countries have indicated these rumours as speculation, this did triggered a long-awaited partial short-covering of speculative positions. As a result, oil prices recovered. The rally in prices came to a halt on a technical resistance level (USD 36/bbl for Brent, USD 35/bbl for WTI), which is also to the fifty-days moving average. As a result, the long-term downtrend is still in place. In the near-term, anew test of the 2016 low is possible. The high daily volatility in oil prices shows that investor sentiment towards oil is changing. It may also be a signals that the trend is about to change. So far, investors have mainly focussed in one direction: downwards. However, currently the market seems to be more divided about expectations of the direction in oil prices. As soon as investors start to doubt that oil prices would move lower, this will likely result in the further unwinding of short positions. A new strong oil price recovery is then on the cards.

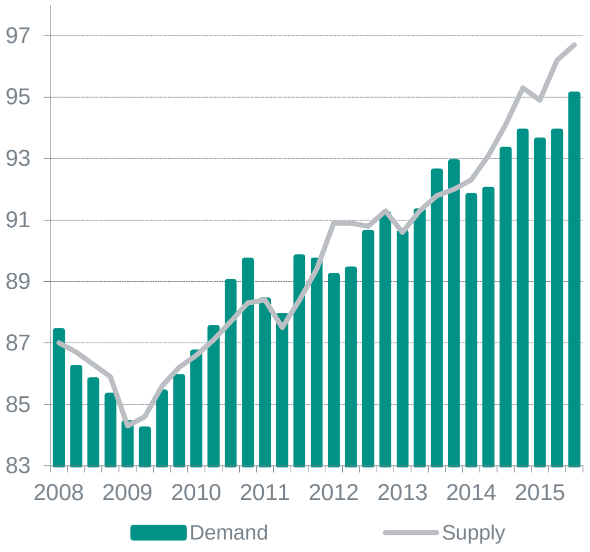
Chinese oil imports continue to rise

Besides oversupply in the oil market, investors are also concerned about a possible slowdown in oil demand, especially from China. This is of the other main drivers behind the pressure on oil prices. Worries that the Chinese economy will cool down more substantially than expected (hard-landing) result in a negative outlook for oil demand as wellAs a result, oil prices are under pressure. Arjen van Dijkhuizen, our China economist, expects a soft landing though or a controlled easing of the Chinese economic growth. Although the Chinese economy still grew by 6.9% in 2015, we expect a slowdown for 2016 and 2017 of respectively 6.5% and 6.0%.

As indicated in Figure 2, there is a divergence between Chinese economic growth and Chinese oil imports. Import volumes show a rising trend, while economic growth clearly slows. On one side, we see the effects of a transition froman industry driven economy towards a consumer driven economy. However, higher living standards also coincide with higher demand for energy, including oil. To conclude, concerns about a slowdown in Chinese oil demand (which continue to dominate the headlines), are not in line with the recent data and the downward pressure on oil prices seems overdone.

Interesting to note is that China uses low oil price as an opportunity to

Figure 3: Global demand versus supply (x mb/d)



Source: International Energy Agency (IEA)

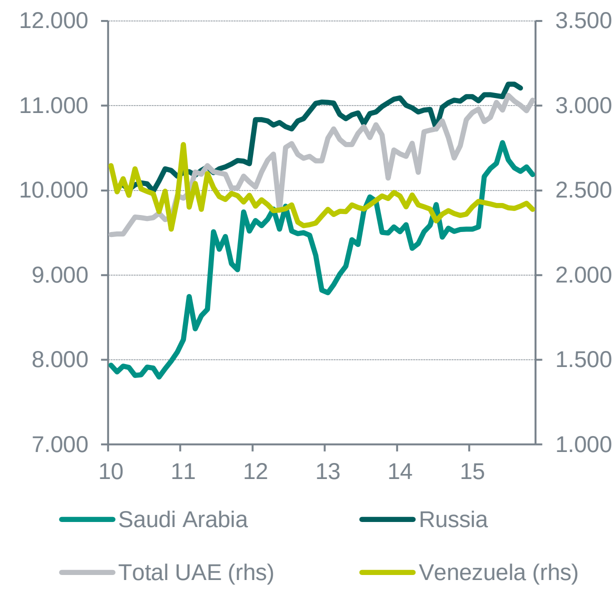
Table 1: ABN AMRO oil and gas price forecast (oil prices in USD/barrel, HH in USD/mmBtu, TTF in EUR/MWh)

Price	Q1 2016	Q2 2016	Q3 2016	2016*	2017*
Brent	40	45	50	50	60
WTI	40	45	50	50	60
HH **	2.50	2.75	3.00	2.75	3.25
TTF ***	17	18	16	16	15

Source: ABN AMRO Group Economics

* year average ** Henry Hub *** Title Transfer Facility

Figure 4: Oil production possible 'coalition' countries to lower oil production (in kb/d)



Source: Energy Intelligence

increase significantly its strategic oil reserves The Chinese aim is to build a substantial amount of strategic reserves. According to the US Energy Information Administration this will equal 500 million barres in 2020. In 2015 alone, according to Chinese sources, the Chinese strategic reserves doubled to almost 200 million barrels of oil.

A coordinated production cut seems unlikely

There have been rumours that several countries within OPEC (Iran, Iraq, Venezuela, Ecuador, Algeria and Nigeria) as well as non-OPEC producers (Russia and Oman) are willing to discuss an oil production cut in order to support oil prices. Nevertheless, we believe that a coordinated production cut of both OPEC and non-OPEC producers remains very unlikely. This is because Saudi Arabia does not seem willing to cut production as well. OPEC's strategy of focussing on market share is currently working, so why would OPEC then significantly cut production of some countries? After all, the production in some countries like Mexico, Kazakhstan, Azerbaijan and of course Libya, has already dropped significantly.

Besides that, an actual production cut would only give a short-term boost to oil prices. Imagine that Saudi Arabia, the UAE, Russia and obviously Venezuela as initiator would cut production by 5% (production levels in Figure 4), the global oil supply would drop by 1.3 million barrels per day (2/3th of the global oversupply). It would give a strong boost to oil prices but this recovery would be short-lived as it would trigger higher oil production in other parts of the world. The reduced market share by the coalition would be replaced by increased production by other oil producers who take this as an opportunity to benefit from this (most likely) temporary price recovery.

A more logical strategy seems to simply hang on during this period of oversupply. The global demand of oil shows an average annual increase of around 1.5 million barrels per day. Therefore, oil production does not need to drop too far in order that the current oversupply would change into a shortage. It would take only several quarters, even by stabilisation of the current global oil supply, supplement with the expected increased output of Iran (+600.000 barrels/day) in 2016. To illustrate: current oversupply is already in place since early 2012 (except for two quarters in 2013), in other words fourteen quarters of oversupply.

Despite the lingering oversupply in the oil market, we stick to our oil price forecast (table 1). Due to the continuous focus on the oversupply, the near-term downside risks remain in place. Although precise timing is difficult to pinpoint, we do expect a better balance between supply and demand in the course of 2016. This is because we expect a rise in global oil demand because of an improvement in global economic Furthermore, we expect that the growth of global oil supply will slow and even stabilise. This better balance will likely go hand in hand with a change in investor sentiments towards oil prices. This is usually a volatile process in markets as investors close excessive positions. Therefore oil prices will likely remain extremely volatile in the near-term, and the recovery will certainly not happen in one straight line upwards. We would like to highlight that the direction in our oil price forecasts is of a greater importance than the actual numbers. With that in mind, it seems that the darkest winter days are behind us, and springtime comes back in focus, even for oil.

Group Economics | Commodity Research
Hans van Cleef
Senior Energy Economist
tel: +31 (0) 20 343 4679
hans.van.cleef@nl.abnamro.com

Group Economics

Commodity Research team

Jacques van de Wal (Head)	tel: +31 20 628 0499	jacques.van.de.wal@nl.abnamro.com
Hans van Cleef (Energy)	tel: +31 20 343 4679	hans.van.cleef@nl.abnamro.com
Casper Burgering (Ferrous, Base metals)	tel: +31 20 383 2693	casper.burgering@nl.abnamro.com
Georgette Boele (Precious metals)	tel: +31 20 629 7789	georgette.boele@nl.abnamro.com
Frank Rijkers (Grains, Soft commodities)	tel: +31 20 628 6437	frank.rijkers@nl.abnamro.com