Monday, July 17, 2017

Market Commentary

Oil prices gained last week as the dollar weakened and global demand forecasts were revised higher by the IEA. US rig count continued to increase but the pace of rise slowed while US oil inventories fell below 500 million barrels for the first time since January. Given that most of the bearish triggers have been baked into prices, the bounce in oil prices could extend further this week.

Context

Oil prices staged a smart recovery after having seen consistent selling pressure in the last few weeks as negative news-flow dented sentiment. Some of the data last week provided hope as demand remains robust, especially in top consumers India and China. China imported 8.55 million bpd of oil in first half of this year, up 13.8% from the same period in 2016. Indian crude imports in June were also higher at 4.38 mbpd, up 3.7% y/y. Adding to this, IEA upgraded its 2017 global oil demand growth forecast by 100,000 bpd to 1.4 mbpd. Markets have been awaiting data on market re-balancing and better demand this year could help bring the oil market close to balance later this year.

The upside for prices however will remain capped given that physical markets remain oversupplied and inventories remain elevated. Despite OPEC's attempts to lift prices, oil is trading near 8-month lows as fundamentals remain unsupportive. Still, there are still no visible signs of tightness in the market. As per our estimates, OPEC's production edged higher by 0.5 mbpd in June to 32.7 mbpd, a six-month high as Libyan and Nigerian production increased. The re-balancing process remains slow and resumption in Nigerian and Libyan output has complicated the OPEC strategy. Equatorial Guinea, which became an OPEC member in May, also resulted in the OPEC output

Crude Oil			
Exchange	MCX	NYMEX-WTI	ICE-Brent
Contract	Aug	Sep	Sep
Open	2989	46.26	48.37
Close	3014	46.75	48.91
1 Week Chg.	25	0.49	0.54
%change	4.40%	5.32%	4.71%
OI	3410	333446	584953
OI change	974	41496	65419
Pivot	3007	46.55	48.72
Resistance	3038	47.13	49.30
Support	2982	46.17	48.34

Natural Gas		
Exchange	MCX	NYMEX-NG
Contract	Aug	Aug
Open	191.3	2.959
Close	192.3	2.98
1 Week Chg.	1	0.02
%change	0.52%	0.71%
OI	892	275176
OI change	2.30%	0.89%
Pivot	191.4	2.97
Resistance	193.6	3.01
Support	190.1	2.94

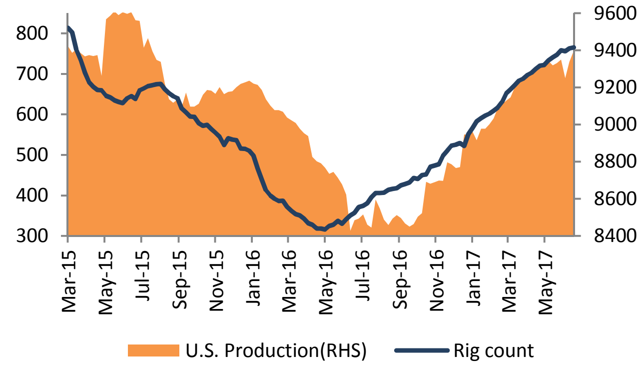
Front Month Calendar Spread		
Exchange	MCX	NYMEX($)
1st month	20	0.17
2nd month	22	0.20

WTI-Brent spread$	
1st month	0.26
2nd month	0.30

increase by 0.15 mbpd. Nigerian production is back at a 17 month high of 2.0 mbpd while Libyan output has nearly tripled from last year with production nearing 0.95 mbpd. This roughly translates to an increase of about 0.4-0.5 mbpd from these two and negates nearly half of the OPEC's 1.2 mbpd cut.

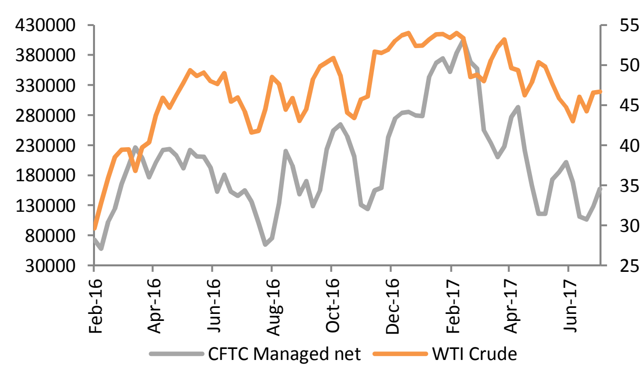
The growing concern is that rising Non-OPEC output, led by the US is increasingly offsetting the reduced OPEC production. Non-OPEC supply forecasts also continue to be revised upwards. The IEA sees Non-OPEC supply growth of 1.4 mbpd next year compared to demand growth of 1.4 mbpd. The revisions have been largely prompted due the fast rebounding shale oil production in the US. At 765 rigs, US oil rigs have more than doubled from the same time last year and point to more increases in oil output.

US oil Rig count vs. Production



Weekly data from EIA shows that total US oil production is close to 9.4 million bpd, the highest since August 2015. EIA forecasts show that US shale oil production is expected to rise further in July. The EIA drilling productivity report shows that shale oil output will likely increase by 127,000 bpd in July to 5.47 mbpd. To put this in perspective, in the downturn of 2015-2016, shale oil output fell from a peak of 5.46 million bpd in March 2015 to a low of 4.75 million bpd in December 2016. Since January 2017, shale production has started to edge up and is now almost back near its peak. The EIA forecasts output to reach a new record and surpass 10.0 mbpd next year. This is going to remain the biggest head-wind for oil prices.

WTI speculative longs



On the inventory side, EIA data showed that oil inventories fell by 7.6 million barrels and total stocks have dropped below 500 million barrels for the first time since late January. Gasoline demand inched up to 9.78 mbpd from 9.70 mbpd which led to stocks declining by 1.6 million barrels. Crude oil production rose back and touched 9.4 mbpd. OECD oil inventories fell slightly in May by 6 million barrels but remain 266 million barrels above the five-year average.

On the whole, global oil stocks and US oil and product inventories still remain elevated and we are yet to see a sustained drawdown implying that market rebalancing has still not gathered pace and that it will be a long drawn process.

For natural gas, prices saw a positive bias last week as total US consumption of natural gas rose by 6% w/w. The upside will however remain capped owing to seasonal factors. Net injections totaled 57 Bcf compared with the five-year average net injection of 72 Bcf. However, in the 2017 refill season so far, net injections into gas storage are lower than the five-year average in most regions.

Outlook

Overall, given the selloff in the recent months, we mentioned last week that some short-covering was on the anvil. The bounce in prices could extend in the near term given that most of the bearish triggers have been baked into prices. The weekly inventory data will provide further triggers to both oil and gas prices.

Crude oil

MCX Crude oil price steadily moved higher as it recovered from 2-week lows near Rs.2820 to close the last week near Rs.3000 level, higher by about 4.5% for the period. Looking ahead, Rs.2900 is likely to provide immediate support and the short-term bias looks positive above the same. An extended rally towards higher resistance zone of Rs.3100-3120 now looks possible. Buying on dips is thus advised.

Natural gas

MCX Natural looks range-bound this week with key supports towards 185/188 levels. Key resistances are now near 196.5/200.

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