Bullish trajectory for crude oil in 2017

MARKET MIND

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We expect the global demand for crude oil to grow by one million barrels per day (bpd) year-on-year in 2017. After two years of strong growth, we expect it to moderate as price elasticity effects fade away. Also, a sharp rise in oil prices will put additional pressure because the past two years was driven by petrol and jet kerosene. On the supply side, we expect that from non-Organization of Petroleum Exporting Countries countries to increase by 200,000 bpd y-o-y in 2017 after the significant decline observed in 2016.

The increase in non-Opec supply is very price-sensitive. US shale oil has clearly demonstrated its ability to fluctuate non-Opec supply significantly because of its short investment cycle. Hence, we can see higher growth in non-Opec supply, especially if US producers hedge aggressively with the price rally on the back of the latest Opec deal. However, part of this higher growth would be offset by the cuts in non-Opec countries.

Given the latest Opec agreement to cut its output by 1.2 million bpd from the October 2016 reference point (some non-Opec countries to cut additional 600,000 bpd), we expect market-balancing (demand-supply match) will be accelerated. Without an Opec deal, we expected oil markets to balance towards the second or third quarter of 2017.

Now, with an Opec cut, we expect market to be balanced as early as the end of the first quarter of 2017. The historic deal in Vienna should have an overall positive impact. However, some gaps remain and we will need to wait until the Opec, non-Opec meeting to bridge some of those gaps.

While the markets grow bullish on the back of this news, we might also see some in prices, especially if the effective cut is not as high as announced by Opec and non-Opec. This will become visible in late January or February. At the same time, even if the effective cuts were not exactly similar to the ones announced by Opec alone or together with non-Opec, we think the news will provide a tailwind for oil prices to take them through the fundamentally weak quarter, which is the first week of 2017. Once we past that, the markets might start looking beyond and we see the markets trending towards a natural equilibrium thereafter anyway, even without the intervention.

We have revised our oil price forecasts closer to our high case scenario after the Opec deal was announced. We now expect Brent to average $64.5 per barrel and WTI to average $62.8 per barrel in 2017. We expect a dip in oil prices sometime in the second half of 2017 on fundamental corrections due to a higher oil price. We also expect high volatility in 2017 as risks to oil prices still remain high. Some risks we anticipate, other than the ones mentioned above, include moves in the dollar on Fed rate hikes and supply-side risks from Nigeria and Libya, and Chinese imports of crude for their strategic reserves and geo-political risks.

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