Oil Update

March 16, 2015

Global oil demand growth has risen steadily since bottoming out in Q2-2014, with year-over-year gains estimated at around 1.0 MBD (IEA) for the current quarter and at 1.2 MBD for 2015 (OPEC) with likely upside revisions. Global demand is estimated to average 93.5 MBD for 2015 while supply was about 94.00 in February, led by a 1.4 MBD year-over year production increase in non-OPEC output.

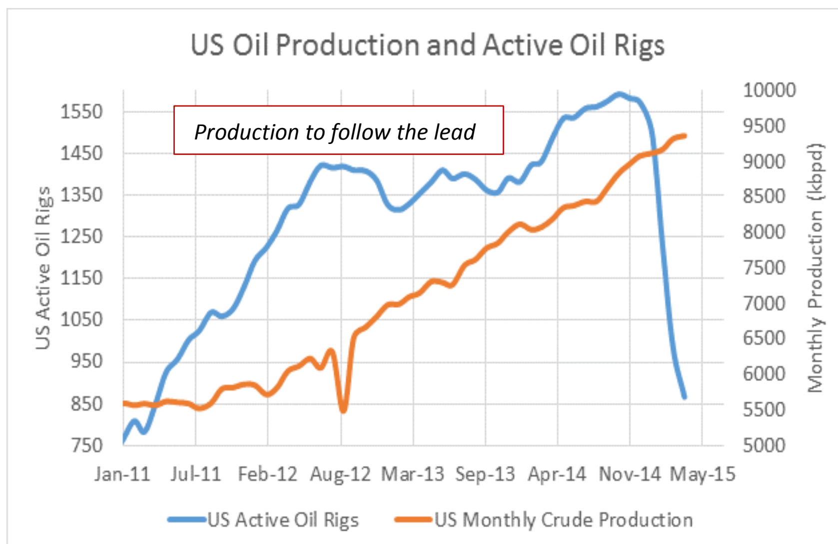
April and May is the weakest period for worldwide demand as many refineries go into maintenance. In the US however, this year refinery maintenance cycle happened earlier (January and February) which led to an outsized increase in oil stocks which should level out in the next few months.

It is important to point out that a key difference with the previous period of sharp drop in oil prices (2008) is that while before it was driven by lower demand this time it is driven by excess supply.

Assuming some price elasticity, the present price drop should generate higher demand but there is time lag as many users have hedged their needs at higher levels, delaying the pass-through to the consumer.

US oil consumption has shown a rise of about 200,000 BPD in the last couple of quarters. End demand for refined products is increasing, primarily gasoline and diesel.

Active oil rigs continue to drop at an accelerated pace but US production is not yet decreasing because there is a time lag (please see graph below). In addition, producers are moving rigs from peripheral areas to core areas increasing productivity per rig and lastly the cost curve is lowering due to better technology. Consistent with a lower rig count, capital expenditures are projected to decrease at least 30% during 2015.



Source: US Department of Energy and Baker-Hughes

US oil producers are lobbying to end the ban on crude exports that started in the 1970s. While political pressure is increasing US oil is exported as refined products. The US has too much light crude (exported as condensates) while it needs heavy crude.

The light oil (WTI) vs heavy oil (Brent) spread should be reduced over time as inland production levels off or if the U.S. government lifts the crude export ban (an unlikely event in our view)

While many commentators continue to state that the world will run out of storage capacity, those fears seem overblown as there are hundreds of millions of barrels of available storage capacity around the world.

***Our take is that US oil production will start decreasing in H2 2015 and 2016, contributing to a re-balancing of the oil market*.**

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