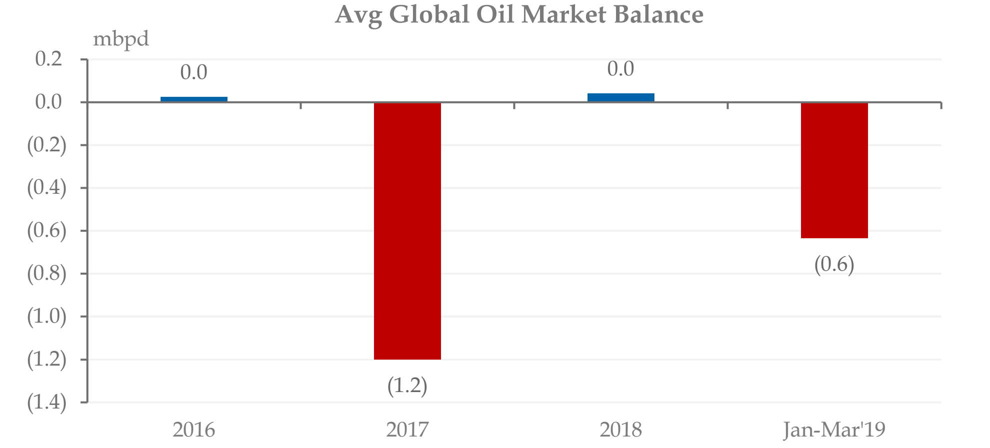
YES SECURITIES
WEALTH BROKING

Oil-nomics

Yet a Sheikh v/s Shale Narrative

Given the recalibration in global supply/demand balance, OPEC supply side measures have apparently yielded results. Supply disruption in Venezuela and Iranian sanctions have also driven the price trajectory higher. However, expanding US output poses a ceiling on the prices. As a case in point, US oil output has surged 3.3mbpd since December 2016. Although global markets have moved into a deficit, the supply shortfall is not that wide, thanks to growing self-reliance of world's largest oil-consumer (US). Looking forward, we see Brent values peaking around US$75/bbl mark, with the overall trajectory consolidating in the familiar range of US$68-75/bbl. Needless to say, the short-term outlook hinges on how OPEC calls the shots on production accord, wherein we see much lower supply cuts later this year given the lure of relatively stable and higher prices.

Exhibit 1: Oil markets in balance, thanks to OPEC cuts

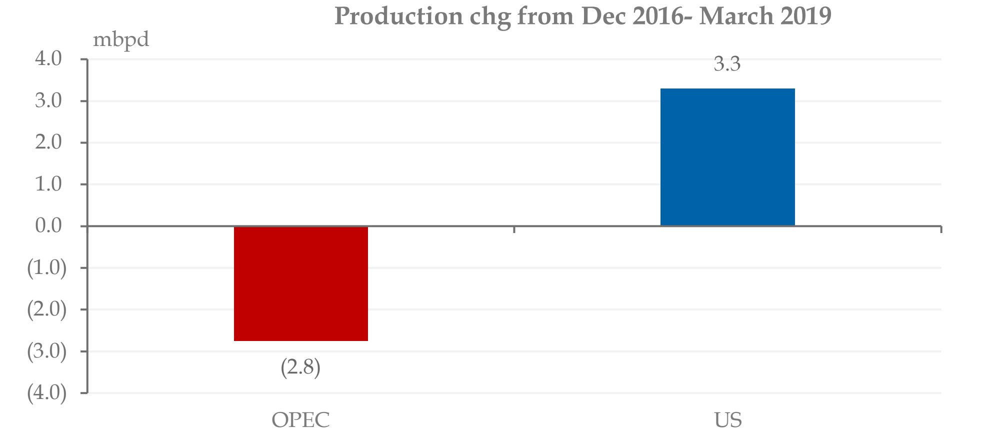


Source: Energy Intelligence, Bloomberg, YES Sec – Research

Balanced Markets thus far

Thanks to curtailed output from OPEC and few non-OPEC players, oil markets were balanced last year and now in a deficit so far, this year. Energy Intelligence numbers show oil markets in a deficit of an average 0.6mbpd during first three months of 2019. Similarly, OECD inventories have declined by 238mn barrels since January 2017, with current levels below the 5yr average. Reaching the five-year average for OECD inventory mark was the primary objective of OPEC's production accord. Meanwhile, markets have tightened, with modest WTI contango in the first 3 months of this year, while various global benchmark crudes are backwardated.

Exhibit 2: US output surge has counterbalanced OPEC cuts



Source: Energy Intelligence, Bloomberg, YES Sec – Research

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Exhibit 3: Crude Oil Snapshot

(US$/barrel)	Mar-19	Feb-19	mom (%)	Mar-18	yoy (%)	YTD (%)	Avg '19	Avg'18
WTI Crude	60.1	57.2	5.1	64.9	(7.4)	39.9	56.5	64.9
Brent Crude	68.4	66.0	3.6	70.3	(2.7)	32.5	65.1	71.7
WTI / Brent Spread	(8.2)	(8.8)	--	(4.5)	--	--	(8.4)	(6.9)
OPEC Crude basket	67.2	65.3	3.0	65.9	2.1	37.4	64.1	69.8
Natural Gas	2.7	2.8	(5.3)	2.7	(2.6)	(14.8)	2.8	3.1
(mn barrels)	**Mar-19**	**Feb-19**	**mom (%)**	**Mar-18**	**yoy (%)**	**YTD (%)**	**Avg '19**	**Avg'18**
EIA US weekly stocks								
Crude Oil	450	446	0.8	425	5.7	3	447	423
Gasoline	237	255	(7.1)	238	(0.7)	-5	248	236
Distillate	128	138	(7.4)	129	(1.0)	(1)	136	128
(mbpd)	**Mar-19**	**Feb-19**	**mom (%)**	**Mar-18**	**yoy (%)**	**YTD (%)**	**Avg '19**	**Avg'18**
DOE US weekly data								
Oil Demand	17.9	19.3	(6.9)	19.0	(5.7)	(4.2)	18.8	18.6
Gasoline Demand	9.7	9.8	(0.5)	10.2	(4.2)	5.5	9.8	10.1
Distillate Demand	5.3	5.2	2.1	5.0	5.2	13.3	5.3	5.3
Oil Imports	6.8	5.9	14.3	7.9	(14.4)	(18.9)	6.9	7.8
Oil Exports	2.9	3.1	(5.9)	1.7	72.7	17.1	2.7	2.0
Oil Output	12.2	12.1	0.8	10.5	16.6	3.4	12.0	10.8
Units	**Mar-19**	**Feb-19**	**mom (%)**	**Mar-18**	**yoy (%)**	**YTD (%)**	**Avg '19**	**Avg'18**
US Rig Count	816	853	(4)	797	2	(6)	846	841
US Supply in days	28	28	1	25	11	13	27	25
(mbpd)	**Mar-19**	**Feb-19**	**mom (%)**	**Mar-18**	**yoy (%)**	**Avg'19**	**Avg'18**	**yoy(%)**
World Supply	99.4	100.0	(0.6)	98.2	1.2	99.8	99.8	0.0
OPEC Output	30.4	30.7	(1.0)	32.0	(5.0)	30.7	32.5	(5.4)
Saudi Output	9.8	10.1	(2.8)	9.9	(0.5)	10.0	10.3	(2.6)
Iran Output	2.7	2.7	(1.1)	3.8	(28.9)	2.7	3.6	(23.4)
Non-OPEC Output	61.9	61.8	0.2	59.3	4.4	61.7	60.4	2.2
Russia Output	11.3	11.3	(0.3)	11.0	2.5	11.3	11.2	1.2
World Demand	99.8	100.9	(1.1)	99.0	0.8	100.5	99.8	0.7
World Balance	(0.4)	(0.9)	--	(0.8)	--	(0.6)	0.0	--

Source: Bloomberg, Energy Intelligence, YES Sec – Research

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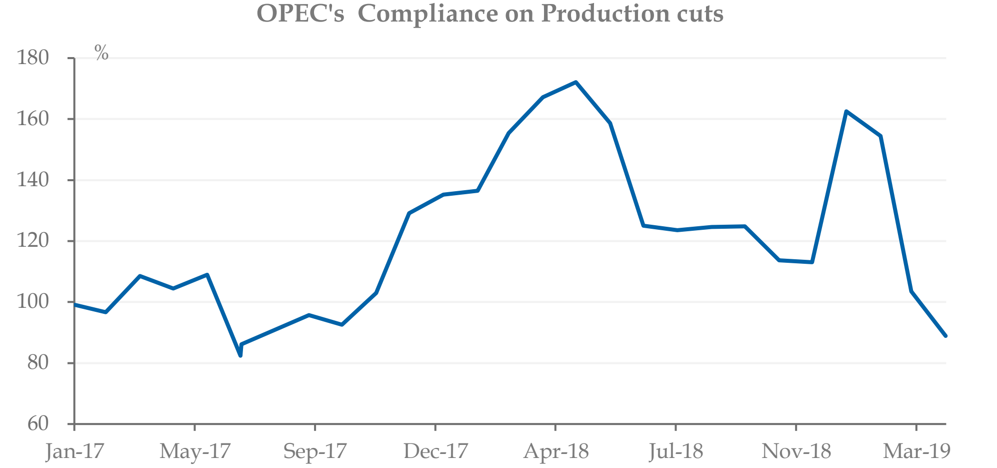
OPEC complies, non-OPEC relents

OPEC has been very compliant on the production accord throughout 2017 and 2018, with Saudi Arabia persistently doing the heavy lifting, while members like Angola and Qatar also under-producing. However, certain members like Iraq and UAE have failed to stick to production targets. OPEC output is now down almost 2.75mbpd since December 2016. Sharp cuts by Saudi (0.6mbpd), as well as cuts due to sanctions from Iran (1mbpd) and Venezuela (1.2mbpd) have contributed to the OPEC declines. On non-OPEC discipline, compliance has been dropping since 2018, with recent levels halving to 50% from 103% in December 2017.

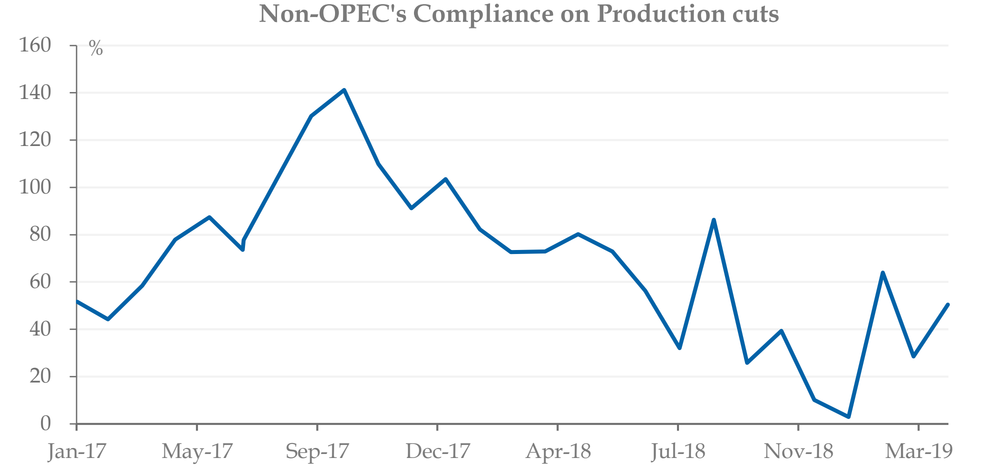
Exhibit 4: Impressive OPEC Compliance on production accord…



Source: Bloomberg, YES Sec – Research

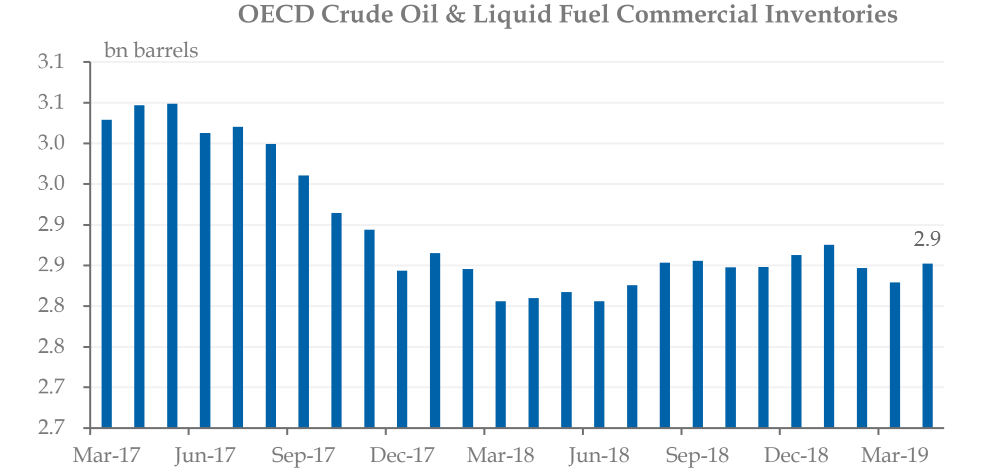
There is indeed high degree of pressure on OPEC from various oil producers to end the cuts given the temptation of higher oil prices and fiscal duress in some nations. The cartel will be debating on whether it wants to extend the production cuts at the June meeting. Russia has already expressed its willingness to hike production. Saudis are committed to production accord; however, the moot point remains how long production cuts would sustain given that the primary objective of bringing OECD inventories below 5yr average has been achieved. There is a strong likelihood of OPEC oil producers exiting the accord later this year. Evidently, OPEC's June meeting in Vienna would provide clues on how OPEC disembarks from the supply side measures.

Exhibit 5: …Non-OPEC nations have been less disciplined



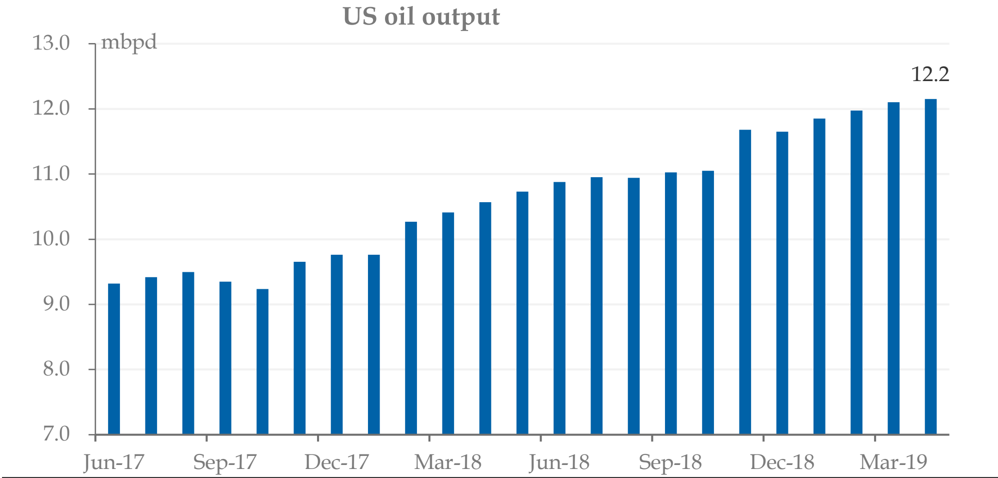
Source: Bloomberg, YES Sec – Research

Exhibit 6: OPEC attains its target of getting the OECD oil inventory level below 5yr average



Source: Bloomberg, YES Sec – Research

Exhibit 7: US output expansion remains unabated

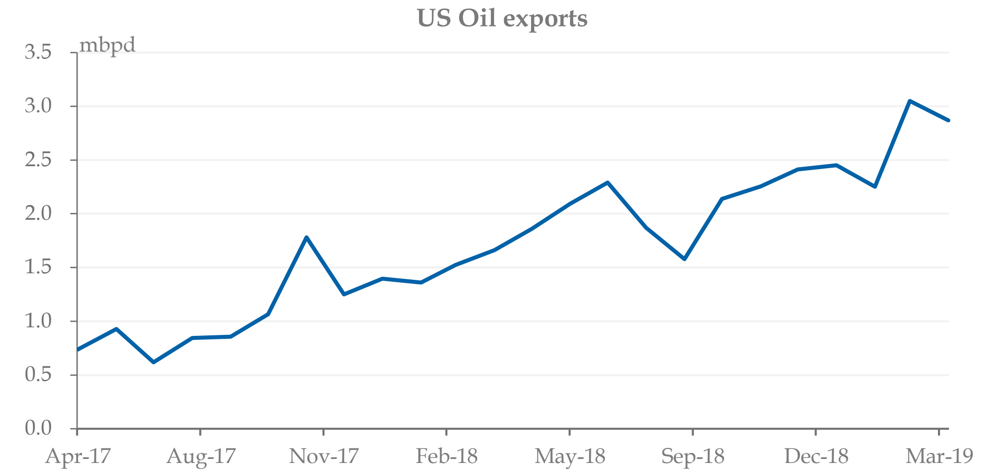


Source: EIA, Bloomberg, YES Sec – Research

Surging US output: Key concern

Markets remain cautious about rising US produce, with output during March averaging 12.2mbpd mark, an astounding growth of 3mbpd from the levels seen in early 2017. If this is not enough, EIA expects it to surpass 13mbpd in 2020. US output has added 3.8mpd from the lows of 8.4mbpd during the third quarter of 2016. There have been structural changes to US trade flows as well, with exports trebling to around 2.8mbpd, when compared with 2017 levels. In fact, exports during February this year surpassed 3mbpd. Consequently, US oil imports have also moved lower over the past two years as the country slowly moves towards the desired self-sufficiency. US output has already replaced Saudi Arabia and Russia as the world's largest producer. Stable higher prices would certainly lure more producers to add rigs and pump more oil. In this regard, breakeven production price for US Bakken Crude oil is estimated to be around US$42/bbl, reasonably lower than prevalent price levels.

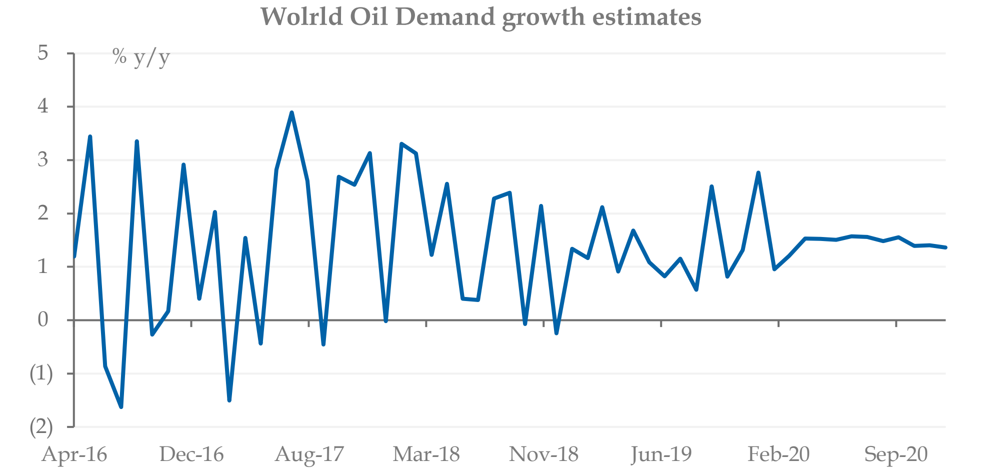
Exhibit 8: US oil outbound shipments have grown multi-fold



Source: EIA, Bloomberg, YES Sec – Research

Stable demand, though projections to be revised lower
Global oil demand so far has held up very well despite the deceleration in global macro numbers. Energy Intelligence numbers state world oil consumption averaging 100.5mbpd in the first three months of this year, when compared with 99.8mbpd in 2018. The three major agencies — OPEC, IEA and EIA see demand growing 1.2-1.4mbpd this year, though these estimates could be pared later given the lower GDP projections in US, Europe and China.

Exhibit 9: Oil demand growth projections likely to be pared

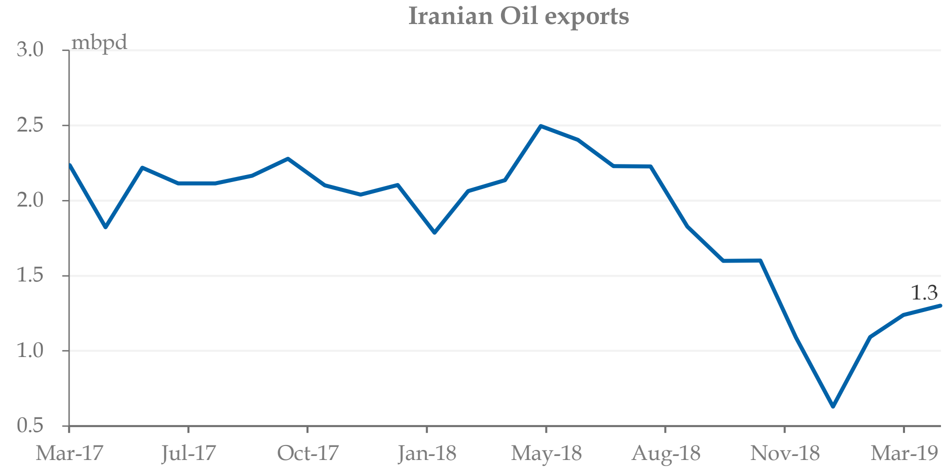


Source: US DOE, YES Sec – Research

Weighing up the imponderables
Oil markets perennially co-exist with myriad uncertainties, and this year is going to be no different. Clarity awaits on the US waivers for 8 importing nations of Iranian crude. Since sanctions were placed on Iran, exports have halved to 1.3mbpd (including condensates). The Trump administration has been talking about forcing Iranian exports to zero, but given where prices are and the relatively tight markets, they will unlikely pursue this goal. They may try to tighten sanctions to move exports to under 1mbpd, or below levels seen under the Obama Administration's sanctions regime. Of course, this is far from certain, nor is there any certainty to the OPEC and Russian reactions. However, given the spare production capacity within OPEC, Saudis can easily step on the gas and compensate for the loss in Iranian supply.

Meanwhile, the situation in Venezuela is precarious and there is a looming question on how long the Nicolas Maduro regime can endure deplorable economic and social conditions. US sanctions has made it impossible for the country to produce and export oil. Venezuelan oil production has declined below 0.9mbpd and could fall further given the cash crunch and dilapidating infrastructure woes of the state-owned oil producer. Nevertheless, markets have very much priced in the Venezuelan situation. The fact that Libyan and Nigerian output has stabilized is also a comforting factor for global supply.

Exhibit 10: US sanctions have taken a toll on Iranian oil exports



Source: Bloomberg, YES Sec – Research

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