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The House View on Oil

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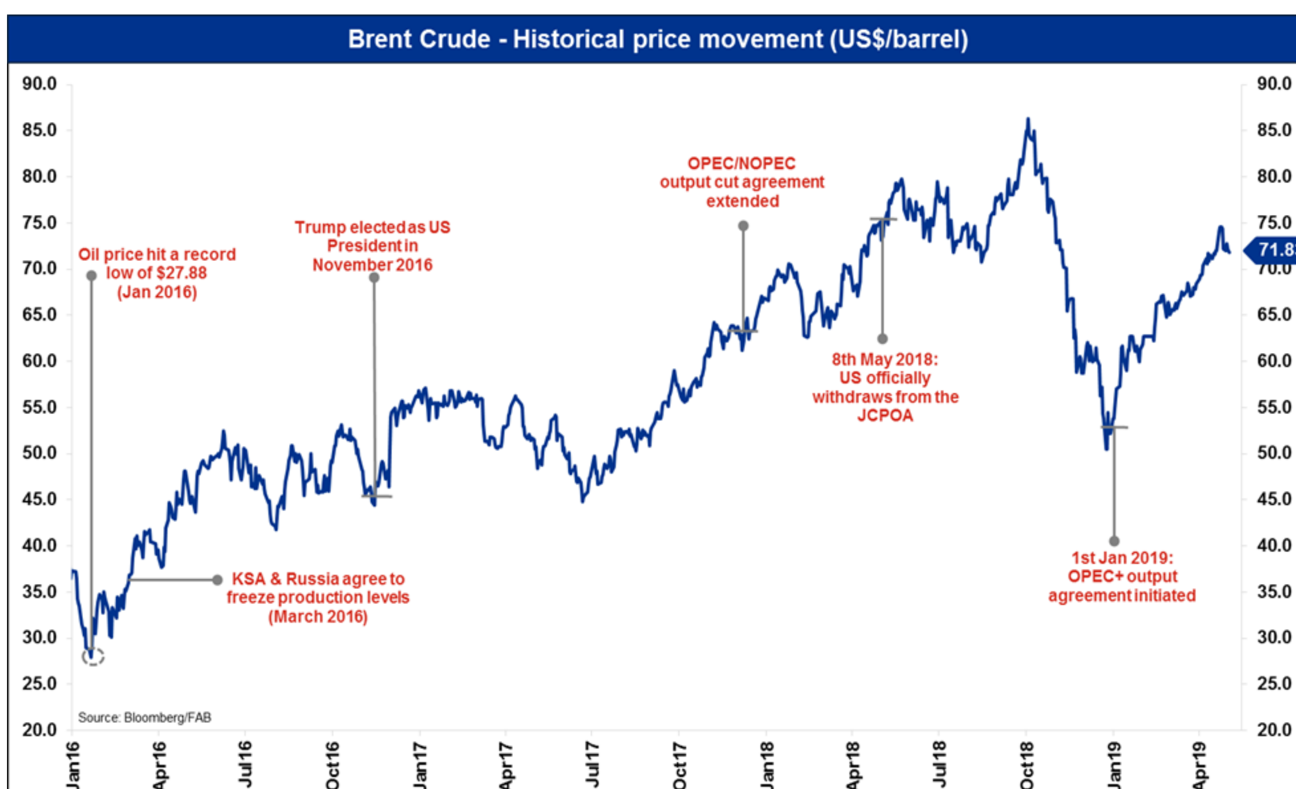
Please find below our newly inaugurated publication of First Abu Dhabi Bank's 'house view' on the current state of the global oil market.

- **Our bottom line**: Despite the sharp drop in Iranian and Venezuelan exports, global producers are still able to pump enough extra crude to prevent the market from breaking sharply higher in the near term. Equally, better coordinated action by the OPEC/NOPEC countries and the formalization of an 'OPEC+' structure, combined with steady demand growth should continue to ensure that a dramatic drop in prices will also be avoided. Thus we maintain our view, which was first expressed in January this year that crude prices should average US$60 (WTI) and US$70 (Brent) in 2019. However in the medium to long term we remain concerned that the ongoing lack of sizeable CAPEX into conventional exploration and production risks an eventual supply shock event unless this issue is adequately dealt with. We also do not believe that US shale is a genuine long-lasting supply source of oil.



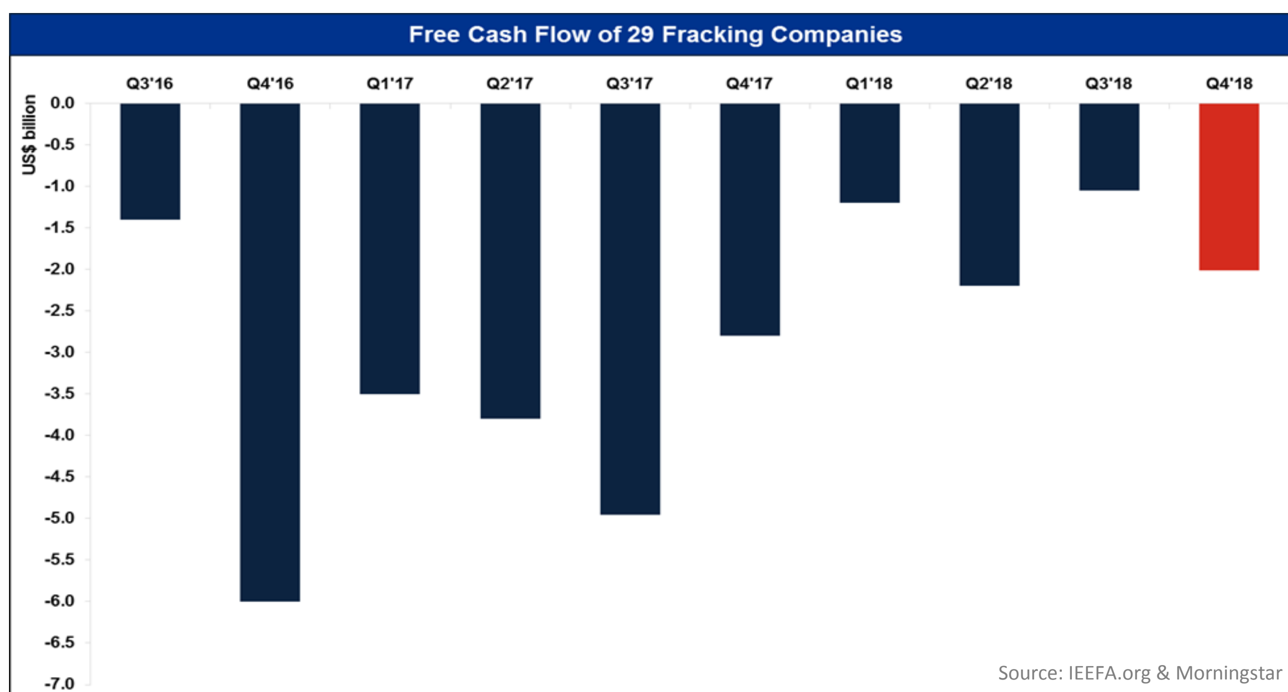
Current Market Drivers

- The output cut agreement has been instrumental in providing both a floor and positive upward driver for crude prices since it was first mooted back in 2016. The close adherence by most signatories to their relevant production allowances surprised many analysts and was key to its success, although it is also acknowledged that Saudi Arabia has borne a large part of these cuts.
- Geopolitics was and continues to be another main support pillar to crude prices, with the resumption of US sanctions on Iran, conflict in Libya and the worsening socio-economic situation in Venezuela keeping the bulls in play. Iranian exports alone fell from 2.50 mio bpd in April 2018 to 1.2 mio bpd in March this year and a further drop is expected now that the US has terminated its waivers on eight of the world's largest buyers of Iranian oil.
- On a technical basis general demand for crude remains firm and this was highlighted within the most recent IEA report which forecast demand growth to average 1.4 mio bpd this year from 1.3 mio bpd in 2018 on the back of continued strong orders from Chinese and Indian buyers. Meanwhile the long signalled change in regulations governing the total permissible sulphur content in marine fuels is due to come into force in January 2020. This will force ship owners to only use fuel that has a maximum sulphur content of 0.50% compared to the current limit of 3.50%. This change by the International Maritime Organization will likely result in an increase in the already heavy demand for low sulphur distillates and thus light crude.
- Of course downside risks do exist with a possible global economic slowdown the one to watch, especially if the US and China are unable to reach an agreement on their high level trade negotiations leading to higher trade tariffs. Other potential issues could include a sharp jump in production by countries such as Russia if the output cut accord is ended prematurely and the lingering chance that the US Congress re-introduces the 'No Oil Producing & Exporting Cartels Act' (although the actual passing of such a bill by both houses and a final affirmation by the President remains unlikely.)

US shale production is not sustainable

- There is no denying the fact that the growth of shale has been a game changer for the US energy sector over the past ten years and resulted in the country becoming a net exporter of crude in 2018 for the first time since 1943.
- However we see the shale oil boom as a short-term phenomenon which will not become a long-term and reliable source of supply for various reasons such as:
    - The average shale oil field has a very short lifespan of 5-7 years.
    - Fracking has a significant and detrimental impact on the health of a shale basin.
    - Pipeline related bottlenecks and refinery capacity limits remain an issue.
    - State environmental laws are tightening (e.g. Colorado).
    - The financial performance of many shale energy firms has been poor and investor appetite is declining.

- The last point above is particularly important. US shale companies have received billions of dollars in financing and investment over the past few years however the financial results for the majority of these firms have been far from stellar, with a recent IEEFA study showing that 29 publically traded oil and gas 'frackers' had an aggregate negative cash flow of US$181 bio between 2010 and 2018. Meanwhile 167 such shale oil and gas companies reportedly declared bankruptcy during the past 3 years after accumulating almost US$100 bio in total debt, whilst the sector overall will need to refinance an estimated US$240 bio in maturing debt between 2019 & 2023 according to Kallanish Energy.
- Therefore investors and banks have become much more cautious when considering fresh lending to this sector forcing firms to focus more on profitability than expansion this year.



CAPEX on conventional oil remains low

- The number of fresh and 'green-lighted' conventional oil projects touched a 70 year low in 2016, and although spending has risen somewhat since then it still remains at a historically low level.
- Global expenditure on exploration into conventional resources dropped by 60% between 2014 and 2017.
- Only 3.50 bio barrels of crude oil, condensate and LNG were discovered in 2017 compared to a historical average of around 9 bio barrels.
- The average conventional oil field has a lifespan of 20-30 years but a number of existing fields are now reaching the end of their economically productive terms. For example some of Russia's big fields date back to Soviet times.
- Therefore without a significant increase in spending on exploration and the development of new conventional fields there is a growing risk that the world could face another supply/demand crunch within the next ten years.

Events & issues to keep an eye on in the near term

- **02 May 2019:** Expiry of a US sanctions waiver for eight of Iran's largest crude buyers. The Trump administration has already said that these waivers will not be renewed and has hinted that further sanctions could follow.
- **19 May 2019**: The next scheduled 'Joint Ministerial Monitoring Committee' meeting in Jeddah to review the latest production data linked to the OPEC+ output cut agreement.
- **25 June 2019:** The next scheduled OPEC Meeting in Vienna at which a decision could be made on whether or not to extend the output cut agreement.
- **Libya:** The recent upsurge of fighting there might lead to a disruption of production in the oil crescent.
- **Venezuela:** The latest coup attempt underscores this Latin American country's fragile political situation. Venezuela is home to the world's largest reserves of crude.
- **China:** A possible sharper economic slowdown due to domestic issues or linked to the ongoing trade tariff dispute with the US.

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