Medium Term Price Outlook on Crude oil

January 2015
Crude oil prices tumbled towards their lowest levels since 2009 in the wake of abundant supplies and weakening demand outlook.

As OPEC refrained from any supply cut to maintain the share while also hinting at upping the output should they be finding any new export destination, prices continued their slide in December posting biggest monthly slide after the 2008 crisis.

Meanwhile, weakness in Chinese industrial and manufacturing output despite rate cut has weighed on the demand prospects pressuring the prices.

Also, a stronger dollar, hovering at more than 8 year highs around 92 amidst increasing expectations of rate hike from FED continued to exert pressure on dollar denominated commodities.
Fundamental Summary

Bearish Factors

- OPEC’s decision to keep supply steady at 30 MBpd for the JFM quarter, escalating the price war.
- Global demand expected to decline by 0.91 MBpd in the current quarter.
- Global supply expected to increase by 0.19 MBpd in the first quarter of 2015.
- Global economic growth for 2015 downgraded from 3.4% to 3% by world bank.

Bullish Factors

- Top consumer United States economy expected to grow at a rate of 3.2% compared to 2.4% in 2015.
- Geopolitical issues in MENA nations – political instability in Libya and infighting in Iraq.
- Burgeoning Chinese imports (9.5% YoY growth in 2014) due to the stockpiling activity.
Detailed Market Analysis
Global Economic Summary

- **US economy** remains on a firm foot leading the global recovery. The third quarter GDP was revised higher to 5%, biggest rise in 11 years demonstrating rapid growth in the US economy which has supported the investor sentiment on global growth to remain less affected by the slowdown in Euro Zone and China.

- US Dollar Index has risen to more than 8 year highs to 92 levels amid increasing expectations of rate hike while EU and Japan persist with accommodative policy measures.

- However, Since the US exports only contribute 13% of GDP, a high dollar value might fail to significantly impact the consumption driven US economy. Cheaper imports amidst an appreciating USD should support domestic demand leading to firm economic recovery in the meantime.

- The **EU** recovery has been dented due to increasing deflation threats coupled with uneven economic activity in the shared currency union. Apart from the peripheral economies, the core of the EU, Germany too witnessed slackening factory activity and dwindling sentiments.

- However, while a recovery in the global economy and lower Euro is set to boost the euro zone’s exports, continues efforts to boost credit growth may increase the domestic spending leading to a recovery in the medium term.

- **China** is likely provide further timely measures, in addition to the rate hike, to deter economic slowdown concerns going ahead. Currently, sluggish manufacturing and weak property market is likely to remain a threat to undermine economic growth.
Going ahead, US may witness slight slack in growth, after being strong in the past two quarters, as the winter season has approached which could lead to subdued consumer spending. However, favorable inflation numbers for the consumers amidst approaching festive season (Thanksgiving and Christmas) may limit the weakness.

Further strength in economic numbers from US could lead to increasing expectations of sooner than later rate hike (possibly towards the end of Q2 15) which would lead to further rally in the dollar index pressuring the dollar denominated commodities.

ECB is likely to unveil further easing measures as even negative interest rate has failed to boost credit growth and the inflation. Any such measures will increase the investors appetite to look for riskier assets.

Japan has delayed the proposed second sales tax hike (from 8% to 10%) as the first one had hit the economy pretty bad. BOJ is likely push more easy money (QE) into the market to ward off the threat of sales tax hike resulting in a weaker Yen.

China is likely see further slowdown despite the rate hike due to the seasonal maintenance period for northern Chinese industries (lower temperatures) which could hit the overall production in the country albeit marginal because of the less no. of industries situated in that region.

On the flipside, further measures, if any, announced by the Chinese government will likely to boost the credit growth and in turn be supportive for crude oil prices.
Crude Oil Market Dynamics
Manufacturing activity in US remains the strongest although it dipped slightly during December amidst strong revival in the economy with increase in consumer confidence and spending.

Chinese manufacturing activity, on the other hand, continue to slip as deflationary scenario continues to prevail at factory gate due to inventory pileup and decline in domestic consumption.

EU and Japan have witnessed hindrances in the pickup despite full pledged measures from respective central banks as there was no credit growth was seen in EU while sales tax hike had hurt consumption in Japan.

Brazil and Russia are likely to have affected by the conscious slide in oil prices that led to devaluation in the respective currencies while India resumed strength post the new government took office.
Chinese demand remained strong despite slowdown mainly due to the increase in imports amidst stock piling activity by the Chinese traders at lower crude oil prices.

US demand, although slightly lower than the previous winter where severe cold weather lead to record high consumptions numbers, remained strong during the past few months led by the increase in gasoline demand due to lower prices.

Demand in Europe expected to remain sluggish as the recovery in economy is still in struggling mode despite the stimulus measures.
US Demand Remains Strong

- Consumption in United States expected to witness moderate gain supported by the economic growth and industrial activity.
- However, lesser cold temperatures compared to last year likely to keep demand growth in check.
- US crude oil imports are expected to witness steady decline due to growing shale oil production despite the lowering of prices by OPEC nations.
Demand from China remained steady despite concerns of slowdown in industrial sector.

Demand is expected to have remained strong in the final quarter of 2014 where it was observed that with the price decline China has imported more of crude oil for stockpiling.

Going ahead, Chinese stockpiling is expected to continue at an increased pace due to lower price levels which is expected to address some of the excess supply concerns in the market.
Non-OPEC supply was seen consciously increasing led by the shale boom in US. Non-OPEC supply likely to have rose to 56.24 Mbpd during the past quarter.

OPEC supply, meanwhile remained steady despite increasing call for a supply cut after the price decline. OPEC while refraining from a production cut has also indicated that they are likely to increase the production should they are to find a new export destination augmenting the price war.

US production continues to see rapid growth driven by shale production in a move to decrease their dependency on imports. The sharp price decline may, however, force small producers of shale oil to lose their competency and suspend production.
Shale Production continue to drive US supply

**Shale resources and oil production**

<table>
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<tr>
<th>Region</th>
<th>Jan-15</th>
<th>Feb-15</th>
<th>Jan-14</th>
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<tbody>
<tr>
<td>Bakken</td>
<td>1,282</td>
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<td>Eagle Ford</td>
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<tr>
<td>Utica</td>
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<tr>
<td>Total</td>
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<td>5,516</td>
<td>4,094</td>
</tr>
</tbody>
</table>

(All units are in thousand barrels per day)

- US crude oil production expected to have averaged 8.54 MBpd by the end of 2014 compared to 7.47 MBpd during 2013.
- Higher output through shale production expected to continue in 2015 eating into the OPEC market share.
Crude inventories in US have increased higher, amidst strong production growth, than the five year average levels during the past year.

During OND, inventories have rose further as the winter demand remained muted as the temperatures have remained better than the last winter which saw a higher consumption growth.

Mainly, inventories at Cushing have increased at a faster pace during OND that also added to the pressure on prices.

Going ahead, inventories are expected to witness decline as United States enters the peak winter demand season.
Stable output from both OPEC and non-OPEC producers shall keep markets flooded with crude oil supplies.

Global demand growth rate likely to remain sluggish due to the economic concerns in China and Japan while slower growth rate in EU is also expected to keep demand in the region muted.

Concisely, higher supplies in the market during next two quarters is likely to keep crude oil price gains limited.
Global Crude oil Production continued to surge as OPEC refrained from supply cut despite lower price. However, demand during OND remained fairly strong amidst stockpiling activity by China due to the lower prices.

Demand from US also remained strong amidst strong growth in industrial activity although seasonal winter demand failed to pick up as temperatures remained relatively higher after the snowstorm.

Escalating Price war is likely to lead to supply overhang in the market in going ahead as demand is likely to remain muted.

Going ahead, real demand from China is expected to slowdown as industrial activity continue to remain sluggish while holiday period is also likely to add to the decline in consumption.
Declining OI & Build up of Non Commercial longs

- Open interest has declined gradually with the price decline while Non commercial have increased their short positions during the past few months.

- Non commercial longs were seen picking up towards December however have failed to stabilize as the prices have fallen further with the build up of new shorts.

- Going ahead, as the prices consolidate the non commercial shorts are expected to decline before ultimately longs increase.

- Overall, Non commercials remain net long while money managers have turned net short in the market during December.
Technical Analysis
Brent Crude Oil Prices likely to hold the support of USD 45/44 and trade higher towards USD 56 initially and then after some decline likely to continue towards USD 64 in the coming 2-3 months.
WTI Crude Oil prices are likely to hold the support of USD 44-42 and then trade higher towards USD 59 in the coming 2-3 months.
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<table>
<thead>
<tr>
<th>Commodity</th>
<th>Last Closing (USD/bbl) (on Jan 12, 2015)</th>
<th>Price range</th>
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<tr>
<td></td>
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<td>Jan 2015</td>
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<tr>
<td>WTI Crude Oil</td>
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<tr>
<td>Brent Crude Oil</td>
<td>USD 47.43</td>
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Thanking you for your attention.

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