



Glut in global oil markets to persist for longer

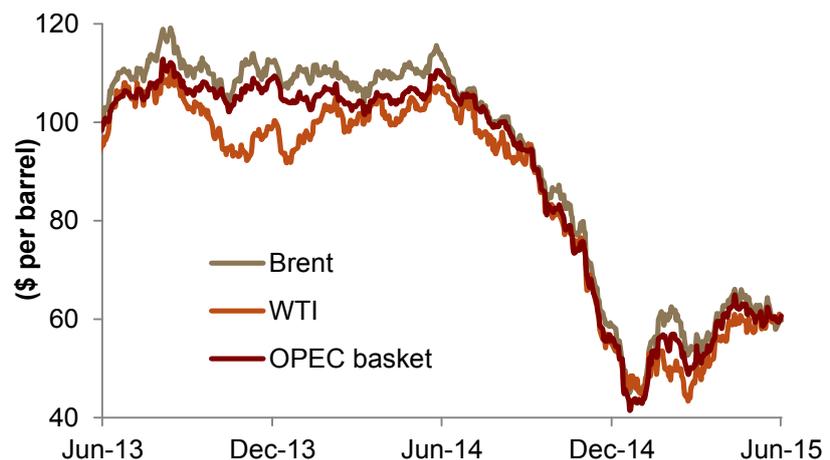
Summary

- Brent prices were up 13 percent, quarter-on-quarter, in Q2 2015, to \$61 per barrel. A general improvement in oil demand and slowdown in the rate of growth in US shale oil output combined to push prices up.
- Saudi crude consumption will reach 3 mbpd in Q3 2015, as domestic demand peaks due to the summer months. In the last three years, quarter-on-quarter growth in Q3 has averaged 250 thousand barrels per day (tbpd), and we expect to see a similar quarterly rise in total crude consumption this year as well.
- US oil production is estimated to have fallen by 4 percent, in Q2 2015, year-on-year, as lower WTI prices started to impact shale oil producers. Increases from OPEC and non-OPEC sources, however, will ensure that global oil balances remain in surplus throughout 2015. As a result we see full year Brent crude oil averaging \$61 per barrel.

Oil Demand

Non-OECD oil demand growth continues to be the main component of global oil demand growth. According to OPEC data, around 95 percent of the total Q2 2015 year-on-year global demand growth, of 1.2 million barrels per day (mbpd), was supported by non-OECD countries. Negative oil demand growth persists in the EU and Japan, which has partially cancelled out healthy year-on-year rises from the US. Flat demand growth in OECD countries is expected to continue into the third quarter of 2015 and the rest of the year. Non-OECD

Figure 1: Brent, WTI and OPEC basket prices



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demand is forecast to grow by 1.1 mbpd in 2015, year-on-year, with the largest rises coming from China (up 3 percent, year-on-year), India (up 2.9 percent, year-on-year) and the Middle East (up 2.7 percent, year-on-year).

In the **US**, lower gasoline prices and a pickup in economic activity is spurring oil demand. As the US benchmark crude West Texas Intermediate (WTI) has fallen, year-on-year, so too have US retail gasoline prices, leading to increased consumption (Figure 2). Rising US oil demand will not, however, support international oil prices, primarily because ample supply of crude and record commercial crude stocks will limit crude imports (Figure 3).

Oil demand was flat in **Europe** in Q2 2015, year-on-year, and is likely to show only modest growth in Q3 2015. The region's long term oil demand trend has been downward due to continuing improvements in fuel economy standards and weak economic growth. Oil demand is expected to decline in 2015, year-on-year. Furthermore, the inability of Greece to reach an agreement with its creditors could negatively impact the European economy, which would add downside risks to the region's current oil demand growth forecasts.

Preliminary Q2 2015 data shows that crude oil imports in **Japan** were down by 260 tbd or 7.4 percent, year-on-year, as result of continued fragility in the economy and the increased use of Liquefied Natural Gas (LNG) in the energy mix. In May 2015, Japan's Nuclear Regulation Authority (NRA) stated that two reactors had passed their final safety tests before being restarted. The NRA has scheduled one restart in late July 2015, and another in September 2015. We expect to see a sharper fall in year-on-year Japanese oil demand in Q3 2015 and Q4 2014, as nuclear energy substitutes some crude oil in electricity generation.

Chinese oil demand grew by an estimated 3.6 percent in Q2 2015, year-on-year. We see this rise due to opportunistic buying by China in an efforts to boost commercial crude stocks. Chinese oil imports rose steeply in Q4 2014, at the time when oil prices were at their lowest, and have averaged 6.3 mbpd in the last three quarters (Figure 4). It has been a long-term energy strategy of the Chinese

Figure 2: US gasoline sales and WTI price

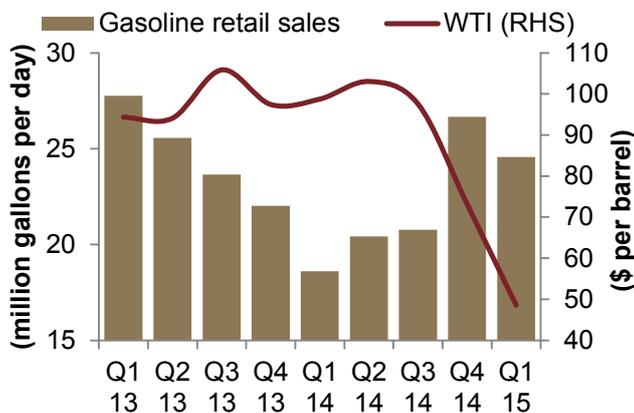
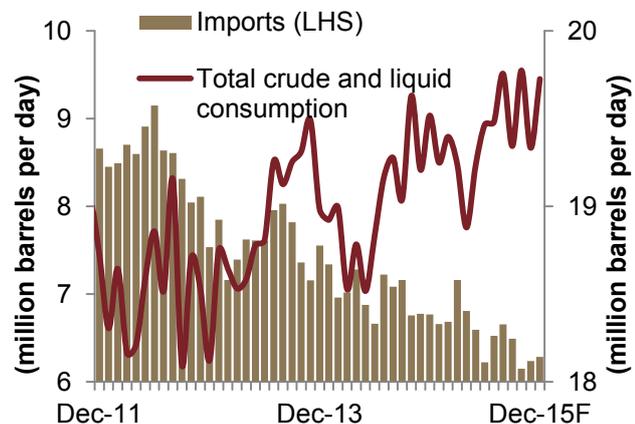


Figure 3: US liquid consumption and imports





Chinese oil demand will be positive in Q3 and Q4 2015, as the country continues to build up stock levels.

The drop in oil prices has acted as an economic windfall for India and resulted in oil demand growing by 3 percent in Q2 2015.

Saudi refinery intake increased by 12 percent (or 235 tbd), year-on-year, in Q2 2015, as the Yasref refinery reached full capacity.

Saudi crude consumption will reach 3 mbpd in Q3 2015.

Non-OPEC supplies grew by 1.2 mbpd in Q2 2015, year-on-year.

government to buy crude for stocks at times when prices are low. China currently has around 31 days' worth of crude imports in stock, but has targeted around 100 days by 2020. Despite the economy facing some economic headwinds, the prevalence of lower oil prices in the short to medium term will ensure that Chinese oil demand remains positive in Q3 and Q4 2015, as the country continues to build up stock levels.

The drop in oil prices has acted as an economic windfall for **India** and resulted in oil demand growing by 3 percent in Q2 2015, year-on-year. The IMF recently upgraded forecasted Indian GDP growth to 7.5 percent, making it as the fastest growing economy in 2015. In Q3 & Q4 2015 we see continued strong economic performance driving oil demand growth. Plans to build up strategic crude stocks will also add to oil demand, and with imports constituting 80 percent of total crude oil demand, India is well-placed to become the third largest importer of crude oil, at near 4 mbpd, by the end of 2015.

We estimate **Saudi** refinery intake increased by 12 percent (or 235 tbd), year-on-year, in Q2 2015, as the 400 tbd Yasref refinery reached full capacity. The refinery, a joint venture between Saudi Aramco and China Petrochemical Corporation (Sinopec), will contribute to total Saudi crude consumption reaching 3 mbpd in Q3 2015, as demand peaks due to the summer months. In the last three years, quarter-on-quarter growth in Q3 has averaged 250 tbd, and we expect to see a similar quarterly rise in total crude consumption this year as well (Figure 5). We have forecasted full year Saudi crude consumption to average 2.7 mbpd. Although we expect increases in gas output from the Hasbah and Arabiyah fields to replace some domestic crude consumption, there is a risk that delays in bringing these projects on-line will lead to upside risk in our full year crude consumption forecast.

Oil Supply

Oil output from non-OPEC grew by 1.2 mbpd in Q2 2015, year-on-year. According to OPEC data, the pace of growth in non-OPEC oil supply will begin to decline in Q3 2015, with output increases amounting to 0.7 mbpd, year-on-year. Annual growth in oil output will

Figure 4: Chinese crude oil imports

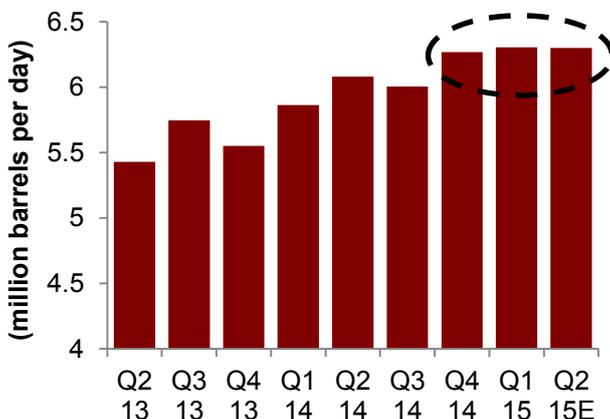
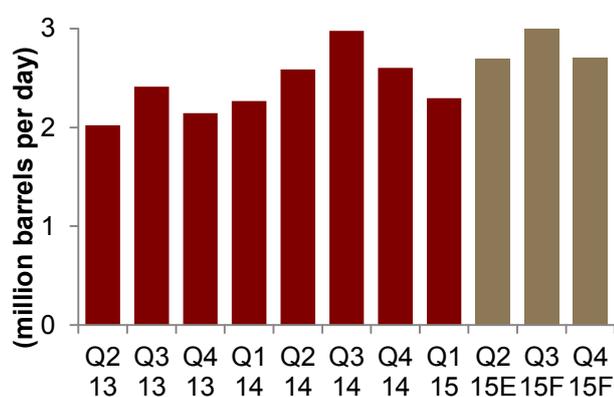


Figure 5: Saudi crude oil consumption





Total US oil production is estimated to have fallen by 4 percent, or 360 tbpd, in Q2 2015, year-on-year.

Full year crude production will be down 1.7 percent year-on-year, in 2015.

We expect Russian crude oil production to remain at elevated levels, year-on-year, in the second half of 2015.

OPEC members Saudi Arabia, Angola, Libya and UAE had large increases in Q2 2015, year-on-year.

Iraqi crude production is estimated to have increased by 4 percent, year-on-year, in Q2 2015, to 3.2 mbpd.

Libyan oil production rose by an estimated 100 percent, or 220 tbpd, year-on-year in Q2 2015.

become negative, dropping to -0.5 mbpd by Q4 2015. The decline in non-OPEC oil supply is likely to be compensated by year-on-year OPEC rises, primarily from Iraq, Saudi Arabia and Iran.

According to latest Energy Information Agency (EIA) data, total **US** oil production is estimated to have fallen by 4 percent, or 360 tbpd, in Q2 2015, year-on-year, as lower WTI prices started to impact shale oil producers. The EIA forecasts further falls in US output in Q3 2015, down 2 percent, year-on-year. The decline in production rates is due to a record low oil rig count, down 60 percent year-on-year, and a buildup of commercial crude stocks (Figure 6). Rising US gasoline demand in the second half of 2015 will aid some recovery in supply by Q4 2015 (Figure 7), although full year crude production will nevertheless be down 1.7 percent year-on-year, in 2015.

Tax changes implemented by the **Russian** government at the turn of the year resulted in a 5 percent increase in production in Q2 2015, year-on-year, due to increased exports. We expect Russian crude oil exports and production to remain at elevated levels, year-on-year, in the second half of 2015.

Total oil output from OPEC was estimated to be up by 3 percent in Q2 2015, year-on-year, as a result of large increases from **Saudi Arabia, Angola, Libya and UAE**. Iranian oil output was down, year-on-year. We see competition both amongst OPEC members and with non-OPEC producers for market share resulting in OPEC output levels showing stronger year-on-year growth in Q3 & Q4 2015.

Iraqi crude production is estimated to have increased by 4 percent, year-on-year, in Q2 2015, to 3.2 mbpd, with production rises helped along by the launch of a new crude grade for export, Basrah Heavy. We see Iraqi crude production averaging around current rates for the second half of 2015 but downside risks to targeted exports are numerous. This includes continued fighting in the northern part of the country, infrastructure constraints in the south, and a delicate political resolution between the central government and the Kurdish Regional Government (KRG) breaking down.

An improvement in the security situation in **Libya** resulted in oil production rising by an estimated 100 percent, or 220 tbpd, year-on-

Figure 6: US oil rig count and commercial crude stocks

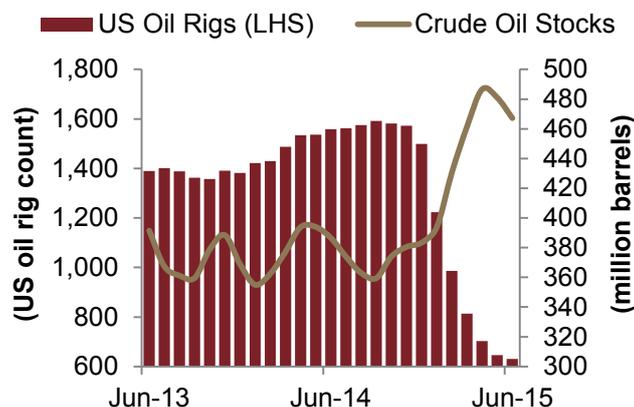
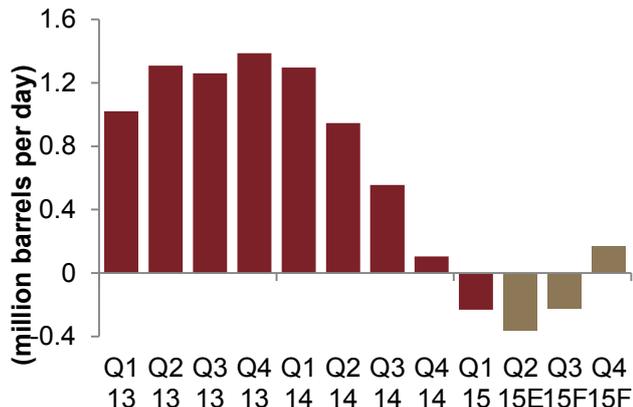


Figure 7: US crude oil production growth (year-on-year)





Iran's crude output decreased 3 percent year-on-year in Q2 2015 as sanctions continued to limit any growth in production and exports.

If nuclear talks are successful we do not see this resulting in Iranian crude flooding the market in the near-term.

Oil production from Angola increased by 10 percent, year-on-year, during Q2 2015...

...but there is limited upside potential since production is close to maximum capacity.

Preliminary data shows that Saudi Arabian crude production was up 6 percent in Q2 2015, year-on-year, at 10.3 mbpd.

Lower oil prices have put intense fiscal pressure on a number of OPEC and non-OPEC producers, although the risks for Saudi Arabia are lower...

...as a result Saudi Arabia, and other Gulf producers, will be extremely protective of market share for some time yet.

year in Q2 2015. We expect a slow uptick in oil output from Libya since much of the oil infrastructure is likely to face technical delays due to damage and neglect. Furthermore, a significant downside risk remains in production relapsing as fighting between various political factions is still ongoing. As such, we expect limited improvement in sustained Libyan production and exports for the remainder 2015.

Iran's crude output decreased 3 percent year-on-year in Q2 2015 as sanctions continued to limit any growth in production and exports, tying current output levels at 3 mbpd. Currently, the US and its allies (P5+1) are negotiating a framework agreement with Iran which was proposed in April 2015, and this should be concluded in the first week of July. If these talks are successful it will result in a number of financial and energy-related sanctions on Iran being lifted, but we do not see this resulting in Iranian crude flooding the market in the near-term. Firstly, a period of 6-12 months will be needed for Iran to fully comply with all the terms agreed upon in July 2015 and secondly, Iran needs higher oil prices itself, fiscal breakeven stood at \$127 per barrel in 2014, so the more prudent option would be to export oil gradually without depressing prices further. As a result we see Iranian crude production rising gradually by around 150 tbpd, year-on-year, by Q4 2015.

Oil production from **Angola** increased by 10 percent, year-on-year, during Q2 2015. Technical problems at some oil fields had seen lower output in the last few months, but these issues have been resolved. Around 65 percent of Angolan crude exports are shipped to Asia, of those 50 percent end up in China. Despite the glut in oil markets, Angolan crude has benefited from steady Chinese demand, but we see limited upside potential since production is close to maximum capacity.

Q2 2015 output for **UAE** is expected to be 7 percent higher, year-on-year. The UAE, much like Saudi Arabia, is expanding output following the latest OPEC meeting in June 2015. UAE's strategy is similar to other GCC and OPEC countries; to hold market share in an oversupplied global market.

Preliminary data shows that **Saudi Arabian** crude production was up 6 percent in Q2 2015, year-on-year, at 10.3 mbpd. This elevated level of production is due to increasing domestic demand and a desire to hold market share. Maintaining market share is even more of a priority now for Saudi Arabia than when prices began to fall in the second half 2014. Global oil markets are more competitive and the Kingdom faces competition from both within OPEC and outside it. A potential agreement with Iran and the P5+1 paves the way for gradual increases in output in H2 2015. Iraq is also pumping near record exports. Added to this is the increase in competition from Russia, where exports are up year-on-year. Lower oil prices have put intense fiscal pressure on a number of OPEC and non-OPEC producers, although the risks for Saudi Arabia are lower, due to ample foreign reserves and low debt levels. As a result we see limited year-on-year change in Saudi crude exports, which will remain around 7 mbpd in 2015. This combined with rising domestic consumption will see full Saudi production at 9.8 mbpd in 2015, although we do see an upside risk to our forecast, as a result of more intensive competition for market share. We do not view the recent high level meetings between Saudi Arabia and Russia paving the way for any coordinated cut in oil supply from either country.



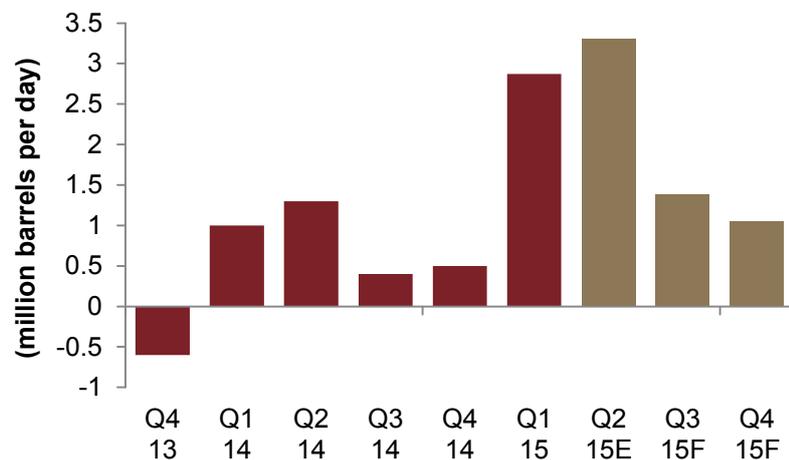
Global oil balances and prices

Brent prices were up 13 percent, quarter-on-quarter, in Q2 2015, to \$61 per barrel.

Global oil balances will remain in surplus throughout 2015.

Brent prices were up 13 percent, quarter-on-quarter, in Q2 2015, to \$61 per barrel. A general improvement in demand and slowdown in the rate of growth in US shale oil output combined to push prices up. Previously, we expected a pick up in global oil demand in H2 2015 to move global oil balances into a deficit by Q4 2015. Although we still expect a pick-up in global economic activity, year-on-year increases from OPEC and non-OPEC sources, such as Russia, will result in global oil balances remaining in surplus throughout 2015 (Figure 8). Furthermore, since commercial crude stocks are still relatively high, even an increase in forecasted global oil demand or a reduction in supply would not immediately put upward pressure on oil prices. As a result we maintain our full year Brent crude oil forecast to \$61 per barrel.

Figure 8: Global oil balances





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