Crude oil: Growing pains

Rising US oil supplies and the liquidation of speculative longs is likely to keep oil prices under pressure

Source: Shutterstock

Crude oil market update

ICE Brent has slipped as much as 11% from its recent high, with bearish data from the EIA weighing on the market. The oil market has also been unable to escape the increased volatility in broader financial markets.

	2018				2019				2020			
	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
ICE Brent (US$/bbl)	65	60	57	57	50	52	55	55	50	55	60	55
NYMEX WTI (US$/bbl)	61	58	55	55	49	51	54	54	49	54	59	54
Henry Hub (US$/MMBtu)	3.0	2.6	2.8	2.8	2.8	2.9	2.7	2.9	2.9	3.1	3.0	3.0
TTF (€/Mwh)	18	15	15	15	16	17	17	19	18	19	20	20

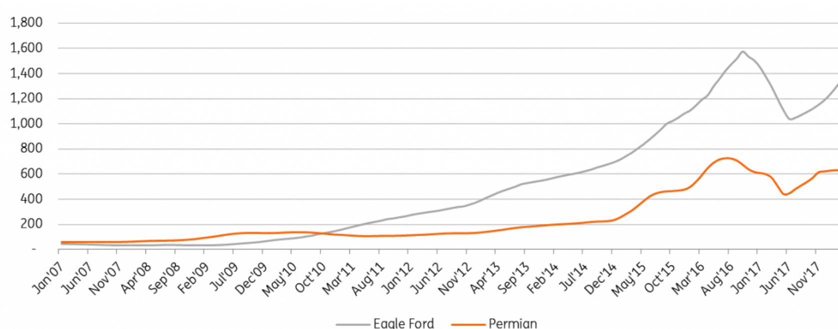
Source: ING

Drilling activity in the US continues to pick-up. The latest data from Baker Hughes shows that the number of active rigs increased by 26 over the last reporting week, to total 791, levels not seen since April 2015. With NYMEX WTI having averaged almost US$58/bbl since the start of 4Q17, it is hardly surprising to see this pick-up in activity.

Furthermore, the EIA continues to increase its production estimates for 2018 and 2019. In its last Short Term Energy Outlook, the EIA raised its 2018 US production estimate from 10.3MMbbls/d to 10.6MMbbls/d, while its 2019 forecast was increased from 10.8MMbbls/d to 11.2MMbbls/d. Adding to this, producers appear to be more efficient than they were mid last year. In Eagle Ford and the Permian region, there has been a recovery in production per rig, and the EIA expects this trend to continue at least through to March, as highlighted in the latest Drilling Productivity Report.

Weekly EIA data has also been bearish, with US crude oil inventories increasing by 10.5MMbbls over the last 3 weeks, driven by domestic production, which is up 393Mbbls/d over the same time period. US crude oil production over the last week stood at a record 10.27MMbbls/d. Meanwhile, there have been significant builds in gasoline and distillate fuel oil inventories, which has weighed somewhat on cracks.

Crude oil production per rig (bbls/d)

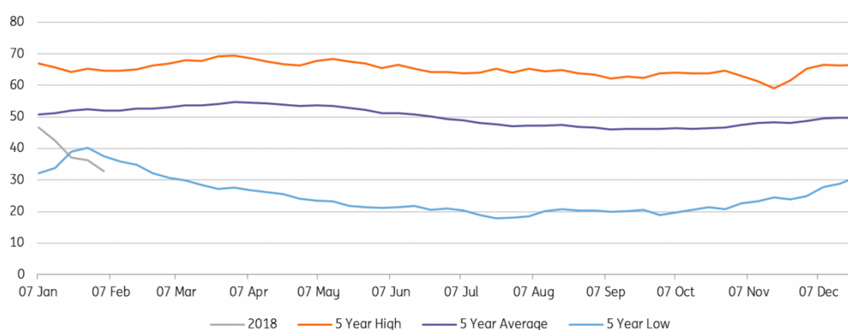


Source: EIA

While US data is pointing towards growing US production and stock builds, the one place where things are looking tighter is Cushing, Oklahoma. Crude oil inventories at the WTI delivery hub have only gone in one direction since November, and that is down. Cushing inventories stand at 32.67MMbbls, down from a little under 65MMbbls in early November. This has left stocks in the hub below the five year average for this time of year. The drawdown in inventory has been supportive for WTI, with the Brent-WTI spread narrowing from almost US$7/bbl at the end of December to around US$3.20/bbl currently.

The recent relative strength in WTI however, does bring the risk of further stock builds in the US. A narrowing in the spread, should reduce the incentive for US exports. In fact, exports have trended lower from the record levels seen over the last quarter of 2017. In late October, US crude oil exports hit a high of 2.13MMbbls/d, and averaged 1.47MMbbls/d over the whole of 4Q17, so far this quarter they have averaged 1.36MMbbls/d. As a result, we believe that further weakness in the spread is limited.

Cushing crude oil inventories (MMbbls)



Source: EIA, ING Research

OPEC compliance reached a high of 137% in January, with Venezuelan output continuing to edge lower. However the strength of the OPEC deal will be tested as we move into 2H18, with the startup of the Kaombo oil field in Angola and the Engina field in Nigeria. These two fields will have a combined capacity of 430Mbbls/d, equal to around a third of the total OPEC cut deal. Then there is also a question mark around how dedicated Iraq is to the deal, their compliance has been poor, standing at an average of around 57%, and in January the country exported a record 3.55MMbbls/d from Basra.

The idea that the global oil market will be largely balanced over 2018 assumes that OPEC production will be largely unchanged YoY, however plans for increased output from a handful of OPEC members suggests that the market could slip deeper into surplus over the year.

Refined products market update

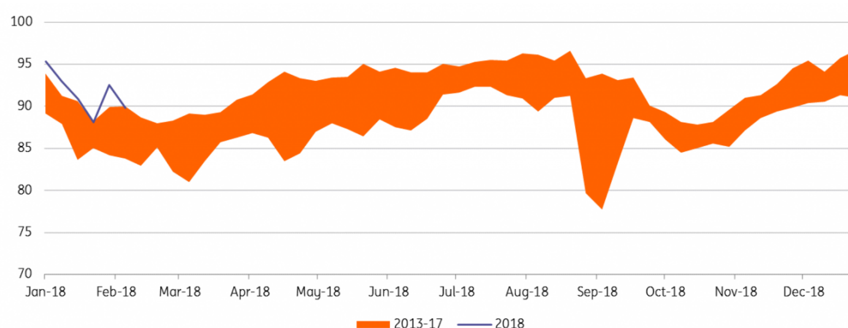
US refinery cracks have been under pressure recently, with growing product inventories. While across the Atlantic, lower inflows into Europe from the Middle East, and larger outflows to West Africa could offer some respite to the weakness in margins recently.

The previous week's EIA report surprised the market with an increase in refinery utilisation rates, having increased from 88.1% to 92.5% WoW. This increase suggested an early end to refinery maintenance, however, the data point was nothing more than a red herring. The latest data from the EIA showed an easing in utilisation rates, with them falling back to 89.1%, much more aligned with the seasonal average.

However, refined product inventories have seen quite the build since the start of the year, with gasoline, distillate fuel oil and jet/kerosene inventories increasing by a combined 21.19MMbbls. The bulk of this build has been in gasoline, with stocks increasing by 15.89MMbbls.

As a result, it is not too surprising that cracks in the US have been under pressure for much of the year, with the 321 crack falling from around US$19/bbl at the end of last year to below US$14/bbl currently. As refineries in the US move closer towards the end of maintenance, we would expect to see further pressure on the cracks, particularly in the absence of stronger refined product exports. Although at the moment, refined product exports remain near the five-year seasonal high.

US refinery utilization rate (%)



Source: EIA, Bloomberg, ING Research

Nigerian woes to offer some support to Europe

Nigeria is witnessing long queues at gasoline stations, as the West African nation faces acute gasoline shortages. To fill the supply gap, the Nigerian National Petroleum Corporation plans to import 100m litres per day (c.2mt per month) of gasoline over the next few weeks. With Europe a key supplier to the African nation, the European gasoline market may tighten somewhat, with increased flows to the country. According to shipping data, 2.17mt of refined products was shipped to West Africa over January, the highest amount since at least May 2017. Given the issues in Nigeria, along with a seasonal pickup in regional demand, expect stronger flows to West Africa in the coming months. Already gasoline cracks in Europe have strengthened from an average of US$6.70/bbl in January to US$10.20/bbl so far this month.

Refinery maintenance in the Middle East

A number of Middle East refineries, including Saudi Aramco's 400Mbbls/d Jubail refinery in Saudi Arabia are undergoing scheduled maintenance which will likely have an impact on product flows into Europe over February and March. January saw product flows from the region into Europe hit at least a 13-month high of 2.57mt. However, Bloomberg data shows that planned cargoes from the Middle East to Europe in February total 1.16mt (577kt delivered and 585kt en route) so far. However, helping to offset this is a slight pickup in Indian product flows to Europe. While it is also expected that diesel shipments from the US Gulf will increase, this shouldn't come as too much of a surprise given the inventory build we have seen over recent weeks.

The impact on gasoil cracks from lower flows from the Middle East is likely to be limited, given the comfortable level of inventory. The latest data from PJK International shows that stocks in the ARA region stand at almost 3.1mt, up more than 1mt since the end of 2017, and the highest gasoil stocks have been since May 2017.

Natural gas market update

Increasing temperatures and returning supply pushed NYMEX Henry Hub back down towards US$2.50/MMBtu; and we expect it to remain under pressure as the shoulder demand season approaches. In Europe, TTF traded flat at €18/MWh, though sufficient inventories mean the outlook remains bearish for now.

NYMEX Henry Hub saw a busy trading week with rising temperatures and returning production seeing money managers liquidate their longs. Aggregate open interest in NYMEX Henry Hub fell from 1.42m lots at the end of January to 1.37m lots currently. Meanwhile, the managed money net long fell 32,406 lots week-on-week to 186,974 lots as of 6 February. Given the pressure on prices, and the decline in open interest, Friday's data is likely to show a further decline in the speculative net long position.

However, the latest EIA data for the last week showed an inventory withdrawal of 194Bcf, 40Bcf higher than the five-year average. Looking ahead, NOAA forecasts warmer than usual weather for the Southern US, while other regions should see a return to more normal weather. This should see lower inventory withdrawals in the coming weeks.

Dutch gas output

The Dutch Mining Regulator has recommended that natural gas output at the Groningen gas field be cut by 44% to 12Bcm, following an earthquake in the region earlier in the year. This recommendation is nonbinding, and the government is still expected to come to a decision by the end of March. Output at the gas field has been gradually reduced over the years, and production for the current year is capped at 21.6Bcm, down from 24Bcm last year. The dilemma for the Dutch government is trying to find a balance between safety and security in supply. The Groningen field supplies nearly 5% of European gas and any sharp cut in output could mean a tighter gas market over the next winter.

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