



CRUDE OIL PRICES REBOUND ON HOPES OF HEALTHIER DEMAND

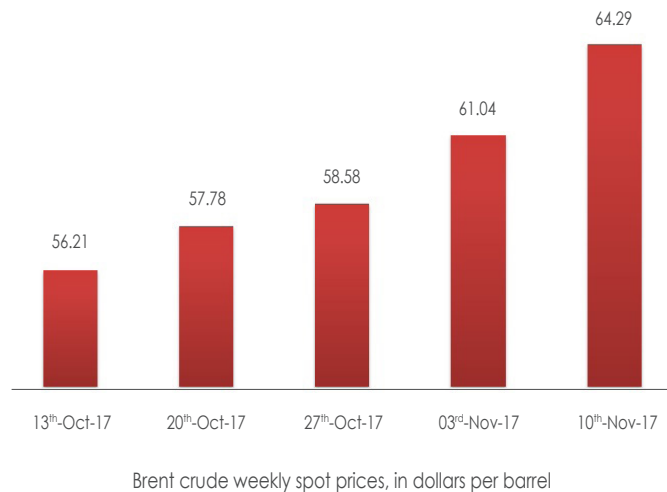
KEY TAKEAWAYS

The healthier global economic growth trends are expected to boost energy consumption, especially in Asia where early signs of a demand recovery are visible. If this trend continues, a large part of the still expanding supplies could be absorbed.

Crude oil prices have rebounded recently, reflecting the renewed optimism about healthier demand in the coming quarters. Brent crude prices, the international benchmark, have moved past \$60 per barrel for the first time in more than two years. The healthier global economic growth trends are expected to boost energy consumption, especially in Asia where early signs of a demand recovery are visible. If this trend continues, a large part of the still expanding supplies could be absorbed. In addition, members of the oil exporter's organization OPEC have so far maintained the production discipline announced last year. Though the continuing shift to alternate energy sources and the growing popularity of electric vehicles could dampen demand growth in the long run, the healthy global economy could support current crude oil prices.

The remarkable growth in U.S. shale oil production and tepid global energy demand were the two main reasons for the oil price collapse in 2014. After dipping to around \$35 per barrel in early 2016, the Brent crude oil benchmark started recovering on expectations that bulk of the shale oil production

Crude oil prices have rebounded recently



Data source: U.S. Energy Information Administration

was unviable at low prices. Nevertheless, the decline in shale oil output was not as precipitous, as producers used technology and efficient processes to drive down costs. Oil prices softened during the first half of this year as crude inventories remained high and demand recovery seemed elusive.

Doubts about energy demand have started easing more recently, as several Asian countries led by China are seeing stronger economic growth. This has led to upward revisions in energy demand forecasts for the short to medium term. The International Energy Agency (IEA) now expects demand to expand 1.6 million barrels per day this year, and 1.4 million barrels per day in 2018. If growth strengthens in the major economies, it is possible that demand growth in 2018 could exceed current estimates.

Global supplies are also increasing and could limit the upside to crude oil prices, unless there is a large enough disruption in one of the producing countries. The IEA estimates that global supplies will increase by 1.5 million barrels per day next year, more than the average increase for the current year. It is widely expected that OPEC will maintain its production limits at its meeting later this year. Crude oil inventories remain above long-term averages, though they are well below the record highs seen earlier this year. As well, output by U.S. shale oil producers is expected to increase from 9.2 million barrels per day this year to nearly 10 million barrels per day in 2018, according to the most recent forecasts by the U.S. government's Energy Information Administration (EIA).

Natural gas prices have also trended higher this year as more utilities now prefer the fuel over coal, for the relatively lower emissions. The EIA expects U.S. natural gas production to increase slightly this year, compared to last year. Production growth is anticipated to be higher in 2018, but the EIA forecasts higher prices as well on growing demand.

In the long run, conventional energy demand growth is expected to remain restricted as supplies from non-conventional sources continue to expand. Cost of production from non-conventional sources such as wind and solar continue to drop. As storage technology matures and becomes more affordable, these sources could turn more attractive. The pace of electrification in the automobile industry has picked up dramatically as most major automakers have announced ambitious plans. Some of them now expect electric cars to account for 25% or more of volume sales by the year 2025. If achieved, this could be a major structural change in conventional energy demand dynamics.

Though energy prices have trended higher, stocks of oil producers and service providers have lagged the broader markets this year. It is likely that investors want to see more capital investment discipline from the sector and return of a larger share of incremental cash flows to shareholders.

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