AFFINITY OIL WEEKLY REPORT

24 May 2017

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OIL MARKET COMMENT

There was yet another twist in the oil markets yesterday as news emerged that US President Donald Trump's budget proposal is set to include the sale of half of the country's strategic oil reserves. Following a two-week rise in oil prices during which Brent saw an 11.4 per cent increase, the price fell upon the news coming out of Washington.

Sentiment was strong in the lead up to Opec's 172nd meeting in Vienna on Thursday, in which it is expected that the production cut will be extended for up to nine months. However the setback is just another blow from the US, who have succeeded in deflating oil prices every time that Brent has threatened the USD 55 per bbl barrier.

The US holds the world's largest strategic petroleum reserves (SPR), half of which equates to around 344 Mn bbls. It is believed that the budget plan proposes to sell half of the emergency oil stockpile between 2018 and 2027, raising USD 16.6 Bn.

Whilst this is a large amount of oil to be released to the market, it averages around 94,000 bpd, which is less than one per cent of the global production.

The budget proposal requires approval from Congress, for which there is no guarantee, but this still clearly reinforces President Trump's agenda to increase American energy output. Whether the proposal is passed or not may be largely irrelevant in the bigger picture of US production activity. The US has already increased output by over 535,000 bpd so far this year and continues to bring an average of 10 rigs online each week. More than anything, this move could be a well-timed tactical ploy designed to take the wind out of Opec's sails so close to their meeting later this week.

Moving elsewhere, severe delays have been reported for several new oil refinery projects across Asia. This could ensure some support to crude producers, such as Saudi Arabia and Russia, looking to extend output cuts to next March to support higher prices.

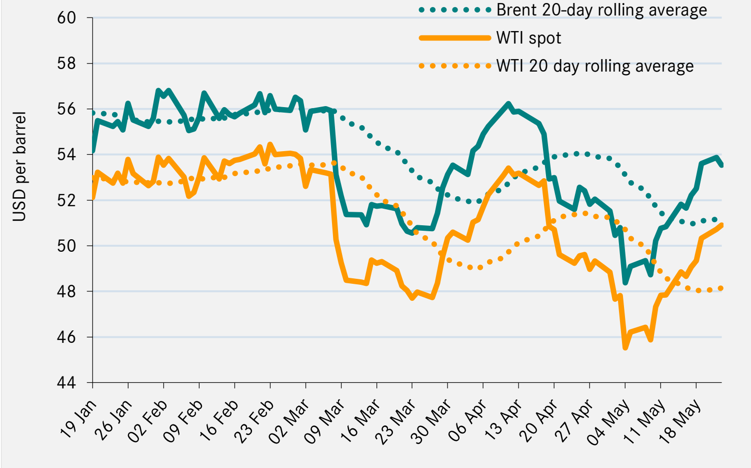
For the current year, we previously forecasted that the growth of Asian refining capacity would be the highest in the last three years. This would be another step taken to make the global oil market return to balance in parallel to the crude production cuts led by Russia and the Opec. But recent delays in Chinese and Vietnamese projects mean that the net refinery capacity addition in Asia could be up to 20 per cent lower than we earlier expected (360,000 bpd instead of up to 450,000 bpd). As a result, the potential extension of the producer-led supply cuts now look like the market's most important reason to hope for any improvement.

In parallel to the declining Asian demand growth and the potential extension of the producer cuts we have to highlight the increasing Asian imports of light crude from the US, which leads to higher competition among producers over local market shares.

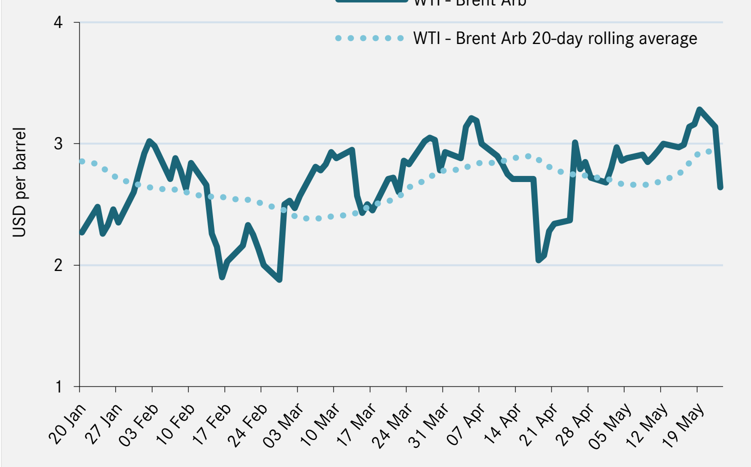
OIL PRICES (at 0930h BST on date of publication)

Brent (US Dollars) 54.54 WTI (US Dollars) 51.80

Front Month Prices



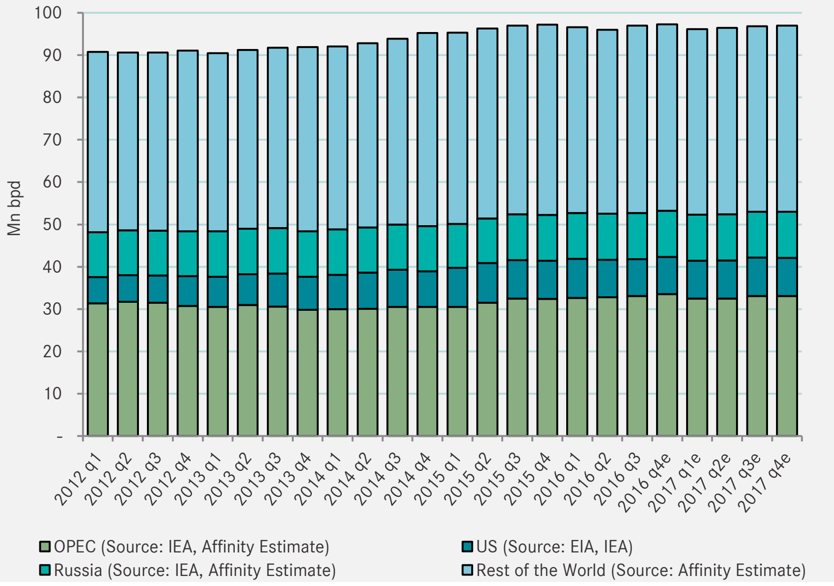
Atlantic Oil Arb



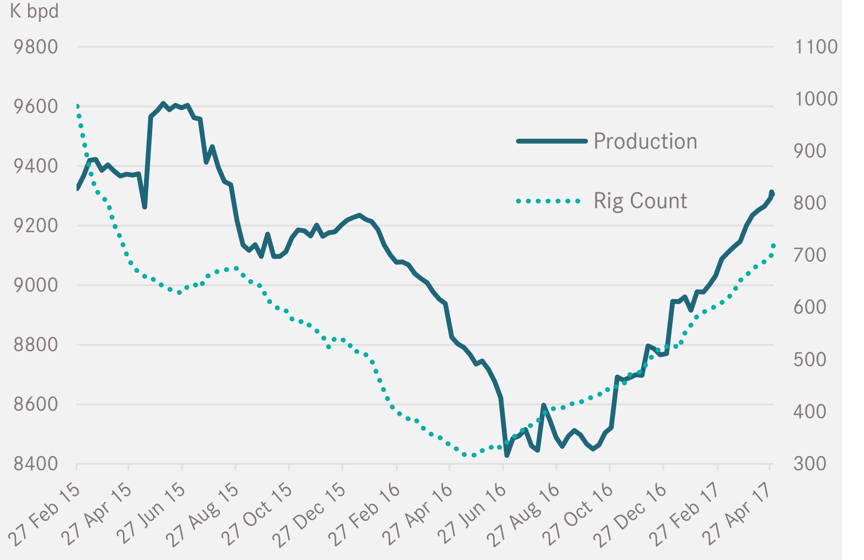
SUPPLY: GLOBAL VIEW FOR 2017

- For the first time in four years, the Chinese state-run oil giants have been raising combined spending. However, this is not expected to stop the decline of the country's crude output, as most companies now focus on producing more natural gas, according to the International Energy Agency. China's production fell during the first quarter of 2017, down by 6.8 per cent year-on-year. The record pace of declines suffered last year seems to be here to stay.
- Russian ESPO crude oil exports are expected to fall 17 per cent next month as oilfields commence maintenance periods. Reduced output will see an increase in ESPO blend premiums.
- US crude production decreased last week, ending a 12-week incline. The decrease was marginal, just 9,000 bpd below the previous week. This is despite a further eight rigs coming online - a total of 720 are now operational. US shale production is expected to increase a further 122,000 bpd next month.
- Data recently published by the American Petroleum Institute (API) suggest that the total US petroleum deliveries in April averaged 19.6 Mn bpd, the highest deliveries for April during the last nine years. April's gasoline deliveries (up 0.6 per cent from same month last year) reached nearly 9.3 Mn bpd, the highest April deliveries on record.
- BP has restarted production at its Quad 204 project in the North Sea. The oilfield has been decommissioned since 2013 prior to redevelopment work which will extend its life until 2035, potentially releasing a further 450 Mn bbls, and up to 130,000 bpd at peak production.
- Libya and Nigeria might be asked to cut production on Thursday as part of the Opec-led production cut extension. Both countries were exempt from the previous agreement following militant attacks which have severely compromised their production capacity. However, with both countries making strong recoveries and increasing their output, they could now be expected to contribute to the cartel's campaign to reduce global oil inventories and raise prices.

Global Oil Production



US Oil Rig Count v Production



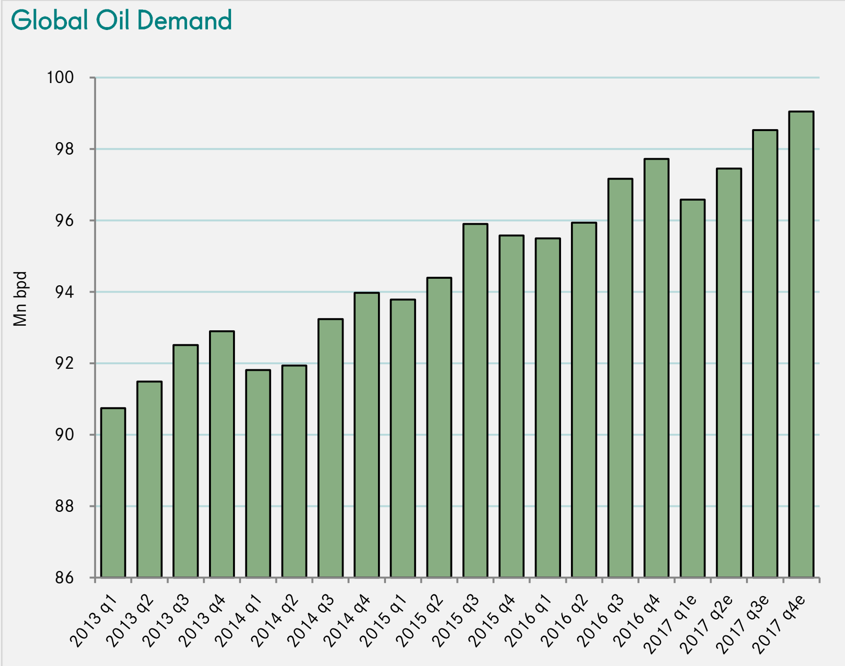
DEMAND: GLOBAL VIEW FOR 2017

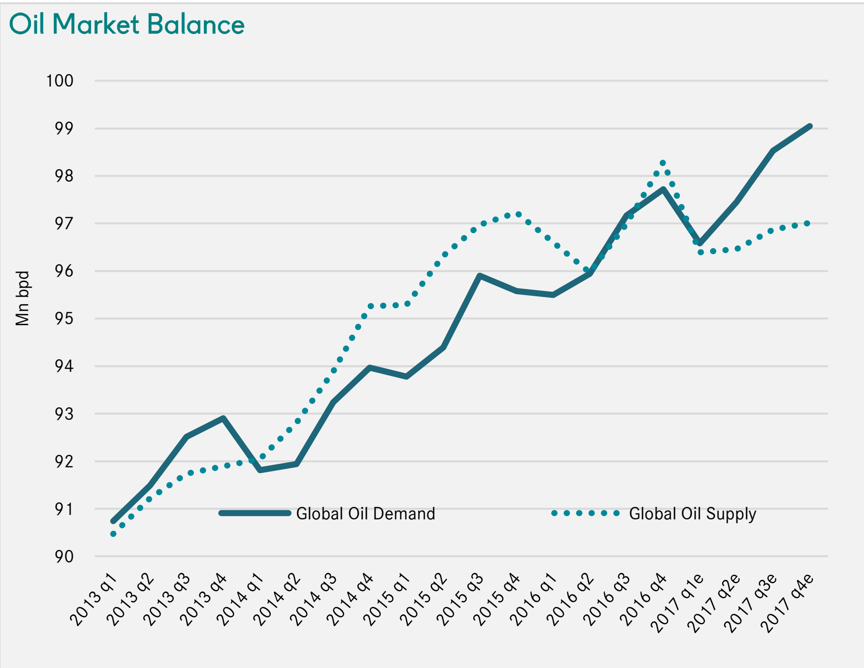
After meeting with Opec's Secretary General Mohammad Barkindo in Vienna, India's Petroleum Minister Dharmenda Pradhan commented that his country would like better deals with the cartel, to achieve a "responsible price" and a "seller-buyer alignment", raising the issue of "Asian Premium", still charged by some Opec members when supplying India. 86 per cent of India's crude oil imports come from the cartel, based on data published by Opec. India now targets to achieve an "Asian Discount", taking advantage of Opec's weakening position.

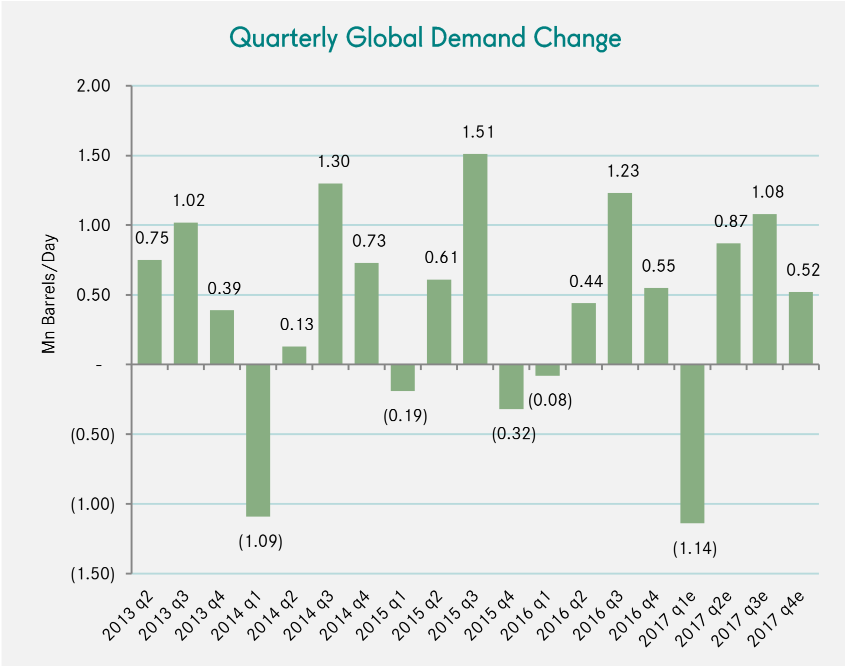
Last week, Vietnamese (state-owned) PetroVietnam announced the delay of commercial operations at its 200,000 bpd Nghi Son refinery till the end of the year. Kuwait Petroleum Corp and Japan's Idemitsu Kosan Co. Ltd have been participating in the project as well.

MARKET BALANCE

All indications point to widespread agreement between Opec and its allies to extend production cuts until March 2018. A nine-month extension is widely considered to be sufficient to balance the market, allowing for increased demand in Q3 and increasing production from various countries including the US and Brazil.







PROFILE: IRAQ

Iraq's dependency on oil has both bound the country together and threatened to tear it apart in recent years. As Opec's second largest producer, oil revenues underpin the fragile Iraqi economy – up to 99 per cent of government revenues are provided by the oil sector. Iraq has been amongst those countries most affected by weakened oil prices, coupled with relentless political unrest and warfare.

It therefore comes as no surprise that Iraq has struggled more than most to comply with Opec's production cut announced last November. Revenues are needed to continue paying for the fight against ISIS, but also for rebuilding its towns and cities both physically and metaphorically.

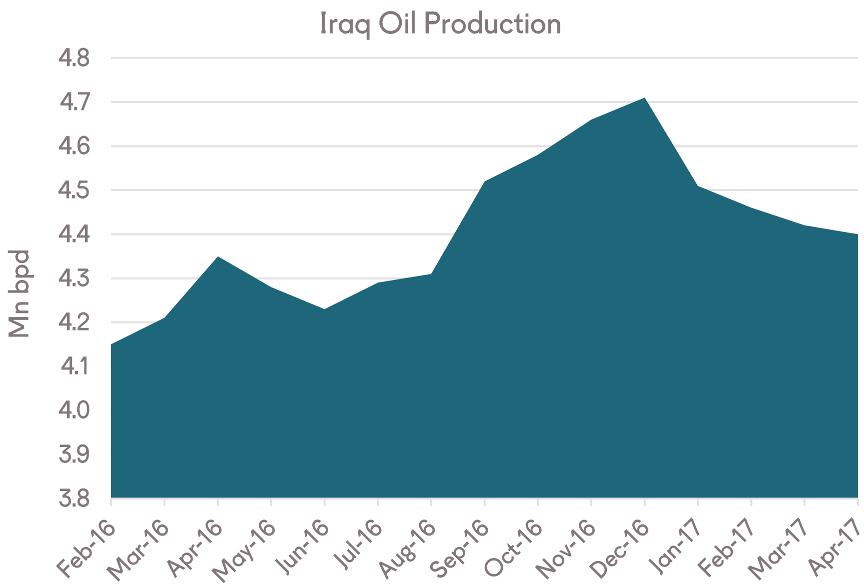
Under the November deal, Opec envisioned cutting 1.8 million barrels a day of production, with Iraq reluctantly agreeing to reduce output by 210,000 bpd to 4.35 Mn bpd. However, Iraq was the worst performing nation involved in the agreement, pumping about 80,000 bpd more than permitted in the first quarter. April saw compliance improve from 61 per cent to 90 per cent, showing positive intent ahead of a potential extension to the agreement this Thursday.

A proposed 6-to-9-month extension is rumoured ahead of Opec's meeting in Vienna and, if agreed, Iraqi compliance into 2018 would be very difficult to maintain given the struggles already shown this year. Plans to increase capacity at key southern fields and to generate more revenues to repay loans and debts following years of fighting will test the resolve of the government.

Despite these difficulties, it seems that Iraq support such an extension. Saudi oil minister Khalid al-Falih visited Iraq on Monday to discuss the extension. Following the meeting, al-Falih confirmed that Iraq are the latest country set to back the extension which will be officially proposed on Thursday.

Meanwhile, ahead of the proposed extension, India are reported to be weighing up their options for future energy supplies. India are Iraq's second largest importer, and traditionally have strong links with nearby Middle-Eastern Opec nations. Yet with increasingly competitive rates coming out of North America and further supply cuts expected from the Middle-East, India are ready to strike new deals at the cheapest rates.

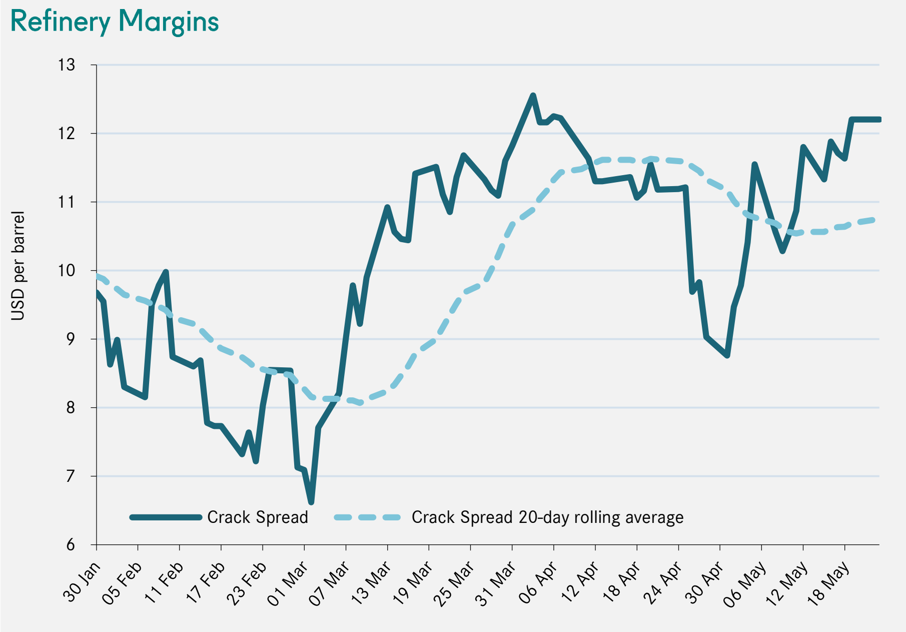
India is in a strong negotiating position with its own oil demand set to increase by 200,000 bpd to 4.5 Mn bpd this year. Iraq requires the income security from its traditional trading nations and will not be willing to risk its most valued relations as a result of cut extensions.



DOWNSTREAM:

REFINERY MARGINS

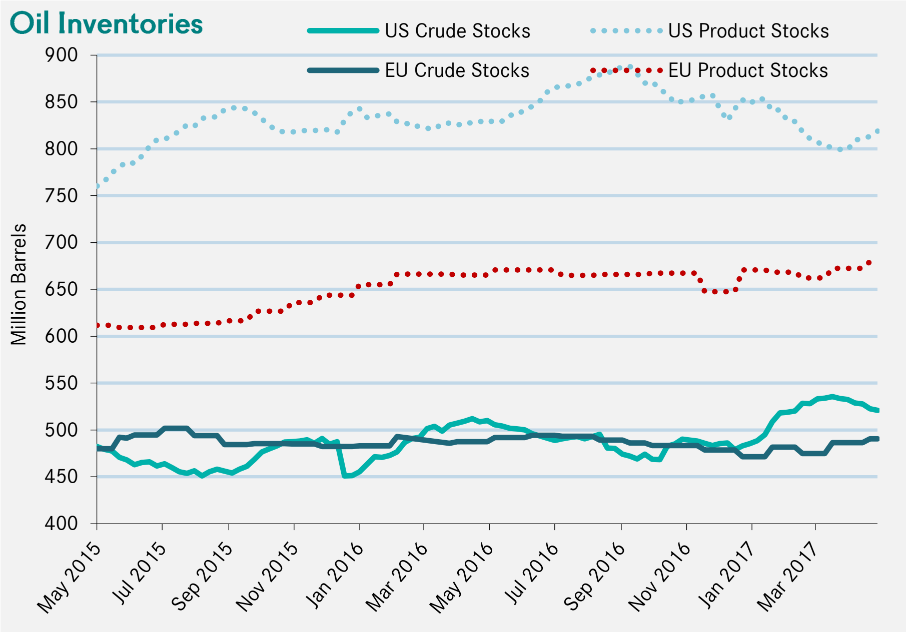
The US crack spread has risen again over the last week, edging ever closer to the highest point this year. The spread hit USD 12.55 per bbl in early April, and now sits at USD 12.20 per bbl following strong recent growth. The current spread is USD 1.41 per bbl above the 20-day rolling average, after a poor end to April for the refineries.



INVENTORIES

US crude stocks continued to fall, recording a sixth consecutive decrease. Stocks have now fallen almost 15 Mn bbls since stocks began to decline at the beginning of April. US product stocks rose again, having increased by over 6 Mn bbls on last week. Product stocks have now risen for four consecutive weeks.

	Mn bbl	Change	Change %
US Crude (Weekly)	520.77	-1.76	-0.3%
US Products (Weekly)	818.93	6.02	0.7%
EU Crude (Monthly)	490.34	3.94	0.8%
EU Products (Monthly)	679.66	7.06	1.0%



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