

Global commodity outlook

Bank of America
Merrill Lynch 

12 January 2016

Francisco Blanch
Commodity & Deriv Strategist
MLPF&S
francisco.blanch@baml.com
+1 646 855 6212

Max Denery
Commodity Strategist
MLPF&S
maxime.denery@baml.com
+1 646 855 5211

Sabine Schels
Commodity Strategist
MLI (UK)
sabine.schels@baml.com
+44 20 7995 7095

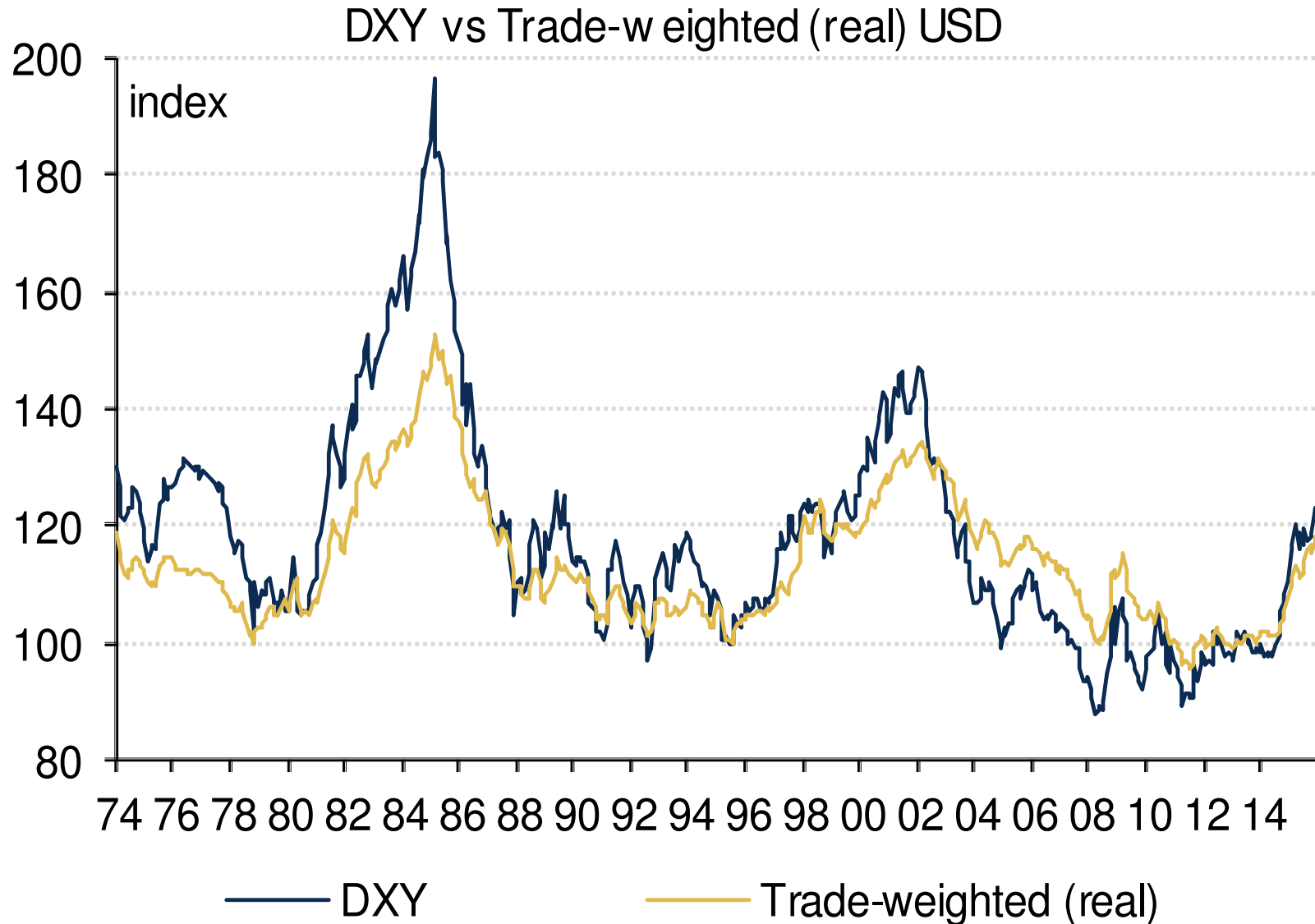
Peter Helles
Commodity Strategist
MLI (UK)
peter.helles@baml.com
+44 20 7996 8154

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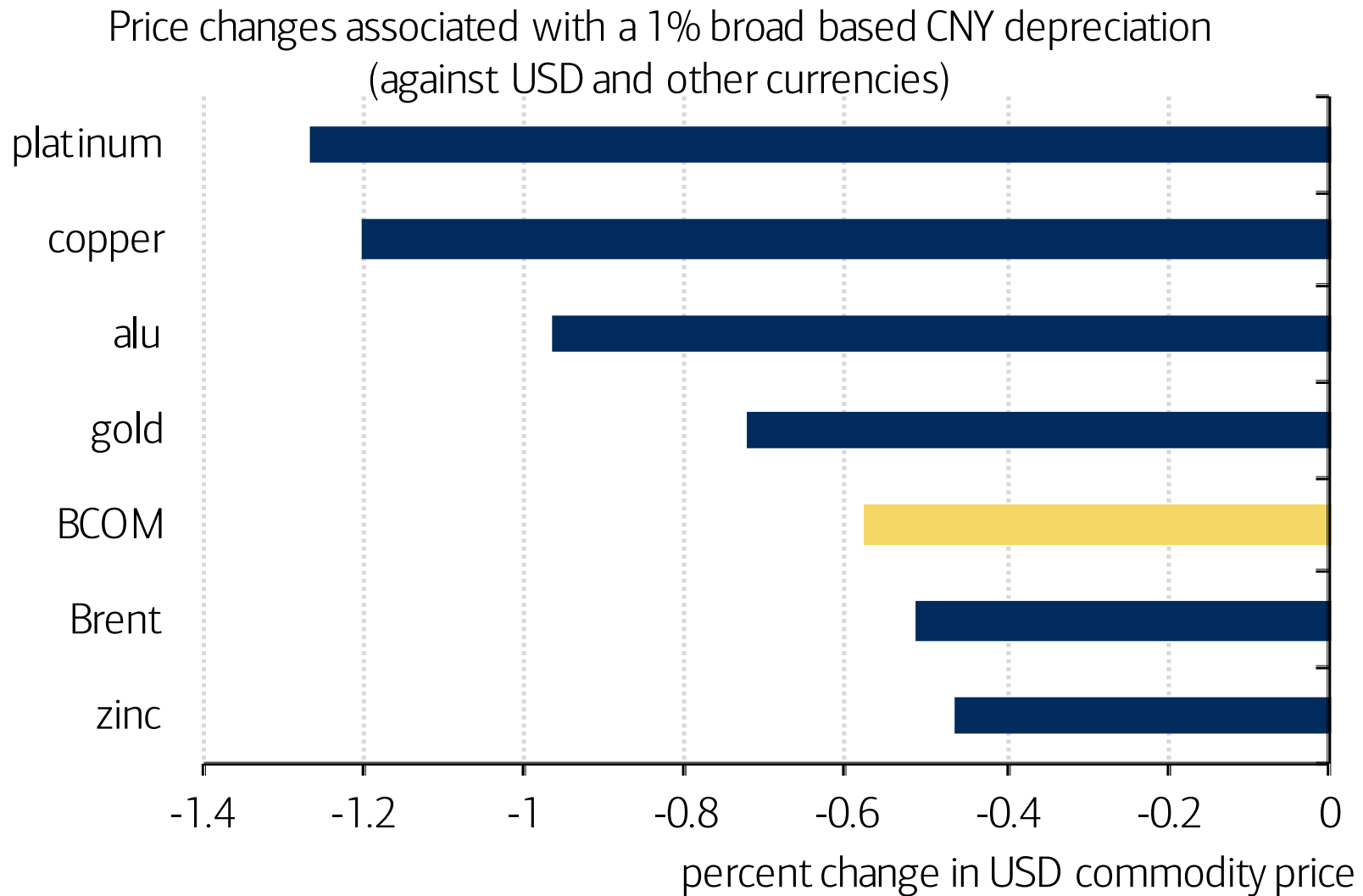
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- **Macro trends** (low growth, low inflation, USD strength) remain a headwind for all commodities
 - Brent and WTI crude oil prices face downside risks in 1Q16 on a strong USD, weak EMs, Iran barrels, and refinery maintenance, among others.
 - A price war within OPEC cartel members Saudi and Iran seems to be unfolding.
 - Assuming a neutral USD ahead, we see long-term crude in a \$60-80/bbl range.
 - **Micro dynamics** in the energy markets are improving:
 - Global **oil demand** is growing at the second strongest pace in more than a decade.
 - Non-OPEC **oil output** is set to drop in 2016. Why would Saudi want sub \$50 oil?
 - High inventory levels should prevent a price spike, but containment risk (\$20 oil) is growing.
 - US nat gas prices struggling on warm winter weather, but should push higher by 2H2016.
 - US natural **gas demand** is poised to jump on power, industrial demand + Mexico, LNG exports.
 - **Major themes:**
 - Heavy crude oil is feeling heavier
 - WTI over Brent as shale production continues to decline
 - Fuel up your gasoline tank for next summer, but diesel faces a slow death
 - It's already springtime for US nat gas
 - Coal is experiencing a full-blown currency war
 - Iron ore will continue to struggle
 - Copper prices need to force more supply cuts

The dollar (either trade weighted or the DXY) is still far off from previous cyclical highs



Source: Bloomberg, BofA Merrill Lynch Global Research

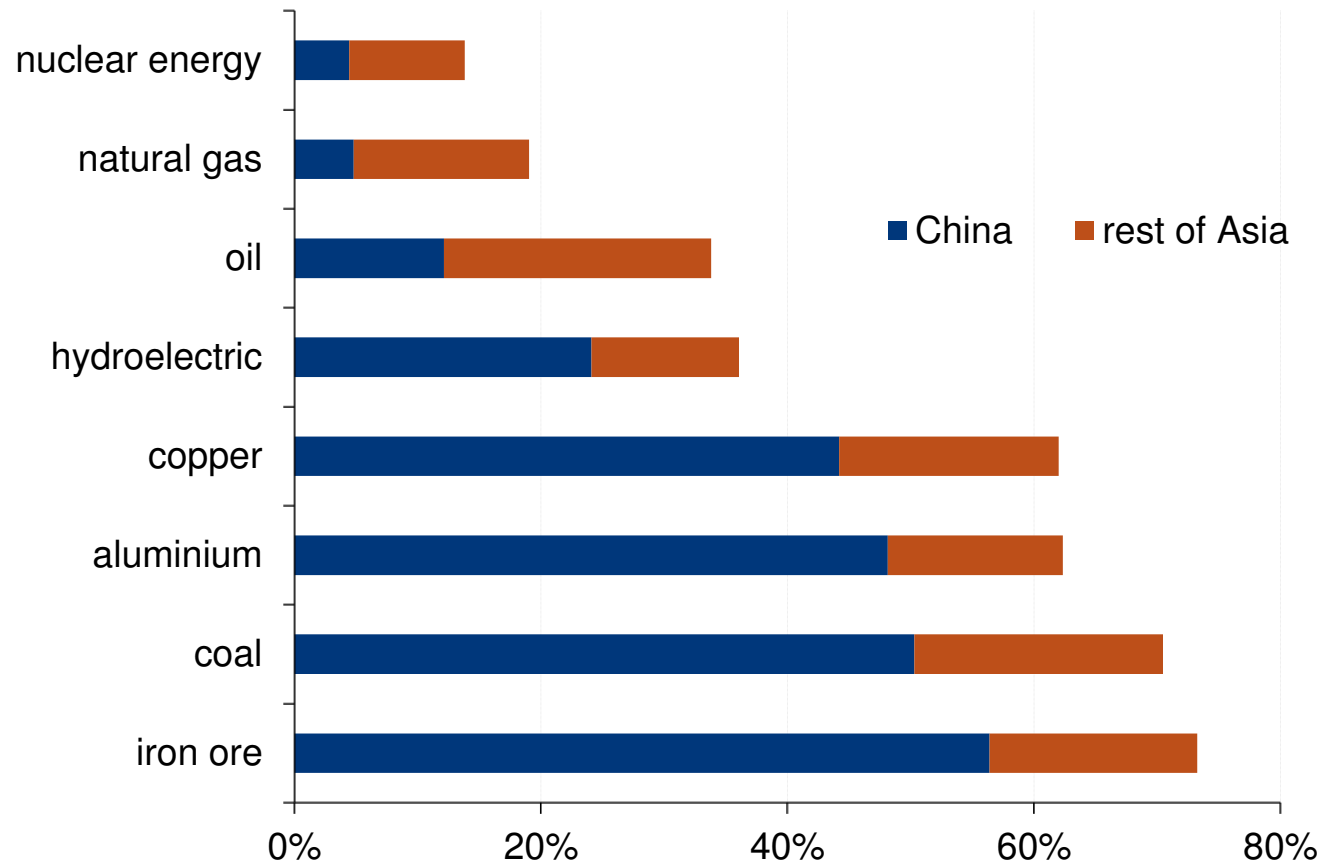
We estimate that a 1% depreciation in the CNY is associated with a 0.6% decline in commodity prices



Source: Bloomberg, BofA Merrill Lynch Global Research

China is now exporting deflation through the commodities channel

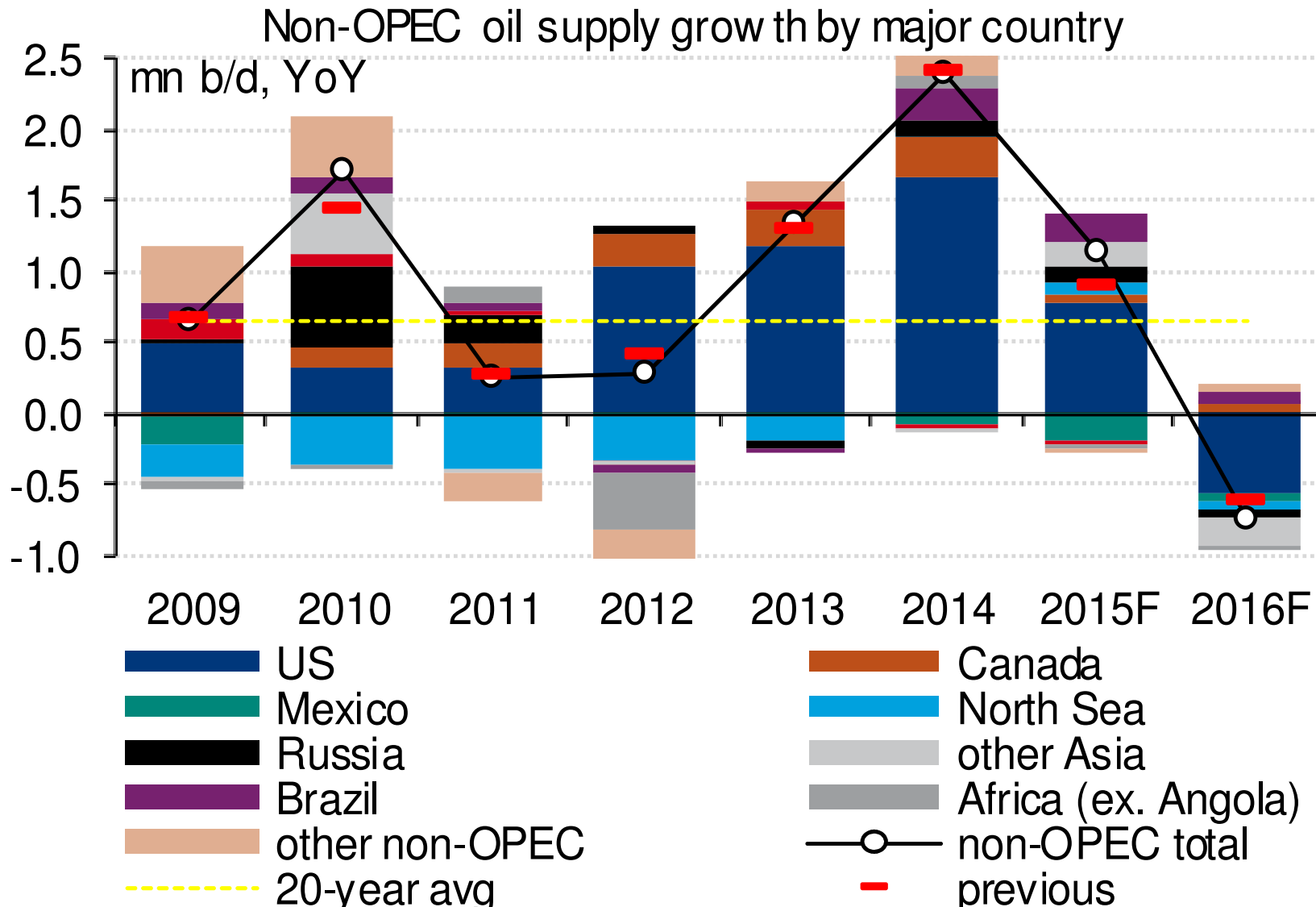
China's share of commodity consumption by type (2013)



Source: BP, BofA Merrill Lynch Global Commodities Research

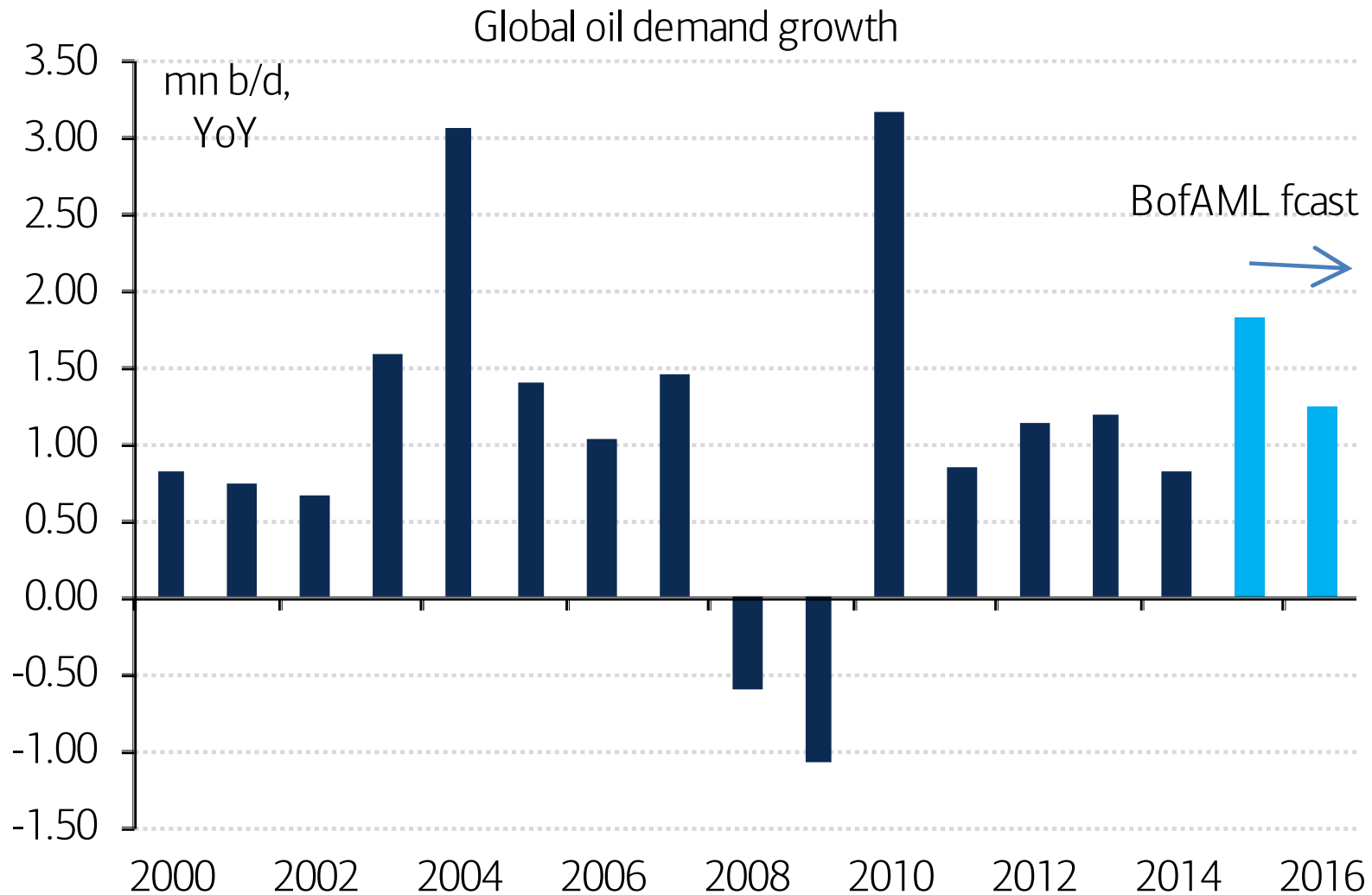
Energy outlook

Non-OPEC supply growth is set to slow down drastically in 2016



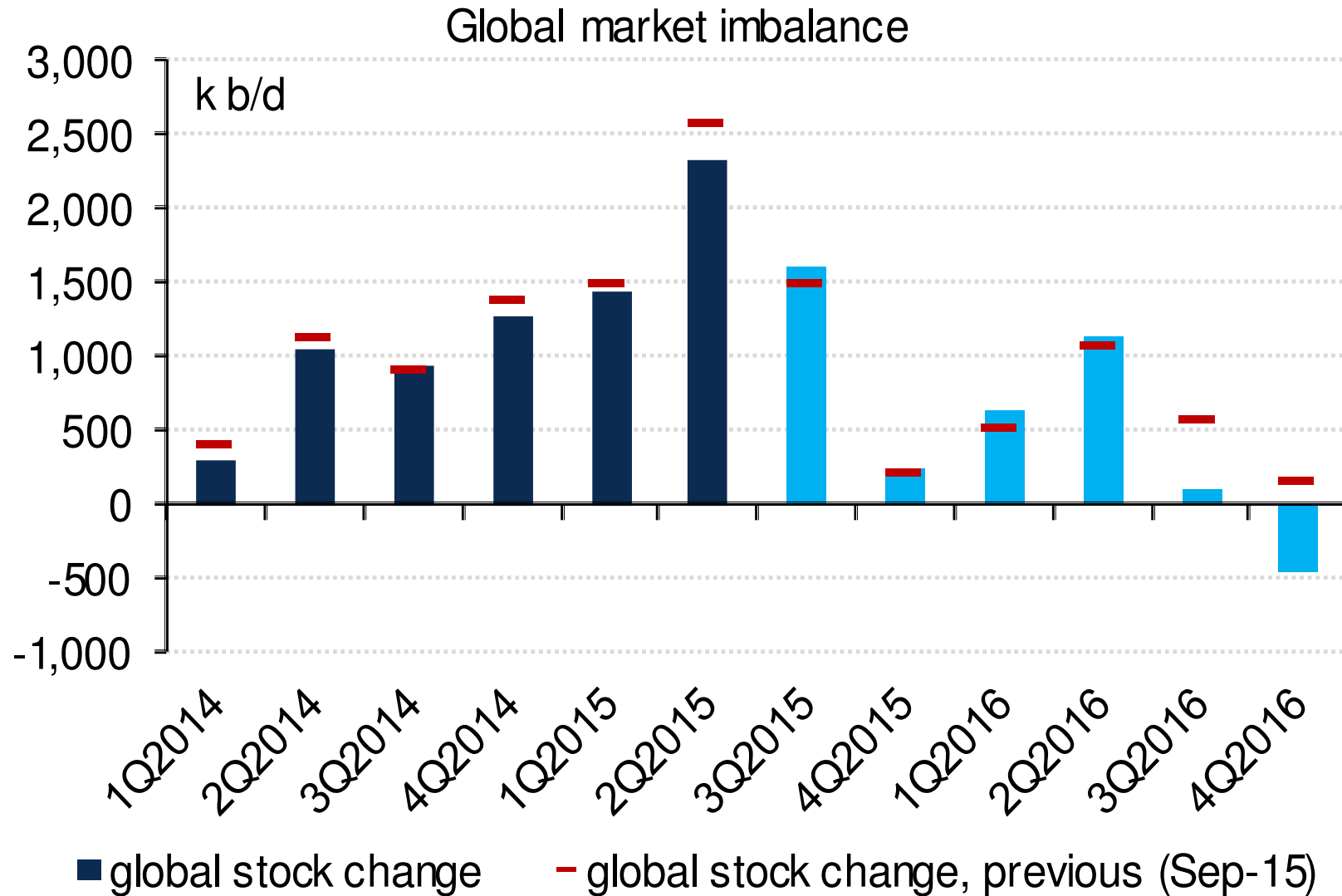
Source: IEA, BofA Merrill Lynch Global Commodities Research

Oil consumption growth in 2015 ran 1 mn b/d above the year prior, the 2nd strongest pace in more than a decade



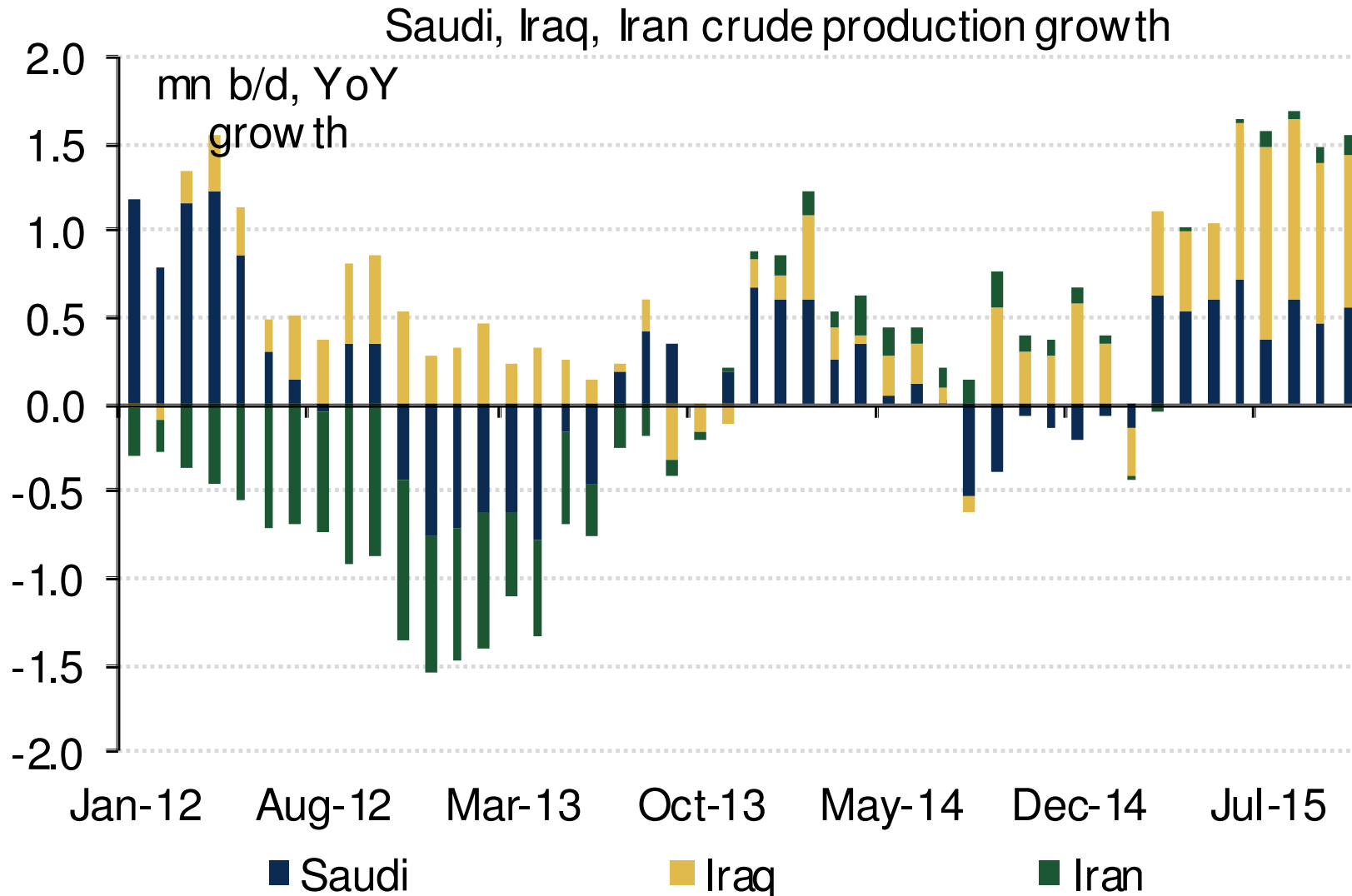
Source: IEA, BofA Merrill Lynch Global Commodities Research

The massive global market imbalance of the last 24 months is now largely behind us...



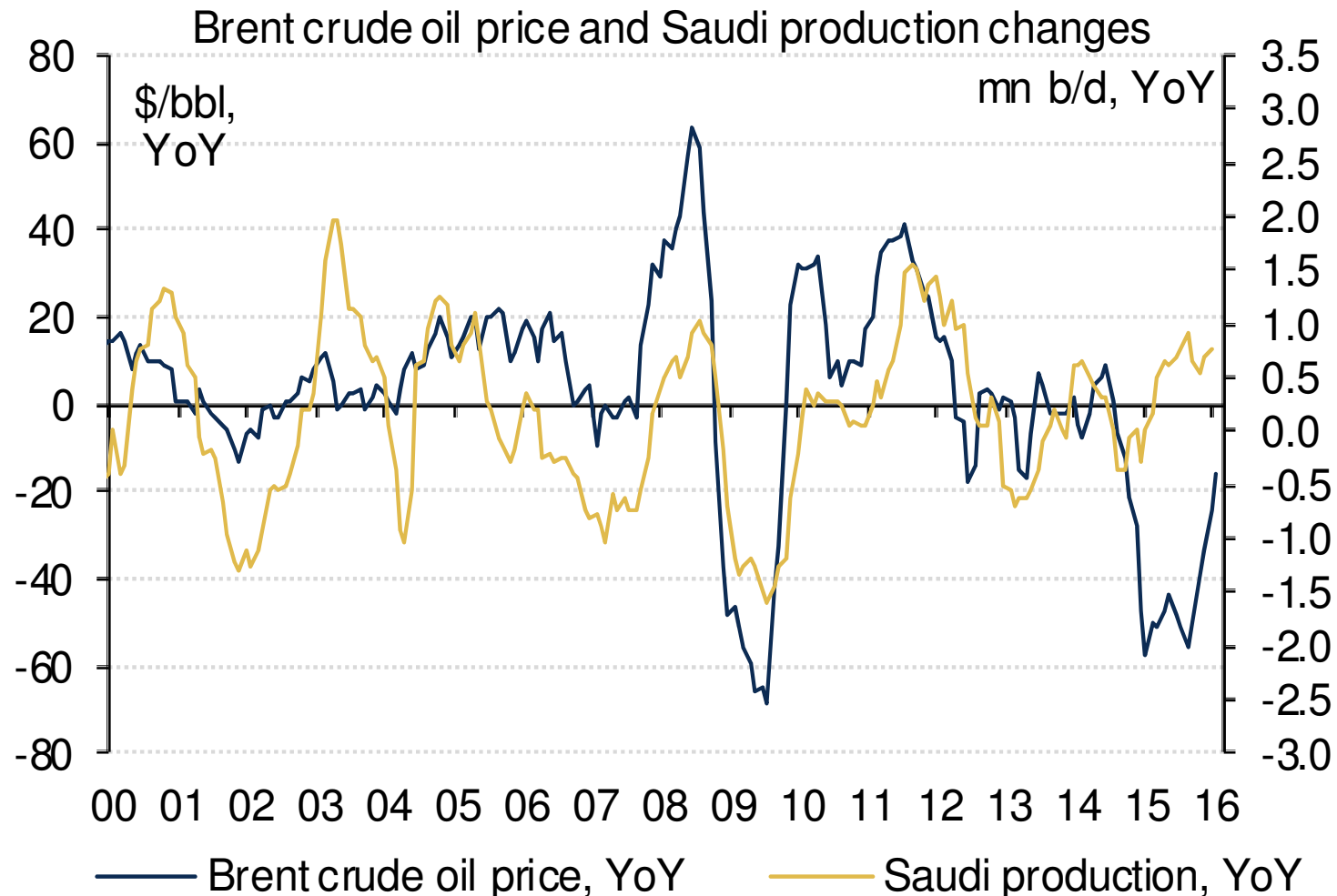
Source: IEA, BofA Merrill Lynch Global Commodities Research

...but Saudi seems reluctant to shoulder any output cut just as Iran prepares to re-enter the market



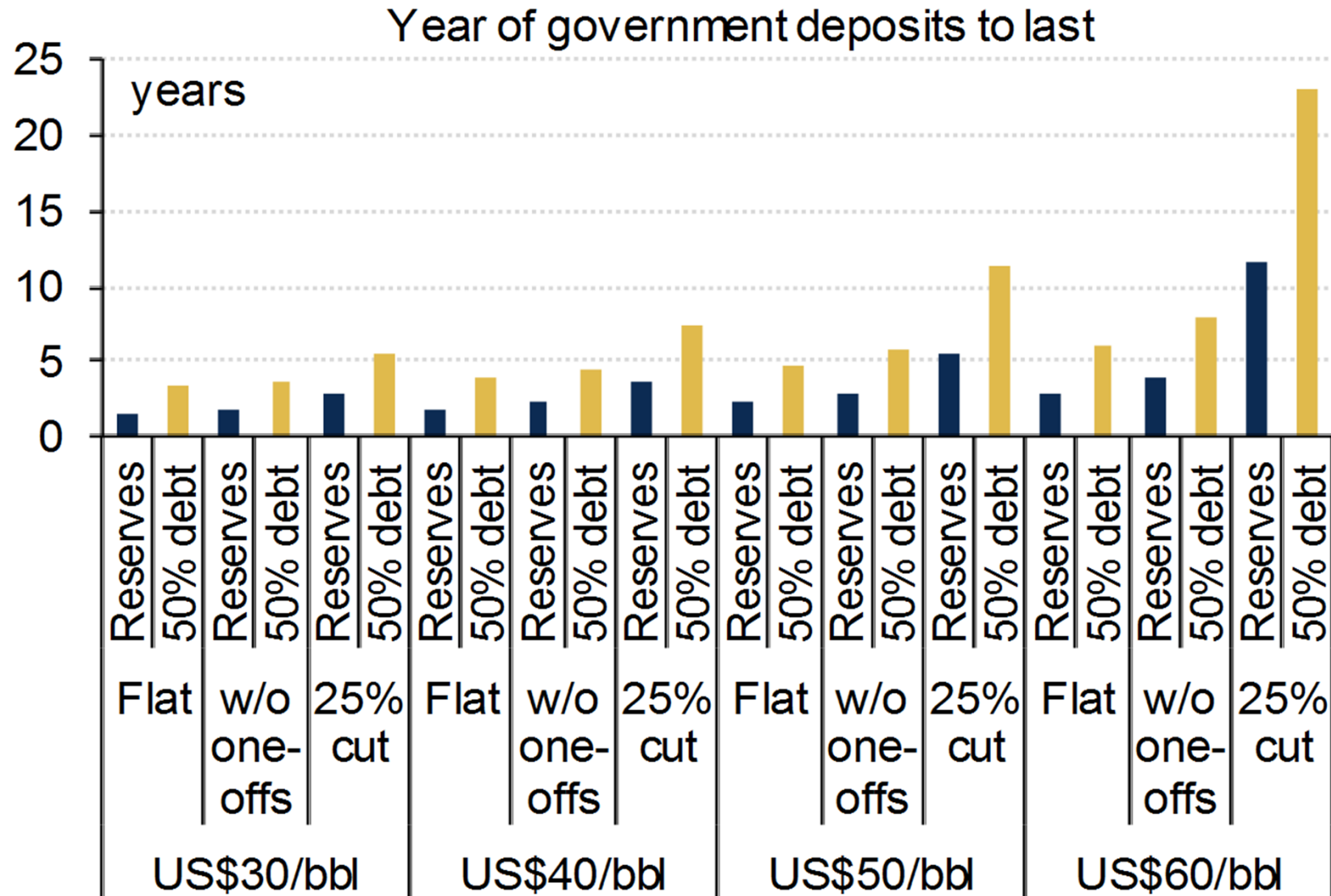
Source: IEA, BofA Merrill Lynch Global Commodities Research

While a market share strategy is a rational decision for Saudi, it does not make sense to gain market share at any price



Source: Bloomberg, BofA Merrill Lynch Global Commodities Research

While Saudi can survive for years on Brent crude prices of \$55 to \$65/bbl, it cannot sustain sub \$40/bbl for very long



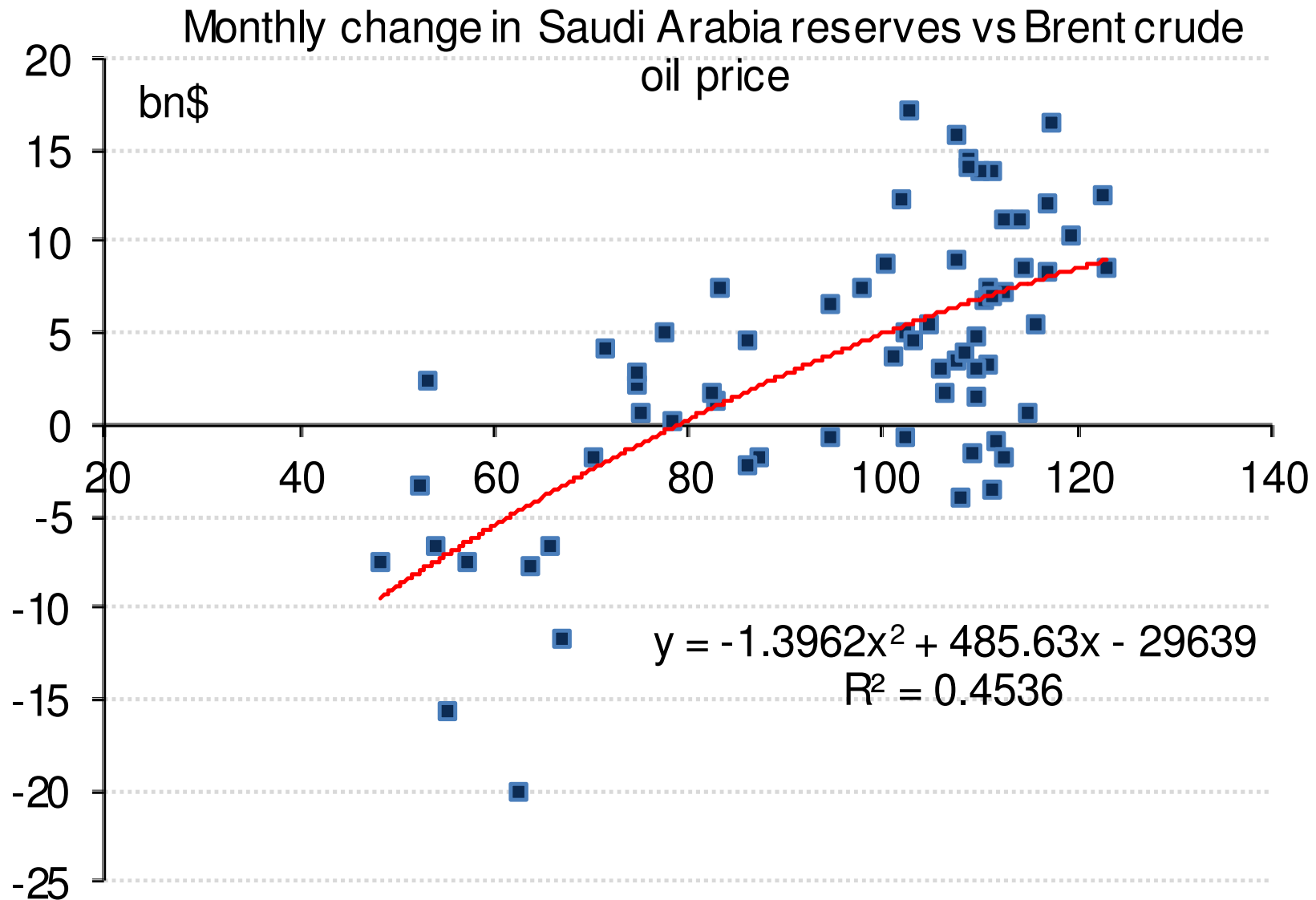
Source: BofA Merrill Lynch Global Commodities Research

Saudi Arabia's FX reserves are still high, but have been falling at a relatively fast rate...



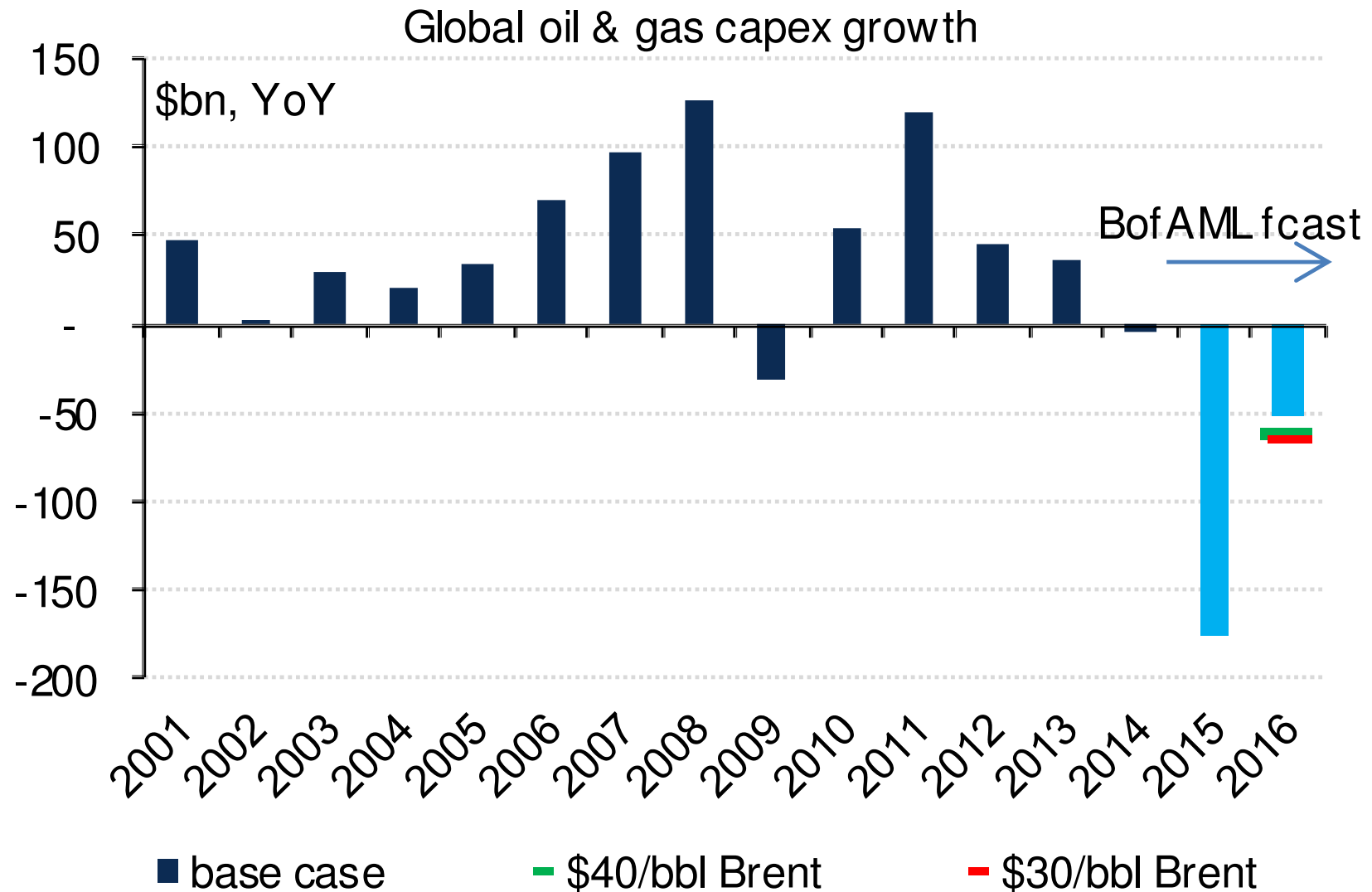
Source: Bloomberg, BofA Merrill Lynch Global Commodities Research

...which could accelerate to \$18bn per month with Brent crude oil prices at \$30/bbl



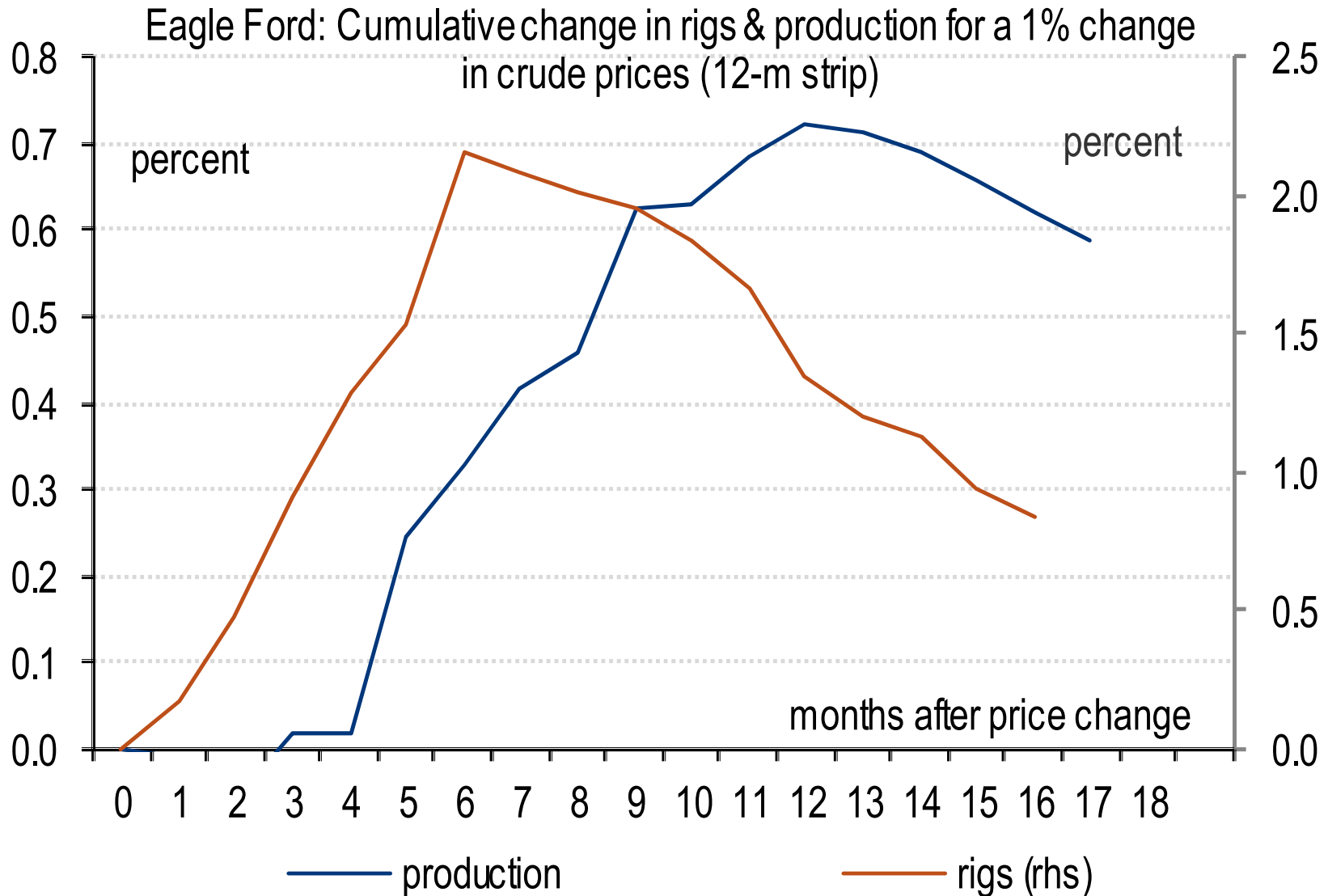
Source: Bloomberg, BofA Merrill Lynch Global Commodities Research

A further drop in prices beyond our expectations will likely have limited additional impact on global capital expenditures



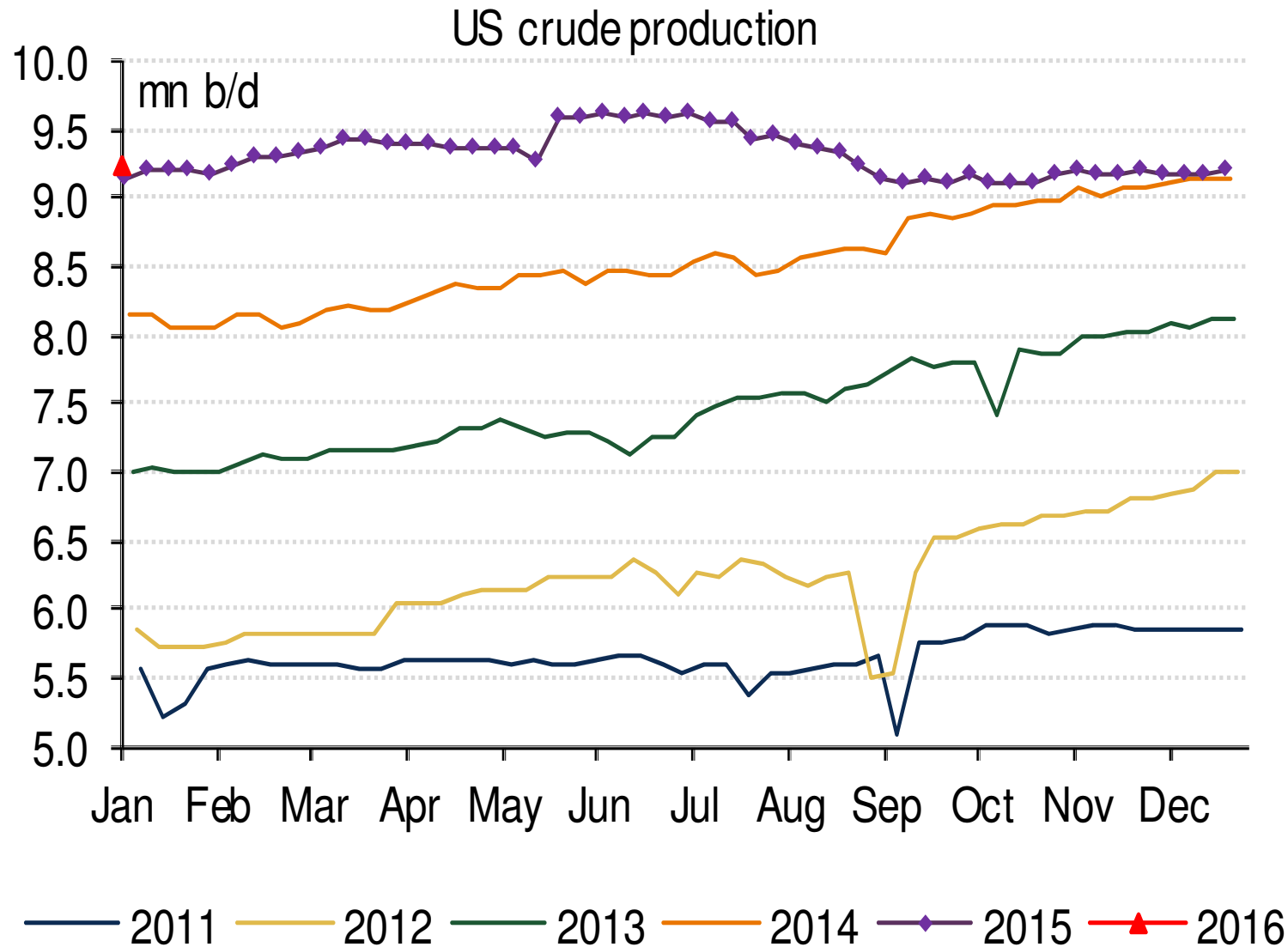
Source: BofA Merrill Lynch Global Research

US shale producers have continued to bear the brunt of the adjustment due to their sensitivity to price



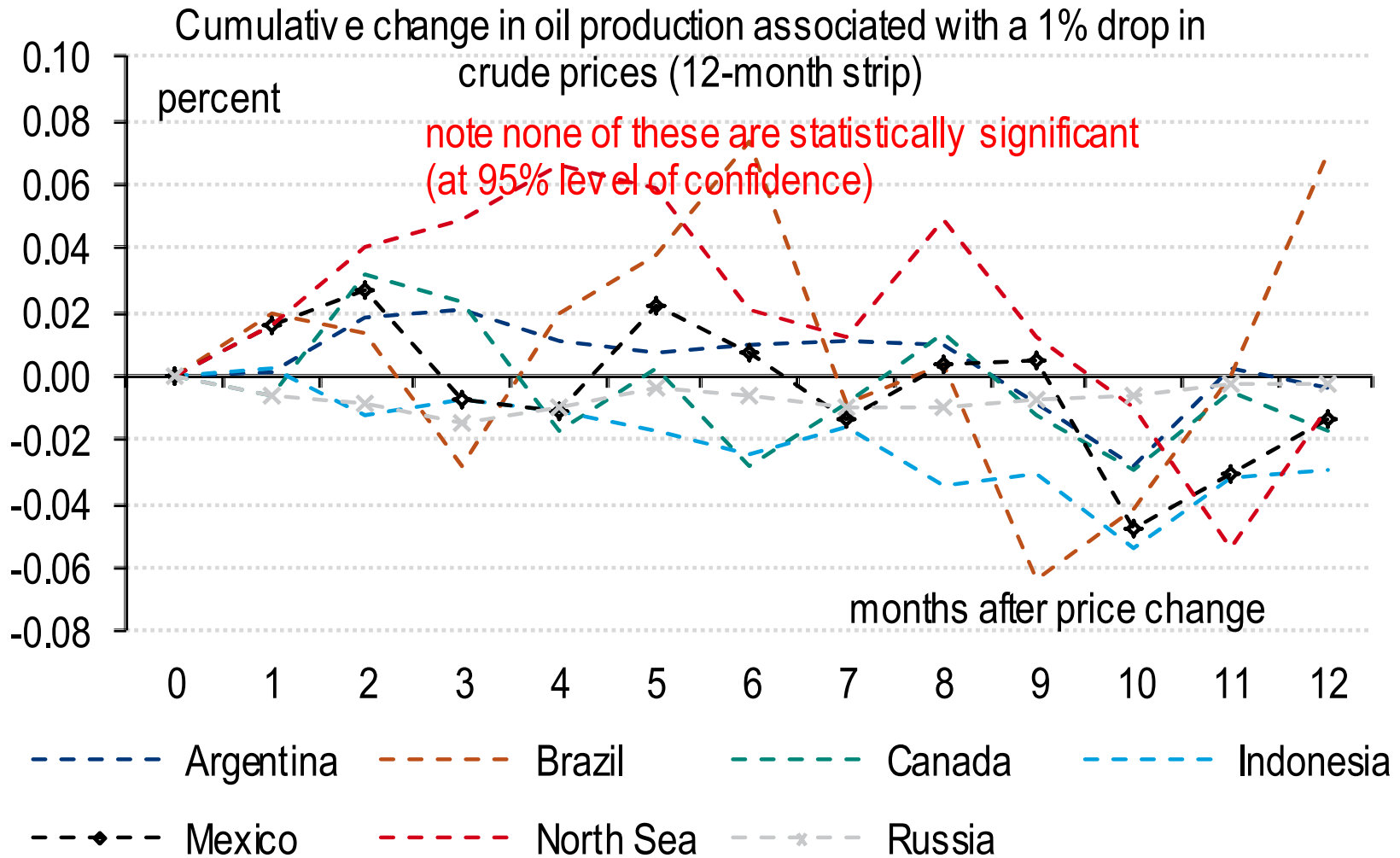
Source: EIA, BofA Merrill Lynch Commodities Research

Looking at US production, we can observe how recent output trends have already deviated enormously from seasonal trends



Source: EIA, BofA Merrill Lynch Global Commodities Research

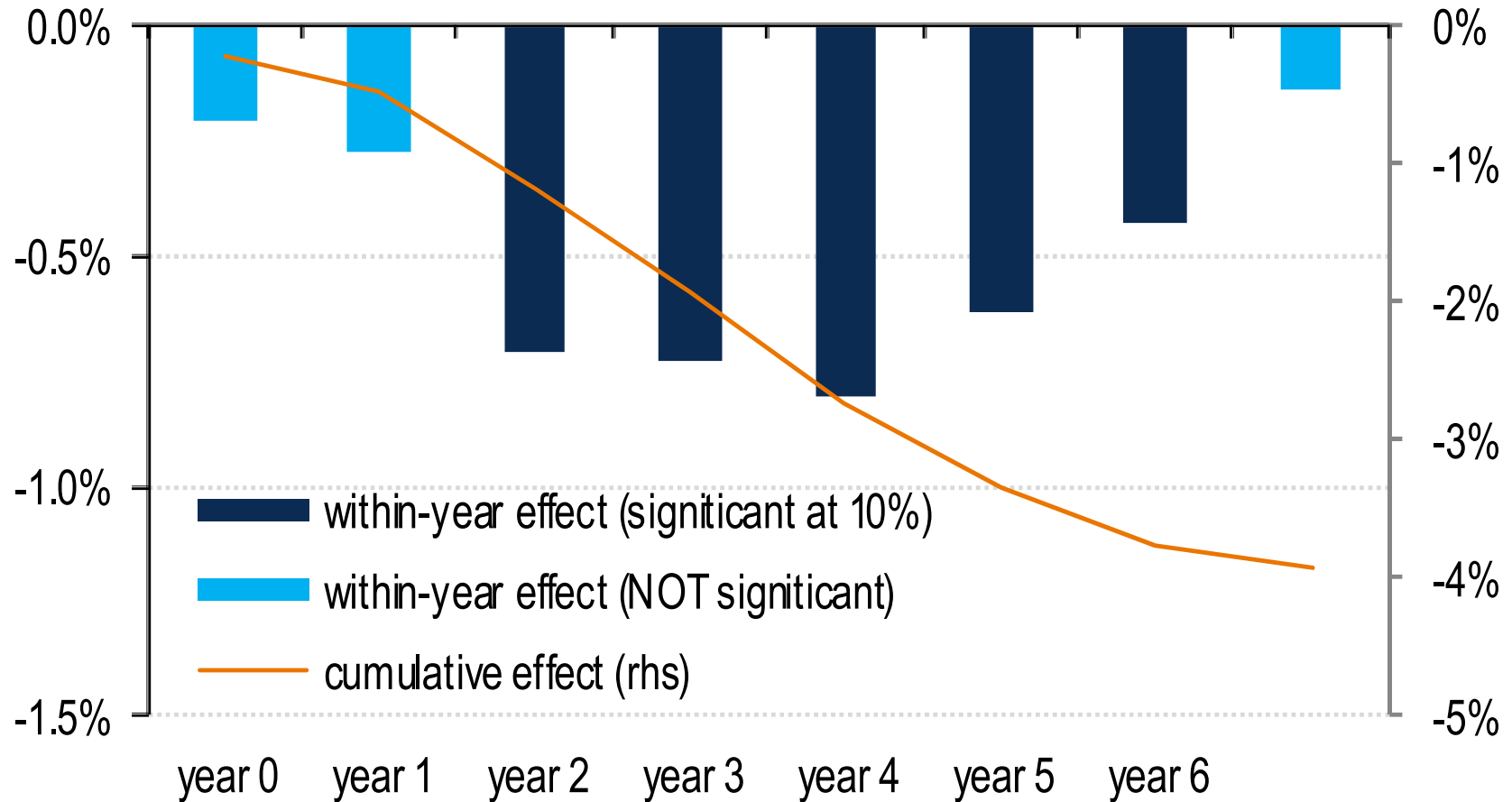
The price sensitivity of supply is rather limited outside the US over a 12-month window



Source: IEA, BofA Merrill Lynch Commodities Research

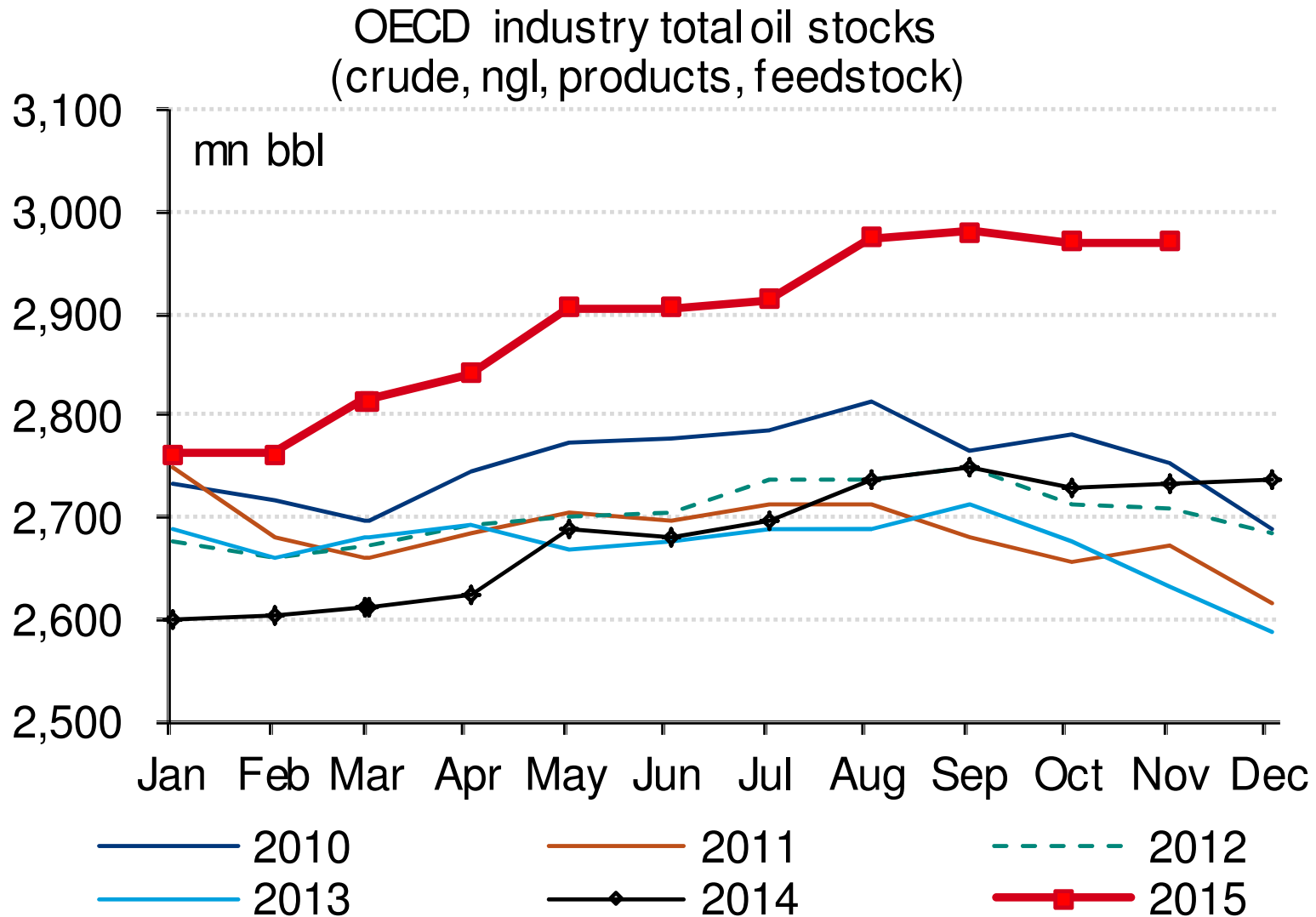
This year's collapse in capex will drive output for non-OPEC ex. North America down by 0.6 million b/d by 2017

Global* average effect of a capex cut on oil production
(for a 10% capex cut in year 0)



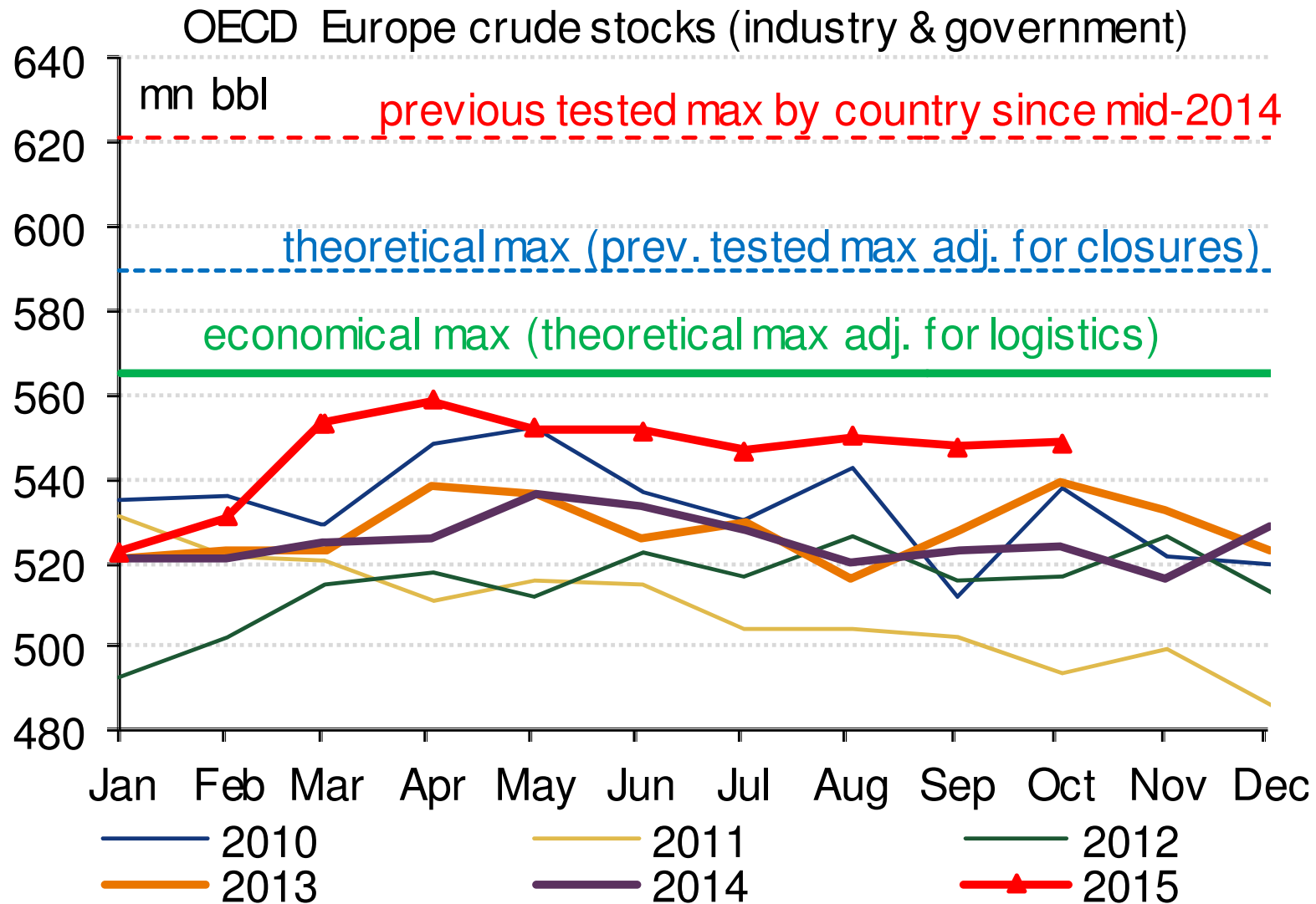
*ex cludes North America and Middle East

Global oil inventories look increasingly swollen and spare storage capacity is close to running out in some regions



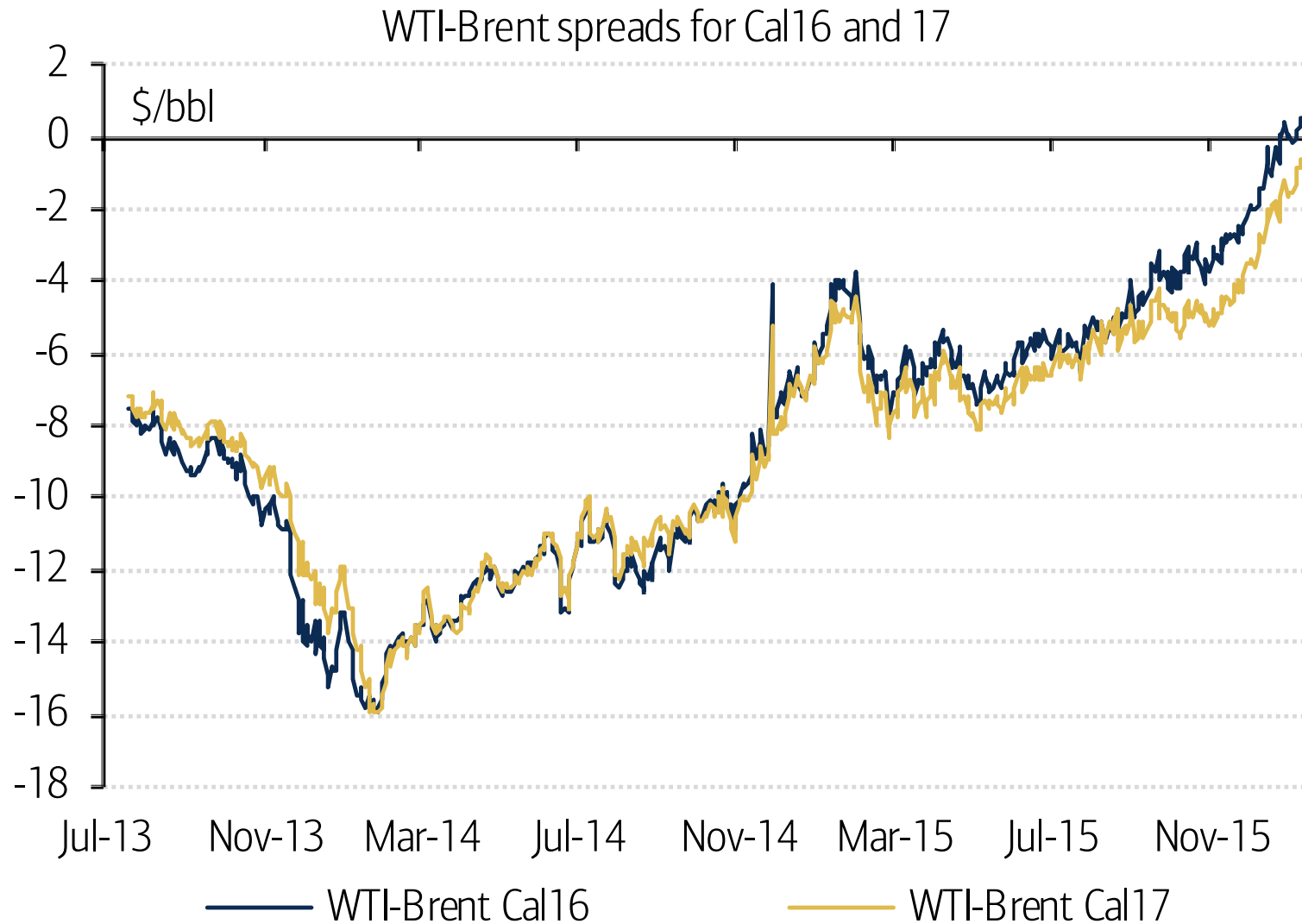
Source: IEA, BofA Merrill Lynch Global Commodities Research

There is only 25 million bbl of crude oil storage capacity left in Europe



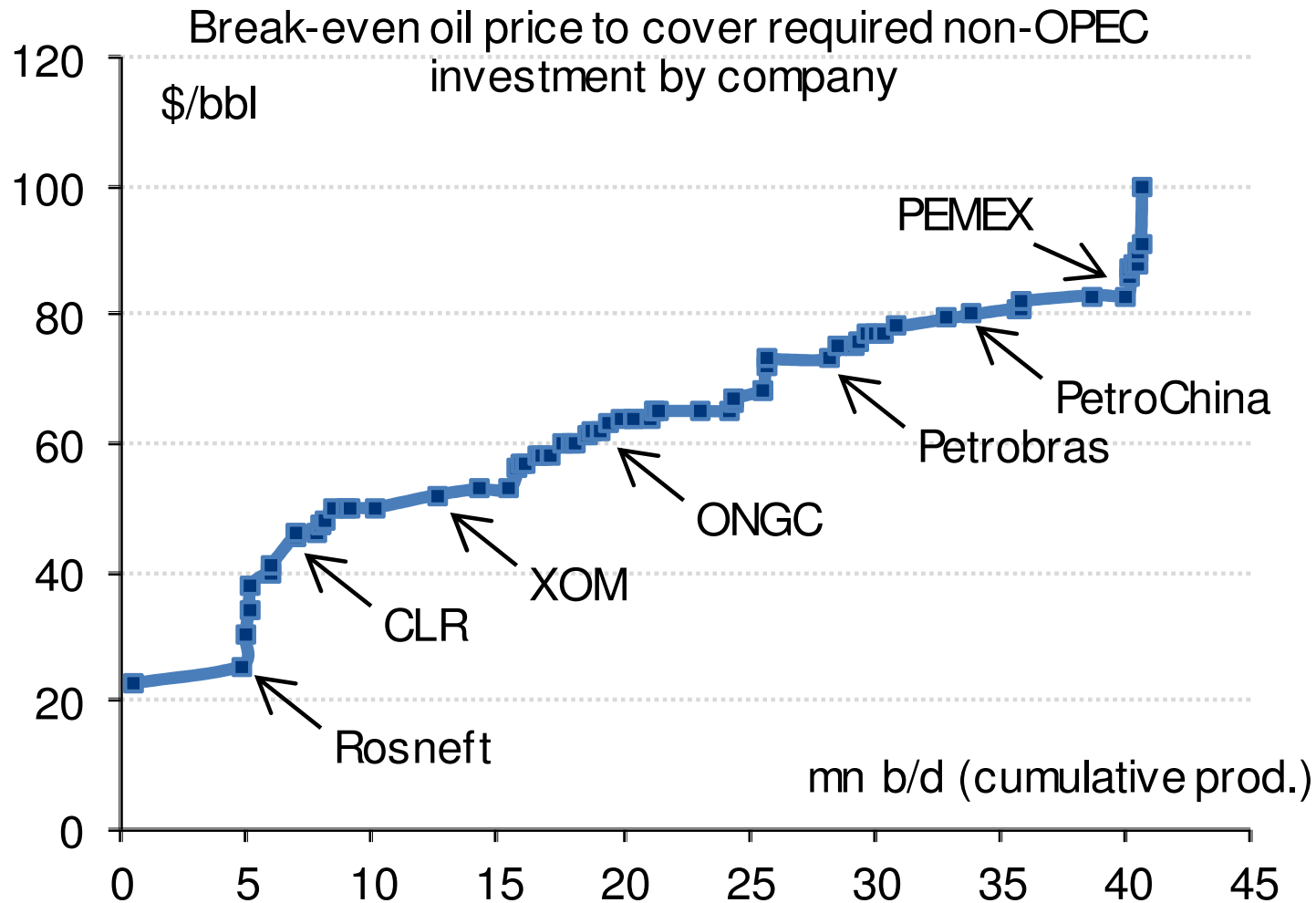
Source: IEA, BofA Merrill Lynch Global Commodities Research

WTI has recently surged above Brent, suggesting that the oil market is starting to rebalance in the US



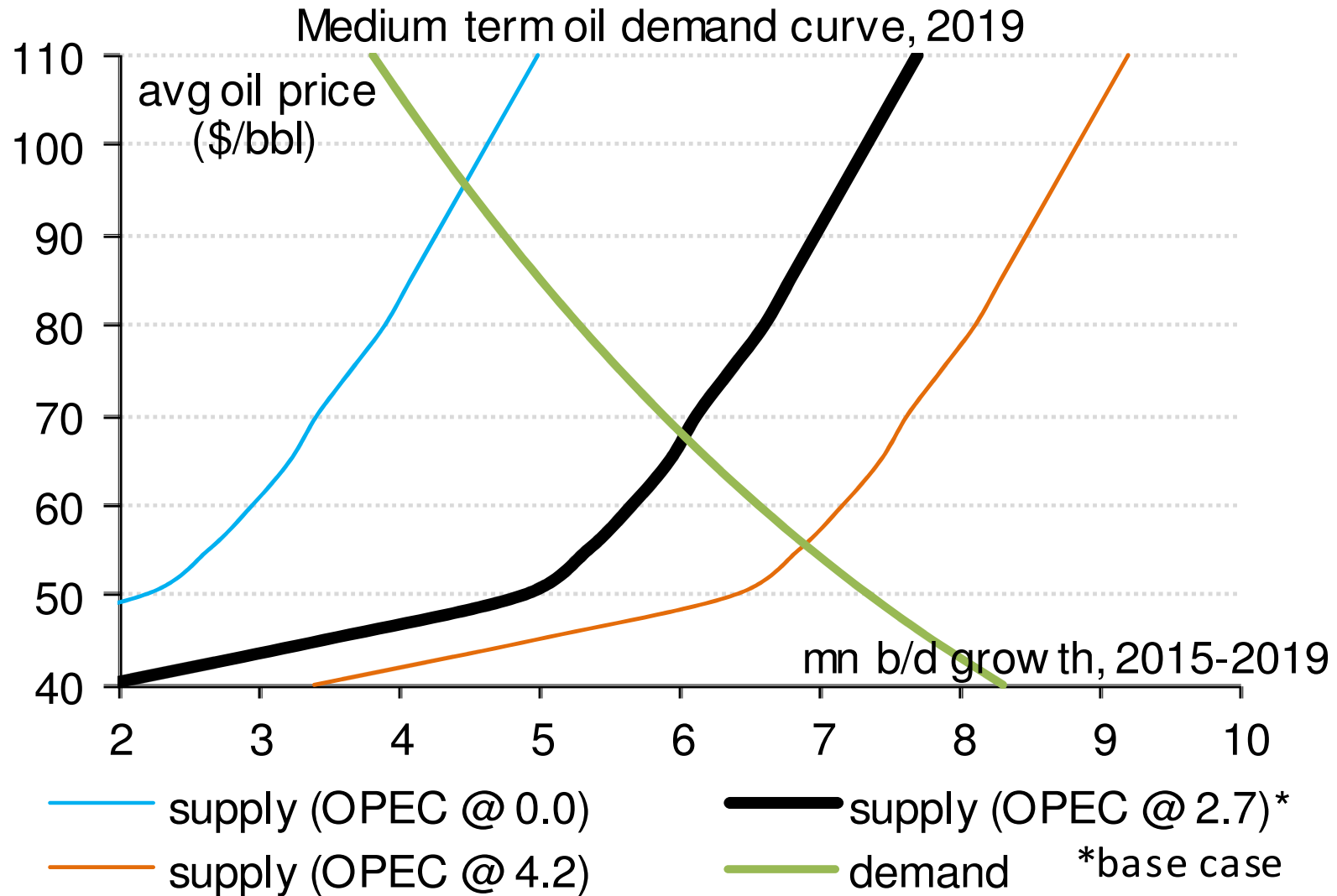
Source: Bloomberg, BofA Merrill Lynch Global Commodities Research

Most producers around the world require about \$80/bbl to keep expanding production



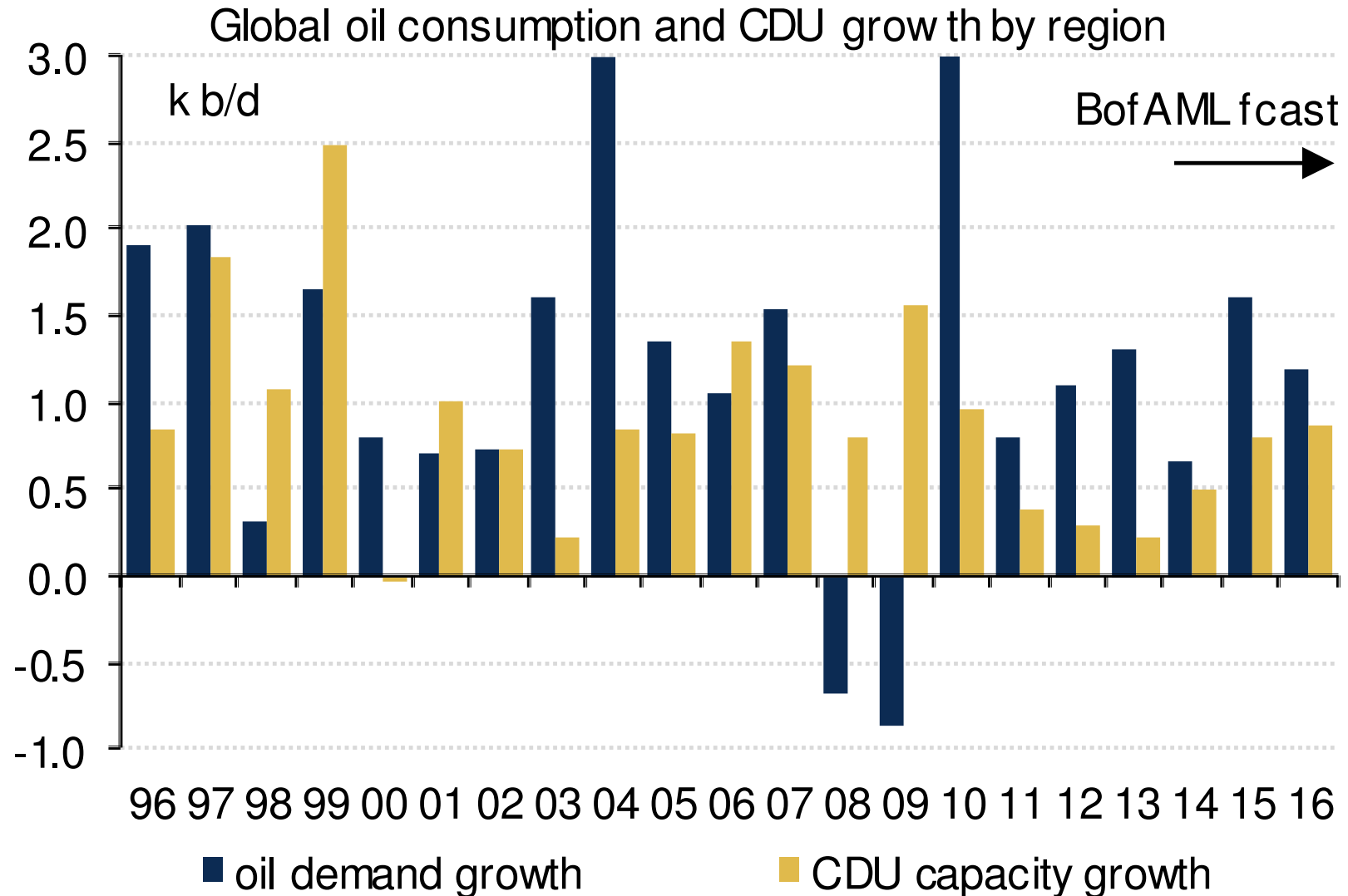
Source: BofA Merrill Lynch Global Research

Demand elasticities point to unsustainably high consumption growth rates if crude oil prices stay at these levels



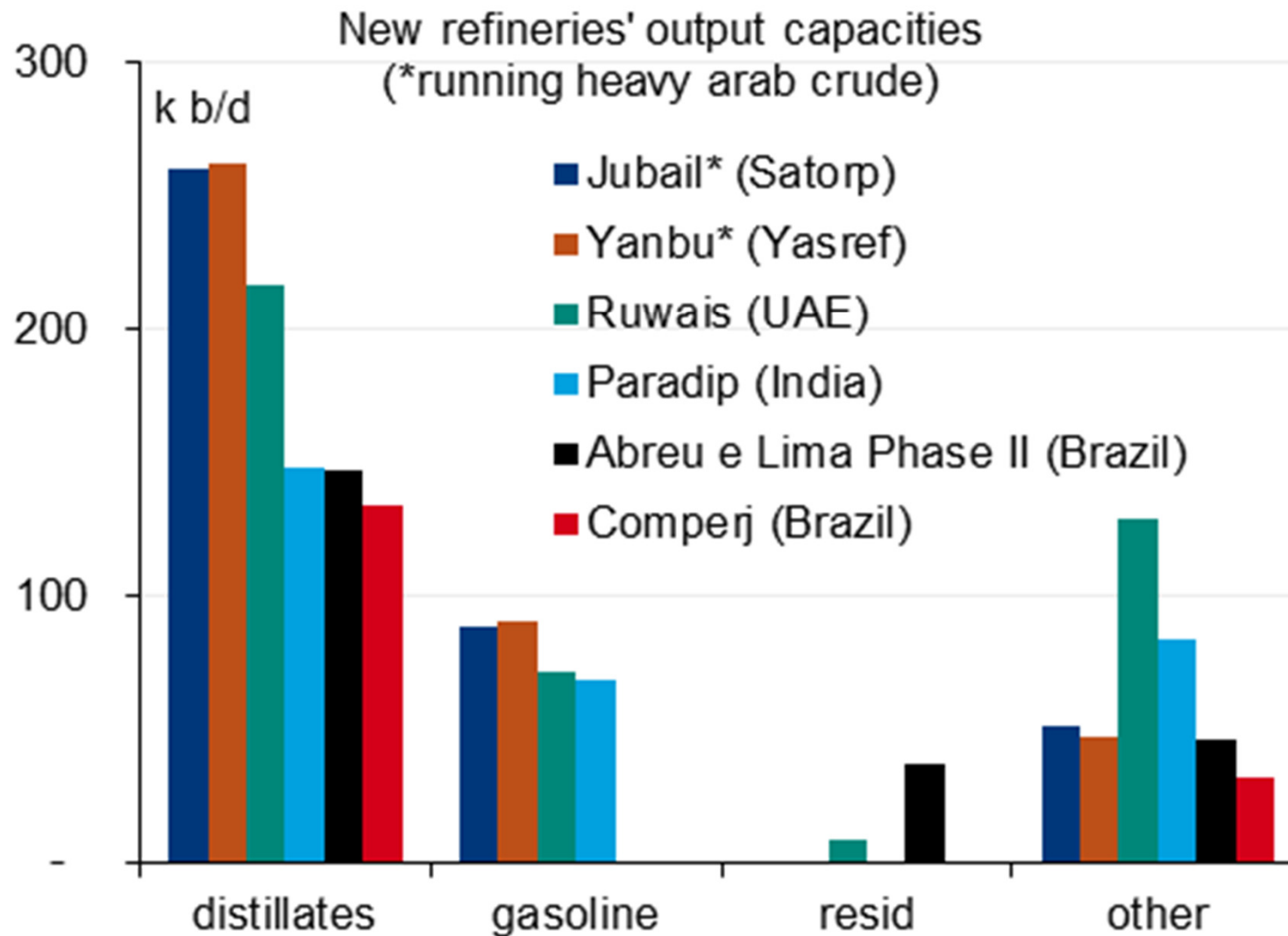
Source: IEA, BofA Merrill Lynch Global Commodities Research

Global oil demand growth will outpace CDU additions for the 6th consecutive year in 2016, an argument for healthy margins



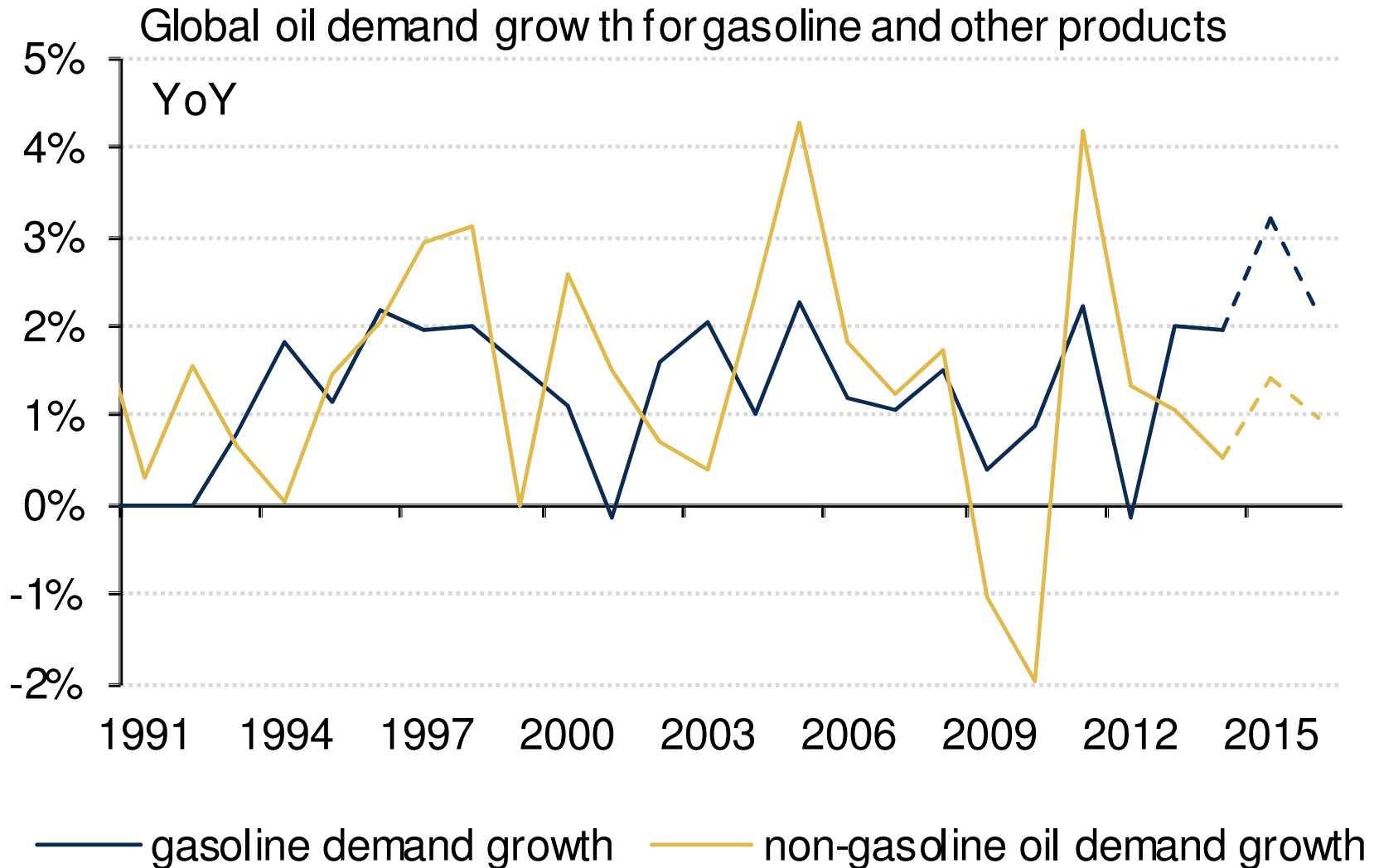
Source: BofA Merrill Lynch Global Research

Most of the new refineries coming on stream are biased toward diesel



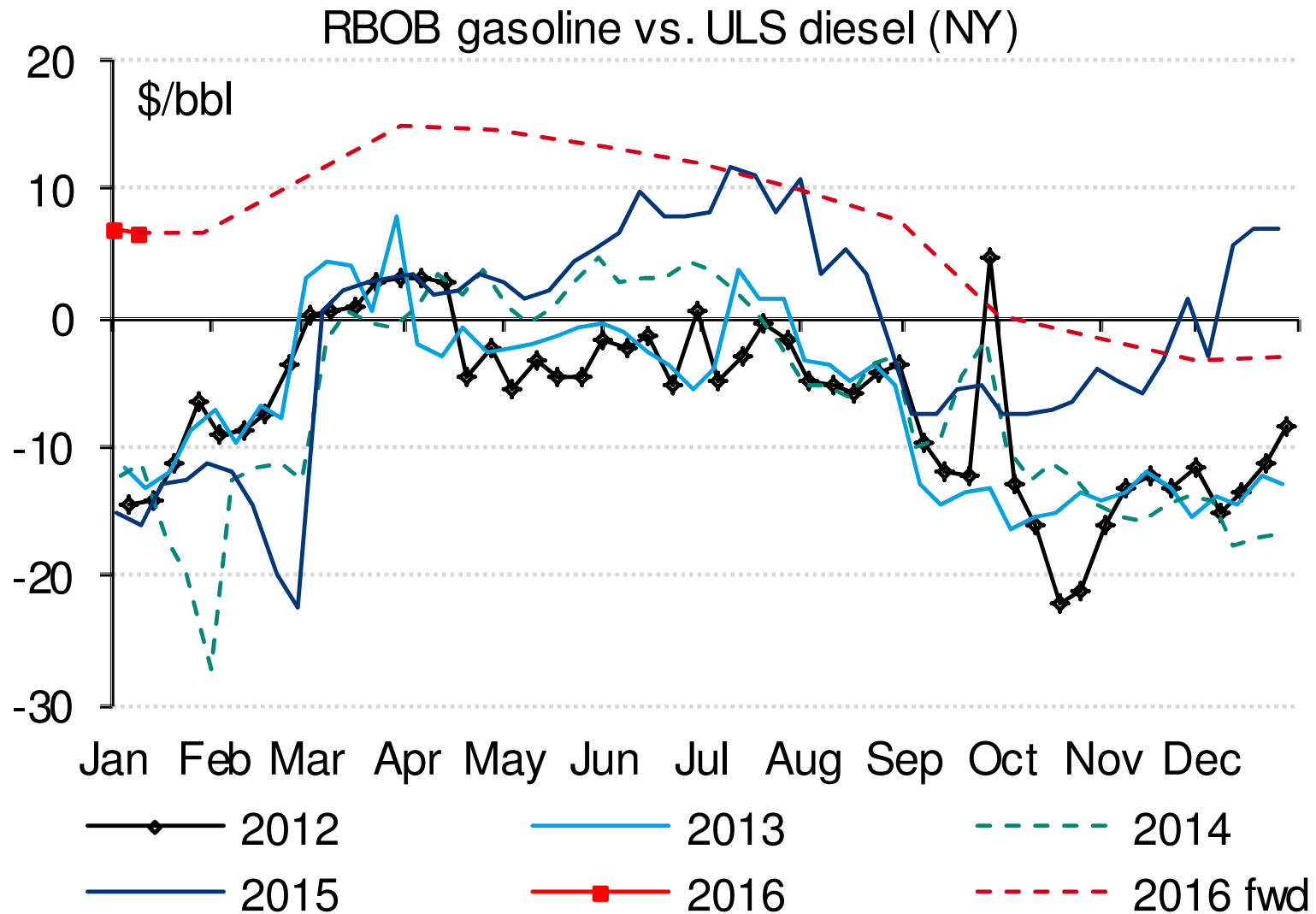
Source: BofA Merrill Lynch Global Research

Gasoline demand growth outpaced the rest of the complex in 2015 and the trend is expected to continue in 2016



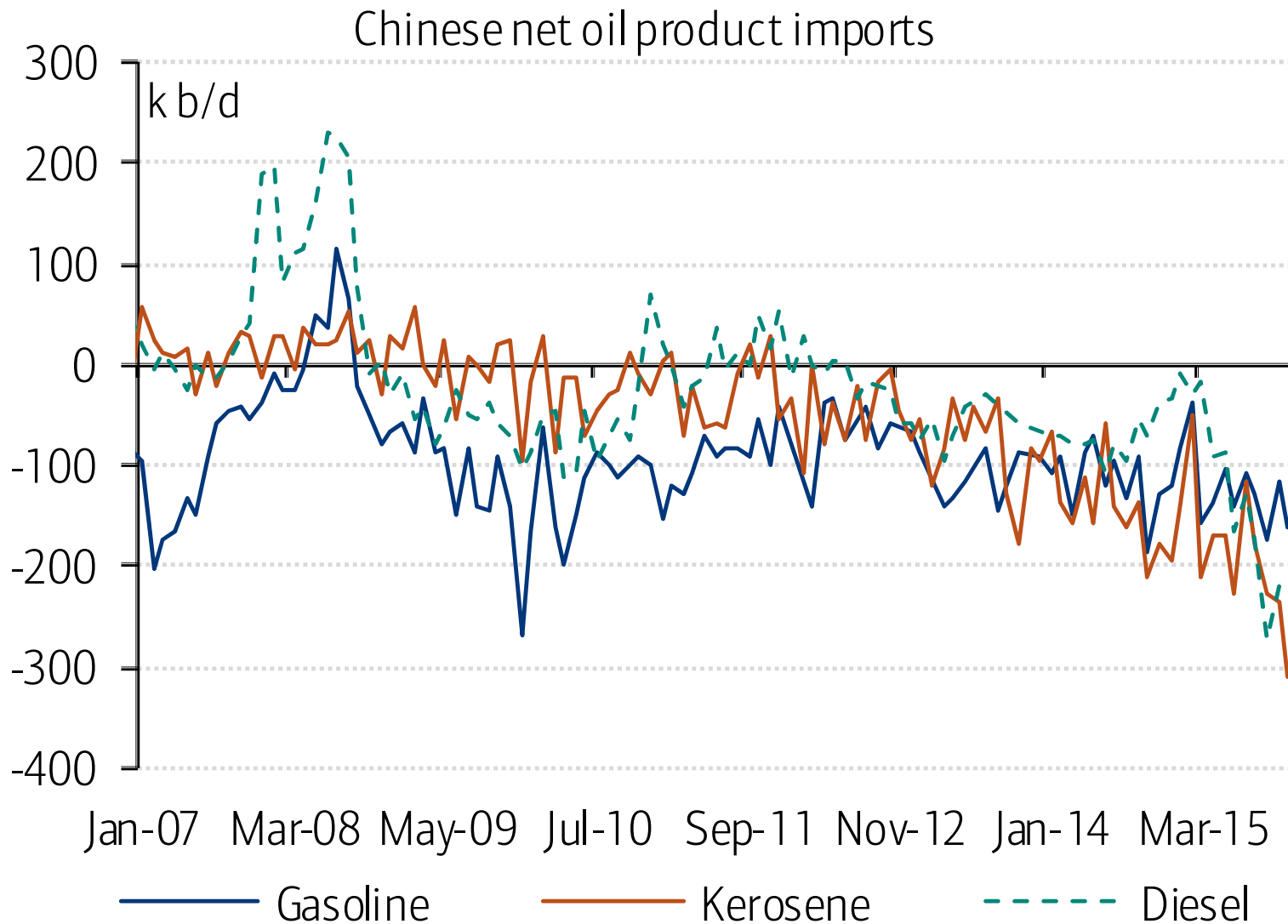
Source: BofA Merrill Lynch Global Research

We continue to prefer gasoline over diesel on a relative basis, but the market has already moved very meaningfully



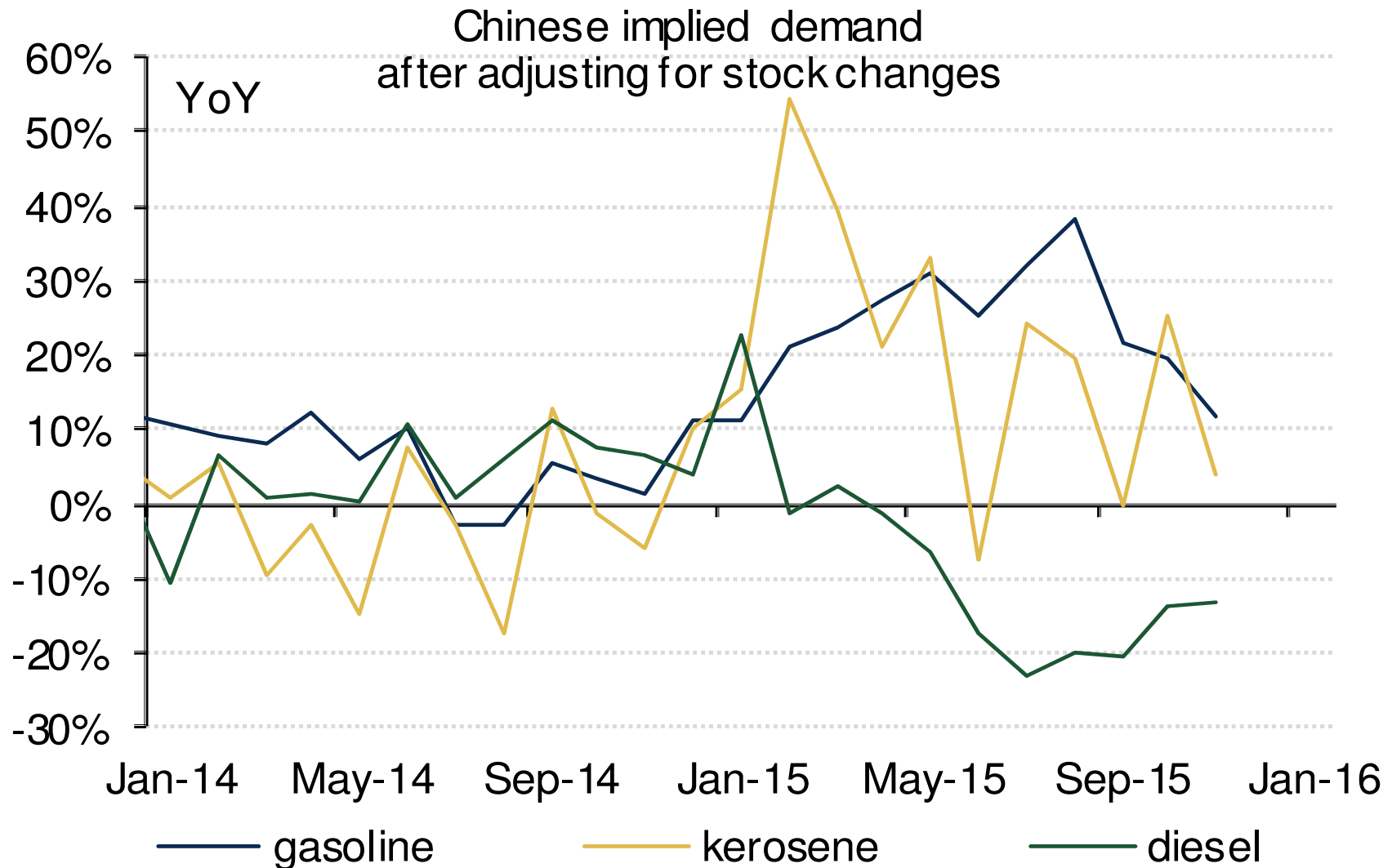
Source: Bloomberg, BofA Merrill Lynch Global Research

Diesel net exports have soared in recent months from virtually zero in February to 220 k b/d in November



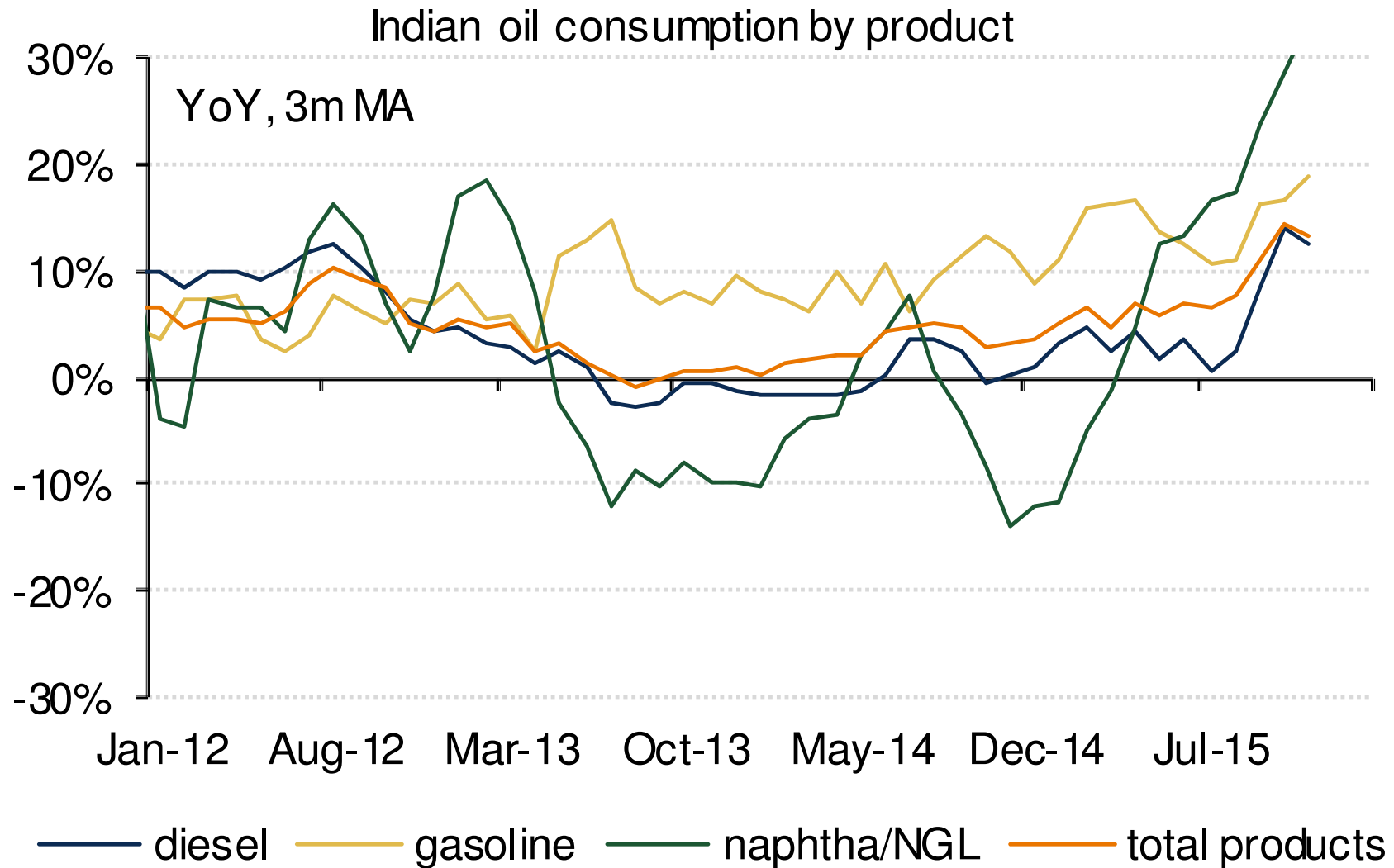
Source: CEIC, BofA Merrill Lynch Global Research

Consumer fuels like gasoline (for driving) and kerosene (for flying) are growing robustly in China...



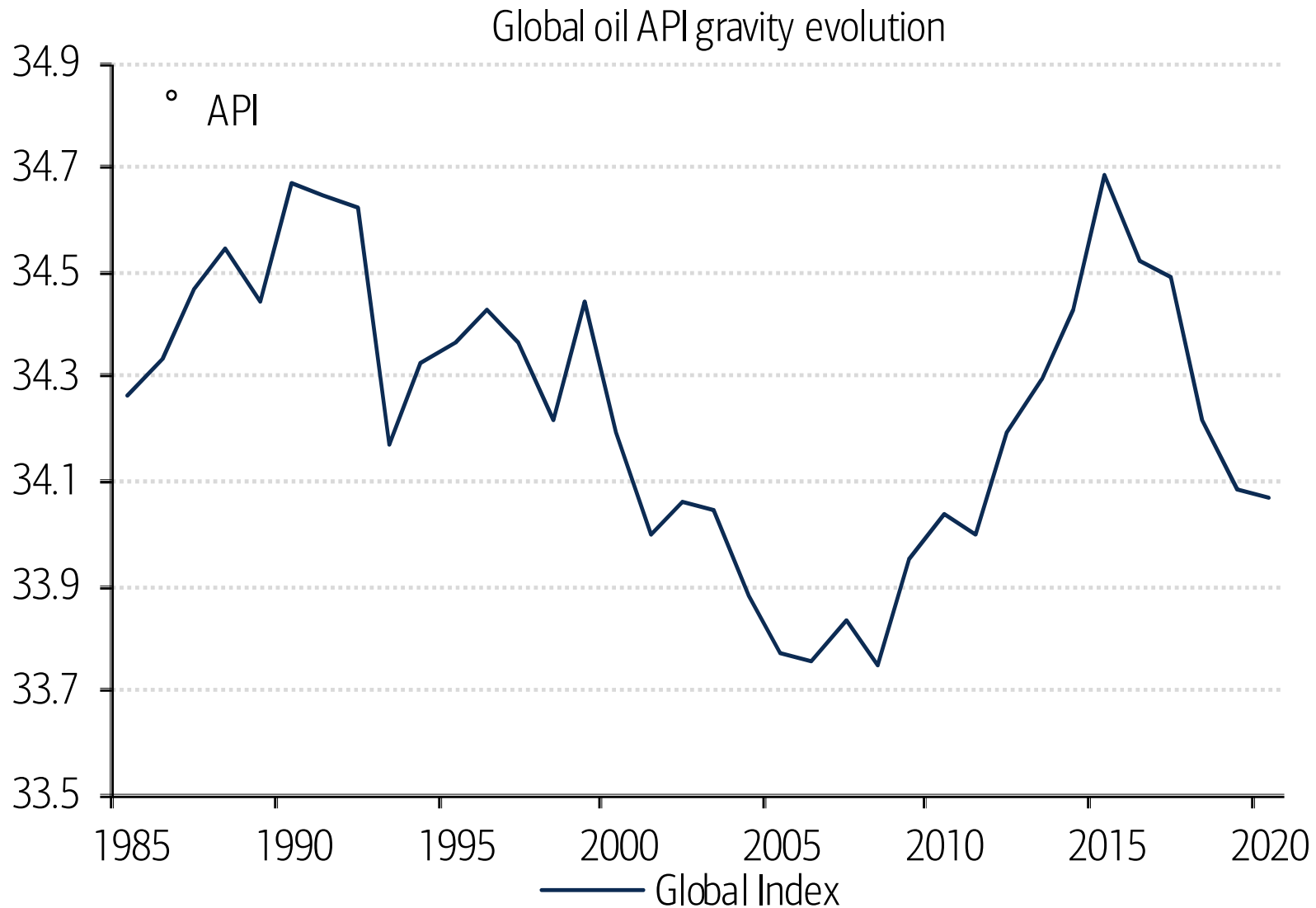
Source: CEIC, BofA Merrill Lynch Global Research

...while in India, refined products demand growth has been remarkably healthy in 2015



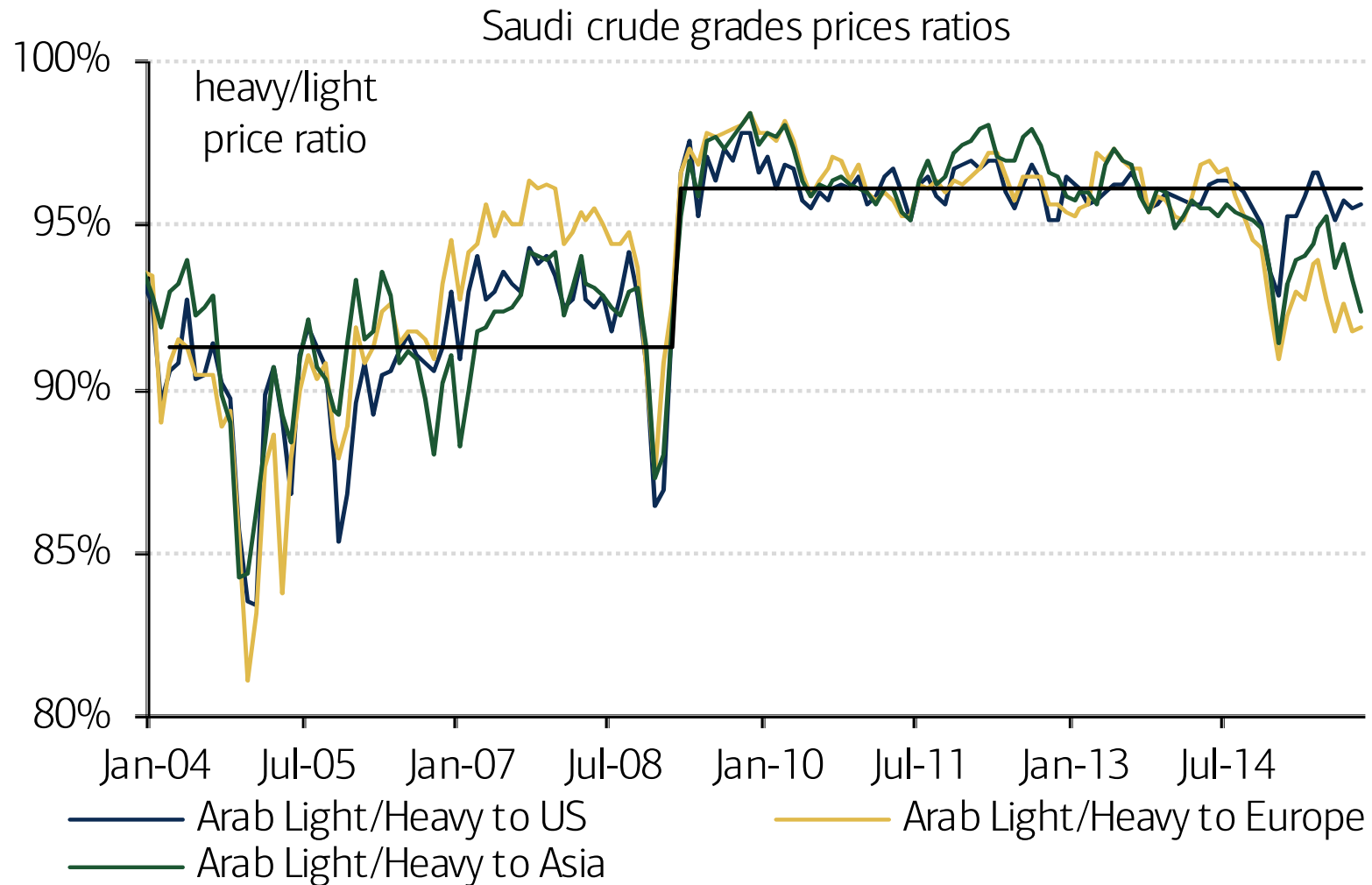
Source: BofA Merrill Lynch Global Research

The increased gravity in the global crude slate could be an ongoing trend over the medium term



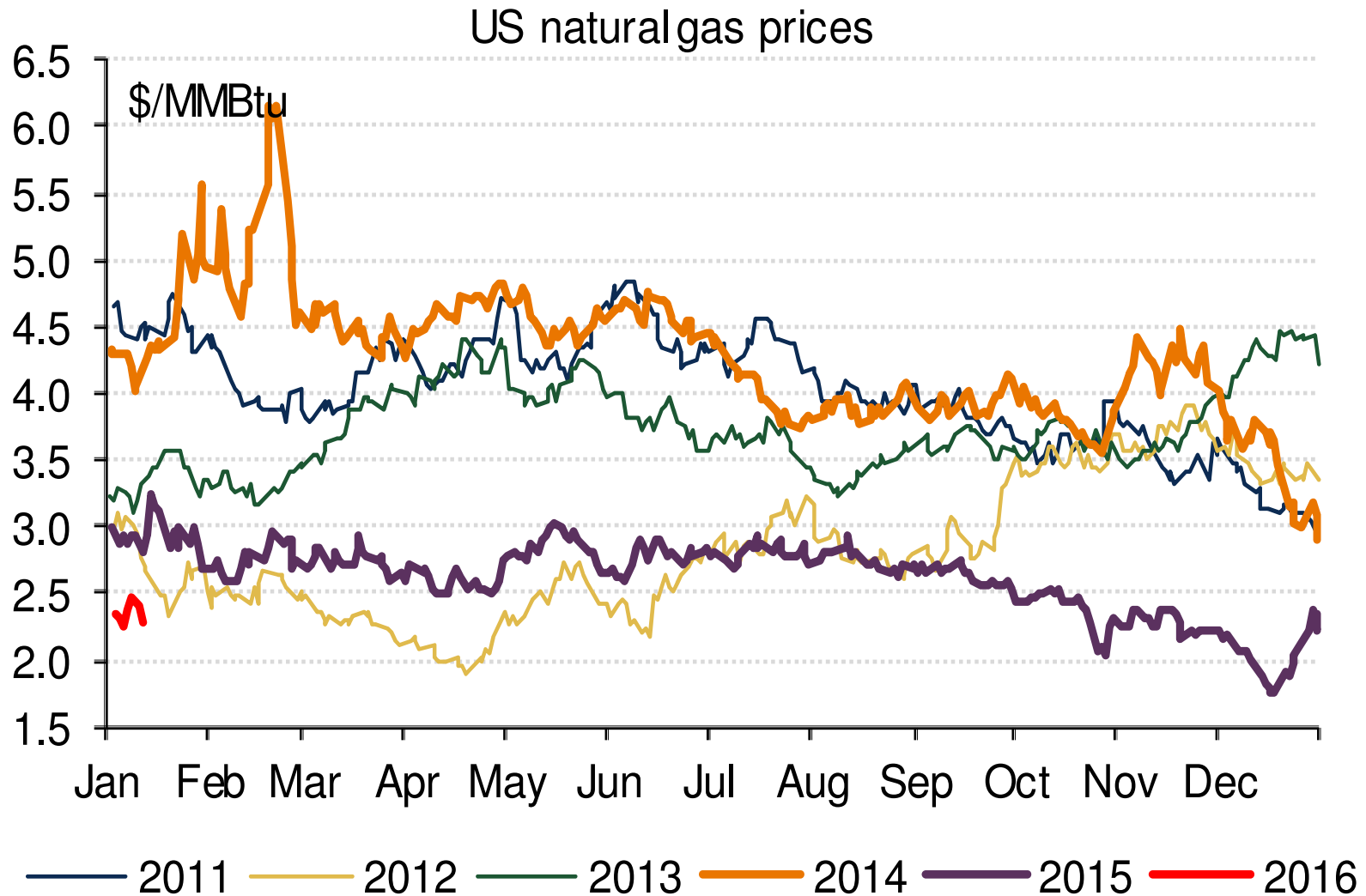
Source: Woodmac, BofA Merrill Lynch Commodities Research

We believe the discount of Arab heavy to Arab light crude may have to widen out structurally again



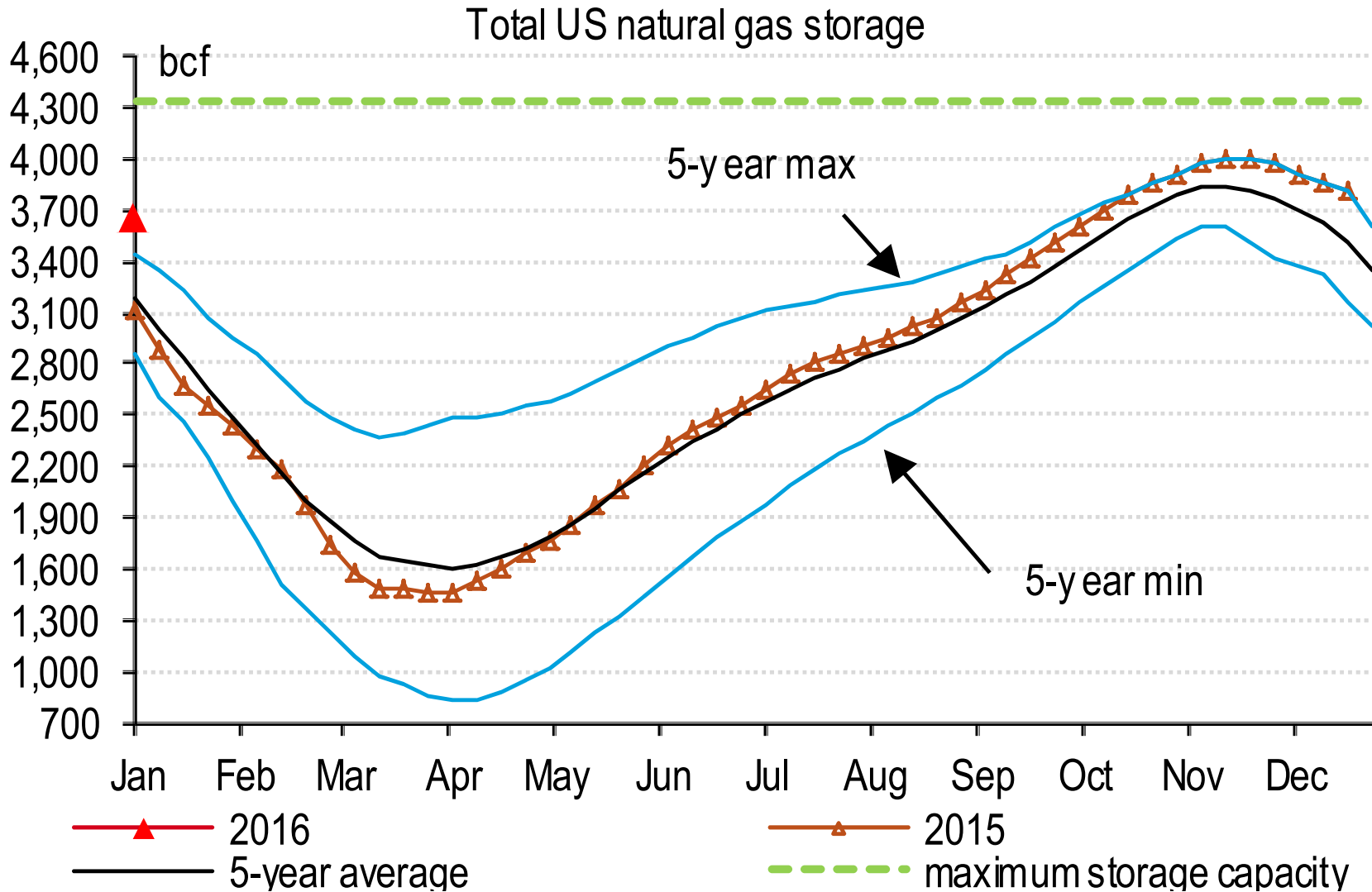
Source: Bloomberg, BofA Merrill Lynch Global Commodities Research

US front-month natural gas prices recently collapsed on pre-winter storage containment risks



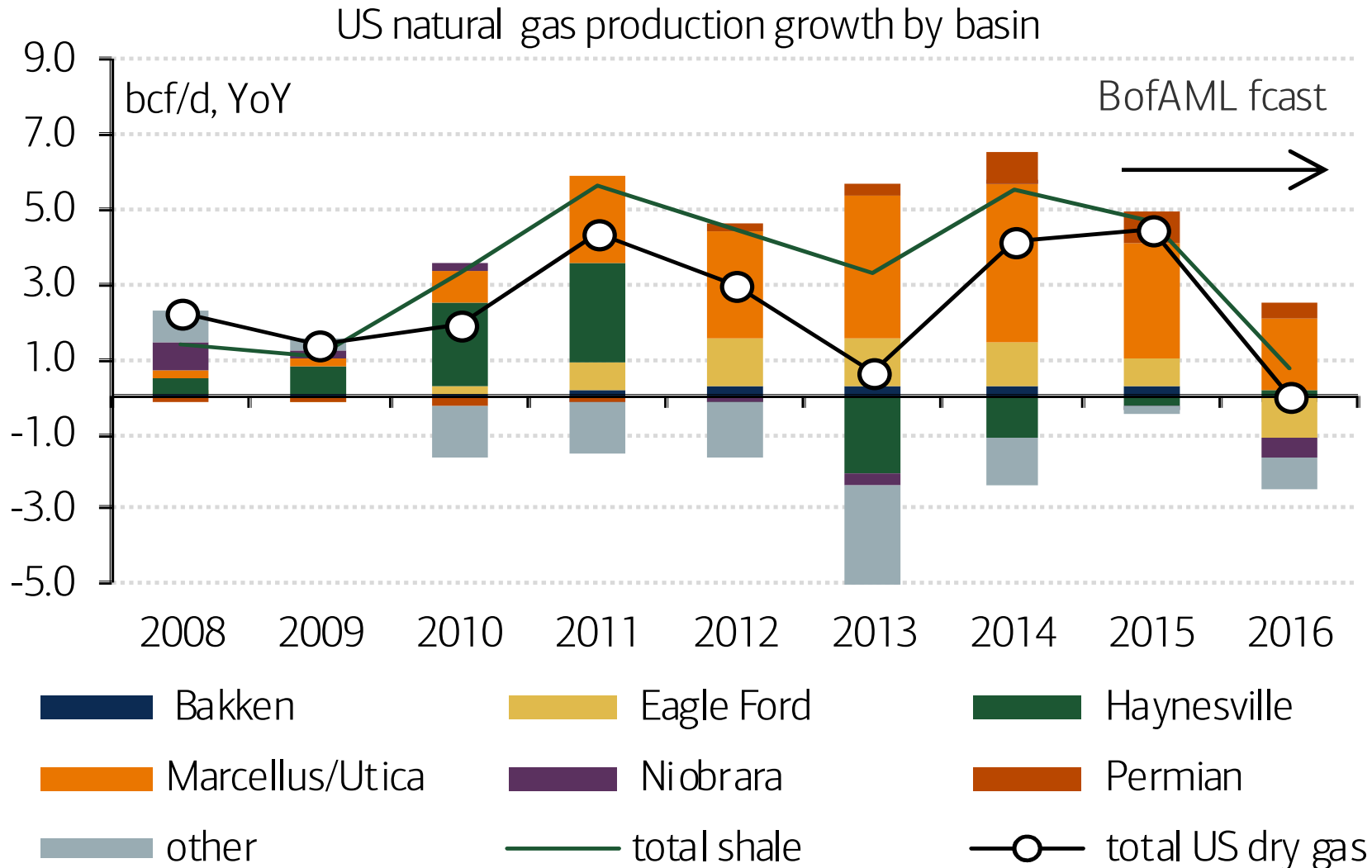
Source: Bloomberg, BofA Merrill Lynch Global Commodities Research

Larger-than-expected storage numbers are a primary factor in driving prices to near-historic lows lately



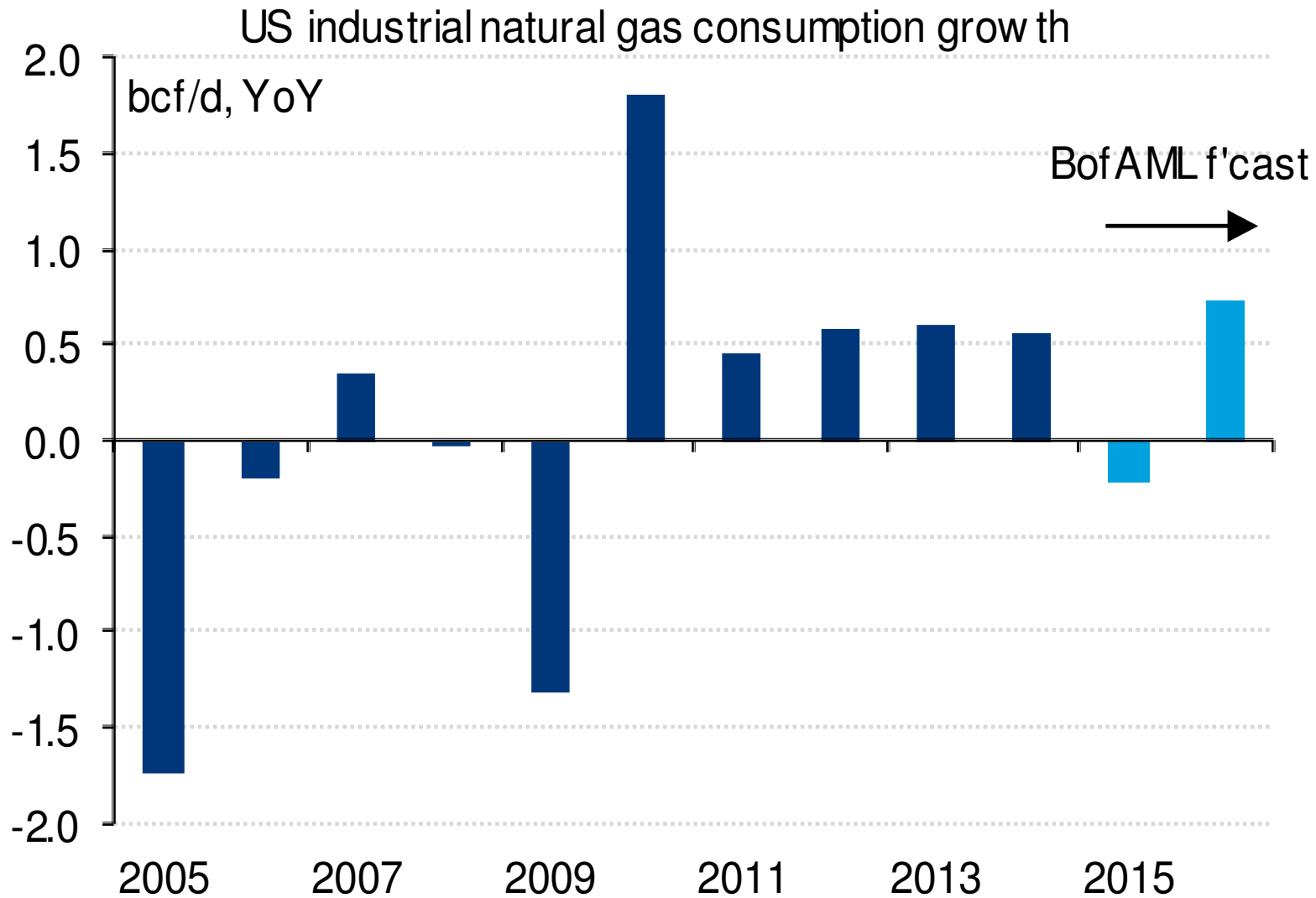
Source: Bloomberg, BofA Merrill Lynch Global Commodities Research

Outside the Northeast, everything points to a downward trend in natural gas production, especially in wet areas



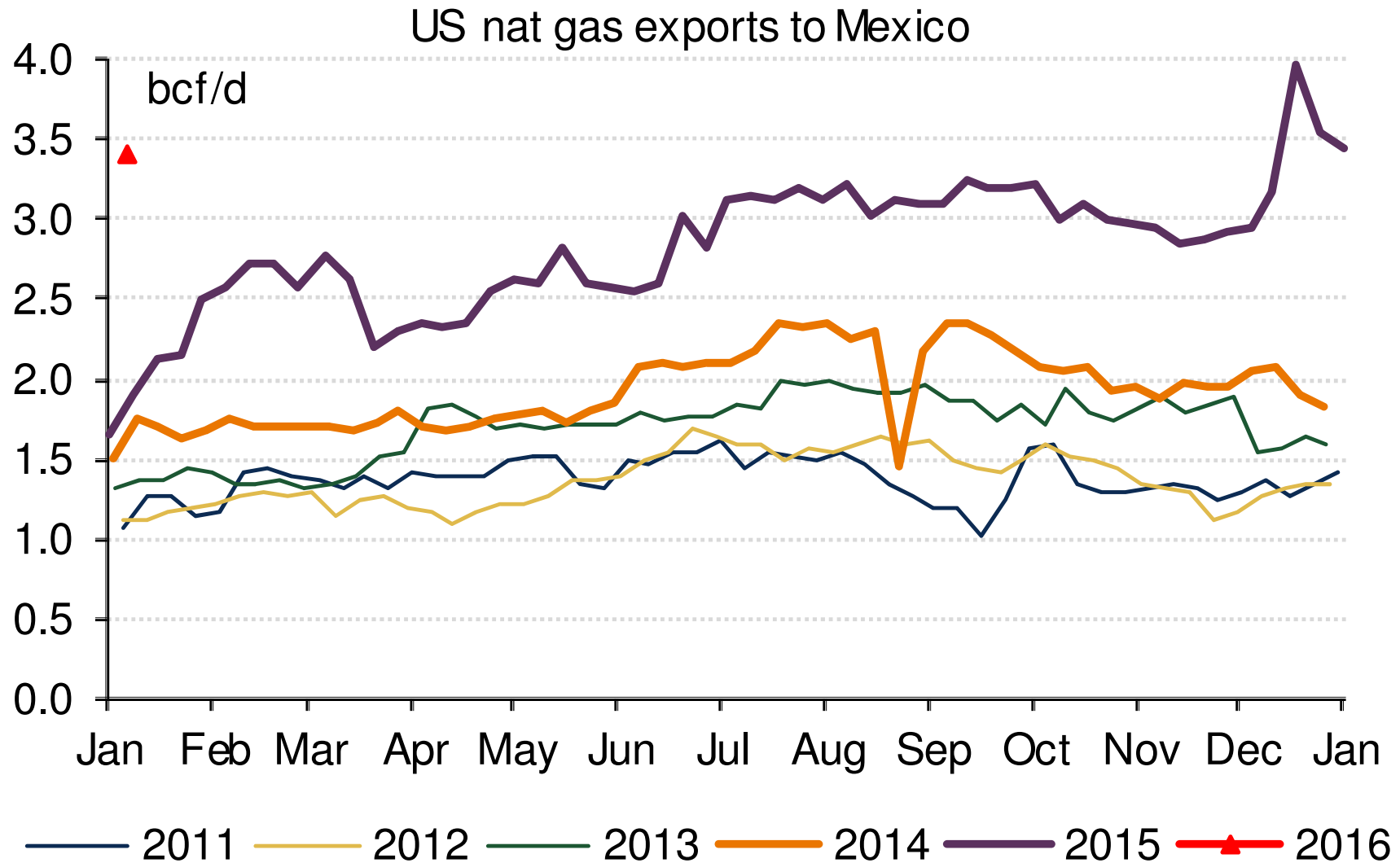
Source: EIA, BofA Merrill Lynch Global Commodities Research

Industrial gas demand declined in 2015, yet we see a 0.7 bcf/d growth in 2016E, mostly on methanol and fertilizer expansions



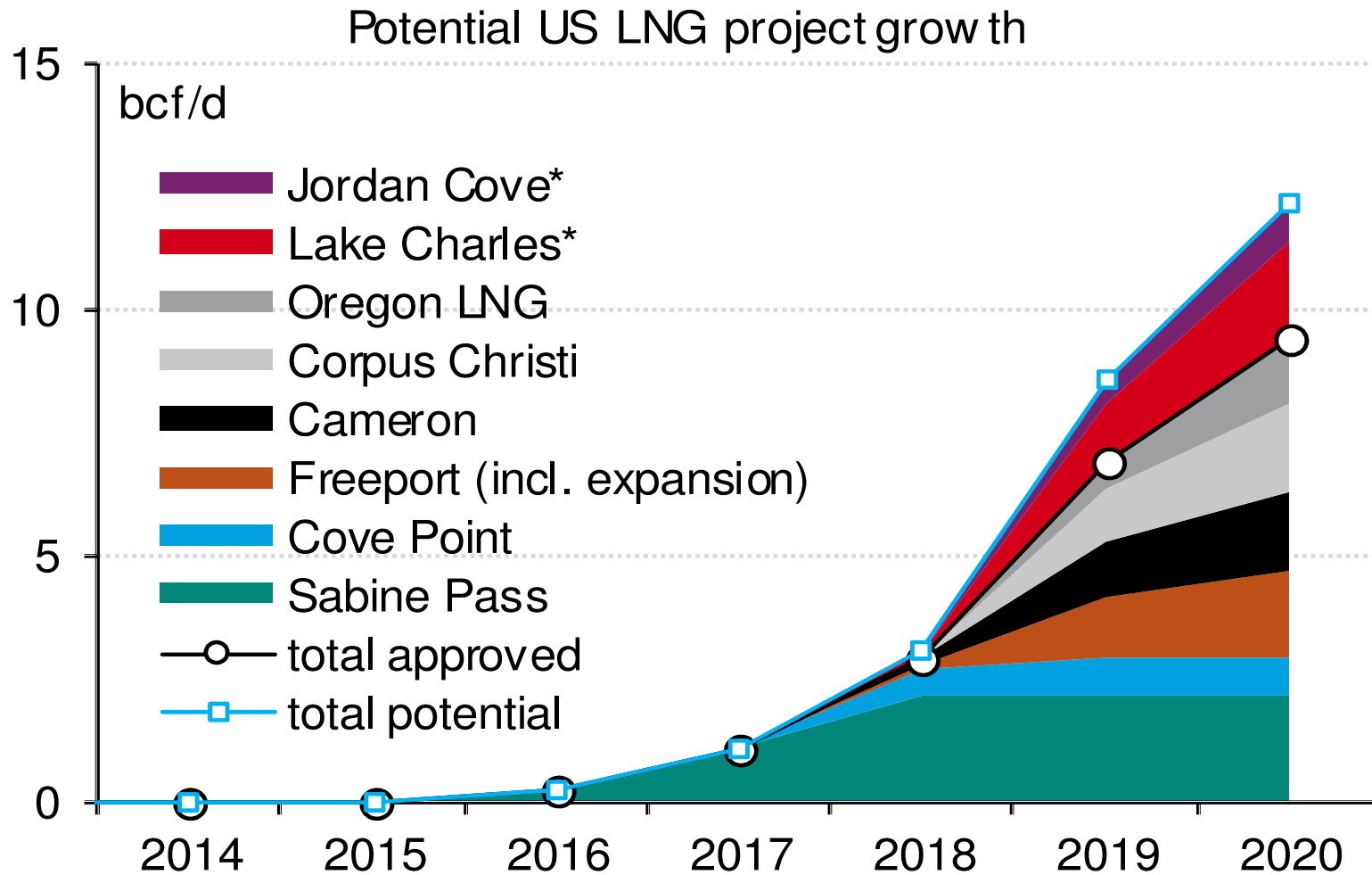
Source: EIA, BofA Merrill Lynch Global Commodities Research

US natural exports to Mexico are expected to increase by 0.6 bcf/d in 2016, driven by the Ramones II pipeline ramp up



Source: Bloomberg, BofA Merrill Lynch Global Commodities Research

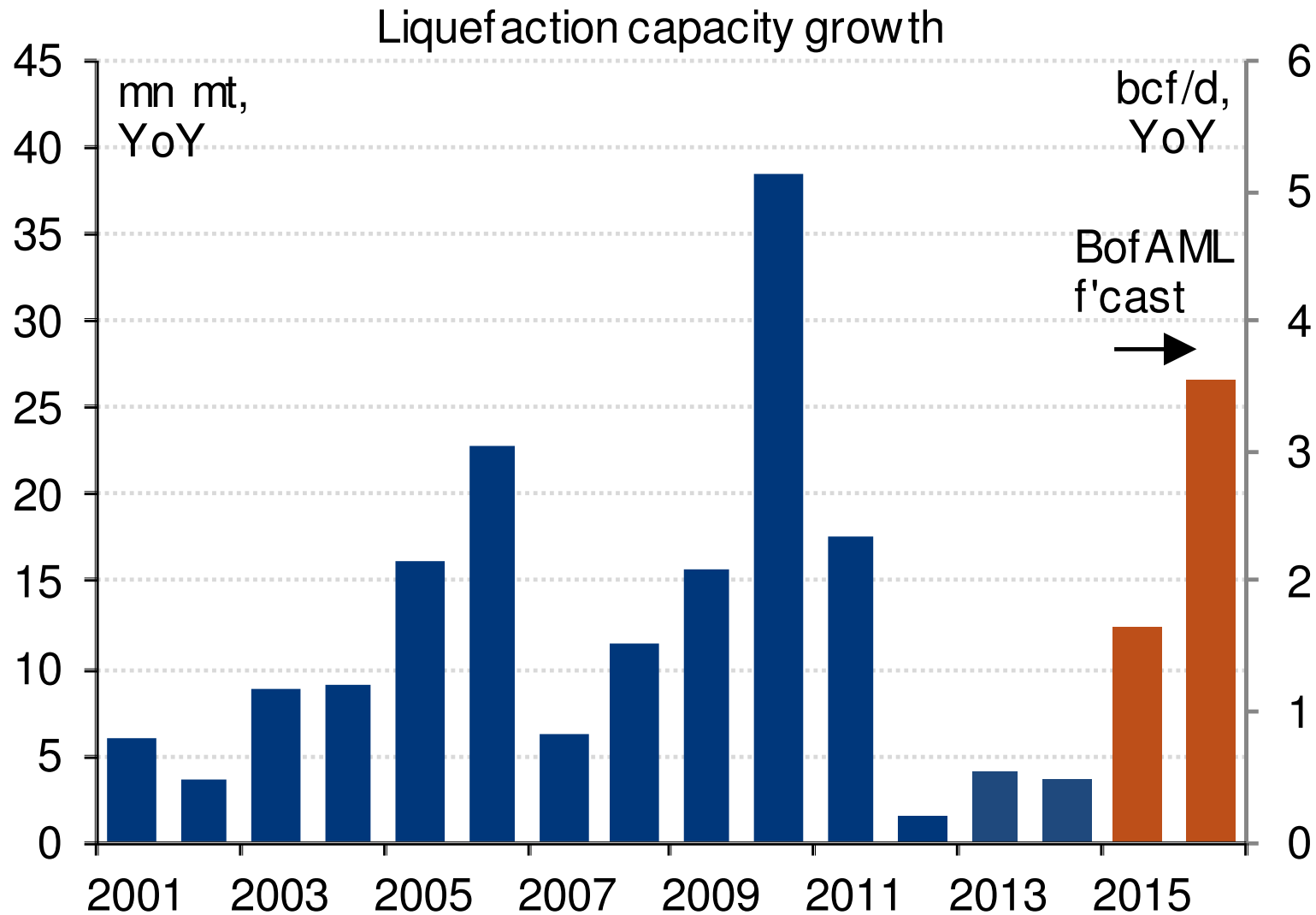
Sabine Pass is the most advanced LNG terminal, with exports set to start early next year



Source: BofA Merrill Lynch Global Commodities Research

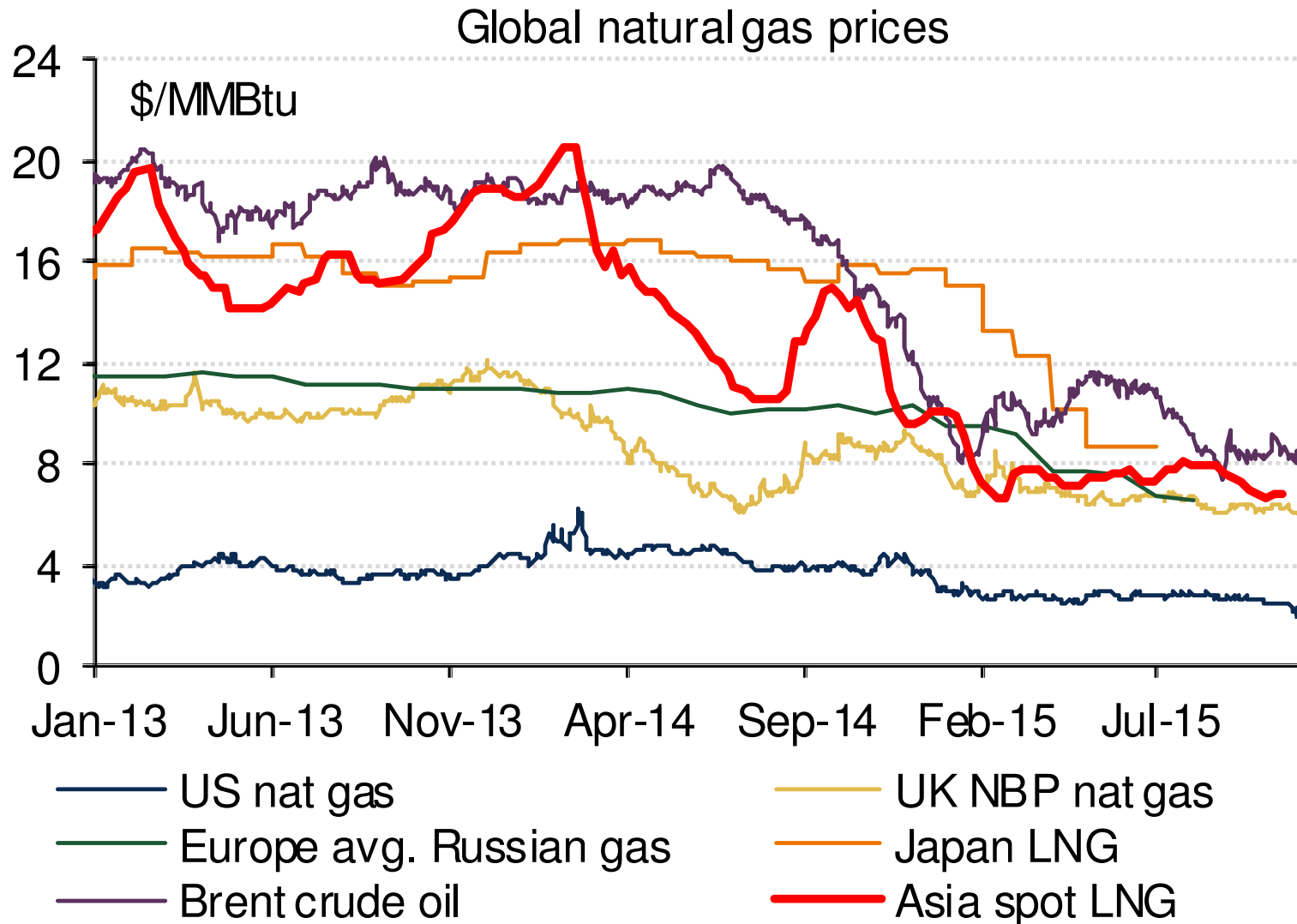
* these projects have not been approved yet

We see 12 mmtpa of liquid gas coming to the market this year and 26+ next year, a strong rate of growth...



Source: BofA Merrill Lynch Global Commodities Research

...suggesting a rather frosty outlook over the next 12 months for spot global LNG prices



Source: Bloomberg, Reuters, BofA Merrill Lynch Global Commodities Research

Crude oil and natural gas prices forecasts

BofA Merrill Lynch Commodity Price Forecasts (period averages)										
	Units	2015	1Q16F	2Q16F	3Q16F	4Q16F	2016F	2017F	2018F	2019F
WTI	(\$/bbl)	48.76	36.00	43.00	49.00	52.00	45.00	59.00	67.00	75.00
Brent	(\$/bbl)	53.60	37.00	44.00	50.00	53.00	46.00	61.00	70.00	80.00
US Nat Gas (HH)	(\$/MMBtu)	2.63	2.60	2.80	3.10	3.50	3.00	3.50	3.50	3.50

Source: BofA Merrill Lynch Commodities Research

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