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Flash Note
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News flow from the energy sector continues to support our projection for cheap oil

Like every month, I am pleased to detail the most relevant information occurred in the energy sector during the last month, in order to review both our positioning and recommendation in this asset.

Positive News flow

1. The big story today is the indication from major OPEC producers that may be some level of preliminary agreement for an extension of the cartel's production cuts. Saudi and Kuwait energy ministers said that "there is consensus building" for an extension, though there is no agreement yet.
2. Hedge funds and money managers raised their bets on rising oil prices for a third straight week (net-long contracts rose by 14,1k or +4.6%). Nevertheless, prices have moved in the opposite direction (slipping 1.9% in the report week).

Negative News flow

1. Al-Falih has left open the possibility that a deal extension could be for fewer than the expected six months. The shorter length of an hypothetical new output cut agreement suggest the lack of compromise with such a moves.
2. Iraq may seek an exemption from the cartel's output-cut deal and ask to boost its own output. Ammar al-Hakim, leader of the nation's Shi'ite ruling coalition, said that his country needs its oil income to continue the fight against the Islamic State.
3. Iran may also be allowed to maintain production level. Kuwait's Oil Minister Issam Almarzooq confirmed this. Iran was allowed to increase its output under the original deal to help its oil industry rebuild after years of international sanctions.
4. Russia officials have indicated that the country's output could climb to its highest rate in 30 years (to 11.07M bpd) and that local oil companies are ready to push up output once the OPEC's pact runs out. Russia has yet to state publicly whether it wants cuts to run beyond June, although Russian Energy Minister Alexander Novak said "the oil market had improved since the beginning of March",

"Aramco is likely worth at least $500B less than the government previously suggested" suggesting that Moscow may be reluctant to extend the output cut agreement.

5. For Aramco insiders, Prince's $2T IPO valuation doesn't add up. Officials working on the deal indicated that “The firm is likely worth at least $500B less than the government previously suggested”. A sale of the company at substantially lower levels will detract much attractiveness to an industry, in itself, unattractive.
6. Industry consultant FGE says OPEC needs another year of cuts to hit target, which is deemed at the moment to be “an impossible mission”. Saudi Arabia has just acknowledged that the group has failed to hit their target of eroding oil inventories below the five-year historical average.
7. Iran becomes #2 oil supplier to South Korea, for first time ever, as it ramped up output to regain market share after sanctions were lifted. Iran took the number two with shipments of 46.73M barrels (>100% y/y).
8. Brent physical oil market is flashing signs of weakness as dwindling Asian purchases and influx of US crude to Europe are all combining to recreate a North Sea glut, just as speculators have begun rebuilding bullish positions.
9. China's oil demand has skyrocketed in recent years but its refinery capacity has expanded even faster, rising to ~15% of the global total by the end of 2015 (and stands now ~20% higher than the country's annual oil consumption), suggesting that a moderation in oil imports could be on the cards. This has been a key factor in Chinese becoming one of the world's largest exporters of diesel and gasoline fuel. Products that could also face downward price pressure globally, and as a result, pushing down also crude prices.
10. US shale production set for biggest rise in more than two years. Based on the latest EIA's monthly Drilling Productivity Report, output in May could see its largest monthly increase in more than two years (+124K bpd) to hit 5.19M bpd, up from an upwardly adjusted 5.069M bpd level in April. Most shale regions are expected to see production gains, with the Permian basin projected to see a 76K bpd hike.

Conditions are all combining to recreate a North Sea glut.

Considering that most of the information is, a priori, unfavorable for oil price, we maintain our fundamental target price of US$45 pbl for the WTI. If the price fluctuates around this level, much of the global inflationary pressures observed in the last year will lack momentum, as the base effect of the oil price rally should have already dissipated in June.