

# Offshore & Marine Monthly

Supply tight but major not spending



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SINGAPORE | OIL AND GAS | UPDATE

9 July 2018

- **Oil prices rallied in the recent consecutive three quarters**
- **The resumption of elevated output is confronting to several limits**
- **Offshore drilling activities are recovering but day rates are soft**
- **Oil market is embracing higher volatilities**

## Oil prices rallied in the recent consecutive three quarters

In 1H18, both of the WTI and Brent crude oil prices were riding on the tailwind of shrinking inventories, and Brent hit a more than 3-year highs of US\$80/bbl in Jun-18. According to US Energy Information Administration (EIA) Short-term Energy Outlook in Jun-18, the excess US crude inventory has been depleting over the past three quarters, see Figure 2, indicating the supply glut had been gradually diminishing since Jul-17. Another positive is during the recovery period, oil market turned from contango to backwardation (current oil supply level is lower than expected). A reflection that spot demand is strong. The status will probably persist as stockpiles are moving downward, as shown in Figure 4. Meanwhile, EIA forecasted supply-demand dynamic will remain at a relatively balanced level in the next three quarters. Therefore, we believe oil prices will be supported at above US\$70/bbl.

## The resumption of elevated output is confronting to several limits

With the increased likelihood of sanctions on Iran, the global oil market is under the pressure of future supply shortfall. As of May-18, Iran's production was 3.8mn bbl/d. Meanwhile, US has urged Saudi Arabia to increase output by 2mn bbl/d. This will be challenging as Saudi Arabia mentioned this spare capacity is expensive to turn on. See Figure 5, the OPEC capacity was below 3mn bbl/d as of May-18, indicating that there is little room for OPEC to pump more oil on a larger scale. For the US, it had been increasing production, reaching a new record of 10.9mn bbl/d as of Jun-18, as shown in Figure 6. However, the production could encounter bottlenecks such as a in pipeline capacity, obsolete infrastructure and lack of workforce. Hence, US production growth may slow down in the near term. In a nutshell, the resumption of lifting global oil supply could be outstripped by the stronger demand.

## Offshore drilling activities are recovering but day rates are soft

Offshore drilling and production activity is bottoming out in 1H18. The average utilization rate of the facilities climbed back to 60%+ by Jun-18, shown in Figure 7 & 8. However, day rates were still on the downtrend, and those operators subject to higher operating costs barely benefited from the market turnaround. We are encouraged that major oil players are reporting strong earnings since 4Q14, see Figure 9. But they were still cautious and prudent on the oil market outlook since the expected capex in 2018 is just slightly higher than that in 2016, shown in Figure 10.

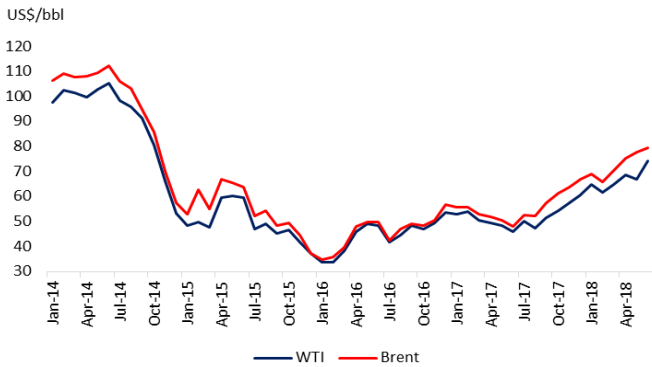
## Oil market is embracing higher volatilities

In the near term, we believe oil prices will fluctuate widely. On the one hand, the market will continue to price in geopolitical risks such as trade war tensions and output disputes. On the other hand, the proceeding of the Fed rate hike cycle and shrinkage of balance sheets in major central banks could slow the recovery of the global economy. Oil market is filled with much more noises moving forward.

Chen Guangzhi (+65 6212 1859)  
Investment Analyst  
chengz@phillip.com.sg

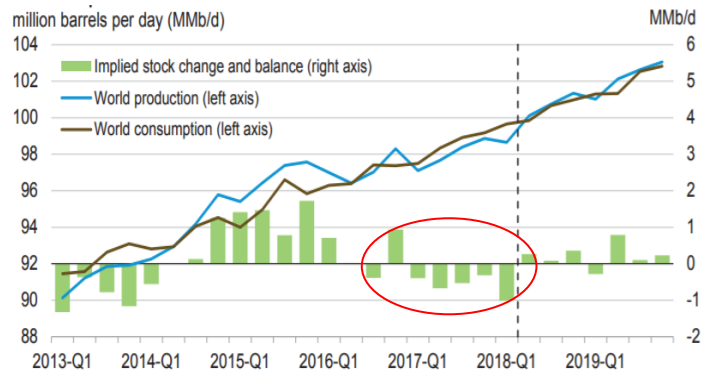
## Sector charts

**Figure 1: Crude oil price more than 3-year high**



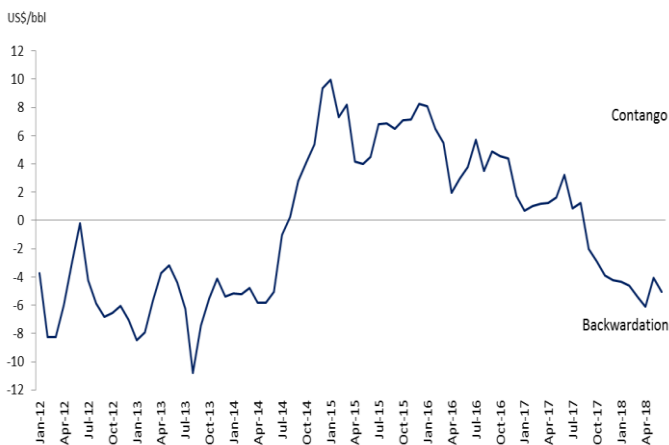
Source: Bloomberg, PSR

**Figure 2: World liquid fuels supply is returning**



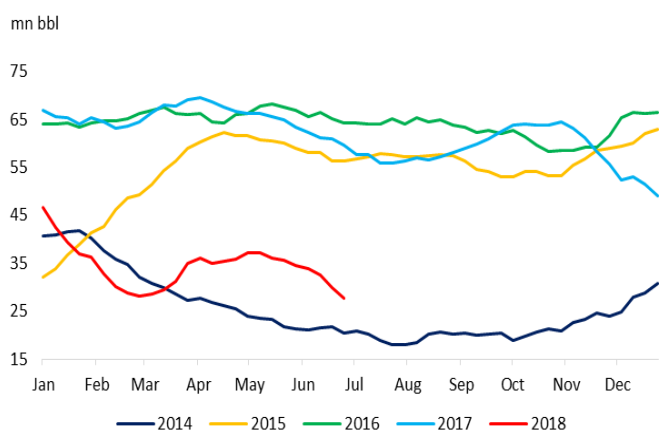
Source: STEO June, EIA

**Figure 3: Backwardation since Jul-17**



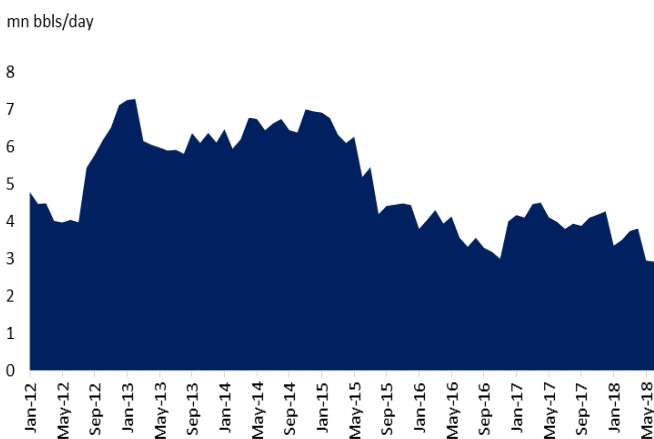
Source: Bloomberg, PSR

**Figure 4: Weekly US crude oil stockpile is trending down**



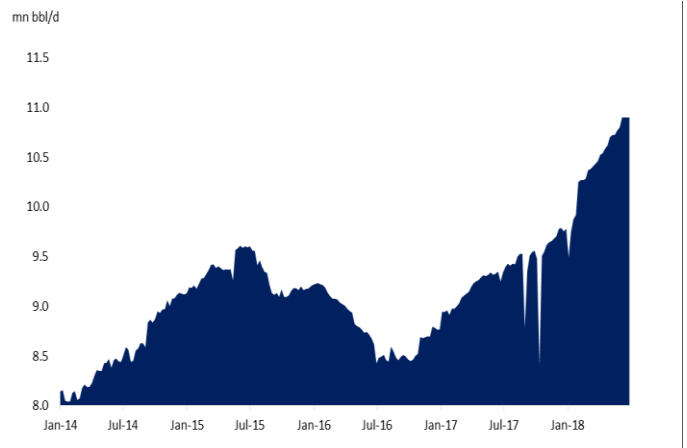
Source: Bloomberg, PSR

**Figure 5: OPEC spare capacity is tight**



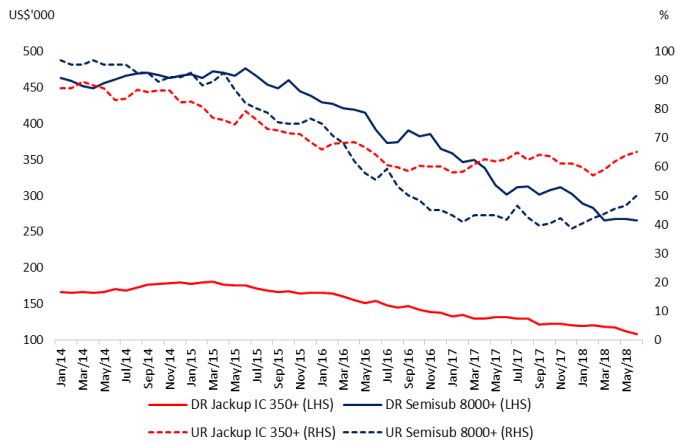
Source: Bloomberg, PSR

**Figure 6: Increasing US crude oil production**



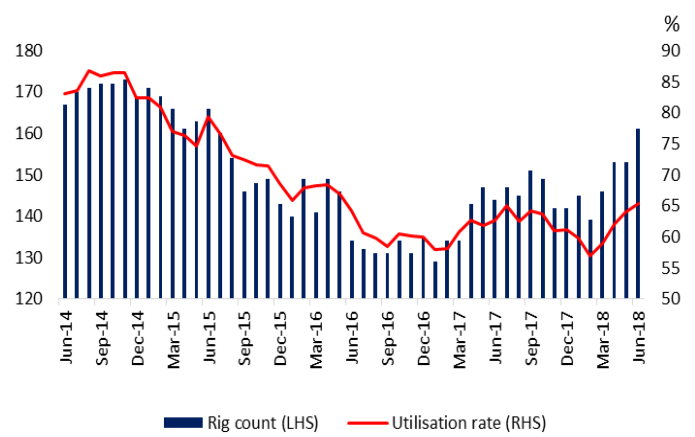
Source: Bloomberg, PSR

**Figure 7: Improving utilisation but depressed day rate**



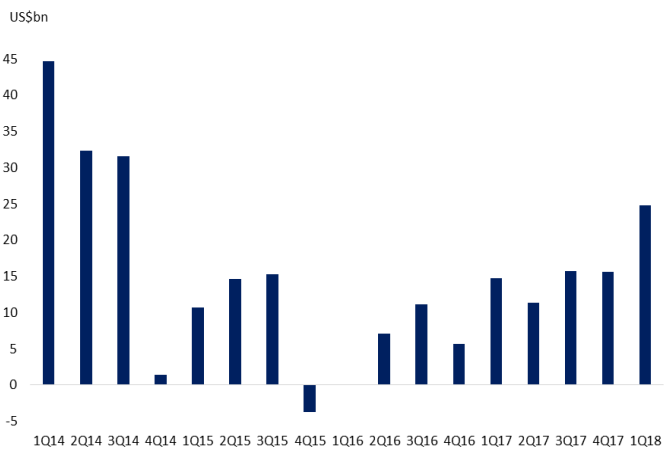
Source: Bloomberg, PSR

**Figure 8: Positive recovery of rig count and utilisation rate**



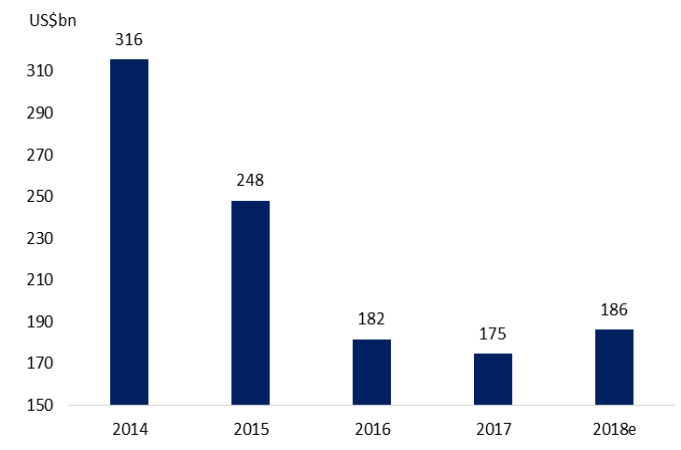
Source: Bloomberg, PSR

**Figure 9: Turnaround of EBIT of oil majors**



Source: Bloomberg, PSR

**Figure 10: Capex of global integrated oil companies bottoms out**



Source: Bloomberg, PSR

<b>Head of Research</b> Paul Chew – <a href="mailto:paulchewkl@phillip.com.sg">paulchewkl@phillip.com.sg</a>	<b>Contact Information (Singapore Research Team)</b> <b>Research Associate</b> Alvin Chia - <a href="mailto:alvinchiawy@phillip.com.sg">alvinchiawy@phillip.com.sg</a>	<b>Research Operations Officer</b> Mohamed Amiruddin - <a href="mailto:amiruddin@phillip.com.sg">amiruddin@phillip.com.sg</a>
<b>Consumer   Healthcare</b> Soh Lin Sin - <a href="mailto:sohls@phillip.com.sg">sohls@phillip.com.sg</a>	<b>Oil &amp; Gas   Energy</b> Chen Guangzhi - <a href="mailto:chengz@phillip.com.sg">chengz@phillip.com.sg</a>	<b>Macro</b> Pei Sai Teng - <a href="mailto:peist@phillip.com.sg">peist@phillip.com.sg</a>
<b>Transport   REITs (Industrial)</b> Richard Leow - <a href="mailto:richardleowwt@phillip.com.sg">richardleowwt@phillip.com.sg</a>	<b>REITs (Commercial, Retail, Healthcare)   Property</b> Dehong Tan - <a href="mailto:tandh@phillip.com.sg">tandh@phillip.com.sg</a>	<b>Technical Analysis</b> Jeremy Ng - <a href="mailto:jeremyngch@phillip.com.sg">jeremyngch@phillip.com.sg</a>
<b>REITs (Commercial, Retail, Healthcare)   Property</b> Tara Wong - <a href="mailto:tarawongsj@phillip.com.sg">tarawongsj@phillip.com.sg</a>	<b>US Equity</b> Ho Kang Wei - <a href="mailto:hokw@phillip.com.sg">hokw@phillip.com.sg</a>	<b>Banking and Finance</b> Tin Min Ying – <a href="mailto:tinmy@phillip.com.sg">tinmy@phillip.com.sg</a>

**Contact Information (Regional Member Companies)**
**SINGAPORE**

**Phillip Securities Pte Ltd**  
Raffles City Tower  
250, North Bridge Road #06-00  
Singapore 179101  
Tel +65 6533 6001  
Fax +65 6535 6631  
Website: [www.poems.com.sg](http://www.poems.com.sg)

**JAPAN**

**Phillip Securities Japan, Ltd.**  
4-2 Nihonbashi Kabuto-cho Chuo-ku,  
Tokyo 103-0026  
Tel +81-3 3666 2101  
Fax +81-3 3666 6090  
Website: [www.phillip.co.jp](http://www.phillip.co.jp)

**THAILAND**

**Phillip Securities (Thailand) Public Co. Ltd**  
15th Floor, Vorawat Building,  
849 Silom Road, Silom, Bangrak,  
Bangkok 10500 Thailand  
Tel +66-2 6351700 / 22680999  
Fax +66-2 22680921  
Website [www.phillip.co.th](http://www.phillip.co.th)

**UNITED STATES**

**Phillip Capital Inc**  
141 W Jackson Blvd Ste 3050  
The Chicago Board of Trade Building  
Chicago, IL 60604 USA  
Tel +1-312 356 9000  
Fax +1-312 356 9005  
Website: [www.phillipusa.com](http://www.phillipusa.com)

**INDIA**

**PhillipCapital (India) Private Limited**  
No.1, 18th Floor, Urmi Estate  
95, Ganpatrao Kadam Marg  
Lower Parel West, Mumbai 400-013  
Maharashtra, India  
Tel: +91-22-2300 2999 / Fax: +91-22-2300 2969  
Website: [www.phillipcapital.in](http://www.phillipcapital.in)

**CAMBODIA**

**Phillip Bank Plc**  
Ground Floor of B-Office Centre, #61-64,  
Norodom Blvd Corner Street 306, Sangkat  
Boeung Keng Kang 1, Khan Chamkamorn,  
Phnom Penh, Cambodia  
Tel: 855 (0) 7796 6151/855 (0) 1620 0769  
Website: [www.phillipbank.com.kh](http://www.phillipbank.com.kh)

**MALAYSIA**

**Phillip Capital Management Sdn Bhd**  
B-3-6 Block B Level 3 Megan Avenue II,  
No. 12, Jalan Yap Kwan Seng, 50450  
Kuala Lumpur  
Tel +603 2162 8841  
Fax +603 2166 5099  
Website: [www.poems.com.my](http://www.poems.com.my)

**INDONESIA**

**PT Phillip Securities Indonesia**  
ANZ Tower Level 23B,  
Jl Jend Sudirman Kav 33A  
Jakarta 10220 – Indonesia  
Tel +62-21 5790 0800  
Fax +62-21 5790 0809  
Website: [www.phillip.co.id](http://www.phillip.co.id)

**FRANCE**

**King & Shaxson Capital Limited**  
3rd Floor, 35 Rue de la Bienfaisance 75008  
Paris France  
Tel +33-1 45633100  
Fax +33-1 45636017  
Website: [www.kingandshaxson.com](http://www.kingandshaxson.com)

**AUSTRALIA**

**Phillip Capital Limited**  
Level 10, 330 Collins Street  
Melbourne, Victoria 3000, Australia  
Tel +61-03 8633 9803  
Fax +61-03 8633 9899  
Website: [www.phillipcapital.com.au](http://www.phillipcapital.com.au)

**TURKEY**

**PhillipCapital Menkul Degerler**  
Dr. Cemil Bengü Cad. Hak Is Merkezi  
No. 2 Kat. 6A Caglayan  
34403 Istanbul, Turkey  
Tel: 0212 296 84 84  
Fax: 0212 233 69 29  
Website: [www.phillipcapital.com.tr](http://www.phillipcapital.com.tr)

**HONG KONG**

**Phillip Securities (HK) Ltd**  
11/F United Centre 95 Queensway  
Hong Kong  
Tel +852 2277 6600  
Fax +852 2868 5307  
Websites: [www.phillip.com.hk](http://www.phillip.com.hk)

**CHINA**

**Phillip Financial Advisory (Shanghai) Co Ltd**  
No 550 Yan An East Road,  
Ocean Tower Unit 2318,  
Postal code 200001  
Tel +86-21 5169 9200  
Fax +86-21 6351 2940  
Website: [www.phillip.com.cn](http://www.phillip.com.cn)

**UNITED KINGDOM**

**King & Shaxson Capital Limited**  
6th Floor, Candlewick House,  
120 Cannon Street,  
London, EC4N 6AS  
Tel +44-20 7426 5950  
Fax +44-20 7626 1757  
Website: [www.kingandshaxson.com](http://www.kingandshaxson.com)

**SRI LANKA**

**Asha Phillip Securities Limited**  
2<sup>nd</sup> Floor, Lakshmans Building,  
No. 321, Galle Road,  
Colombo 03, Sri Lanka  
Tel: (94) 11 2429 100  
Fax: (94) 11 2429 199  
Website: [www.ashaphillip.net](http://www.ashaphillip.net)

**DUBAI**

**Phillip Futures DMCC**  
Member of the Dubai Gold and  
Commodities Exchange (DGEX)  
Unit No 601, Plot No 58, White Crown Bldg,  
Sheikh Zayed Road, P.O.Box 212291  
Dubai-UAE  
Tel: +971-4-3325052 / Fax: + 971-4-3328895

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