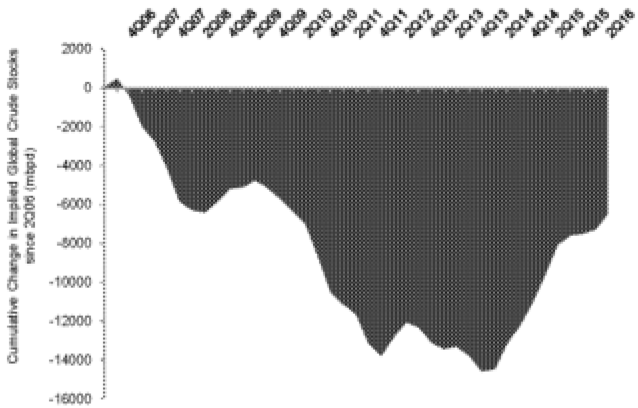
Crude inventory overhang

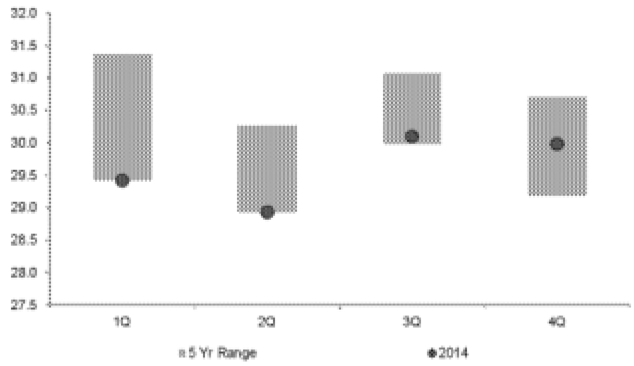
One of the lingering challenges in tightening global crude balances, and thus pricing, is the significant crude inventory overhang, with estimated OECD crude inventories currently at 1030 MMbbls (excluding gov't stocks), or 45% above the 5 year average. We anticipate crude inventory levels to increase though mid 2016 as increasing non-OPEC supply is brought on-stream and as US onshore production gradually adjusts to a new 'normal'. The pace of inventory builds is anticipated to peak in 2Q15 with inventory levels anticipated to dip modestly in 4Q15 prior to heading into weaker seasonal demand in the 1st half of 2016. At its peak (in 2Q16) we expect accumulated crude inventories post 4Q14 to reach 500 mbbls or ~17.5% of annualized 2Q15 production. While on first blush this may seemingly present a significant headwind to our outlook, we contend that a) relative to historical levels we aren't visiting new ground, and b) low commodity driven demand growth and lower product inventory levels will largely mitigate against the risk.

Figure 63: Though global crude inventory levels are expected to increase during the correction, we aren't headed anywhere we haven't already been…



Source: Deutsche Bank, IEA, Implied global crude stock builds

Figure 64: OECD total products days forward metrics reveal historically low inventory levels/ability to absorb excess crude



Source: Deutsche Bank, Wood Mackenzie, IEA

While current OECD crude inventories are ~45% of 5 yr averages, product inventories are essentially flattish to historicals offering some potential relief to the crude overhang. Further we would note that looking at absolute inventory levels without regard to the role of demand trends as incomplete. Looking historically at incremental QoQ global product demand growth vs. implied crude inventory builds, we find that movements in global crude stocks closely led those in product demand (by a quarter) in the data set we looked at. Further, when adjusting for demand, OECD product inventories look more poised to potentially absorb increasing crude stocks as the IEA estimates product growing annually by ~1200 mbpd.