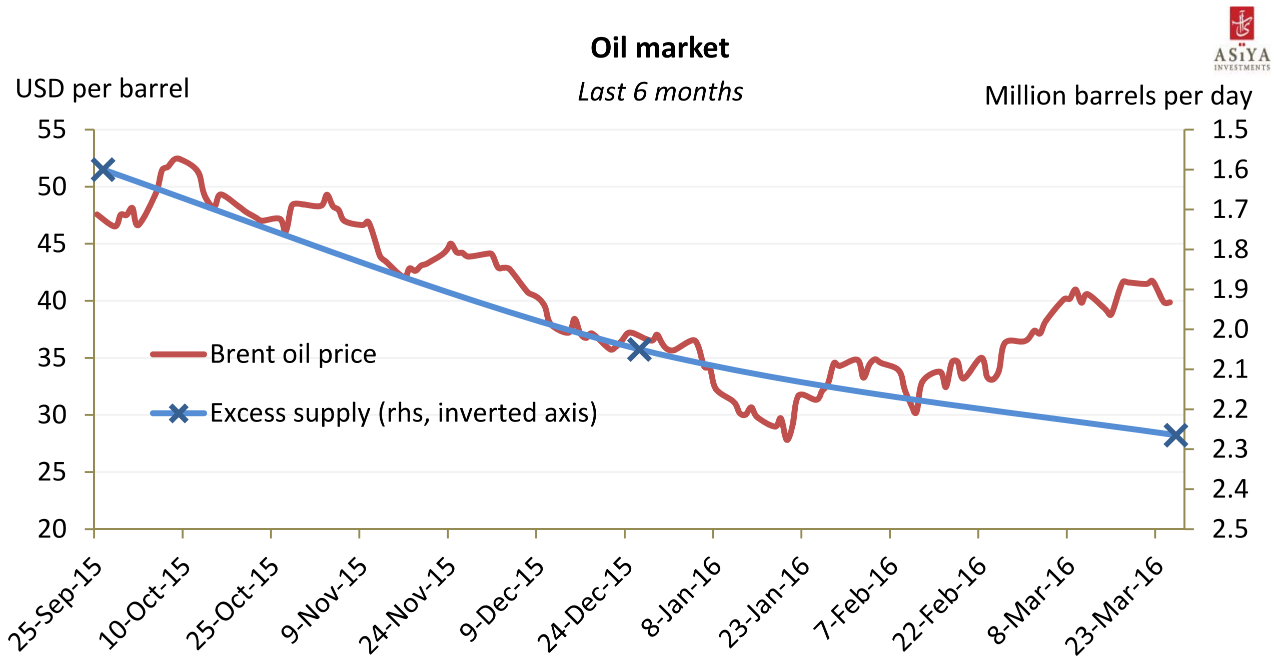
Oil price could fall further in 2016

A combination of supply increases, despite a potential agreement between major oil producers, demand weakness and disappointed investors could push oil prices down.



Source: Asiya Research on OPEC, 2016. *www.asiyainvestments.com*

The mismatch between oil supply and demand has increased further this quarter, rising from 2.0 to 2.3 million barrels per day (mb/d), according to OPEC data. The key reason is the decline in demand, which fell 0.6 mb/d compared to the previous quarter. Global supply decreased by 200,000 barrels per day in February, mostly in Iraq, Nigeria and United Arab Emirates. However, output in the two largest producers Saudi Arabia and Russia increased in February suggesting ongoing competition for market share. Moreover, data confirm that Iran is steadily returning to the market, increasing output from 2.9 mb/d in January to 3.1 mb/d in February. In the United States, oil inventory stocks are also increasing rapidly, around 10% so far this year.

But prices are not responding to the glut. Instead of falling, oil prices have been trending upward since the end of January, driven by hopes that major oil producers will join an output freeze agreement – a meeting is set for mid-April. There are two major reasons why investors are being too optimistic about the deal. First, the agreement may not happen. Saudi Arabia has been increasing market share with the main objective of hurting high-cost oil producers in the US, the main source of the oversupply, and that mission has not been fully accomplished. Although oil output began to fall in the US, production is still relatively high. Also, it remains unclear whether Saudi Arabia would agree to join a deal exempting regional rival Iran. The second reason is that, even if the agreement takes place, its effect will be limited, as the countries involved are already producing near record levels. Those that are not, Libya and Iran, are unlikely to join. Iran has claimed that it will not halt production until it reaches 4.0 mb/d, probably in

2017, which means that this year it will increase from 3.1 to 3.8 million per day. On a different note, the US shale industry has been resilient during the decline in oil prices, showing quick responsiveness to oil price movements. All in all, we think that the glut will take time to clear.

OPEC expects the global economy to grow by an additional 0.2 percentage points and oil demand to rise 1.3% YoY in 2016. We find these forecasts too high. With flat growth in Europe and Japan, and the US, China and most emerging markets decelerating, we project a 0.3 percentage point decline in global growth and a 0.8% YoY increase in oil demand. On the supply front, we assume an increase in Iranian output, other OPEC countries' output to remain around January levels – whether a freeze agreement takes place or not – and non-OPEC output to fall in line with the 0.7 mb/d decline projected by OPEC. Taking all these factors into account, supply will continue to exceed demand in 2016 by 2.0 mb/d, as much as last year when the price of Brent crude averaged around $50 per barrel. Market disappointment about the oil agreement, rapid technological development in the shale industry, stronger than expected Iranian production and weaker than expected global demand could push oil prices further below the fundamental-based price forecast. The combination of fundamentals and market expectations will most likely keep the price of oil below last year's level.

Prepared by Camille Accad - For more information please visit: www.asiyainvestments.com or email: research@asiyainvestments.com. Asiya Investments is an Asia-focused investment company. Licensed and regulated by the Central Bank of Kuwait, it facilitates capital flows between the Middle East and emerging Asia by providing financial and advisory services, and managing third party capital.

(Cap. 571) ("SFO") for carrying on Type 4 "Advising on Securities" and Type 9 "Asset Management" regulated activities and is regulated by the Securities and Futures Commission in Hong Kong ("SFC"). Pursuant to its license, Asiya Investments Hong Kong Limited provides services to Professional Investors solely and does not hold client assets (both defined under the SFO). Asiya Investments Hong Kong Limited is also a registered investment adviser (CRD Number: 171241) with the US Securities and Exchange Commission (SEC). The CMA, CBK, CIMA, SFC, SEC and DFSA have no responsibility for reviewing or verifying this report or other documents in connection / associated with these Companies. Accordingly, the CMA, CBK, CIMA, SFC, SEC and DFSA have not approved this report or any other associated documents nor taken any steps to verify the information set out in this report or presentation and has no responsibility for it.

If you do not understand the contents of this document you should consult an authorized financial advisor.

This report is intended for Professional and Market Counterparty Clients, as defined in the DFSA's Conduct of Business Rules ("COB") and Professional Investors as defined under the SFO and subsidiary legislation in Hong Kong and therefore is not directed at, and must not, be delivered or relied upon by, a retail client."