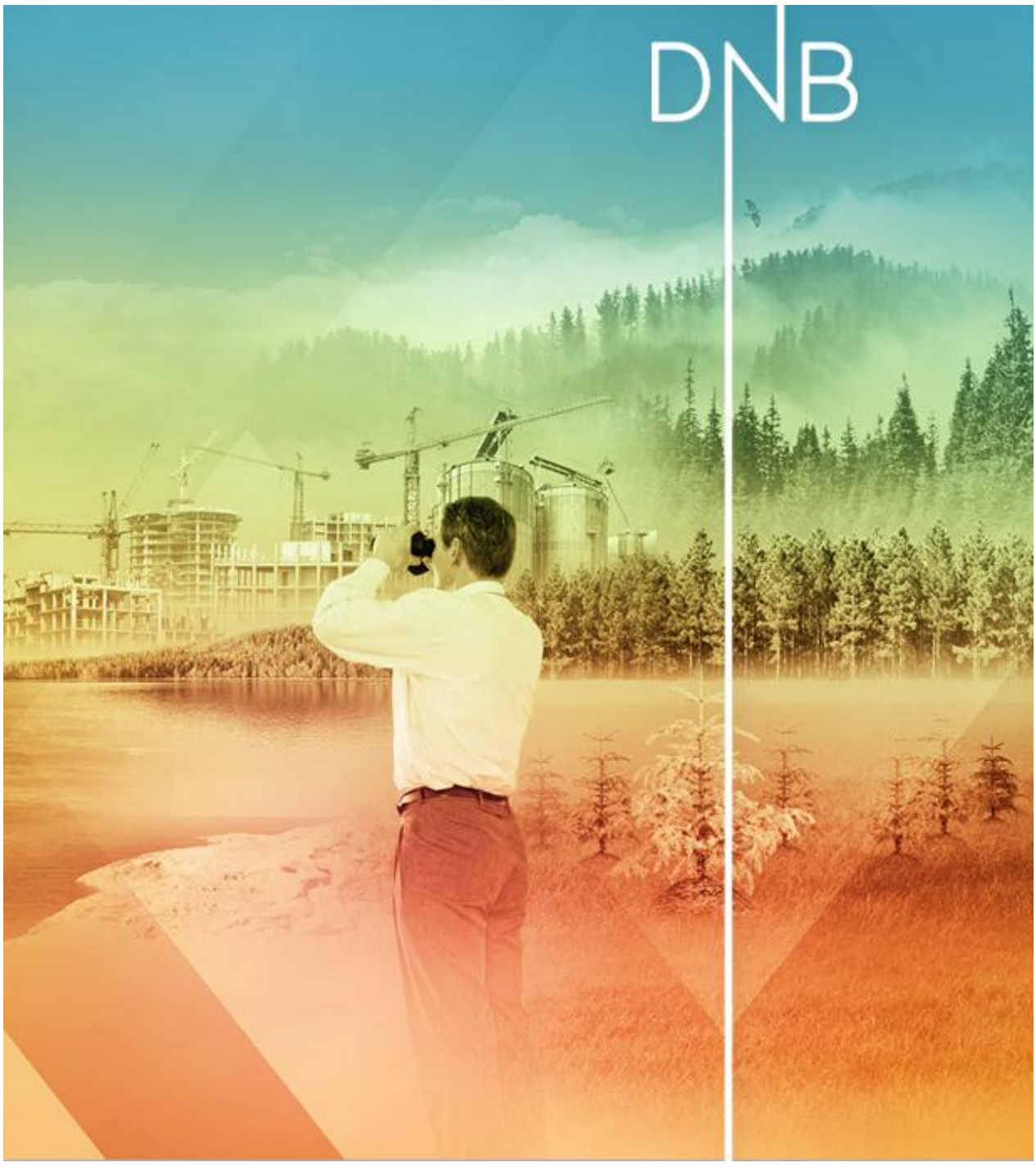
Short Term Oil Market Outlook

- High geopolitical risk related to Ukraine, Iraq and Libya offset by close to record net long oil positions held by Money Managers in both London and New York. The conclusion becomes neutral for the oil price in the short term.

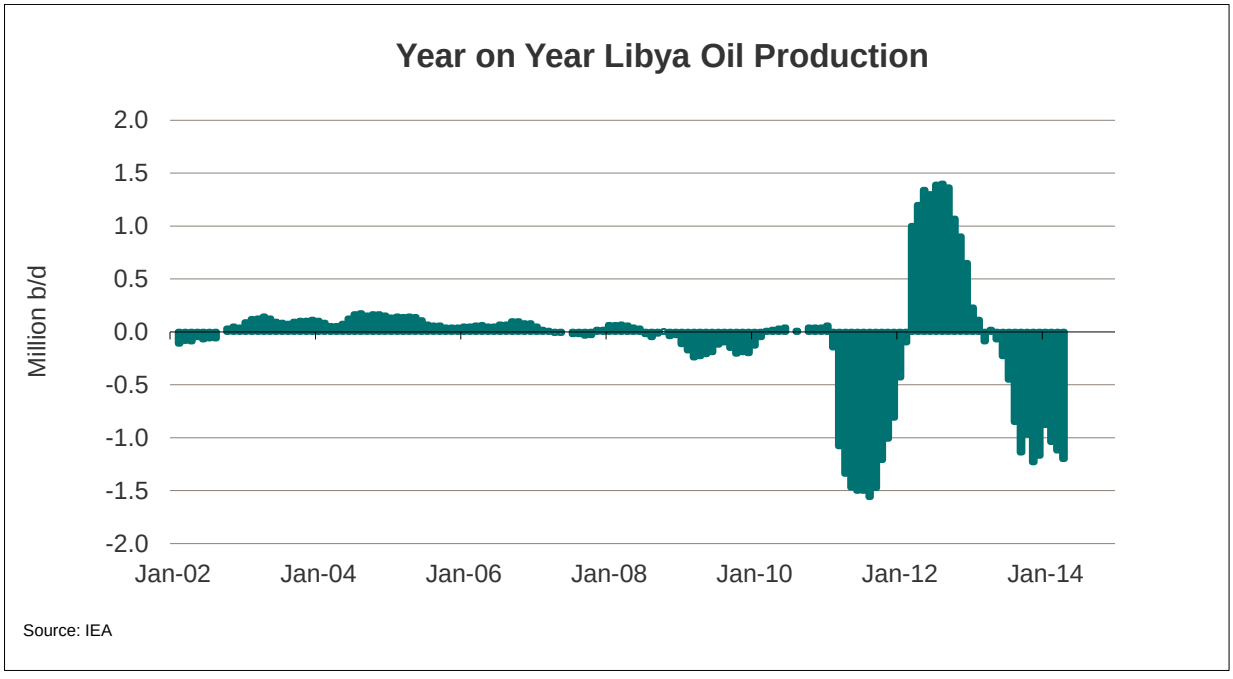


Content

1 Overall outlook

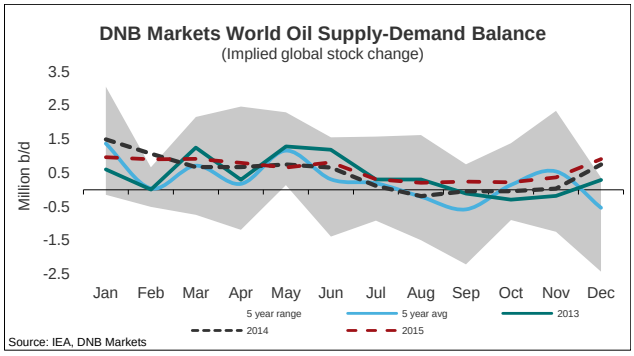
When we started 2014 we had assumed a gradual return of Libyan production back to about half of its prewar potential. We had assumed that Libya half way through 2014 would have reach about 600-800 kbd in output. The production has been around 0.5 million b/d lower than that so far this year and with General Khalifa Hafter coming in from the sidelines in May we look to be very close to a broader civil war in Libya between Islamists and anti-Islamist (led by general Hafter). The Libyan parliament swore in a new prime minister at the start of May, but this choice was disputed by non-Islamist groups and with the recent attack by General Hafter the Libyan situation is very chaotic.

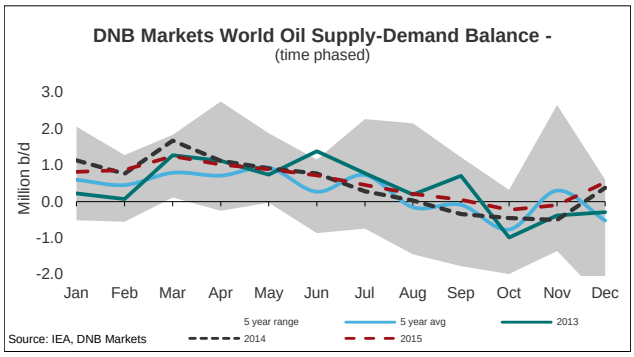
We now assume that through the rest of 2014 Libya will produce only between 300-500 kbd of crude oil. If a new strong man takes control of Libya (maybe General Hafter) this situation could change in 2015 however and it is probably prudent to assume that the country should reach a higher production in 2015 than in 2014 so that some of the shut out barrels will re-enter the market next year. Based mainly on this development we are revising up our Brent price forecast for the second half of 2014 with 3 $/b. We revise up Q3-14 from 104 $/b to 107 $/b and Q4-14 up from 102 $/b to 105 $/b. The average Brent price for 2014 is revised up from 103 $/b to 107 $/b. This means we are less bearish than before to 2014, but still expect lower prices in the second half of 2014 than the first half. We do not believe global oil demand will increase 2.1 million b/d from the first to the second half, like IEA believe, and we believe non-OPEC production growth will continue strongly through the rest of 2014, particularly in the US. We are not doing anything with the rest of our price deck which means we still assume 100 $/b for Brent in 2015 for then to drop below 100 $/b in 2016. If we see that global investments in the oil industry drops significantly this year and the next we might revise our oil price forecast for 2018-2020 higher, but it will do nothing to save the oil price for the next three years due to the large lag effects from investment to harvest in the oil industry. The next three years will most likely provide a large flow of start-ups of new oil projects globally, no matter what happens to oil prices and investments during the same three years.



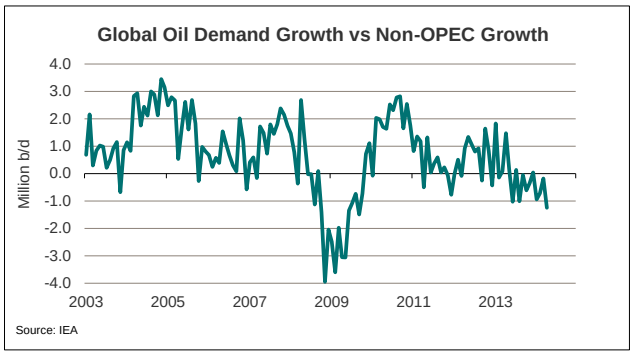
2 Global oil supply-demand balance

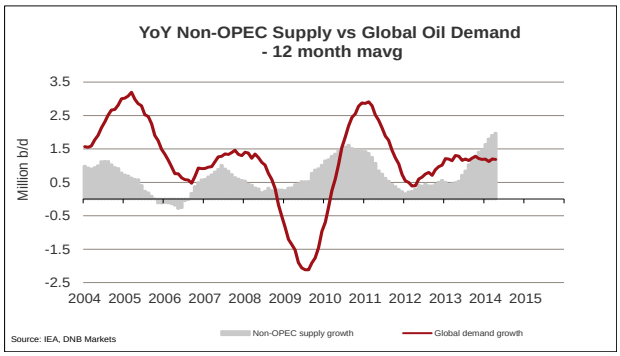
Our fundamental balance of supply vs demand is looking a bit stronger, or should we say less weak, in the second half of the year. Our time-phased balance is slightly stronger than the original version as can be seen in the graph to the right below. In the time-phased balance we have assumed that for production in the Middle East it takes on average about one month for production to reach the refinery for processing while for West Africa, Latin America and Europe we have assumed half a month. For North America and Asia we have assumed no time lag. Our supply-demand balance is however very similar to the 5-year average development, so in that respect it does not really provide too much of a conclusion as to what should happen to the price development. As we have explained further below under headline number six there is no seasonality in the crude oil price formation despite the fact that average second half of the year oil demand is significantly stronger than demand in the first half of the year. The IEA balance is stronger (more bullish) than our own balance even with our forecasted 1.6 million b/d global demand growth from the first half of the year to the second half. We believe our own forecast is probably rather too high than too low, noting that the average demand growth from the first to the second half is 1.1 million b/d since year 2000 while the average the last 5 years is 1.3 million b/d. For some reason the IEA believe global oil demand will increase 2.1 million b/d from the first to the second half this year. Last year global oil demand grew 1.7 million b/d in the same period and 0.6 million b/d was in the US. We are highly sceptical that this kind of demand growth will materialize in the US from the first to the second half this year.





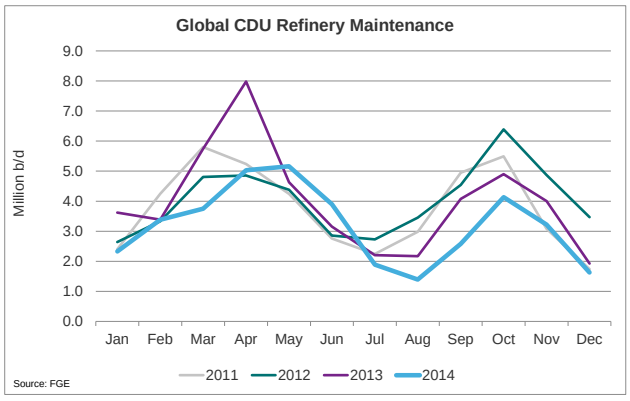
Even though the second half of the year looks stronger fundamentally than the first half, there are some larger parts on the move in the oil market. The last two years we have seen a stronger and stronger tendency for non-OPEC production to cover a larger and larger part of global oil demand alone and the latest year non-OPEC production has been growing quicker than global oil demand. That can hardly be described as a bullish development for the fundamental supply-demand balance. The market has however the last couple of years been saved by all the lost OPEC barrels, but will that continue? Can we have as a base case that the Iran negotiations will fall apart, Iraq will fall into civil war, no barrels will return from Libya and Venezuela will break apart? It could happen of course but to have that as a base case is not prudent in our opinion.

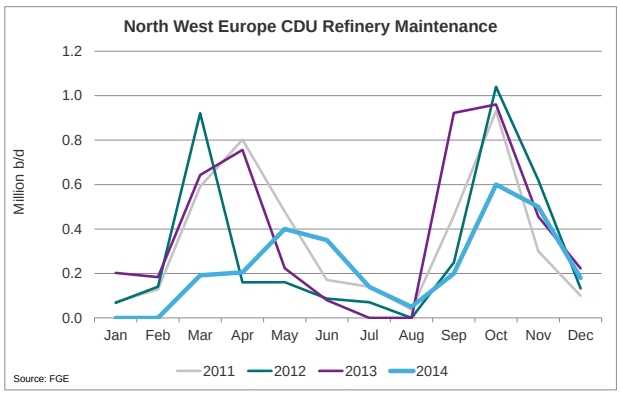


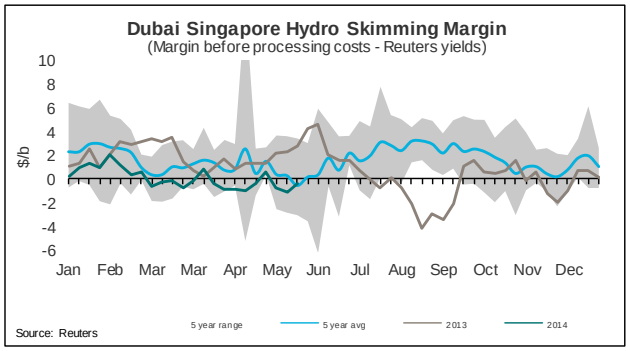


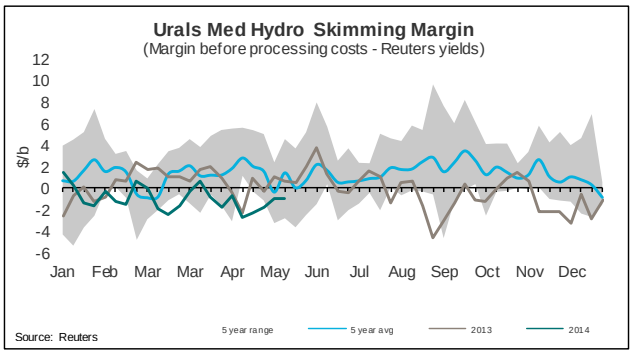
3 Refinery activity

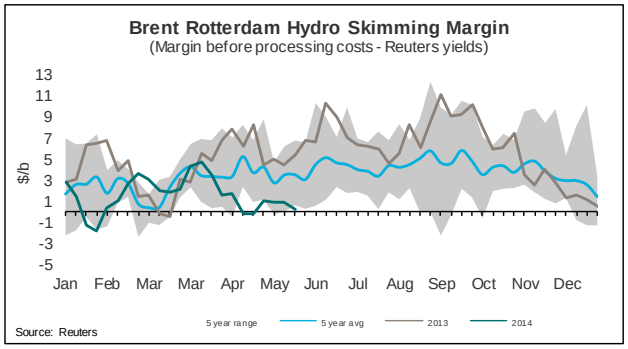
In theory we should in the coming months see a large increase in refinery activity as global refineries come out of maintenance. According to surveys on refinery maintenance we should see more than 3 million b/d of refining capacity return to service from May to August. This should then add to the demand for crude oil. The problem is however that all this capacity will not return to the market if refinery margins are crushed in the process. Last year global refinery throughput increased more than 4 million b/d from May to the peak in July according to IEA data, but then margins were decent when refineries were ramping up from May to July. This is not the case right now. Refineries have started the seasonal ramp up in output but margins are already suffering. Note particularly the weak simple margins in a typical Rotterdam refinery that runs Brent as feedstock. The weakening margins are a sign that oil product demand is not strong enough to capture the increase in refinery throughput. In other words, maybe people have too high expectations for increased crude demand in the coming months. More evidence of the weak European refining sector have become visible in 2014 as Hungary's MOL Group shut down its Mantua refinery in northern Italy and the Milford Haven refinery in Wales has stopped processing crude as its owner Murphy Oil is looking for a buyer of the asset. More on weak margins under headline number 6 below.

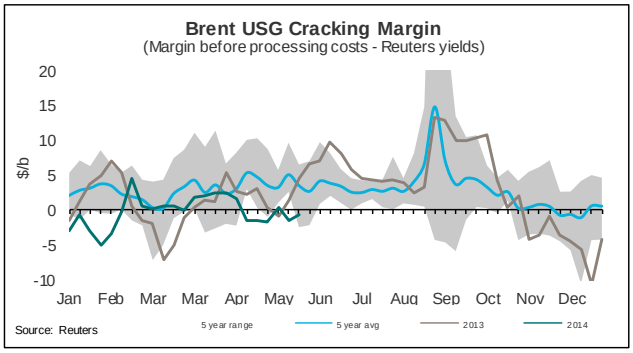






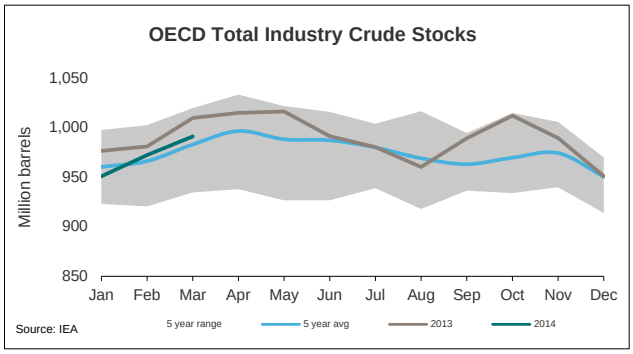


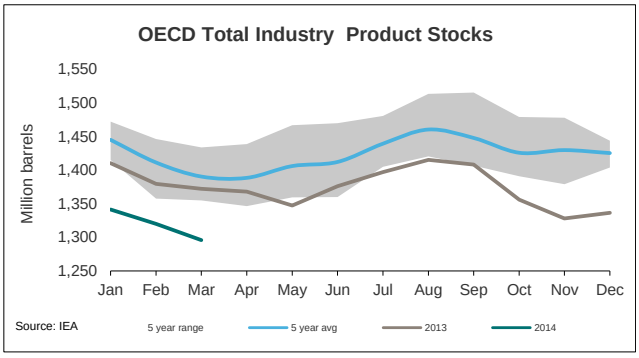

Brent Rotterdam Hydro Skimming Margin
(Margin before processing costs - Reuters yields)
$/b
13
11
9
7
5
3
1
-1
-3
-5
Jan Feb Mar Mar Apr May Jun Jul Aug Sep Oct Nov Dec
5 year range
5 year avg
2013
2014
Source: Reuters


Brent USG Cracking Margin
(Margin before processing costs - Reuters yields)
$/b
20
15
10
5
0
-5
-10
Jan Feb Mar Mar Apr May Jun Jul Aug Sep Oct Nov Dec
5 year range
5 year avg
2013
2014
Source: Reuters

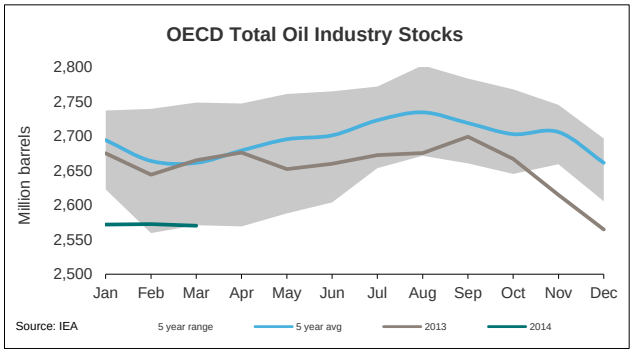
4 Oil stocks

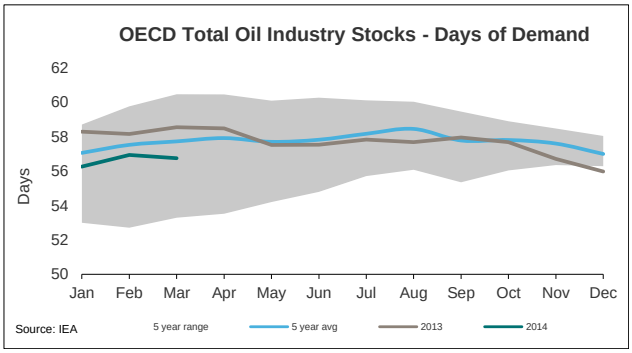
Total crude oil stocks in the OECD are slightly above the 5-year range. There hence seems to be no lack of crude oil. The challenge is the product stocks which are very low as can be seen in the graph below. Increased refinery throughput should however allow refined product stocks to build.

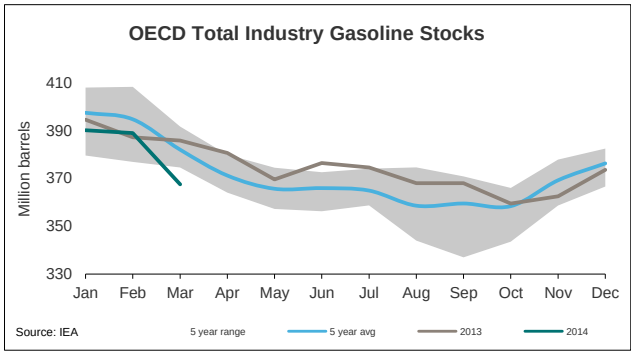


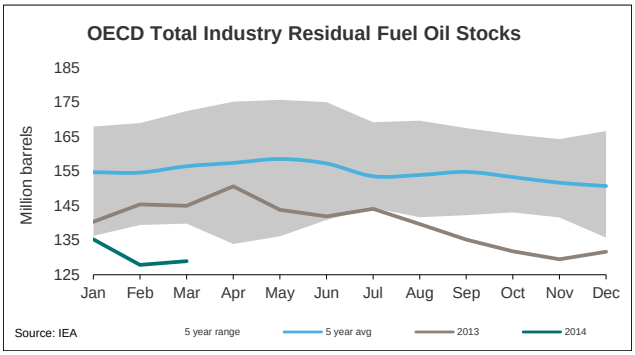


Since refined product stocks are so low, total oil industry stocks in the OECD are low as well, but if we translate the stock level over to days of demand coverage the picture becomes considerably less bullish.

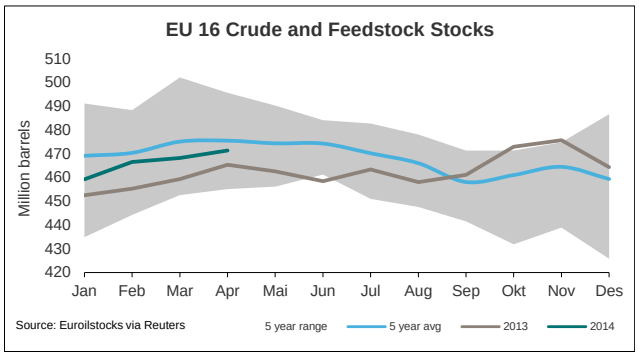


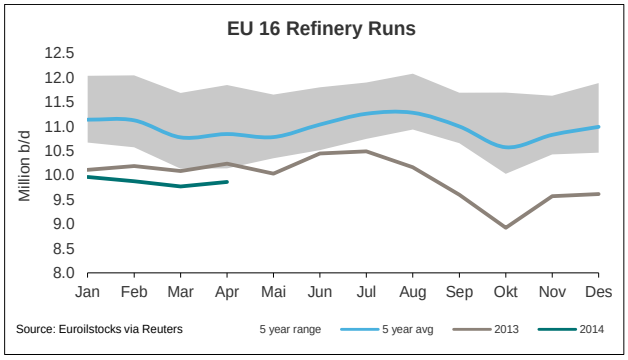


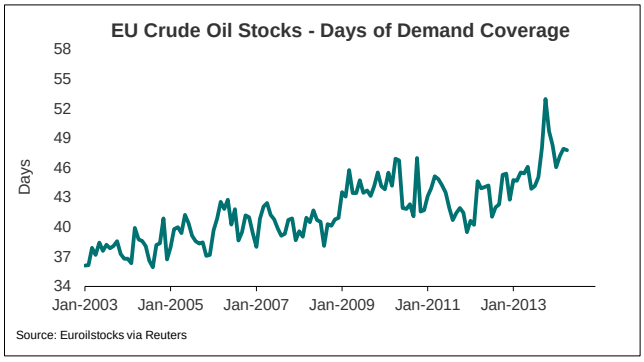


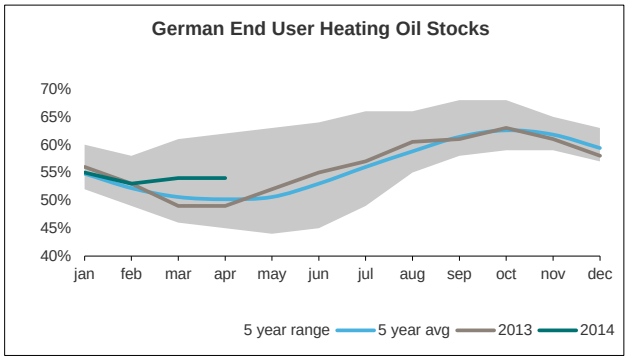


In Europe there is no lack of crude oil as crude stocks are about at the 5-year average according to Euroilstocks data. In fact since refineries in Europe is suffering from competition with its US peers, the level of crude oil stocks in Europe continues to trend higher measured in days of crude demand coverage.

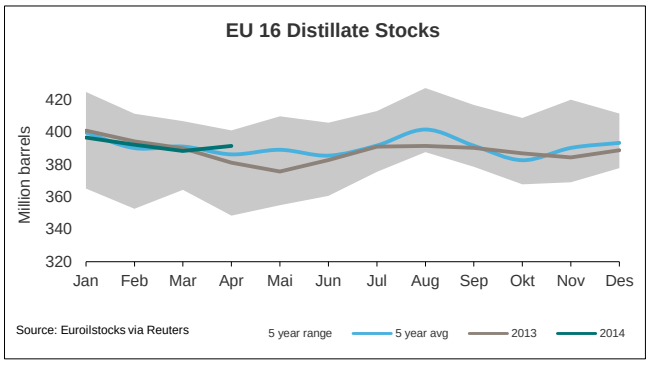


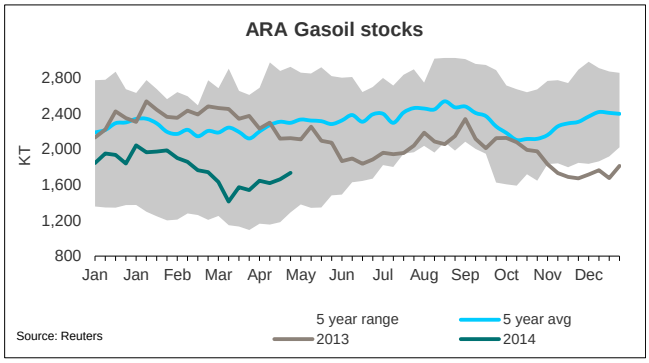


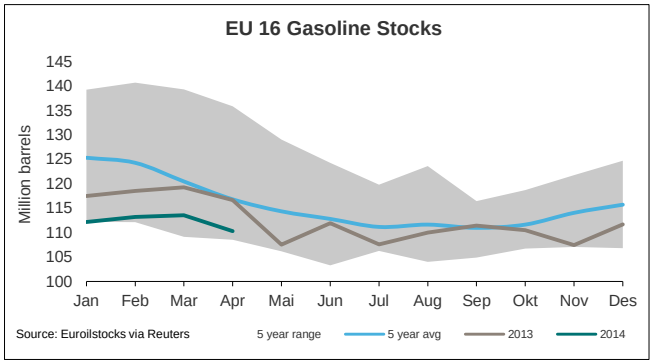


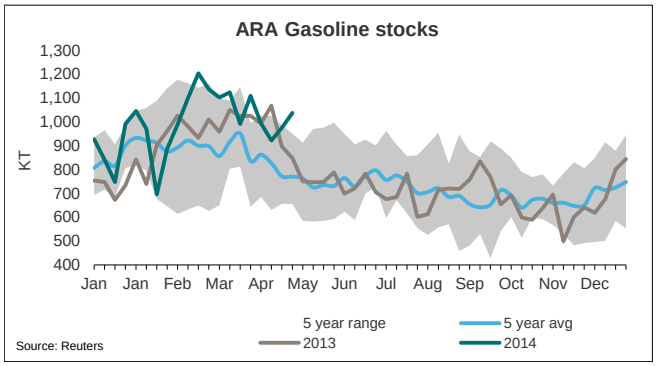


If we look closer on stocks in Europe it becomes clear that distillate stocks are on the high side while gasoline stocks are on the low side. This does not look to be the situation in ARA (Amsterdam, Rotterdam, Antwerp) but for the EU it looks to be the case based on Euroilstocks data. Most of the yield for a European refiner will be in Gasoil (Distillates). It is not a good sign for gasoil sales in the coming months that German end-user stocks are much higher than last year. This situation is probably already depressing the gasoil market as Gasoil cracks have dropped from 15 $/b to 10 $/b since the middle of April. We have to go more than a year back in time to see a weaker gasoil crack spread, and this is of course the key element behind the weak refinery margins described above.



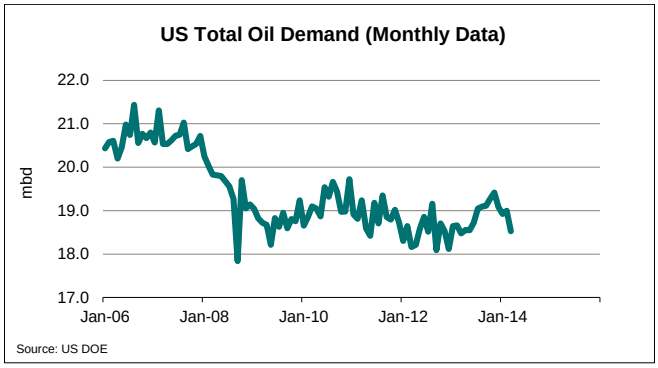


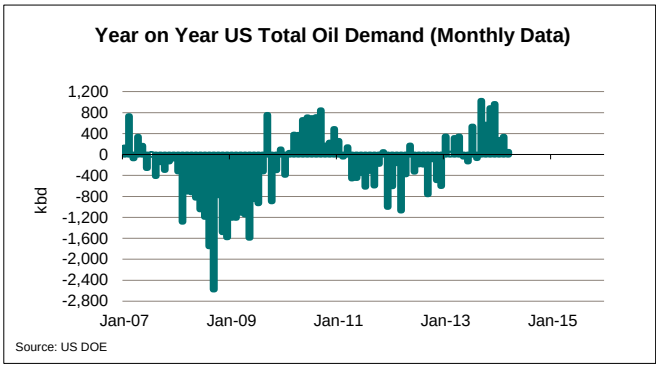




5 US oil data

The US Department of Energy (DOE) released its final monthly March oil data late last week. Compared with the preliminary data released in the weekly statistics through September, the final monthly demand number was revised down 14 kbd to 18.5 million b/d. Total oil demand in March were 50 kbd (0.3%) higher than in March last year. The strong demand growth we have seen since September last year now seems to have disappeared. In September the demand growth surpassed 1 million b/d and growth remained strong between 0.5-1.0 million b/d until Jan-Feb when the growth rate fell to around 0.3 million b/d and now the last growth number is 50 kbd (0.05 million b/d).

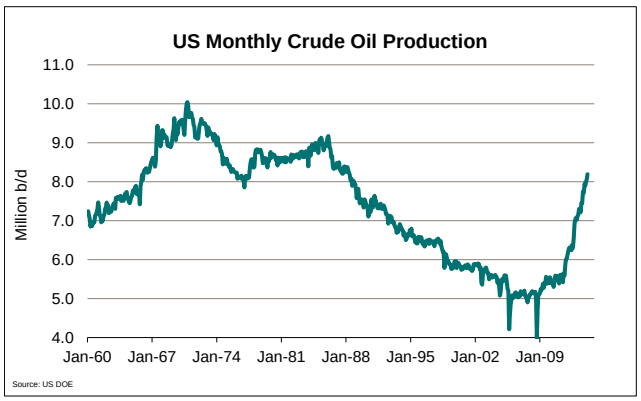


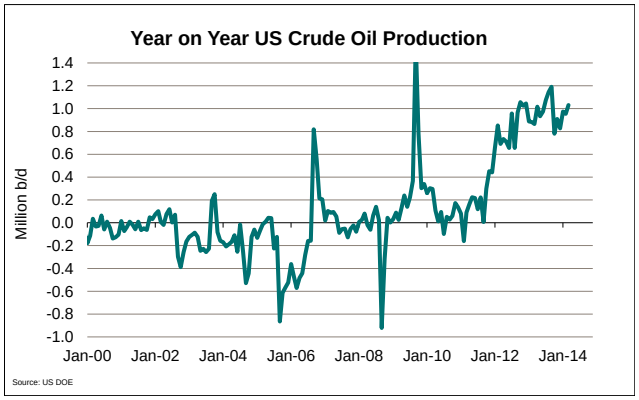


The key weakness in the YoY demand data is however in resid fuel oil (down 215 kbd) and in other products (down 148 kbd). Gasoline demand is up 68 kbd (0.8%) and distillate demand is up a strong 274 kbd (7.3%) despite milder weather in March than in Jan/Feb. Note however that heating degree days in the US for March were 26% colder than normal and 15% colder than last year, so the temperature effect probably contributed meaningfully to the distillate demand growth.

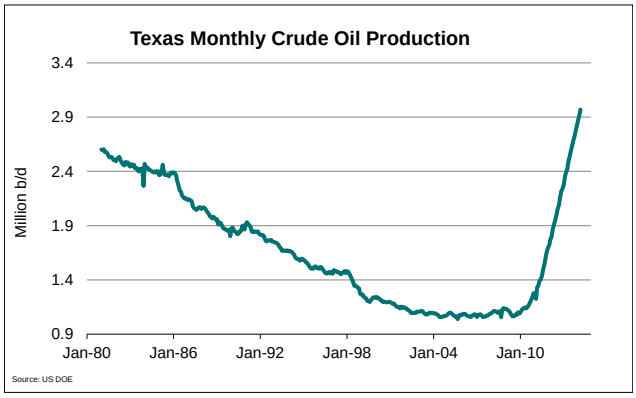
Demand has been posted quite strong in the weekly data since March, particularly for gasoline and distillate. The problem is however that we do not know how much of this that is in fact exports and not domestic demand. Consultancies that track exports of refined products have in reports written that the DOE exports plug used in the weekly data after March is probably too low, which suggest the weekly demand might be revised lower when the final monthly data is posted.

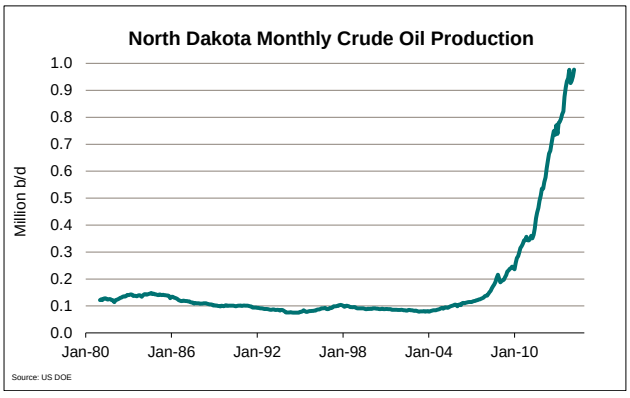
When it comes to the supply side of the equation, the growth is back in full pace in March after having struggled significantly through the cold winter months. Total US crude production increased 115 kbd from February to March to stand at 8.19 million b/d. This is 1.03 million b/d above the level produced in March last year. Based on the number of drilling permits issued we expect very strong growth in US crude production for the rest of 2014, possibly tempered again by winter weather as we approach November-December.





The largest growth in production is still coming from Texas which increased another 49 kbd in March to now stand at 2.97 million b/d. This means that Texas' crude production has doubled in less than 3 years and Texas is now a larger crude oil producer than most OPEC countries. North Dakota production increased 25 kbd in March to 977 kbd. This is 194 kbd higher than in March 2013. The growth rate in North Dakota started dropping in the summer of 2012 and many thought this would continue from then on. The yearly growth rate has however stabilized in a range of 160-200 kbd the latest year. If we see just 3 more years of such a growth rate North Dakota crude production will reach 1.5 million b/d well before 2017. We have read many reports claiming that North Dakota will peak long before 1.5 million b/d and there are still huge disagreements on how high production will reach before it peaks, so this will be one of the more interesting issues to follow in the oil market for the coming couple of years.





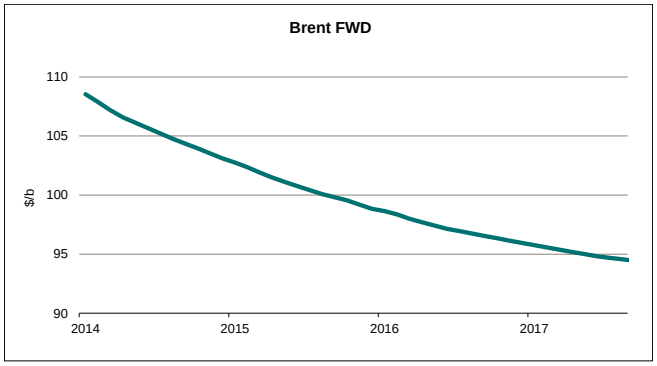
Production also increased meaningfully in March from Colorado, Alaska, New Mexico and Oklahoma. Monthly growth in these 4 states in March was 63 kbd in total. Total US crude production is now reported at 8.5 million b/d in the weekly data (about 0.3 million b/d higher than the monthly data reported for March). If this becomes reality in the monthly data as well, we will see US crude production growth at 0.96 million b/d for 2014 even with no production growth for the rest of the year…

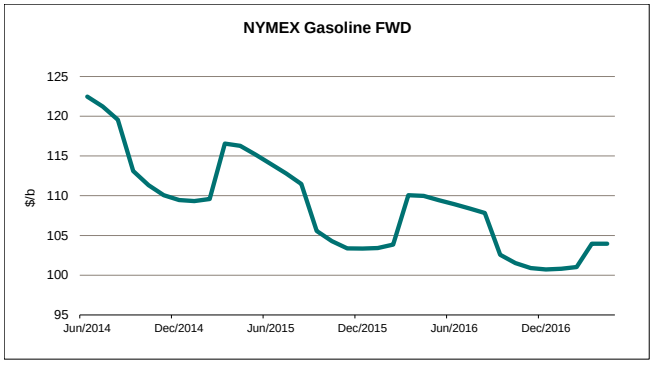
6 Other important oil/energy issues – Seasonality; is it there?

In the oil market there are several important seasonal effects that take place almost every year at the same months. Some of the most important are refinery maintenance (peak in April/May and August/September), oil field maintenance (particularly in the North Sea), demand for heating products (gasoil, heating oil, propane), demand for gasoline (the US driving season), production of biofuels (always easier in the summer), the Atlantic hurricane season (peak in early September), Saudi Arabia's direct crude burning in the summer time for generating power to air-conditioning, etc, etc. We treat the weather effects under a specific headline and the same with refinery maintenance (Refinery activity) and field maintenance (North Sea output).

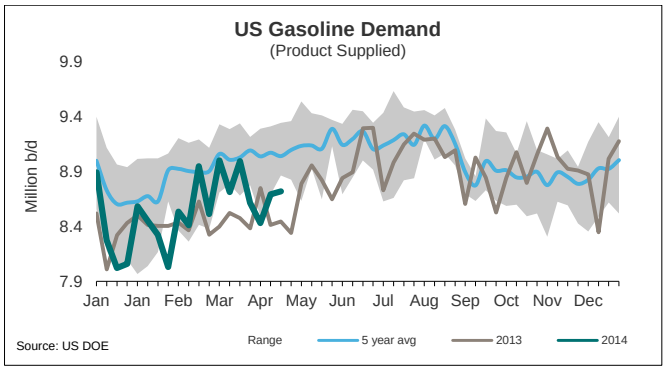
Quite often one will see arguments from analysts relating to seasonal elements being used as bullish or bearish arguments for the direction of crude oil prices. This is in isolation problematic. Why is that? Because despite all the seasonal elements mentioned above there is no statistical significant element that suggest that there is any seasonality in the crude oil prices.

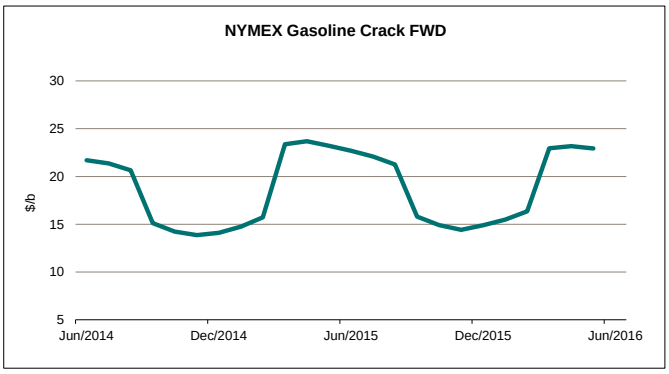
If there was seasonality in crude prices the Brent forward curve would have shown seasonal swings in the pricing but that is clearly not the case and has never been the case either when looking at historical forward curves.



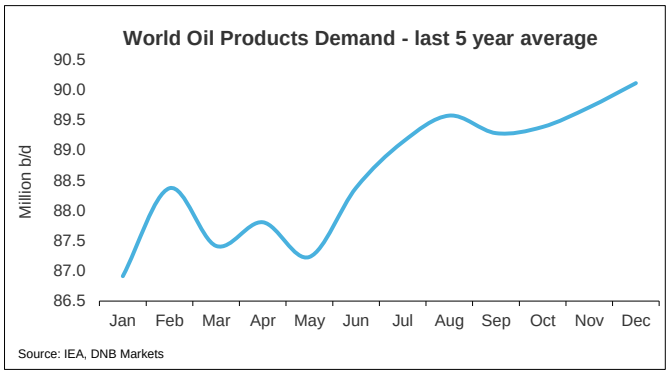


The gasoline forward curve is however showing the seasonality that is not present in the crude forward curve. The gasoline price and hence also the gasoline crack spread normally peaks in March/April for then to drift lower and drop in September as physical demand for gasoline falls off from the August peak. Sometimes we hear people arguing that they expect the US driving season to send the gasoline prices higher and hence also the crude prices. This must be a poor argument as we have shown above that the forward price curve for gasoline peaks before the US driving season starts and this is of course related to the fact that historically the gasoline price has normally topped off months before the peak of the US driving season.

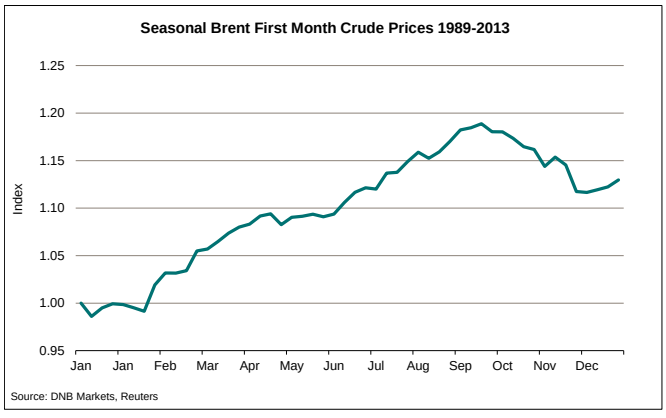


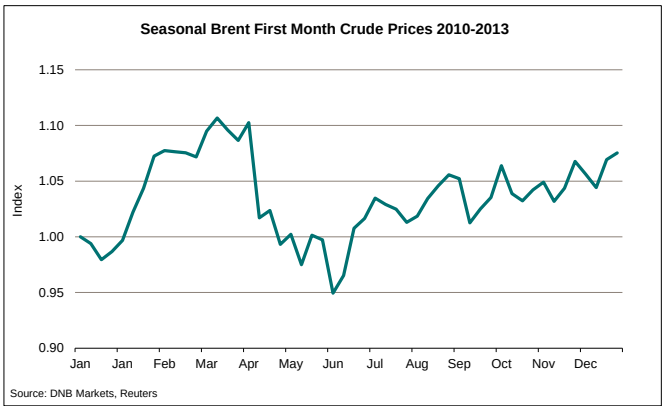


During the last 4 years we have seen an oil price development through the year where prices have fallen into the second quarter, but then recovered into the third and fourth quarter. One might think this was the normal behavior as global demand for oil products normally increases into February for then to fall until May and then rise significantly during the rest of the year.



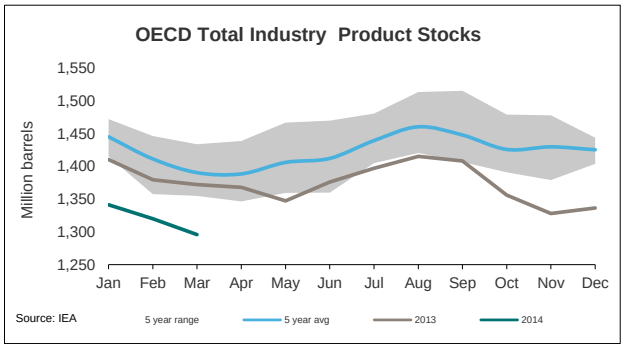
Despite the fact that global oil demand has moved in a very similar pattern as the oil price the last four years, it is in fact not according to the normal price movement through the year. If we look at the average price movement for Brent-prices through the year since 1989 another pattern emerge where the price on average has increased until September for then to drop back during the last 4 months of the year. The same pattern would be visible for the Brent price after the change of the millennium.

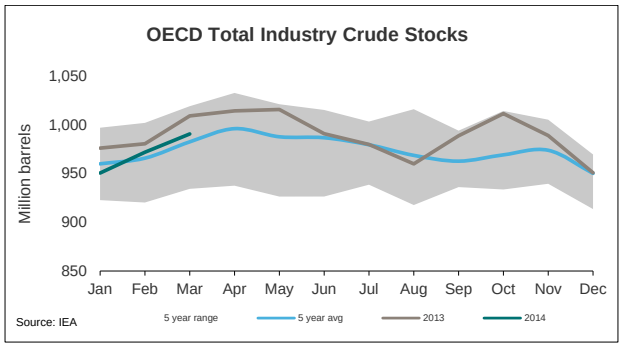




Since the forward curve is not reflecting any seasonality in the Brent price and since the average price development for Brent-prices the last 25 years (and also the last 10 years) is showing no relationship with what is happening to seasonal oil demand through the year, it is probably a good argument against using seasonal demand patterns as a key argument for what is going to happen to oil prices. We are not saying that seasonal factors never affect the price discovery but it probably needs to be in combination with other factors in the oil market in order to move prices. It is for example not enough to state that we think oil prices will drop in the second quarter because that normally happens in the second quarter. We have shown above that it is in fact only the last 4 years that a price drop in the second quarter has materialized. Equally it is not a particularly good argument for higher oil prices when you for example are standing in September that global oil demand is now increasing seasonally so the oil price should increase as well. But if for example the seasonal change comes in addition to another argument it could definitely have a price effect in our view.

If for example global demand for crude oil (refinery throughput) is increasing significantly as refineries are coming out of maintenance at the same time as global inventories of crude oil stocks are very low, the seasonal effect of the refinery throughput may provide an upward price movement in crude oil. We are now in a situation where OECD oil stocks are low and that could be used as an argument for higher oil prices. The problem with this argument however is that it is not crude oil stocks that are low, but product stocks and as refineries return from maintenance in the coming months a lot of new oil products are going to be produced while crude stocks will draw down but from a quite high level (as can be seen below). It is also visible in the graphs below that despite increasing demand for oil products from May to August last year, there was no drawdown in OECD product stocks but instead a build as refineries were ramping up runs. Had we now been in a situation where crude stocks were on the low side while refineries are into the seasonal ramp up we would however view the situation differently and would say that the seasonal ramp up in crude throughput should be bullish to crude oil prices.

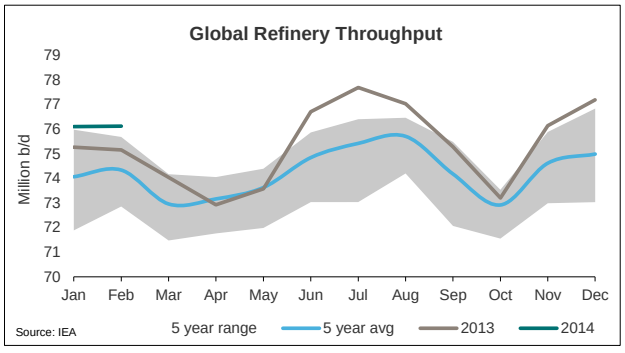


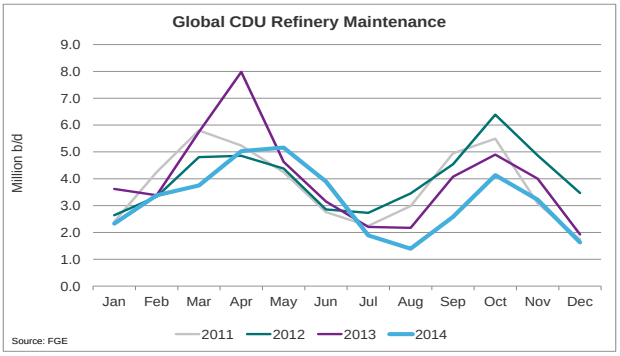


Last year global refinery throughput increased more than 4 million b/d from May to the peak in July according to IEA data. How was the world able to cope with this massive increase in refinery throughput in just those few months? Did we see a large increase in OPEC production to cover for this massive increase in crude demand? The answer is no. OPEC reduced its crude production by about 0.2 million b/d from May to July. How about non-OPEC crude production then? Yes there was an increase but only 0.35 million b/d in crude output. Biofuel also increased 0.2 million b/d in the period but that did not do anything to cover crude demand of course. We have one more

contribution in the visible reported data and that is crude stocks in the OECD. Did they draw down massively then in this period? Well, they drew down 36 million barrels which equals 0.6 million b/d. It can hardly be described as a massive stock drawdown compared with the reported increase in refinery throughput of more than 4 million b/d for the period. Something is clearly missing in the data here. We have demand for crude increasing by 4 million b/d and we can only identify increased crude supply and stock draws of net 1 million b/d. Using the JODI-database and adding our own database for Chinese oil stock movements, we can identify another 16 million barrels stock draw for the May-July period last year. This is only about 0.3 million b/d and still leaves us with about 2.7 million b/d of increased crude demand that we cannot figure out how was covered. The most plausible alternative is probably that the crude stock draws in the non-OECD was much larger than what we can find in the JODI-data, but 2.7 million b/d equals 162 million barrels and that seems very large. One would think that this large increase in crude throughput last year without a subsequent large increase in production would send crude oil prices exploding to the upside in this period. The Brent price did increase from May to July but by no more than 5.5 $/b. The peak month for the Brent price last year was in fact September, and by then the demand for crude oil had already decreased for two months.

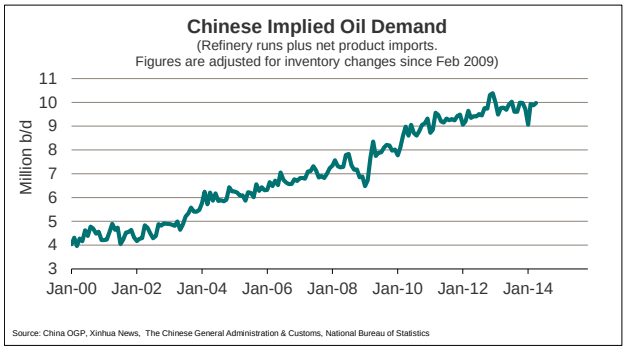
The point is that it is hard to forecast the price development for crude prices based on the global seasonal changes in crude demand. We have seen people forecasting that global refinery throughput will swing seasonally up by 2.4 million b/d from May to August, and they wonder where this incremental production is going to come from. Well, this number is very close to the average increase in global crude throughput from May to August and crude stocks in the OECD are higher than the 5-year average. US have close to record high crude oil stock levels while Europe is close to the 5-year average. Non-OECD crude stocks are not very visible and based on the story from last year the JODI-data does not seem very trustworthy but at least is seems that China holds more crude inventory than last year. The bottom line is that seasonal factors can be quite tricky to use as arguments for what is going to happen to oil prices.

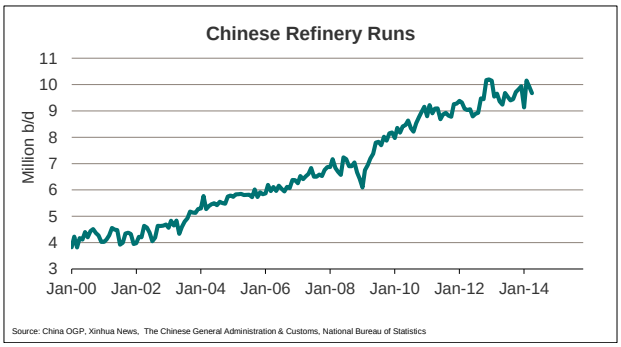




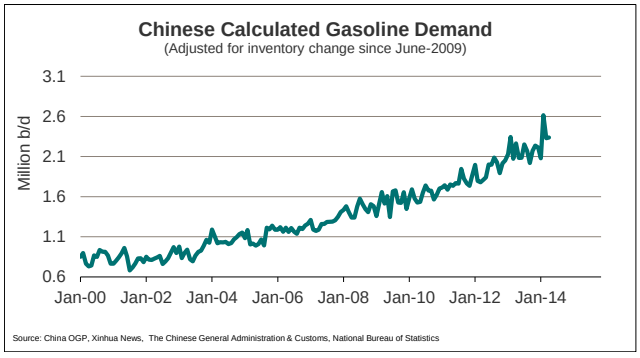
7 Chinese oil data

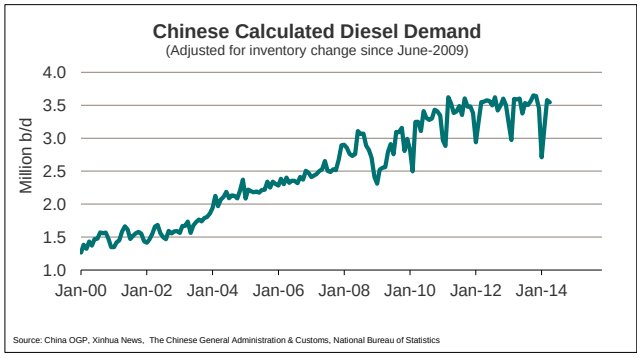
We calculate that total Chinese demand for refined products in China in April was 9.97 million b/d based on refinery throughput plus net oil product imports and adjusted for stock changes in commercial refined product stocks. This is 193 kbd (2%) higher than April last year.





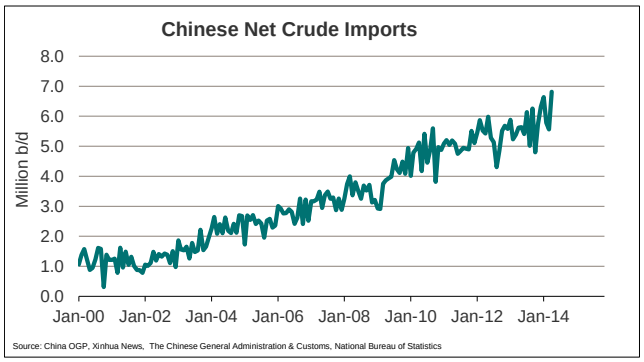
Demand for gasoline increased by 73 kbd vs April last year while year-to-date gasoline demand is up 132 kbd (6%). Last year Chinese demand for gasoline increased by 229 kbd (11.8%), so this year's growth rate looks much weaker so far both in terms of absolute growth and of course very much so in percentage terms. There is still however very decent growth in gasoline demand, which it should be based on still strong car sales. But it is a bit surprising that the growth rate in demand for gasoline is cut almost in half vs last year so far in 2014. The numbers are looking much worse for diesel which posted a demand drop of 45 kbd in April vs last year. Year-to-date demand for diesel in China is now down 72 kbd (-2.1%). Who would have thought that just a few years ago when demand for diesel on average increased 223 kbd per year in the years 2010-2012. We think this weak diesel trend will continue.

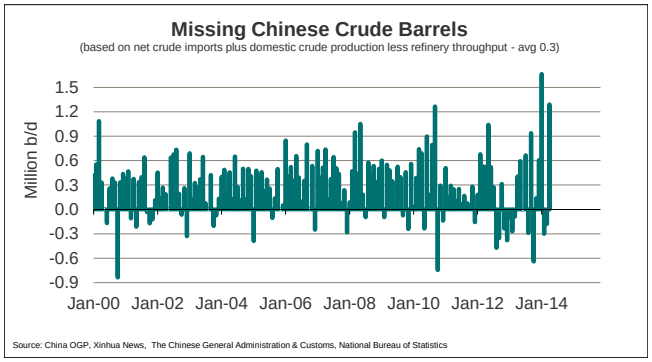




Crude oil imports for April were record high at 6.8 million b/d. This means that the missing crude barrels in April were extremely high at a massive 1.3 million b/d. Crude supply was 6.8 million b/d in imports and 4.15 million b/d in domestic production, adding up to a total of 10.95 million b/d. Crude runs (demand for crude) were however reported at just 9.67 million b/d and commercial crude stocks were reported practically flat in April. What happened to all these barrels of crude oil? Our take is that the Chinese have probably already filled large volumes of crude into strategic storage so far this year. This has been very supportive to the global crude oil balance. We calculate that supply of crude into China so far in 2014 has been on average 0.6 million b/d higher than the Chinese refinery throughput. Commercial crude stocks have in our calculations drawn

down only 3 million barrels since January. In China there is also some direct crude burning to generate power, just like in Japan, but still accounting for 0.2 million b/d of such crude usage, it implies a strategic stock build of about 50 million barrels so far this year.



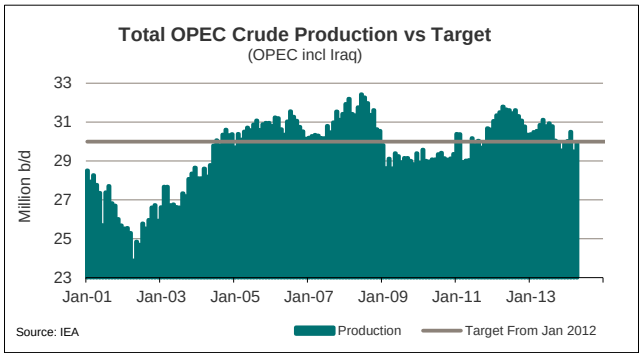


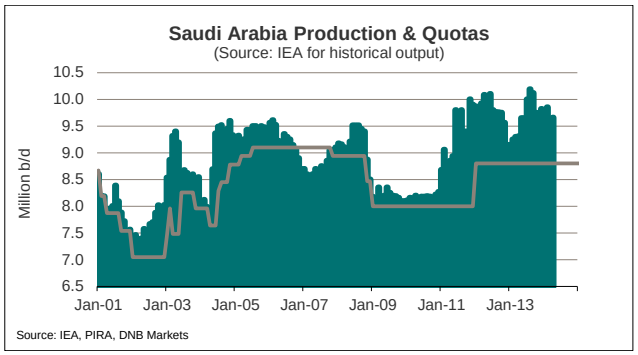
Reuters have reported that China has started to pump oil into new strategic tanks at Bihai Oil Terminal in Tianjin and at Huangdao. Most of this is probably related to the filling of the Tianjin site which reportedly was opened in November last year. It was originally planned to be ready by the end of 2011. The current level of strategic crude storage in China is unclear, but on January 28 China's National Energy Administration (NEA) reported that phase one (which is supposed to hold 103 million barrels) was full. Phase two consist of six tank farms under construction. The mentioned Tianjin site is part of phase two and has started filling. When finished, phase two is supposed to have a capacity of 207 million barrels, but most of the filling of that capacity is not expected to start until 2015. It has been a bullish factor for the oil market so far this year that the Chinese seems to have started filling of their phase two of strategic stocks. If they however have already filled 50 million barrels so far this year it remains to be seen how much of a support this can provide in the second half of 2014.

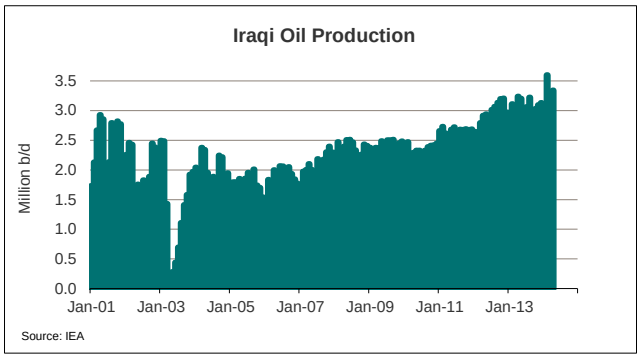
Iran jumped to represent 12% of total Chinese crude imports in April. In December Iran was at 8% but has since increased its exports to China from 500 kbd to 800 kbd. The 800 kbd Chinese imports from Iran in April was the by far highest level in at least the last 3 years and stands in contrast to the requirement by the US that China and others should reduce their imports from Iran gradually in order to continue to receive waivers from the US financial sanctions relating to the Iranian nuclear program. Data from Reuters for May, however, shows that Imports from Iran looks to fall back to between 500-600 kbd for that month.

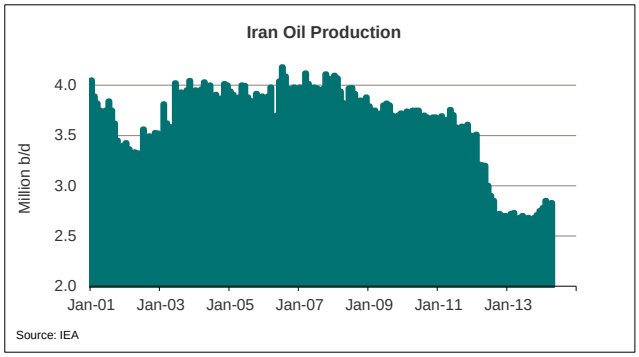
8 OPEC

Total OPEC crude oil production increased 0.4 million b/d to 29.9 million b/d in April according to IEA data. This was mainly due to increases from Algeria (+100 kbd), Angola (+130 kbd), Iraq (+140 kbd) and Saudi Arabia (+95 kbd). A Reuters survey for OPEC's crude production suggest we saw another 340 kbd increase in the cartel's crude production in May on further increases from Angola, Iraq and Saudi. This week the Saudi's released their OSPs for July where the Kingdome increased its light crude prices to US refiners, but reduced prices to Asia and Europe. This suggest that Saudi exports to the US will decrease going forward as the Kingdome tries to move more crude to the higher priced Asia/Europe instead of the US.



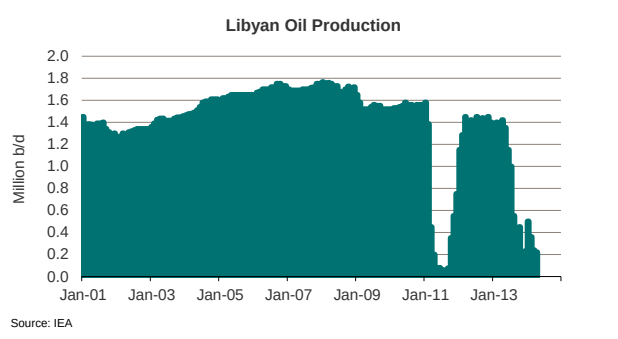


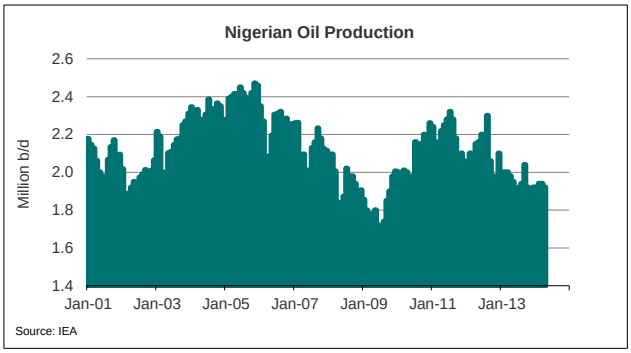




Tanker tracking agencies reports that Iraqi exports of crude oil for May was the highest since May 2003 from the Basrah region at 2.6 million b/d. Things are not going so well in the north of Iraq however where shipments from Kirkuk have stayed offline since sabotage and bombings of the Kirkuk-Ceyhan pipeline has kept that flow off the market since March. Some analysts estimate that the potential for exports from northern Iraq could be 0.5 million b/d if the security situation improves and if Baghdad approves exports through the new built pipeline through Turkey. Despite the problems in northern Iraq, total Iraqi production was estimated by the IEA at 3.34 million b/d in April. During the first four months of 2014, Iraqi production is up 225 kbd vs last year, due to the improvement in infrastructure and startup of new production in southern Iraq.

Libyan production is however struggling big time and was estimated at only 220 kbd in April. This is a large 1.2 million b/d lower than April last year. Year to date production in Libya is only 330 kbd, compared with 1.4 million b/d last year. As we write under the chapter of political risk, we are now assuming fewer barrels in the market from Libya in 2014 than what we had assumed at the start of the year. Currently Libyan production is estimated to be below 0.2 million b/d.

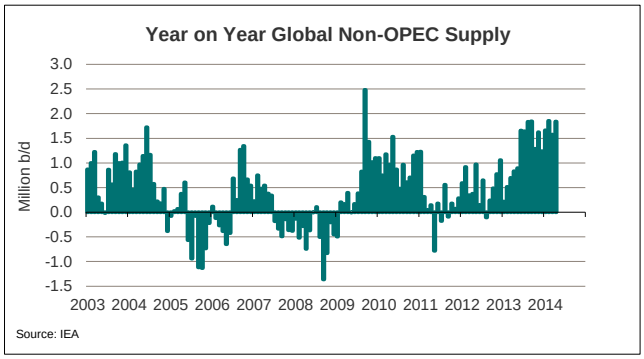


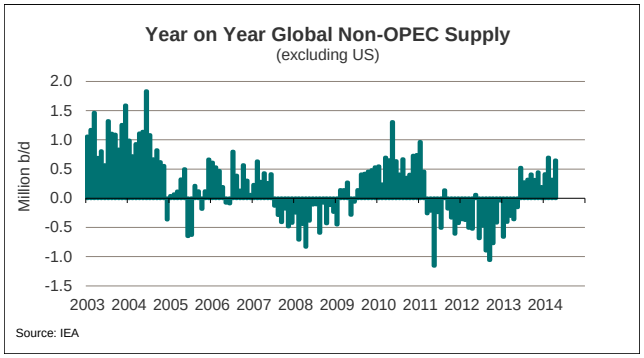


9 Non-OPEC

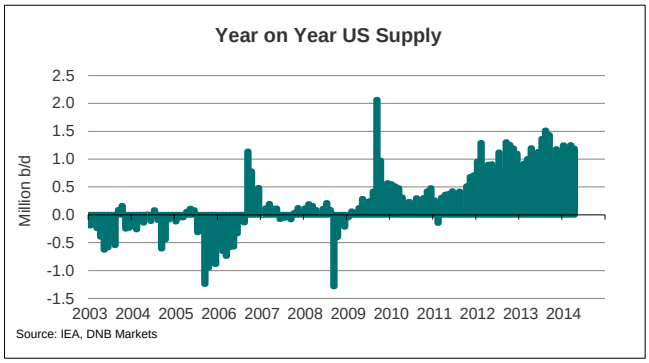
Production of oil liquids outside of OPEC increased 1.84 million b/d in April compared with the same month last year. According to the IEA 1.19 million b/d of this was from the US. This means that the trend of higher supply growth outside of OPEC than growth in global oil demand continues.

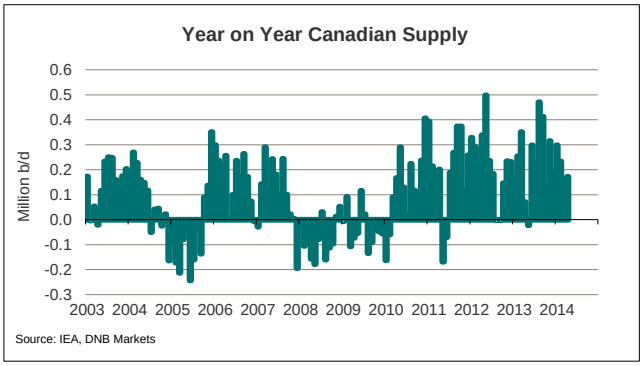
The growth is still heavily concentrated in the US, but it is interesting to note that even without the US included in the numbers we do now see decent growth also in other parts of the world. This changed during 2013 as can be seen in the graph below. In 2011 and 2012 there was negative growth in non-OPEC if we took the US out of the data. This is no longer the case.





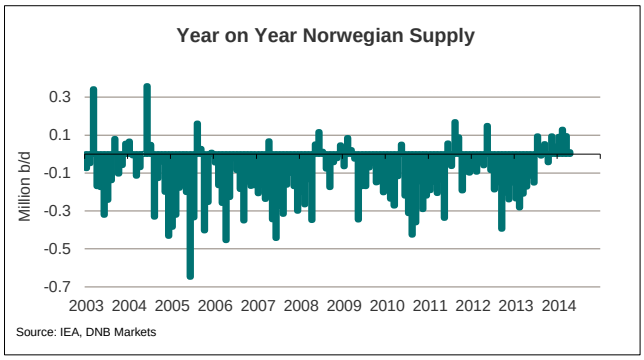
We see decent production growth in countries like Canada (+171 kbd in April) and Brazil (+233 kbd in April). Production is in fact also growing in countries like Norway, Australia, Kazakhstan, Ghana, Columbia, Oman, etc. In Russia we have seen production growth since 2009 and it continues into 2014.

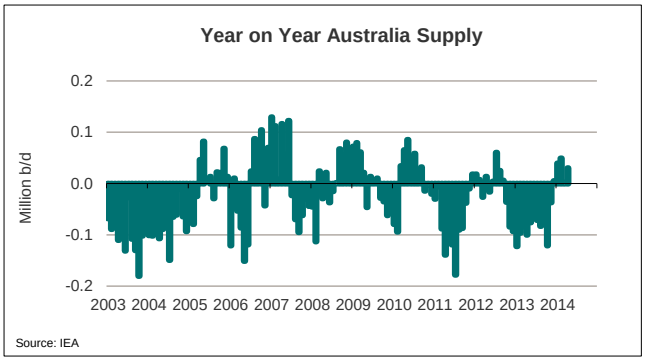





Year on Year Brazil Supply
Million b/d
0.30
0.20
0.10
0.00
-0.10
-0.20
-0.30
2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014
Source: IEA, DNB Markets

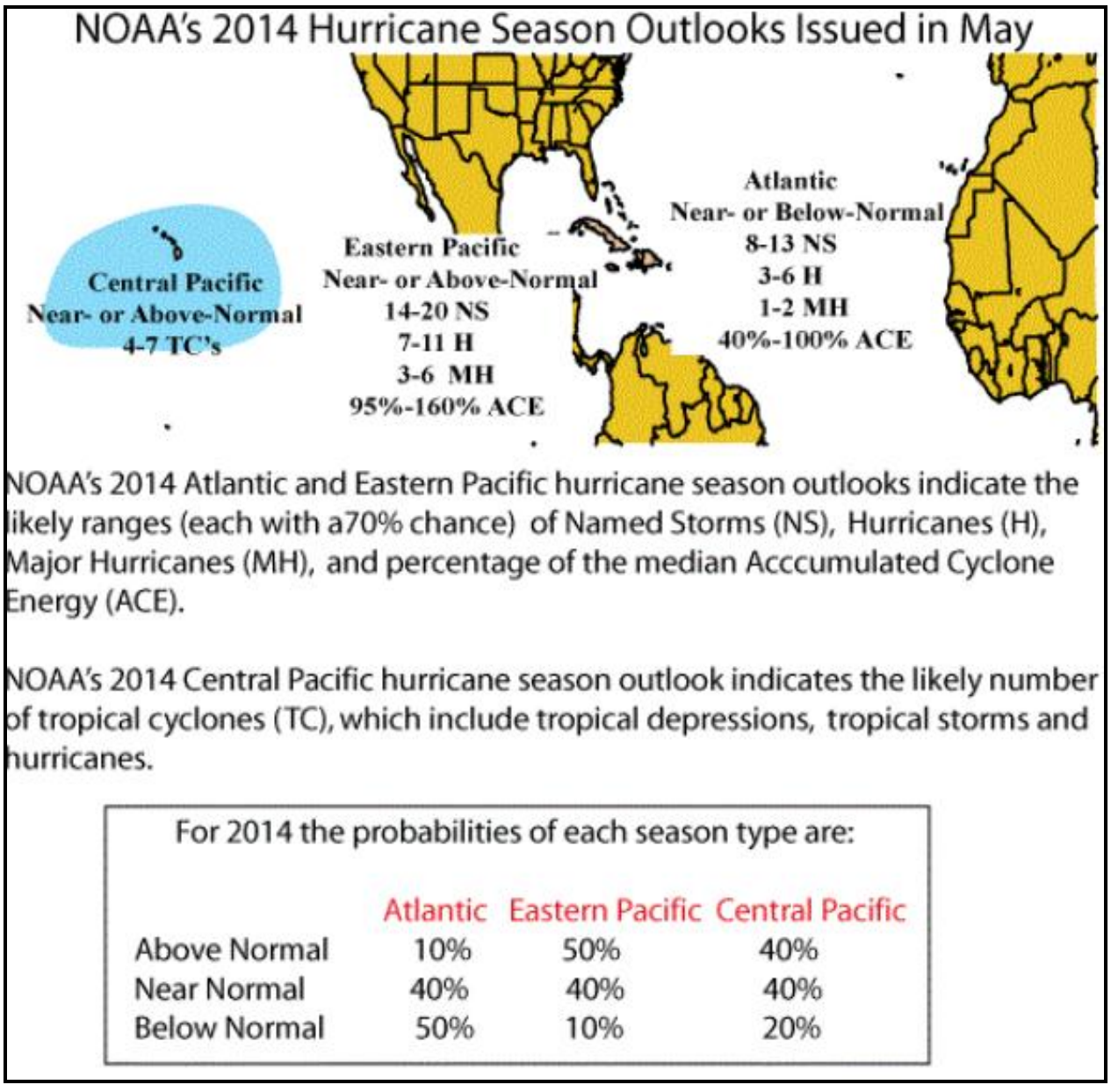

Year on Year Russian Supply
Million b/d
1.0
0.8
0.6
0.4
0.2
0.0
-0.2
2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014
Source: IEA


Year on Year Norwegian Supply
Million b/d
0.3
0.1
-0.1
-0.3
-0.5
-0.7
2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014
Source: IEA, DNB Markets


Year on Year Australia Supply
Million b/d
0.2
0.1
0.0
-0.1
-0.2
2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014
Source: IEA

10 Temperatures and other weather effects

Winter temperatures are no longer important for the oil price discovery at this time of year. We have to wait until October/November before cold temperatures again could have an effect on crude prices. We are however now approaching the time of year when the Atlantic Hurricane season can start to affect the production and demand for crude oil. The US National Oceanic and Atmospheric Administration (NOAA) issued its latest Hurricane Outlook for the 2014-season on May 22. NOAA is predicting that the Hurricane season this year will be near-normal or below-normal. The outlook calls for a 50% chance of a below-normal season this year, a 40% chance of a near-normal season and only a 10% chance of an above-normal season. We are still several months away from the normal peak of the season however, so this seasonal effect is not at all close to its peak in importance. Normally the peak of the Atlantic Hurricane season is not until early September as can be seen in the second graph below.

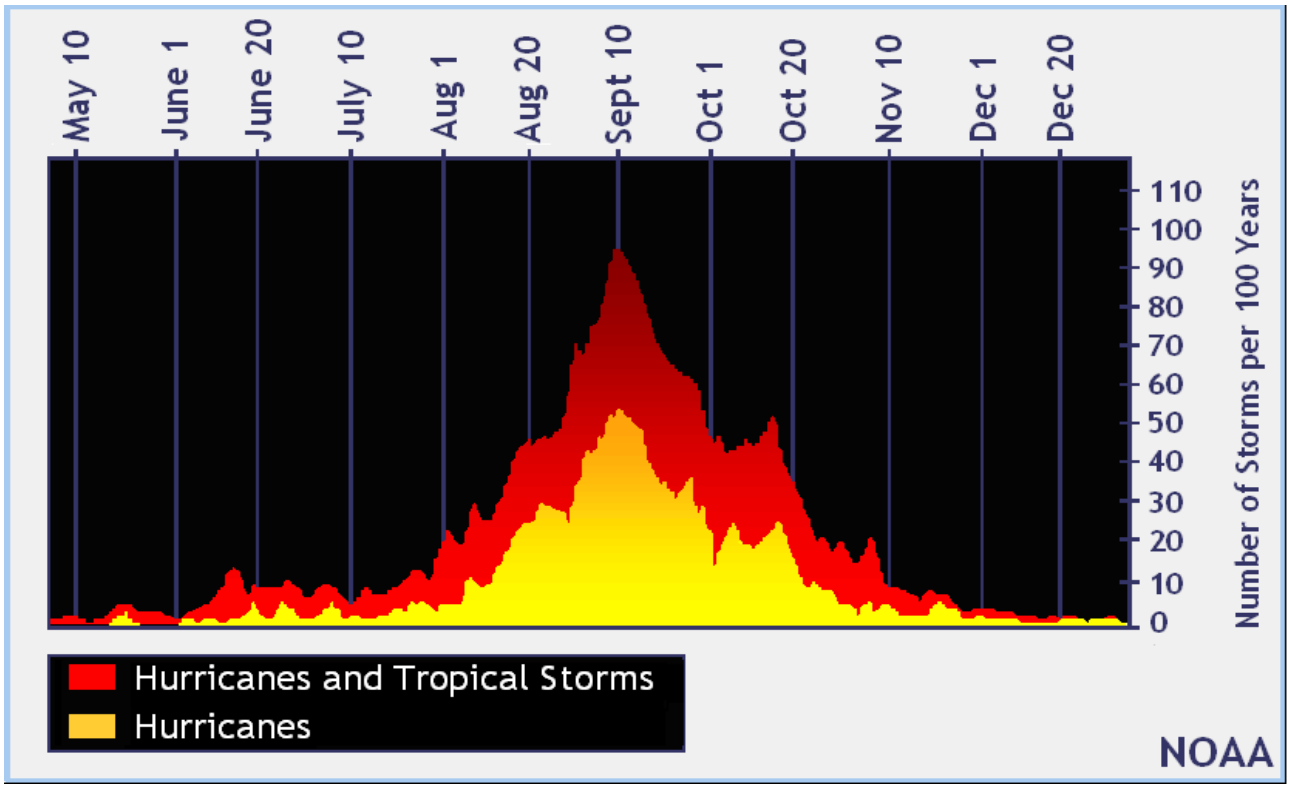


NOAA's 2014 Atlantic and Eastern Pacific hurricane season outlooks indicate the likely ranges (each with a70% chance) of Named Storms (NS), Hurricanes (H), Major Hurricanes (MH), and percentage of the median Acccumulated Cyclone Energy (ACE).

NOAA's 2014 Central Pacific hurricane season outlook indicates the likely number of tropical cyclones (TC), which include tropical depressions, tropical storms and hurricanes.

For 2014 the probabilities of each season type are:

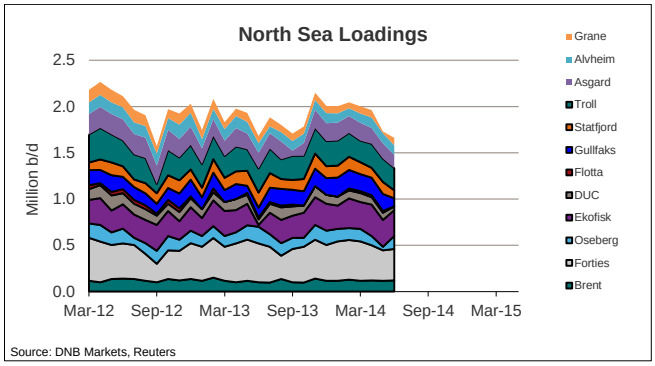
	Atlantic	Eastern Pacific	Central Pacific
Above Normal	10%	50%	40%
Near Normal	40%	40%	40%
Below Normal	50%	10%	20%

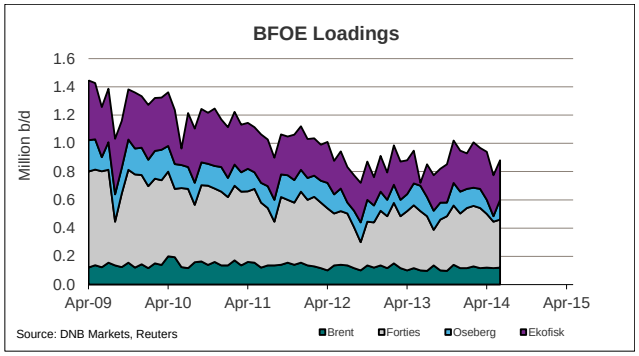

May 10
June 1
June 20
July 10
Aug 1
Aug 20
Sept 10
Oct 1
Oct 20
Nov 10
Dec 1
Dec 20
110
100
90
80
70
60
50
40
30
20
10
0
Number of Storms per 100 Years
Hurricanes and Tropical Storms
Hurricanes
NOAA

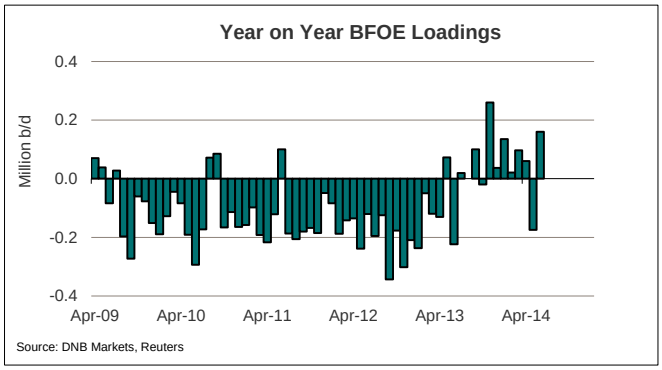
11 North sea output

The North Sea loading program for June suggests that the total loading program for the largest grades are down 70 kbd from May to June, due to maintenance. The key fields that see reduced output is Gullfaks, Statfjord and Åsgard. The BFOE (Brent, Forties, Oseberg, Ekofisk) loadings are however set to increase by 110 kbd from 770 kbd to 880 kbd due to a 100 kbd higher Oseberg loading program. Compared with June last year the BFOE loading program is in fact up 160 kbd.

This week the Norwegian Oil and Gas Association said that wage talks between oil companies and the largest union representing land-based workers ion Norway has broken down and are heading to state-appointed mediation. The negotiations affect about 5000 employees. Two years ago about 10% of Norway's offshore workers went on strike for 16 days, cutting oil output by 13%. The dispute ended when oil companies threatened a full lock-out and the government stepped in to impose a deal. The first mandatory mediation is scheduled for June 16-17 and unions are saying that if talks fail they would shut down two Exxon platforms and one GDF Suez platform with combined production of about 80 kbd.





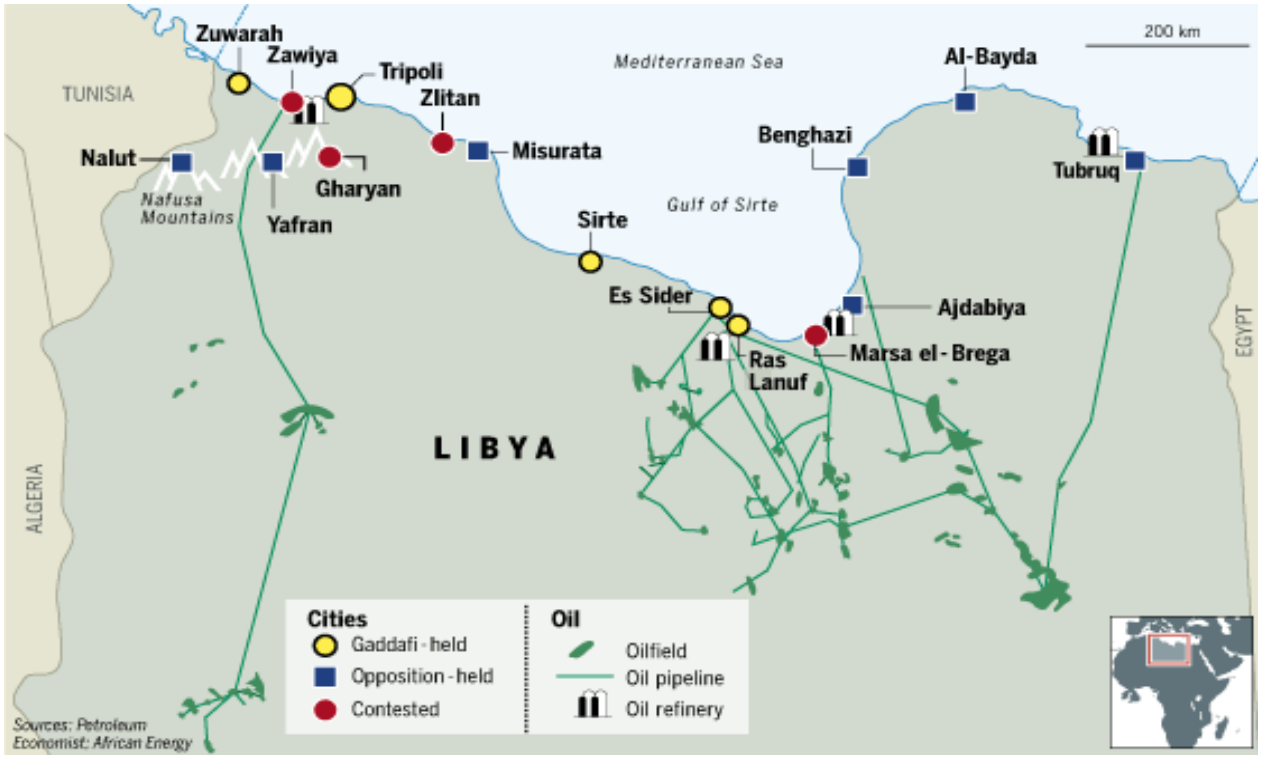


12 Political risk

In February a retired General named Khalifa Haftar appeared in a Libyan television broadcast calling on the military to rescue the country. He wanted a caretaker government to take over from the paralyzed Libyan government. Still, no further physical action was taken by Haftar in February, and many dismissed him. In May, however Haftar launched an attack on the parliament in Tripoli and also assaulted Benghazi to clear out Islamist militants. Several military units have backed Haftar's self-declared Libyan National Army. Haftar's movement may draw up a broader anti-Islamist front in Libya. The US has temporarily moved about 250 marines to Sicily from Spain in order to be able to evacuate US citizens in any crisis.

Khalifa Haftar joined Gaddafi in a coup in 1969 but later fell out with Gaddafi during the 1980's and he fled to the US where he spent 20 years before returning to Libya in 2011 to help topple Gaddafi. He is said to have been backed by the CIA. Some are drawing comparisons to Egypt's army chief Abdel Fattah al-Sisi who removed the Muslim Brotherhood and some diplomats says he is probably positioning himself as a new "strongman" in Libya which many Libyans say is needed to get a governable country.

Haftar calls for a presidential council to take over power in the country before the June parliamentary elections as the current parliament has become a sponsor for terrorism. Politicians in the 200-seat parliament divide on the legitimacy of the one-chamber legislature and whether it should be dissolved. His action has been condemned as a coup by the parliament, by he has recently gained more allies as several political parties, army officials and armed groups have showed support for him.



The escalating conflict in Libya is worrying for neighboring countries like Algeria and Egypt. Since Haftar started his attacks there have been rumors of possible US, Algerian or Egyptian support for his forces. According to the political intelligence agency Stratfor, these countries may try to stabilize Libya by providing critical support to General Haftar. It will however be hard for any of these countries to openly support the General before he proves that he can actually win the conflict. At the end of the day, however both Egypt and Algeria wants a stable Libya and both are likely to support whoever they believe can guarantee it. The problem is that neither Haftar nor his opponents seems to have a strong military advantage and we should hence expect an extended stalemate. The Libyan geopolitical risk to the oil market has taken a turn for the worse for the rest of 2014, compared with our evaluation at the start of the year. Still, if Haftar becomes the new Libyan "strongman" things could of course calm down in Libya, but we think that with the latest development it is probably prudent to reduce our expectations for Libyan barrels in the market. We now believe we will see fewer barrels from Libya in the global oil market for 2014 than what we believed at the beginning of the year. So far in 2014 the average oil production in Libya has been only 330 kbd, which is more than 1 million b/d lower than the same months in 2013. The Libyan parliament swore in a new prime minister at the start of May, but this choice was disputed by non-Islamist groups and now with the attack by General Haftar the Libyan situation is very chaotic. We now assume that through the rest of 2014 Libya will produce only between 300-500 kbd of crude oil. If a new strong man takes control of Libya (maybe General Haftar) this situation could change in 2015 however and it is probably prudent to assume that the country should reach a higher production in 2015 than in 2014 so that some of the shut out barrels will re-enter the market.

The Ukraine-Russia crisis was not at our radar at all when the year started (we doubt any other oil analysts had it on their radar either). This new "cold war" between Russia and the west includes possible supply disruptions due to possible sanctions from Europe/US which could choose to target oil in a step up in sanctions towards Russia. Russia could also choose to use the oil weapon against Europe and redirect parts of their oil exports towards the east. This would short term boost the Brent-price but any extra volume to Asia from Russia would most likely mean less need for West-African barrels to the same region and we would expect more barrels from Angola, Nigeria, etc to then head for Europe. The West-African barrels would need to find other takers and that would be Europe. In other words, the upward price pressure on Brent in such an incident might be short lived. We have also seen some analysts arguing that a physical supply disruption from Russia towards Europe could be bearish to oil prices if it materializes because it would imply that western governments release strategic stocks at the same time as Russian exports is not reduced, just redirected. It could also mean a temporary suspension of the ban on domestically produced crude oil from the US. As such it could imply more physical supply to the market and not less. Such an outcome is definitely possible, but how it would play out with respect to timing, etc would still be very uncertain for the market players. We hence believe that the Ukraine-tension is adding to the oil price, at least for now, as the uncertainty to what this could mean for physical oil balances is very high.

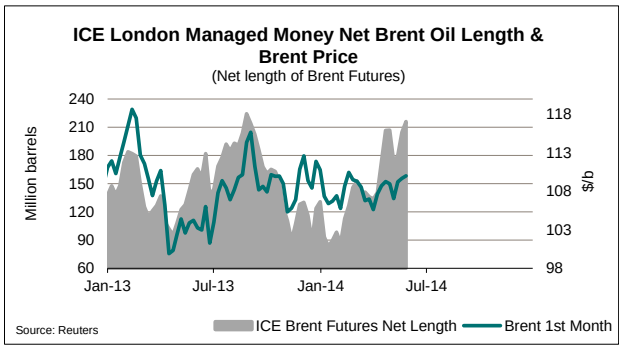
Another high risk country for oil supplies is Iraq, where parliamentary elections were held on April 30. This was only the third parliamentary elections in Iraq after the fall of Saddam Hussain. As we have shown before, violence has increased dramatically in the country during the last year. Prime Minister Al-Mailiki won 93 out of the 328 seats in the parliament. No other bloc won more than 30 seats. It will still not be easy to form a new governing coalition in Iraq, despite the solid victory of Al-Maliki. One would think that if the Shia blocs achieved enough votes together that it would be easy to form the coalition, but the rivaling Shiite blocs led by Muqtada al-Sadr and Ammar al-Hakim, which are both closer to Iran than A-Maliki, have been lobbying for the removal of Al-Maliki according to the consultancy Stratfor. The blocs of al-Sadr and al-Hakim won 29 and 28 seats respectively. The Sunni votes were divided mainly between three alliances; 23 seats to Parliamentary speaker Osama al-waaniya, 21 seats for former interim Prime Minister Ayad Allawi and 10 seats for Deputy Prime Minister Saleh al-Mutlaq. The Kurdish votes mainly went to the KGR President Massoud Barzani who won 25 seats but 21 Kurdish seats also went to Jalal Tablani's Patriotic Union of Kurdistan. Prime minister al-Maliki needs 165 seats in order to form a governing coalition. It will hence not be enough with the Shiite votes and we know that his relation with the Kurds, who have played a critical role in supporting the Shiite dominance, is now at a low point. In addition it will be even harder than before for al-Maliki to exploit divisions among the Sunni-bloc as these factions have announced that they will vote as a unified bloc in the parliament. The whole situation in Iraq means violence will probably continue to rise in the coming months and pose risk to oil supplies. The risk is mainly relating to the northern Iraqi oil production but both US and UK has recently warned their citizens working in the Basrah region that militant groups may target them for kidnappings. The technical potential for Iraq to increase oil production massively is definitely in place, but political stability seems so far a long way off.

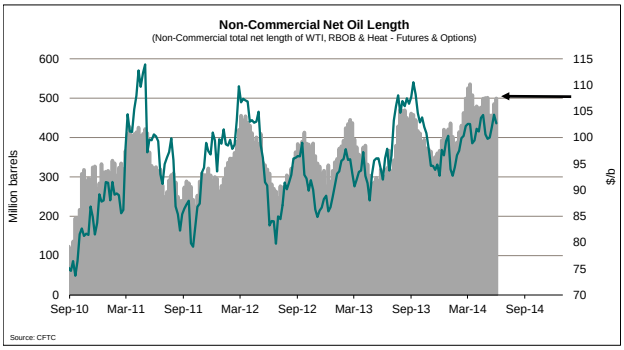
Recently Iraqi Kurdistan started loading oil from its new pipeline for shipment from the Turkish port of Ceyhan. This is against the will of the Iraqi central government which claims authority over all Iraqi crude sales and declares all independently sold oil as smuggled. The Turkish government has earlier pledged that it would wait for the Iraqi central government and the KRG to reach an agreement on the revenue split before sales are executed from Ceyhan, but now it however seems that Ankara no longer sees a point in obstructing exports as the tanks in Ceyhan are full and no progress has been made between KRG and Baghdad. This export is one of the key sources of disagreements between Prime Minister al-Maliki and the Kurds and just increases the tensions and difficulty in implementing a new government in Iraq.

The interim nuclear agreement between Iran and world powers expires on July 20. For us the base case is that a comprehensive agreement will not be reached before this date and that negotiations will be prolonged another half a year into January 2015. We believe too much diplomatic effort has been invested from both sides the last half a year to totally cease negotiations should an agreement not be reached by July 20. A recent statement from the US State department says that the department is concerned with the short amount of time that is left until July 20, but they still however believe a deal can be reached. The recent negotiations in Geneva were supposed to start on a draft final text for the agreement. This did not happen as key differences emerged relating to the number of centrifuges Iran should be allowed to keep for peaceful uranium enrichment. It also seems difficult to reach an agreement for the duration of the agreement where western powers are calling for a ten-year agreement while the Iranians want a 3-5 year deal.

13 Hot money – net speculative positions

Currently there is very high downside risk connected with net financial positions in the oil market. This is the case both on the NYMEX in New York, but also on ICE Brent in London. Net length held by non-Commercials in oil contracts on the NYMEX is close to record high as can be seen below. The same is true for net positions held by Money Managers in Brent futures in London. This is always a large red flag for the flat price of oil, particularly when we are close to record levels on both sides of the Atlantic.

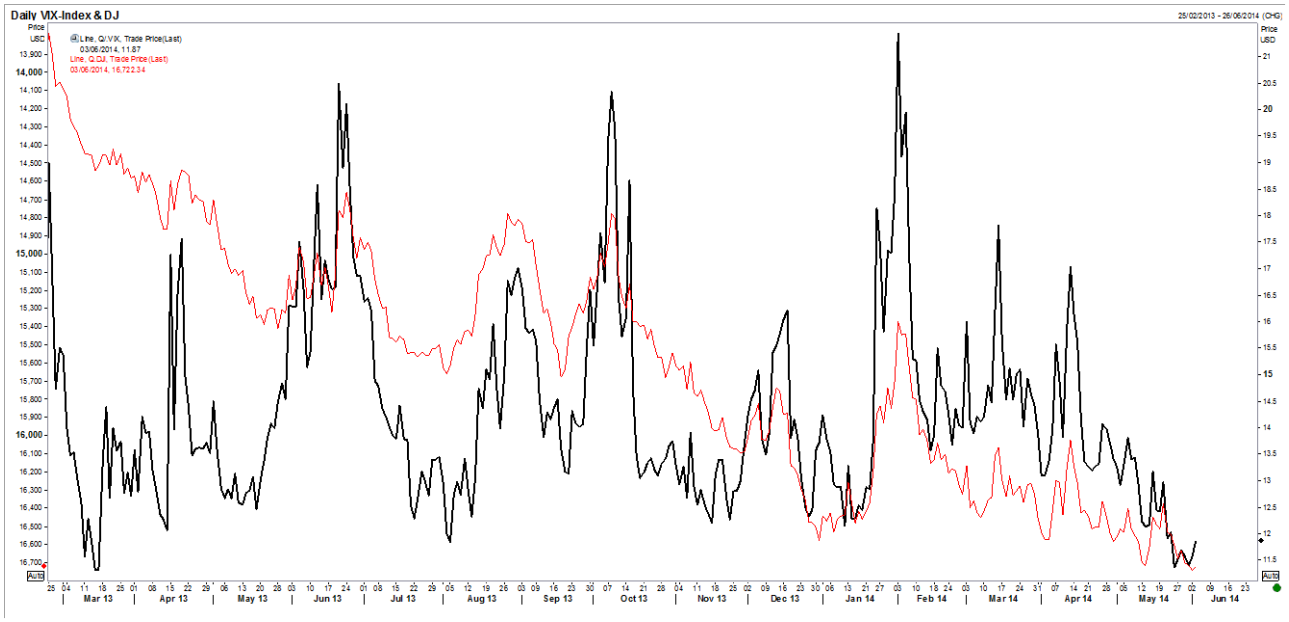




14 Market psychology – sentiment- macro economics

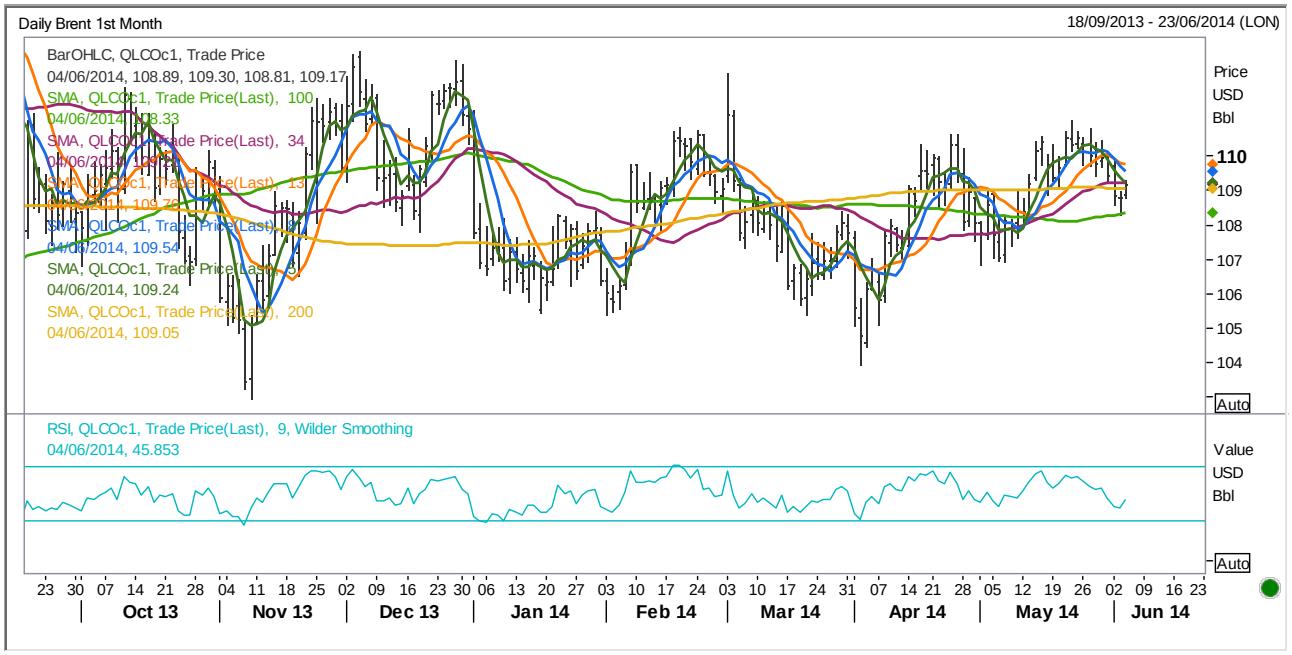
The equity market is still on a positive ride and the VIX index is low, suggesting that risk appetite is decent at the moment. When it comes to the macroeconomic indicators we are tracking we see some improvements recently, particularly in the household sector in Europe. The table below indicates more red than blue changes, which means a “hotter” economy than at the last update.

May-14		Households				Industry					
Country	Weight	Confidence	consumptio	Housing	Labour mkt	Confidence	Production	Orders	Exports	Total	Inflation
USA	35.2	-1	1	0	2	0	1	0	-1	0.250	-1
Japan	10.3	-1	2	0	1	0	2	1	-1	0.500	-1
EMU	26.1	1	0	-1	-1	0	0	0	0	-0.125	-2
UK	5.3	1	2	2	2	2	1	2	-1	1.375	0
Sweden	0.8	0	1	1	-1	0	-1	0	0	0.000	-2
Norway	0.7	0	0	0	0	0	0	0	-1	-0.125	0
China	21.6	0	0	-1	0	-1	0	0	0	-0.250	-1
Total	100.0	-0.1	0.7	-0.4	0.6	-0.1	0.6	0.2	-0.5	0.125	-1.2

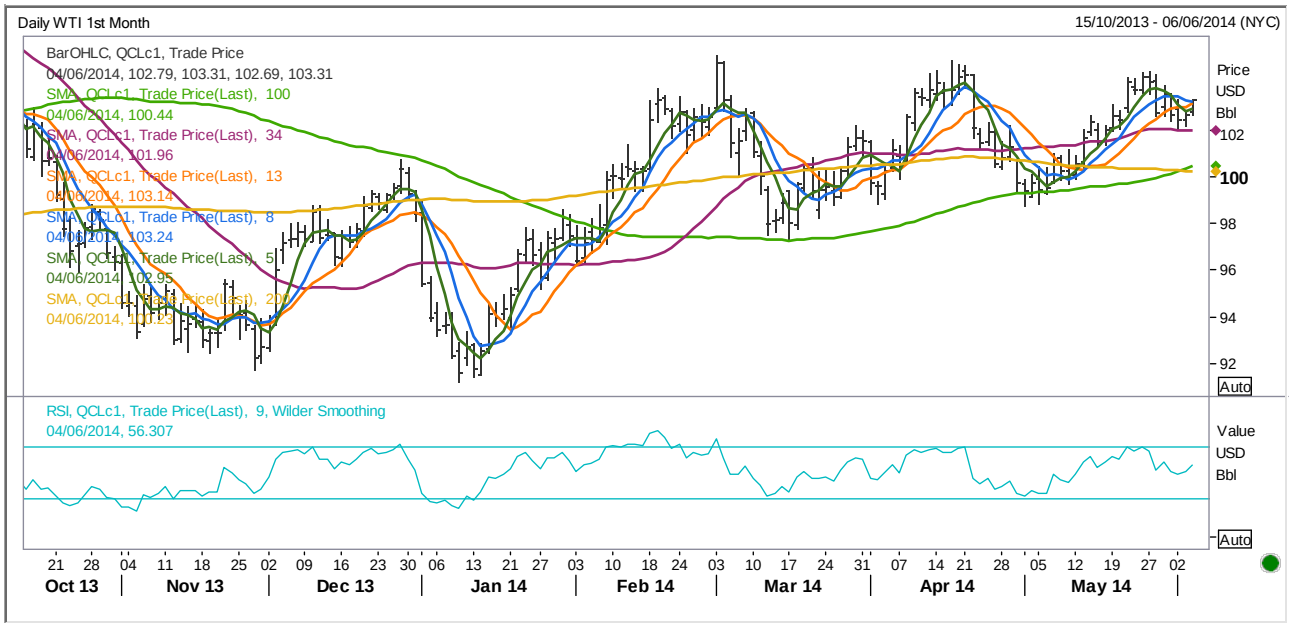


15 Technicals

The technical trend in the Brent market since Nov/Dec is still down to flattish.



WTI has had a better run this year and has so far been able to sustain the above 100 $/b level.



16 Short term oil price score card

Monthly Scorecard	Comments	Oil Price	Weight
Overall Outlook	Geopolitical risk is very high, but is offset by close to record net long financial positions held by Money Managers and Non-Commercials. Short term score card looking fairly balanced. We end up with a neutral view of the market in the short term.	**NEUTRAL**	
Fundamentals			
Global Fundamental Balance	Stronger global supply-demand balance in 2H-2014, but maybe less bearish is a better description	NEUTRAL	MEDIUM
Refinery Margins (Crack Spreads)	Very weak refinery margins currently, particularly in Europe. Run cuts on the table?	BEARISH	MEDIUM
OECD Oil Stock Levels	Low products stocks in the OECD, but adequate crude oil stocks	BULLISH	LOW
US Oil Statistics - Fundamentals	Crude production is still growing much quicker than demand. Production up 14%, demand up 0.3%.	BEARISH	MEDIUM
Other Important Energy News	There is no seasonality in crude oil prices, even though there is seasonality in some product prices	NEUTRAL	MEDIUM
Chinese Oil Statistics & News	Still weak oil data coming in from China, particularly for diesel. Crude imports high but for stock builds.	BEARISH	MEDIUM
OPEC	OPEC is producing close to its target of 30 million b/d. Up 0.4 million b/d in April from March.	NEUTRAL	MEDIUM
Non-OPEC	Non-OPEC liquids supply growth is broadening. 1.8 million b/d YoY growth in April.	BEARISH	MEDIUM
Seasonals			
Temperature Outlook	Temperatures not important at this time of year (Saudi air-conditioning important later in the summer)	NEUTRAL	NA()
Hurricanes & Other Weather	Hurricane season predicted to be below normal this year.	BEARISH	LOW
North Sea Fundamentals	Loading programs for BFOE up in June due to more Oseberg, but danger of strike in Norway	BULLISH	MEDIUM
Political Risk			
Iraq, Iran, Nigeria, Venezuela, US, Russia, Israel, China, etc	High oil risk in Ukraine and Iraq. Libya almost totally out of the market currently. Civil war in the cards?	**BULLISH**	**HIGH**
Other factors			
Hot Money Net Exposure (Speculators)	Close to record net long positions held by Money Managers on both NYMEX and ICE	**BEARISH**	**HIGH**
Market Psychology/Sentiment/Macroeconomics	Good performance for equity markets and more positive than negative macro indicators recently	BULLISH	MEDIUM
Technicals/Price Trends	Trend is still down for Brent, but more flattish for WTI	NEUTRAL	MEDIUM

17 Global supply vs demand – DNB, IEA, OPEC & EIA

DNB Markets World Oil Supply-Demand Balance:	2008	Change	2009	Change	2010	Change	2011	Change	2012	Change	2013	Change	2014
OECD Demand	48.1	-2.0	46.1	0.6	46.7	-0.6	46.1	-0.5	45.6	0.1	45.7	0.0	45.8
Non-OECD Demand	37.9	1.2	39.1	2.3	41.4	1.2	42.6	1.6	44.2	1.2	45.4	1.1	46.5
Total Demand	**86.1**	**-0.8**	**85.2**	**2.9**	**88.2**	**0.5**	**88.7**	**1.1**	**89.9**	**1.2**	**91.1**	**1.1**	**92.2**
Non-OPEC Supply	49.2	0.6	49.9	1.0	50.8	0.2	51.0	0.5	51.5	1.2	52.7	1.5	54.2
OPEC NGL's and non-conventional oil	4.5	0.6	5.1	0.4	5.5	0.4	5.9	0.2	6.2	0.1	6.3	0.2	6.5
Global Biofuels	1.4	0.2	1.6	0.2	1.8	0.0	1.8	0.0	1.9	0.1	2.0	0.1	2.1
Total Non-OPEC supply	**55.2**	**1.4**	**56.6**	**1.6**	**58.2**	**0.6**	**58.8**	**0.8**	**59.6**	**1.5**	**61.0**	**1.8**	**62.8**
Call on OPEC crude (and stocks)	**30.9**	**-2.3**	**28.7**	**1.3**	**30.0**	**0.0**	**29.9**	**0.4**	**30.3**	**-0.2**	**30.0**	**-0.6**	**29.4**
OPEC Crude Oil Supply (Last known number dragged fwd)	31.6	-2.5	29.1	0.1	29.2	0.7	29.9	1.4	31.3	-0.9	30.5	-0.5	29.9
Implied World Oil Stock Change	**0.7**		**0.5**		**-0.8**		**0.0**		**1.0**		**0.4**		**0.5**

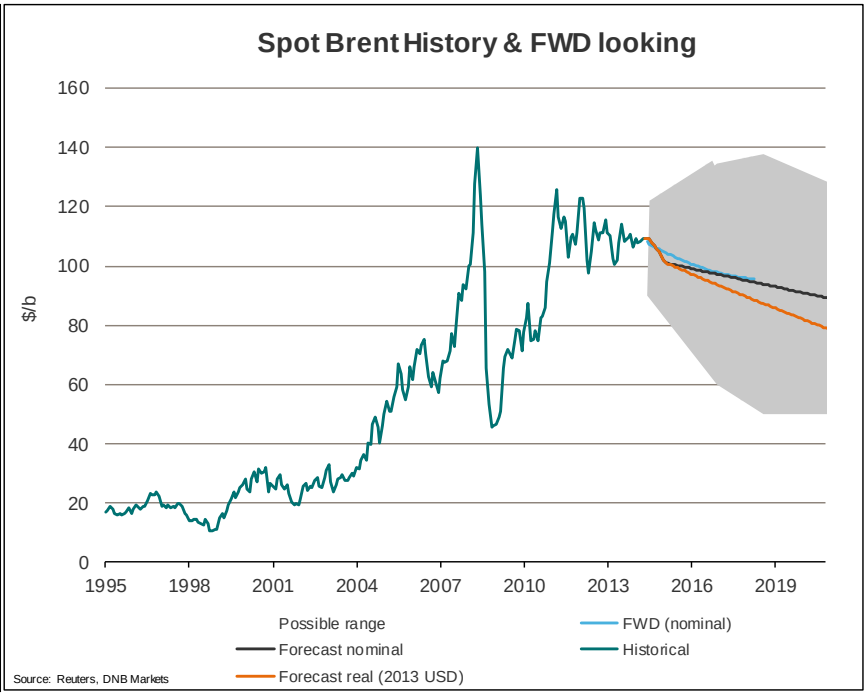
IEA World Oil Supply-Demand Balance (May 2014):	2008	Change	2009	Change	2010	Change	2011	Change	2012	Change	2013	Change	2014
OECD Demand	48.4	-2.0	46.4	0.6	47.0	-0.5	46.5	-0.5	46.0	0.1	46.1	-0.1	46.0
Non-OECD Demand	37.9	1.2	39.1	2.3	41.4	1.2	42.6	1.6	44.2	1.2	45.4	1.4	46.8
Total Demand	**86.4**	**-0.8**	**85.5**	**2.9**	**88.5**	**0.6**	**89.1**	**1.1**	**90.2**	**1.2**	**91.4**	**1.3**	**92.8**
Non-OPEC Supply	49.2	0.6	49.9	1.0	50.8	0.2	51.0	0.5	51.5	1.2	52.7	1.4	54.1
OPEC NGL's and non-conventional oil	4.5	0.6	5.1	0.4	5.5	0.4	5.9	0.2	6.2	0.1	6.3	0.2	6.5
Global Biofuels	1.4	0.2	1.6	0.2	1.8	0.0	1.8	0.0	1.9	0.1	2.0	0.1	2.1
Total Non-OPEC supply	**55.2**	**1.4**	**56.6**	**1.6**	**58.2**	**0.6**	**58.8**	**0.8**	**59.6**	**1.5**	**61.0**	**1.7**	**62.7**
Call on OPEC crude (and stocks)	**31.2**	**-2.3**	**29.0**	**1.3**	**30.3**	**0.0**	**30.3**	**0.3**	**30.6**	**-0.2**	**30.4**	**-0.3**	**30.1**
OPEC Crude Oil Supply (Last known number dragged fwd)	31.6	-2.5	29.1	0.1	29.2	0.7	29.9	1.4	31.3	-0.9	30.5	-0.5	29.9
Implied World Oil Stock Change	**0.4**		**0.2**		**-1.1**		**-0.4**		**0.7**		**0.1**		**-0.1**

OPEC World Oil Supply-Demand Balance (May 2014):	2008	Change	2009	Change	2010	Change	2011	Change	2012	Change	2013	Change	2014
OECD Demand	48.4	-2.0	46.4	0.6	47.0	-0.5	46.5	-0.5	46.0	-0.1	45.9	-0.1	45.8
Non-OECD Demand	37.7	0.7	38.4	1.9	40.3	1.3	41.6	1.4	43.0	1.1	44.1	1.2	45.3
Total Demand	**86.1**	**-1.3**	**84.8**	**2.5**	**87.3**	**0.8**	**88.1**	**0.9**	**89.0**	**1.0**	**90.0**	**1.1**	**91.1**
Non-OPEC Supply (Incl all Biofuel)	50.4	0.7	51.1	1.3	52.4	0.0	52.4	0.5	52.9	1.3	54.2	1.4	55.6
OPEC NGL's and non-conventional oil	4.1	0.2	4.3	0.7	5.0	0.4	5.4	0.2	5.6	0.1	5.7	0.1	5.8
Total Non-OPEC supply	**54.5**	**0.9**	**55.4**	**2.0**	**57.4**	**0.4**	**57.8**	**0.7**	**58.5**	**1.4**	**59.9**	**1.5**	**61.4**
Call on OPEC crude (and stocks)	**31.6**	**-2.2**	**29.4**	**0.5**	**29.9**	**0.4**	**30.3**	**0.2**	**30.5**	**-0.4**	**30.1**	**-0.4**	**29.7**
OPEC Crude Oil Supply (Last known number dragged fwd)	31.2	-2.5	28.7	0.5	29.2	0.7	29.9	1.4	31.3	-0.9	30.5	-0.5	29.9
Implied World Oil Stock Change	**-0.4**		**-0.7**		**-0.7**		**-0.4**		**0.8**		**0.4**		**0.2**

EIA World Oil Supply-Demand balance (May 2014):	2008	Change	2009	Change	2010	Change	2011	Change	2012	Change	2013	Change	2014
OECD Demand	47.6	-2.2	45.4	0.7	46.1	-0.3	45.8	0.1	45.9	0.1	46.0	0.0	46.0
Non-OECD Demand	38.2	0.7	38.9	2.1	41.0	1.5	42.5	0.8	43.3	1.1	44.4	1.2	45.6
Total Demand	**85.8**	**-1.5**	**84.3**	**2.7**	**87.1**	**1.2**	**88.3**	**0.9**	**89.2**	**1.2**	**90.4**	**1.2**	**91.6**
Non-OPEC Supply (Incl all Biofuel)	49.7	0.8	50.5	1.3	51.8	0.2	52.0	0.7	52.7	1.4	54.0	1.6	55.6
OPEC NGL's and non-conventional oil	4.5	0.3	4.8	0.8	5.5	-0.3	5.3	0.5	5.8	0.6	6.3	0.0	6.4
Total Non-OPEC supply	**54.1**	**1.1**	**55.2**	**2.1**	**57.3**	**-0.1**	**57.2**	**1.2**	**58.4**	**2.0**	**60.4**	**1.6**	**61.9**
Call on OPEC crude (and stocks)	**31.7**	**-2.6**	**29.1**	**0.7**	**29.8**	**1.3**	**31.1**	**-0.3**	**30.8**	**-0.7**	**30.0**	**-0.4**	**29.6**
OPEC Crude Oil Supply (Last known number dragged fwd)	31.3	-2.2	29.1	0.1	29.2	0.7	29.9	1.4	31.3	-0.9	30.5	-0.5	29.9
Implied World Oil Stock Change	**-0.4**		**0.0**		**-0.6**		**-1.1**		**0.6**		**0.4**		**0.3**

18 Brent forecast

	Historical Nominal $/b	Historical Real (2012) $/b
2001	24.4	31.7
2002	25.0	31.9
2003	28.8	36.0
2004	38.3	46.5
2005	54.5	64.1
2006	65.1	74.2
2007	72.4	80.2
2008	97.3	103.7
2009	61.7	66.0
2010	79.5	83.7
2011	111.3	113.6
2012	111.7	111.7
2013	108.7	108.7
	Forecast Nominal $/b	**Forecast Real (2014) $/b**
Q1-14	108	108
Q2-14	108	108
Q3-14	107	107
Q4-14	105	105
2014	107	107
2015	100	99
2016	98	95
2017	96	91
2018	94	87
2019	92	84
2020	90	80



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