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InvestBank.

OIL

OUTLOOK 2010

CONTENTS

Our outlook for international crude oil prices in 2010 is dependent on the answer to the following

a) Does the global economic outlook predict sufficient demand in 2010 and 2011 for oil prices to justify existing levels?
b) Where will demand come from, developed or developing world?
c) Does the historic economic growth - crude oil demand correlation hold true in light of subsidy elimination reforms in China and India?
d) What is the reducing spread between WTI, Brent and Arab Light (AL) indicating?
e) What are US crude stockpiles revealing?
f) How will the supply side factors influence crude oil prices?
g) Where would new supply come from? How will it influence the underling dynamics of crude oil market?
h) What is the role of financial institutions in the future crude oil prices?
i) Do crude oil future-to-spot spreads reveal any trend?
j) How expensive is crude oil in dollar terms accounting for the depreciation/appreciation of USD against other major currencies?

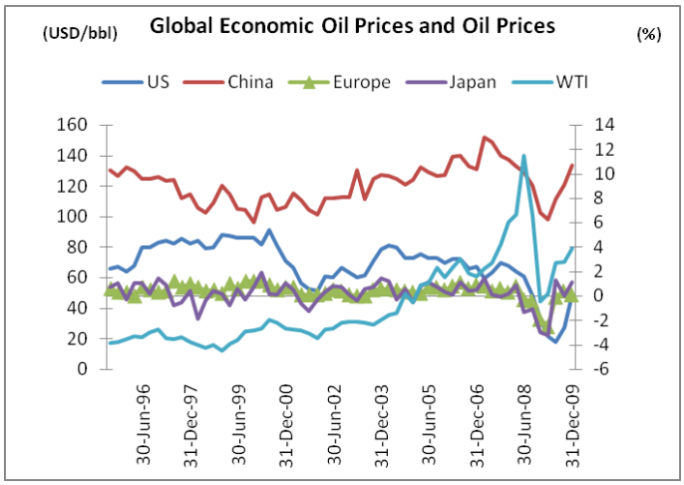
Global Economic Growth vs Oil Prices

So far, crude oil has been considered as an engine to the overall economic growth. The commodity prices and demand both have shown a high correlation to the global economic growth. Therefore, oil prices will primarily be hinged upon a rebound in global economy going forward.

Historically, the correlation between economic growth and oil prices have held true, which has helped support oil prices moving northwards – except the unusual price-hike during 2008. Post commencement of the global recession in 2008-09, lower oil demand dictated prices to adjust downward. Therefore, the economic recovery outcome for major economies post 2009, is expected to help prices inch-up again as shown in Figure-01. We have taken the data for countries which contribute the largest chunk (59%) to global oil demand, including United States with 24%, Europe 17%, China 9%, Japan 6% and India with 3%, considering the economic[1] outlook forecast for 2011 and onwards.

1 Economic Forecast 2009-2010 : IMF Raises GDP Growth Expectation. Published on 09 Jul-09

Figure 01



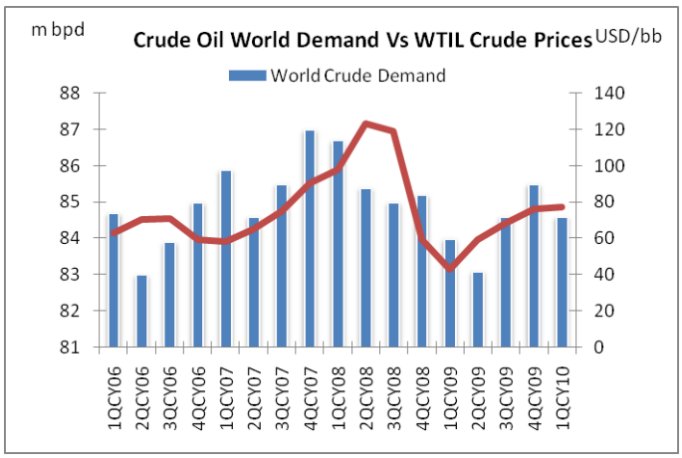
Source: IMF, InvestCap Research

Global Crude Oil Demand – One Factor Amongst Four

First Impression – International energy Agencies' demand forecast

Reviving growth prospects in the global economy primarily boosted the demand for crude oil, which in turn was reflected in the price movement of the WTI (West Taxes Intermediary) - considered as world benchmark. In this regard, Figure-02 depicts the said relationship between crude oil demand and WTI spot prices. The figure also indicates that the signs of recovery in the global economy have raised optimism regarding the rejuvenated crude oil demand, and thus, expectation of increase in crude oil prices in the near future.

Figure 02



Source: IEA, Bloomberg, InvestCap Research

As per International Energy Agency (IEA), the world crude oil demand is expected to average at 86.5 million barrel per day (mbpd), touching 87.2mbpd towards the end of 2010, in line with International Monetary Fund (IMF) global economic forecast of 3.8% in the same period. A point to highlight here is that forecasted crude oil demand for end-2010 equals 87mbpd recorded by the end 2007, which is the highest ever in history. This subsequently led to crude oil prices to surge to all-time high of USD147/bbl. Furthermore, as per the Energy Information Administration (EIA), demand for 2011 is expected to increase by 2.25mbpd over 2009 to stand at 87.15mbpd, which stands in line with the expected world GDP growth of 4.5% YoY.[2]

Our Take on the First impression

The first impression based on the historical correlation between the global economic (GDP) growth and crude oil demand leads towards rejuvenated crude oil demand. However, due to change in the global economic dynamics (growth centers shifting from OECD to Non-OECD) alongside swift in crude oil market dynamic itself, the said historical correlation doesn't fully capture the essence of future crude oil market and it prices. In order to capture a holistic picture, it is important to identify where future crude oil demand is coming from, its nature coupled with other factors (supply consideration, financial institutions role and USD parity against major currency) that played their due role behind in the determination of crude oil crude oil prices. It was this combination of various factors that caused crude oil prices to touch USD147/bbl in Jul-08.

Demand coming from developed or emerging market?

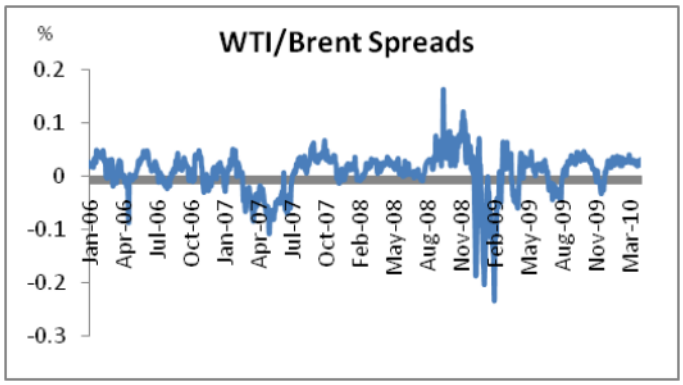
As per the international energy agencies, major triggers for higher crude oil demand in 2010 onwards, will mainly be Non-OECD countries. To be precise, the growth centre for crude oil demand is expected to be the two giants amongst emerging markets i.e. China and India. As per the IMF forecast, Chinese and Indian economies will grow by 10 % and 6.5% respectively in 2010. In this regard, as per IEA's recent outlook, China would account for one-third of the world's total incremental crude oil demand in 2010, while OECD countries' demand is expected to remain stagnant in this period.

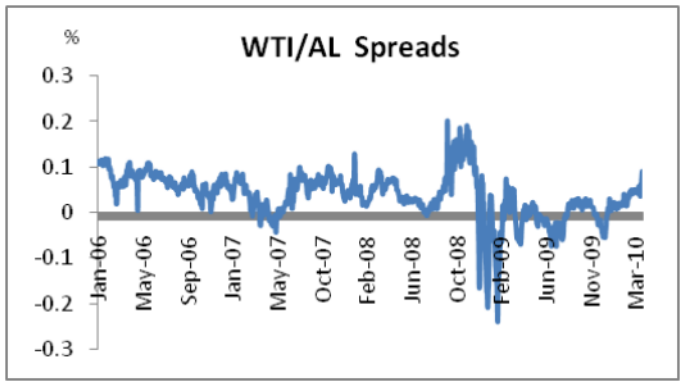
What are spreads between various crude oil benchmark prices indicating?

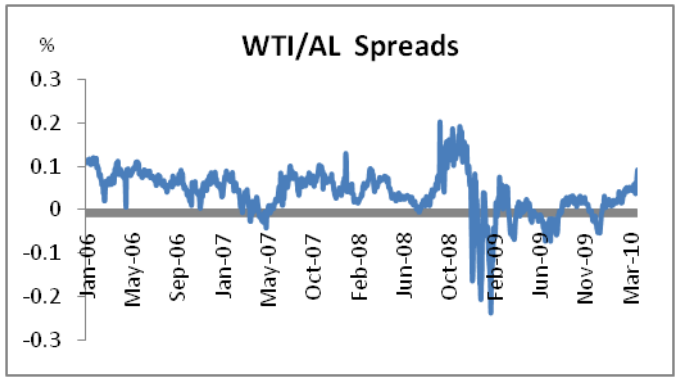
Regarding the origin of future crude oil demand, we have analyzed the spreads between prices of the three benchmark crude oil categories i.e. WTI, Brent and Arab Light (AL). Figure-03 shows that the spreads between WTI with Brent and AL have been reduced from their recent high of around an average of USD5.4/bbl (WTI to Brent) and USD6.98 (WTI to AL) recorded in Sep-08, to below USD1.98/bbl and USD3.86/bbl respectively in Mar-10. Spreads between Brent and AL were also at their recent highs at USD4.46/bbl in Oct-09, which has now come down to a mere USD1.39/bbl. This also supports are initial assessment regarding demand growth origin that growth centers are emerging markets (Non-OECD countries) rather than the OECD itself, with due consideration for the transportation cost incurred.

2 EIA Short-Term Energy Outlook. Published on 09 Mar-10

Figure 03







Source: IEA, Bloomberg, InvestCap Research

China and India

After establishing the source of future oil demand, we intend to discuss the nature of the oil demand now.

Subsidy elimination in China and India, impact on crude demand

The IMF estimated that global subsidies on petroleum products is expected to stand around USD250bn in 2009 (up from USD60bn in 2003). It was as high as USD520bn in 2007, or 0.7% of global GDP.[3] Therefore, while assessing demand from China and India, we cannot ignore the element of the subsidy being provided on petroleum products in these countries, and the steps they are taking to eliminate them.

With respect to China, the petroleum prices in the country are pegged to weighted average prices of Singapore, Rotterdam and New York. However, the Chinese government has shown aversion to the passing on impact of oil price surge to end-consumers (primary users include farmers, truckers, fishermen and motorists rather than the industry), making the actual oil demand price inelastic. The said groups pay 15-20% below market level, and are the chief contributors to the growth in country's demand.[4] Therefore, the recent Chinese government plan to revamp its oil pricing mechanism (announced in Dec-08 to eliminate subsidy on petroleum product prices) will have a major bearing on crude oil consumption of the country, as it has a potential to convert China's inelastic crude oil demand to a more price-elastic crude oil demand.

3 IMF staff Position note: Published on February 25, 2010

4 Reducing Energy Subsidies in China, India and Russia: Dilemmas for Decision Makers by Grant Dansie 1, Marc Lanteigne 2 and Indra Overland 1,3,*. Publish on 01 Feb-2010.

On the other hand, India is more aggressive towards the elimination of subsidy on petroleum prices (expected subsidy payment of Rs450bn or USD9.96bn in FY10)[5]. A government panel has recently recommended the Indian government to liberalize gasoline and gasoil prices and remove subsidy on LPG and Kerosene. The same were put forward in 2006 and 2008 as well, however, due to adverse political environment; the recommendations were not implemented upon. We expect that due to subdued energy prices at present, Indian government will start to implement on the said recommendation. In such case, the crude oil demand from India will also be converted from a price-inelastic demand to a more price-elastic demand and will subdue overall oil demand in the country in this regard.

Due to the afore-mentioned reasons, subsidy elimination is expected to have a marked impact on the future crude oil market dynamics while the historical correlation between global economic growth and crude oil demand might not fully capture its future essence. A recent statement from the IEA Executive Director Nobouo Tanaka says, 'Oil demand isn't recovering at the same pace as the economy in developing nations' also supports our argument. With respect to the subsidy removal and its impact on crude oil market, we have a downward bias to the future crude demand projected by international energy agencies.

Delinking behavior of demand and prices

Another change in the nature of crude oil demand is the subdued link of oil prices with demand appetite in the major oil-consuming countries. A case in point here is that China has used its financial muscle to secure the supply of the crude oil through three separate deals worth USD39bn from Russia, Brazil and Venezuela. Amongst the deals, a loan of USD25bn (USD12/bbl) to Russia has secured China the supplies of 301k bpd for next quarter of the century[6]. At present, though the China-Russia deal will have minimal impact on the crude oil market as it constitutes only 7% of China's total crude oil import, but marks a beginning of new direction in the crude oil market.

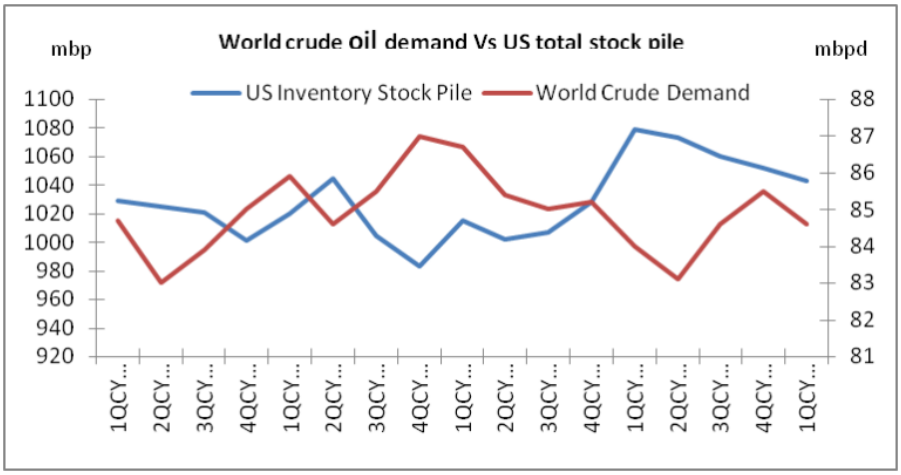
US crude oil inventory stockpile

As mentioned earlier, major crude oil demand will come from the emerging markets, but the role of the US crude oil demand in the analysis of oil dynamics cannot be ruled out. In this regard, Figure-04 indicates the relationship of world crude oil demand with US crude oil inventory stockpiles. It is evident from Figure-04 that the rising US crude oil stockpile indicates weak crude oil demand and vice versa. Therefore, the recent rising trend (reported by EIA US in its weekly petroleum update) in the crude oil inventory indicates weakening demand at first.

5 International Energy Agency's Oil Market Report. Published on 11 Feb-2010.

6 Forbos. Published on 18 Feb-10

Figure 04



Source: EIA, IEA InvestCap Research

However, we have to look beyond this conventional aurgument, as crude oil demand is seasonal in nature as well, with two peak seasons being winter and driving, each followed by a lean demand period. Figure-05 below illustrates this fact.

Figure 05- i

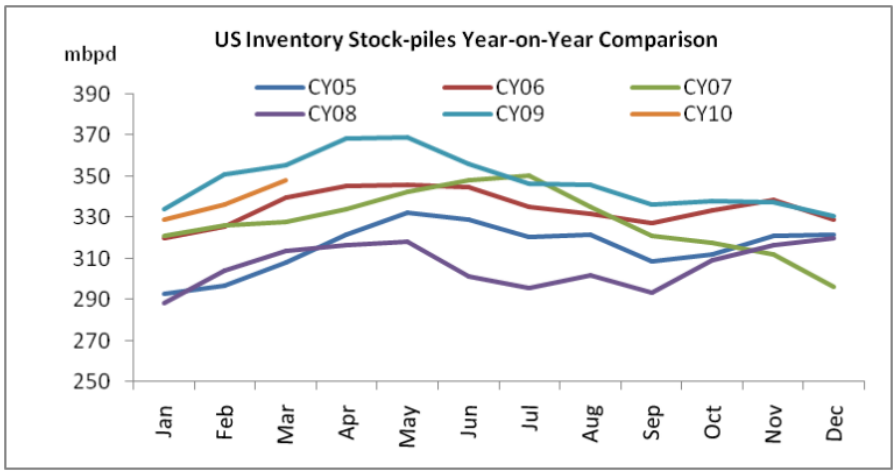
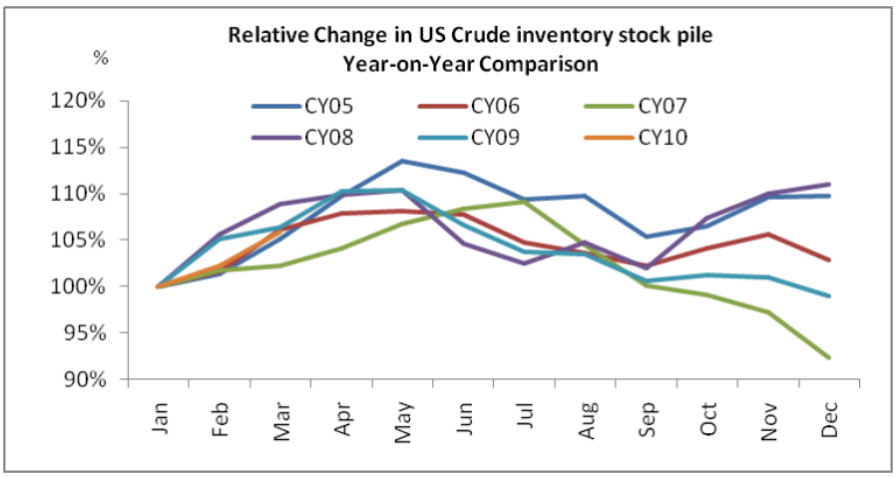


Figure 05- ii

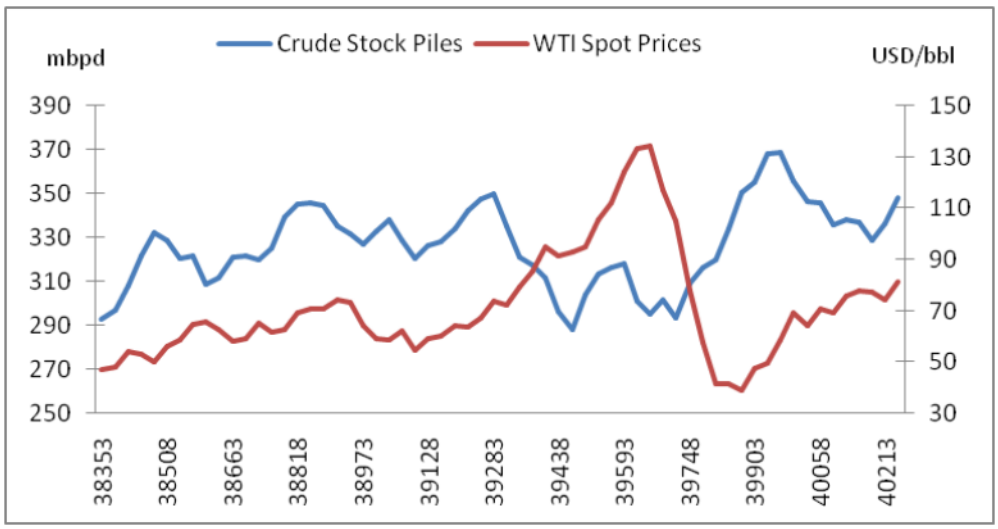


Source: EIA, InvestCap Research

Figure-05 clearly reveals that the inventory stockpile rises during the period Feb-May each year, as crude refineries gear up for the upcoming driving season. Post this period, crude oil inventory slacks off marking the start of the driving season. This is followed by an increase in the inventory in Sep-Oct as refineries prepare for the winter season. Therefore, the recent rise in the crude oil inventory in the US is in line with this cycle, and is indicative of its cyclical nature rather than weakening of demand. A point worth mentioning here is that, in absolute terms, 2010 crude oil inventory stockpile stands below the inventory levels recorded in 2009, while in relative terms, the increase is lower in 2010 as against last year. The two indicate improved demand in the US, contrary to the common perception of weak crude oil.

As an indicator of world crude oil demand, change in the inventory levels also reflects in the crude oil prices. The relationship of the two is depicted in Figure-06 below.

Figure 06

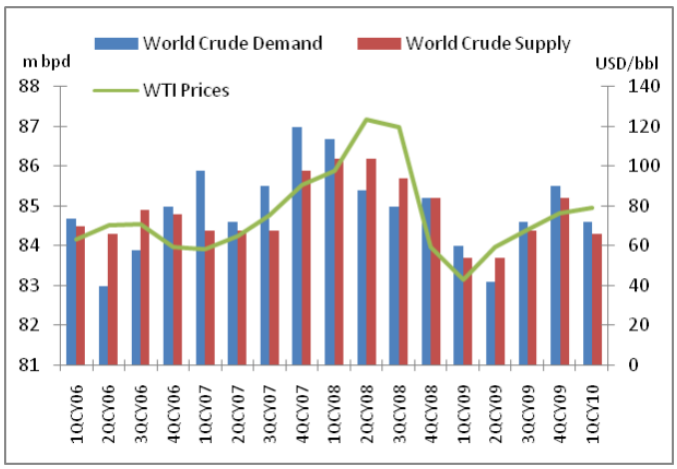


The US economy is expected to come out of recession (IMF projects US GDP growth at 3.3% in FY10, recovering from -2.0% recorded in FY09), which should be reflected in terms of reduction in country's crude oil inventory stockpile and rising prices. However, looking at the broader picture, US crude oil inventory stockpile is a subset of the total crude oil demand, and therefore, should be viewed in the ambit of an overall crude oil demand-supply scenario, and not on a standalone basis.

Supply The Other Half Of The Equation

After analyzing the demand side of the crude oil market, lets highlight the major factors of the other side of the equation, the crude oil supply. For the purpose, we have modified Figure-02. Figure-07 highlights the importance of the supply side in determining crude's price behavior, as demand factor alone is not enough.

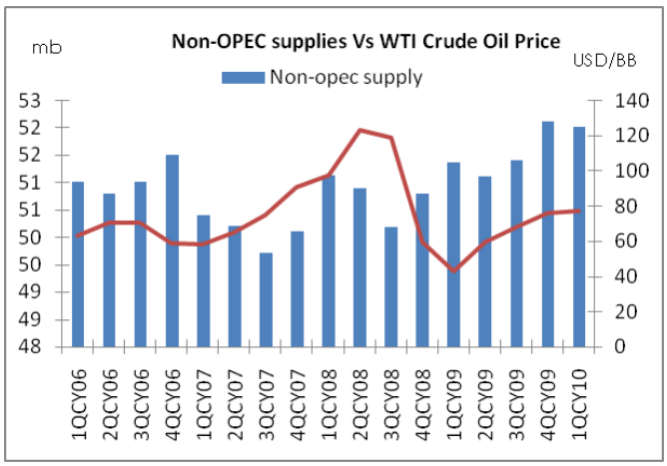
Figure 07



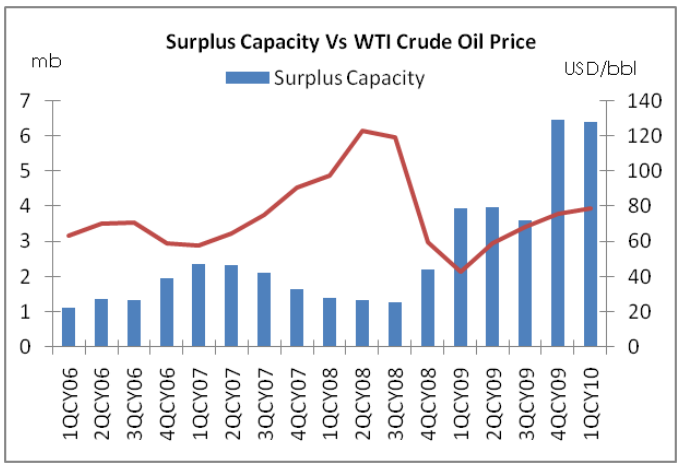
Source: IEA, Bloomberg, InvestCap Research

The supply-side of the equation is chiefly a twofold phenomena i) crude oil supply from non- OPEC and, ii) surplus capacity of the OPEC (Organization of the Petroleum Exporting Countries). The relationship of said factors to WTI prices is illustrated in Figure-08.

Figure 08



Source: IEA, Bloomberg, InvestCap Research



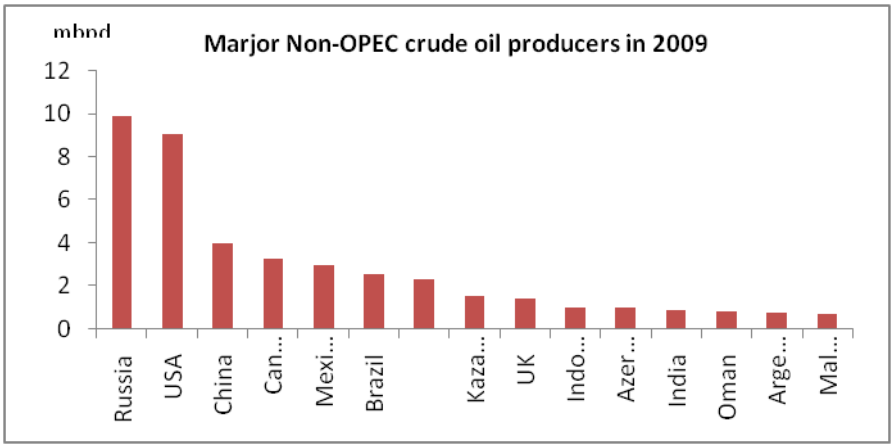
Source: IEA, Bloomberg, InvestCap Research

It is evident from Figure-08 that the increase in Non-OPEC supply and/or surplus capacity of OPEC, leads to weak crude oil prices and vice versa. It is evident in Figure-08 that during later part of 2006 and early part of 2007, WTI prices remained subdued in presence of surge in the Non-OPEC supplies in addition to excess capacity. As the crude oil demand steadily picked up on the back of world economic growth, OPEC surplus capacity eroded in congruence with reduced Non-OPEC supplies. This in turn, pushed WTI crude oil prices above levels of USD140/bbl in 2nd and 3rd quarter of 2008. In line with this relationship, the slump in the crude oil prices in the beginning of 2009 is due to the surge in surplus capacity and enhanced production from Non-OPEC countries.

Non-OPEC Supply

As per data available from EIA, Non-OPEC production stands highly concentrated, with fifteen countries contributing 83% of total Non-OPEC production in 2009. Figure-09 below shows major Non-OPEC crude producers in 2009.

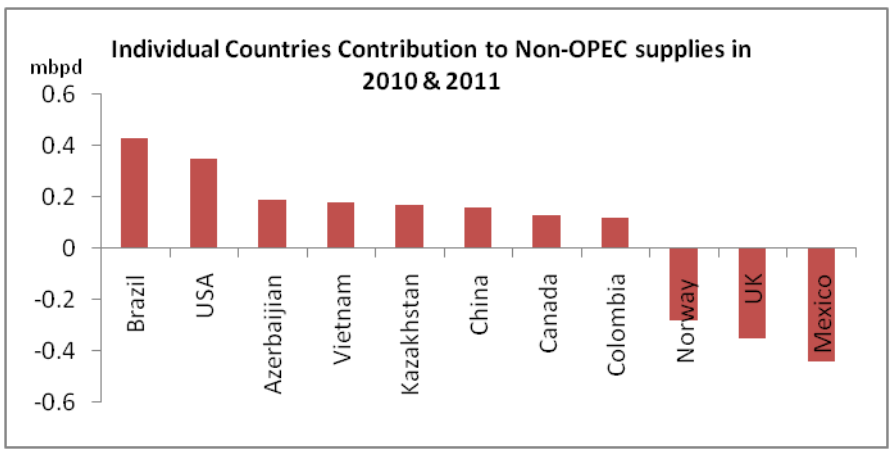
Figure 09



Source: EIA, InvestCap Research

Furthermore, as per EIA, Non-OPEC supply is expected to grow by 550,000bpd in 2010, but will shrink back by 90,000bpd in 2011. The major sources of growth in the next two years will be Brazil followed by the USA, Azerbaijan and Kazakhstan. The incremental Non-OPEC production and its contributors are given in Figure-10. The said increase will offset the decline in the production from Mexico, United Kingdom (UK) and Norway on account of the natural decline.

Figure 10



Source: EIA, InvestCap Research

Amongst Non-OPEC circle, Brazil is expected to cumulatively increase its production by 430,000bpd during 2010-11. In this regard, three large Brazilian projects, each adding 100,000bpd, include i) the pilot project of Tupi fields ii) relocation project unit of Cacholate fields, and iii) enhanced product from Peregino fields. Furthermore, data also reveals that Azerbaijian and Kazakhstan will cumulatively add an additional 360,000bpd in the same period. Enhanced production from the said countires is expected to offset the decline in production from Mexico, UK and Norway of 440,000bpd, 350,000bpd and 280,000bpd respectively[7] from 2009 to 2011.

The comparison between incremental Non-OPEC oil supplies and global crude demand reveals that incremental demand is expected to outstrip the increased production from the Non-OPEC side. This in turn augments the role of the OPEC countries (discussed ahead) in the crude oil market, and that, future oil prices are expected to primarily hinge on how OPEC plays its cards.

Enhanced OPEC role

With Non-OPEC countries expected to maintain their crude oil supply in next two years at the same levels, OPEC would have an enhanced role in the future crude oil market. In order to have a better understanding of the OPEC role, it is vital to have a historical percpective of OPEC, its impact on crude oil market and the changing dynamics of the OPEC itself going forward.

A brief account of OPEC

The organization was established back in September 1960, with five founding members i.e. Iran, Iraq, Kuwait, Saudi Arabia and Venezuela, and six more members joining by 1971. The organization intended to influence the crude oil prices by limiting production similar to that of the Texas Railroad Commission. In its subsequent years, OPEC was effective in controlling oil prices (as illustrated by Yom Kippur War - Arab Oil Embargo, 1974), with principle controlling mechanism of surplus production capacity (mainly residing in the Kingdom of Saudi Arabia). However, increased global crude oil appetite caused OPEC surplus capacity to erode away with rising fears of unprecedented demand-supply gap. This fear was played over by the players outside the crude's fundamental demand-supply equation. This eventually caused the crude to touch all-time highs of USD147/bbl in the recent times. These other-than-fundamental factors are discussed in the following sections.

In 2008, when oil prices crossed into triple-digit figures, OPEC surplus capacity dried up to a mere 1.35mbpd. On the flip side, current surplus capacity stands at above 5.5mbpd with more installation coming online (particularly outside Saudi Arabia), advocating not only for revived OPEC role but also change in the internal dimensions of the OPEC itself.

7 Energy Information Administration, Short-Term Energy Outlook March-2010

Iraq and Nigeria surplus capacity- diluting OPEC power

After establishing enhanced role of OPEC in future crude oil demand, it is also important to understand the changing dynamics within the OPEC itself. Future crude oil supply will come from OPEC, but more particularly from Iraq and Nigeria who are non-compliant quota members. As per international energy agencies, Iraq plans to increase oil capacity from an existing 2.5mbpd to 10-12mbpd over the next decade.[8] Meanwhile Nigeria's 2.6mbpd is being under-utilized due to its internal political conflicts, however, it is expected to come online in the coming months. With the clarity on political front with respect to the country's new figurehead, crude oil output from country is expected to rise steadily to 2.6mbpd (actual country capacity) from existing 2mbpd. Therefore, going forward increased production from above-mentioned countries is expected to have material dampening impact on crude oil prices owing to i) enhanced surplus capacity, and, ii) diluting OPEC power in the crude oil market due to internal quota compliance issues.

Demand And Supply
A Consolidated Picture

In the preceding two sections, we have discussed the major demand and supply factors of crude oil market and their respective impacts on crude prices. At one side, increase in the crude oil demand (86.5mbpd in 2010, 87.15mbpd in 2011) points towards increase in crude prices, while enhanced surplus capacity of the OPEC paints the other side of the picture.

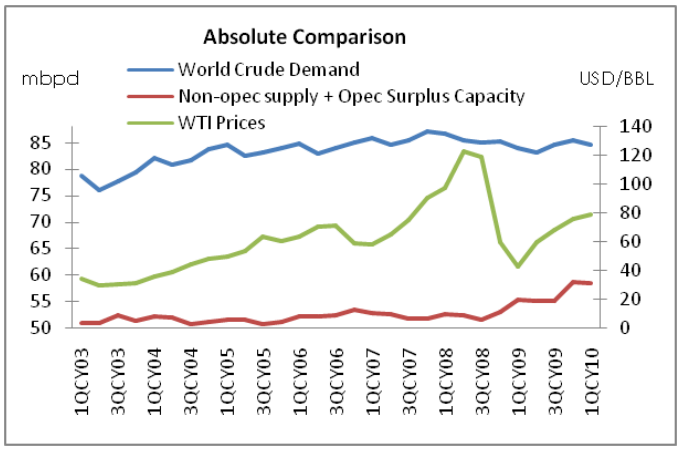
Cumulatively, we believe surplus capacity from OPEC is estimated to stand in the range of 5-6mbpd during 2010-11 which is expected to offset the bullish elements arising from incremental crude oil demand and restricted supply from the Non-OPEC countries. Therefore, future demand and supply situation - one of the four major determinants of crude prices - advocates for a weak crude pricing outlook.

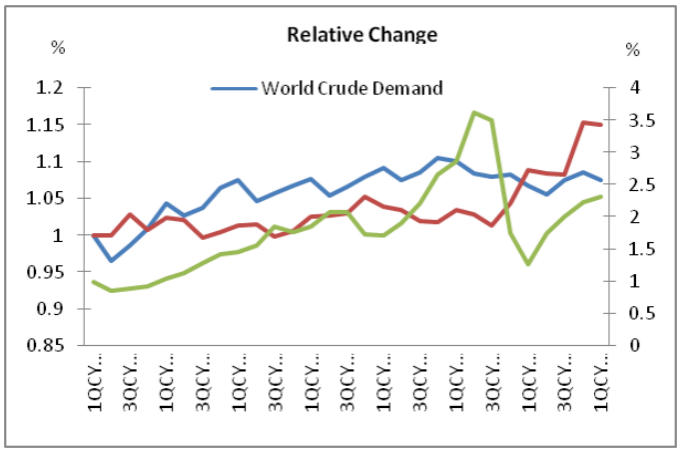
Other factors

As mentioned earlier, in addition to the 'demand-supply situation', other factors also play a crucial role in determination of crude oil prices. This is mentioned in Figure-11, which reveals that, although crude oil prices are primarily a demand-supply function, there exist other factors as well causing erratic movements in oil prices.

8 Businessweek. Published on 23 Dec-09

Figure 11





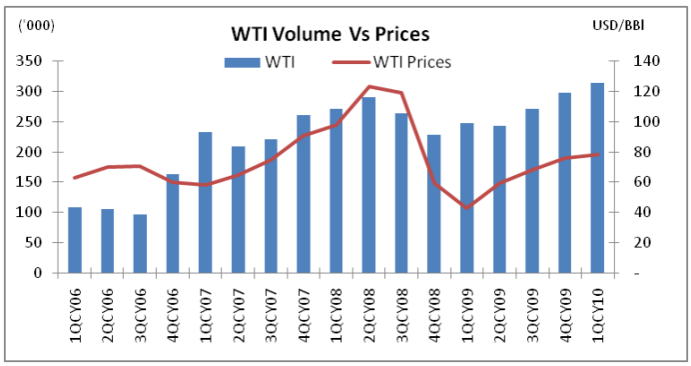
Source: IEA, Bloomberg, InvestCap Research

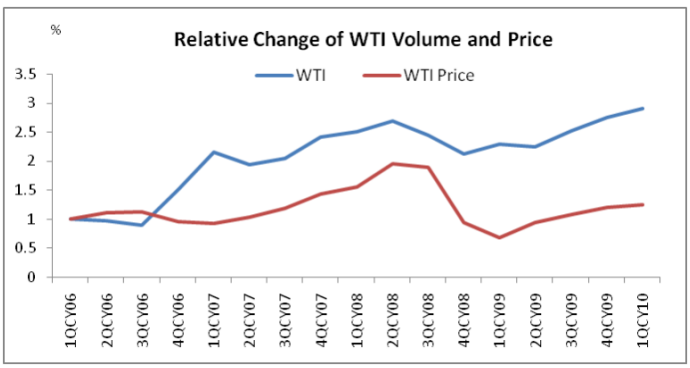
The additional factors that influence crude oil prices are i) scale of liquidity available in the crude oil market ii) USD parity against major currencies like EURO, YEN and GBP iii) and Future-to-spot crude oil spreads. We will discuss these factors one by one with their respective impacts on crude prices.

Market Liquidity – A Source Of Divergence From Fundamentals

In addition to fundamental factors of demand and supply, crude oil market like any other financial market is also a function of available liquidity in the system. Considering trading volumes as a proxy to the market liquidity, there was a marked increase observed in oil trading volumes during the later part of 2006, leading to an increase in prices. Figure-12 reveals this behavior.

Figure 12





Source: IEA, Bloomberg, InvestCap Research

CFTC failed to control flood gates in 2006

In order to comprehend the liquidity function of the crude oil market, we have to understand the role of Commodity Future Trading Commission (CFTC) along side its restriction. The mission of CFTC is "to protect market users and the public from fraud, manipulation and abusive practices related to the sale of commodity and financial futures and options, and to foster open, competitive, and financially sound futures and option markets."[9]

9 Official website of CFTC (http://www.cftc.gov/aboutthecfc/index.htm)

Since CFTC is responsible to oversee all the commodity future only within the US premises, we believe, when ICE Futures initiated trading of WTI contracts in Jan-06, it opened flood gates for financial institutions including hedge funds to enter unregulated side of the crude oil market. This led to a sudden influx of liquidity causing crude prices to diverge from its fundamentally-driven levels. This was in set-up with sentiments of an unprecedented demand-supply gap on account of depleting OPEC capacity. This provided financial institutions with an opportunity with limited regularity oversight to exert their influence on the crude oil market.

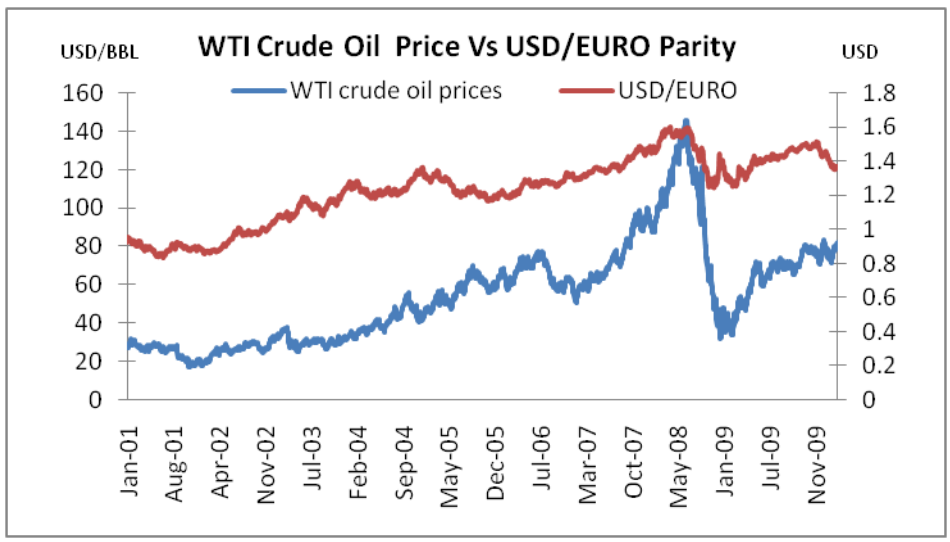
Stringent rules rolling in for financial institutions

The new wave of stringent regulations for the financial institutions are being introduced to rope in their extraordinary speculative behavior. This is expected to also lead to a relatively subdued role of the financial institutions in commodity market. One such proposed scheme of new rules was by US President Barak Obama on 21 Jan-10 that includes a ban on retail banks from using their own money in investments - known as proprietary trading. Instead, banks would be limited to investing their customers' funds. Furthermore, restructuring some major financial institutions was also proposed, which in turn would limit their role in the crude oil market and would constrain market liquidity. The limited role of financial institutions will enhance the role of the demand-supply factor (discussed in the previous sections), and thus, enhanced role of the OPEC surplus capacity.

USD Against Other Currencies

Another major factor playing its role in the determination of the crude oil prices is the USD parity against the Euro and other major currencies. Figure-13 below indicates that, whenever the USD depreciated against the Euro, investors intended to hedge value of their money by placing funds in USD denominated commodities especially crude oil. As a result, crude oil prices stand with an inverse relation with the USD/Euro parity.

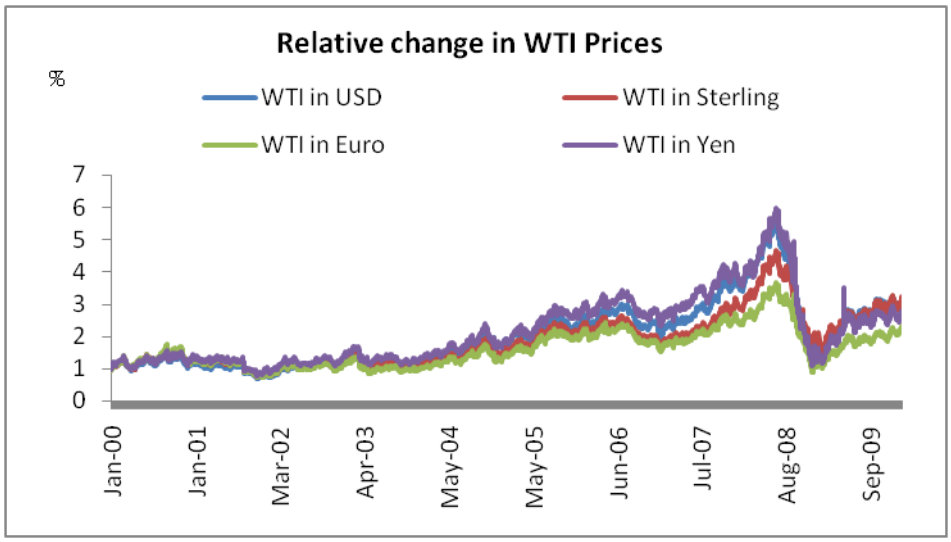
Figure 13



Source: Bloomberg, InvestCap Research

Moving forward from the traditional investment hypothesis, we also believe that the concept of 'Opportunity Cost' plays a vital role when currency factor comes in to play. In Figure-14 below, we have tried to capture the same concept through 'Translation Analysis'.

Figure 14



Source: Bloomberg, InvestCap Research

It is evident from Figure-14 that relevant strength of Euro, Yen and GBP against the USD created an opportunity cost, which means that the countries could get crude oil at a cheaper rate when USD is at lower levels.

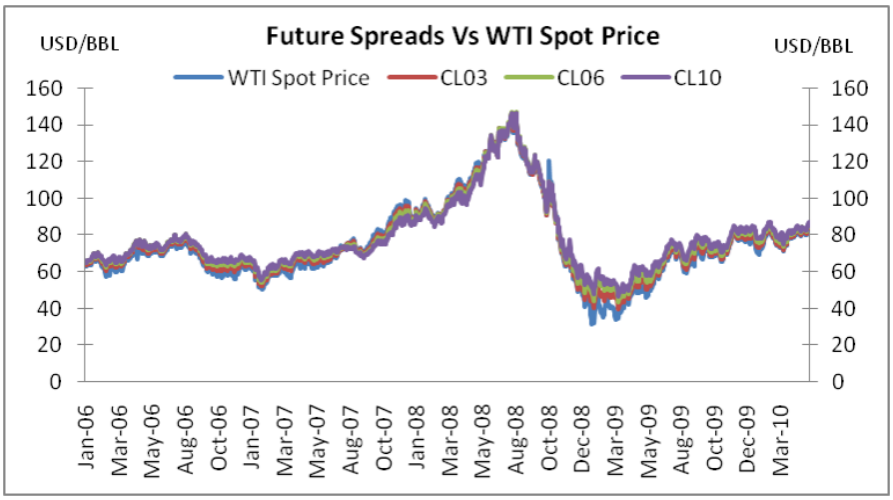
The US economy coming out of recession is expected to provide strength to the greenback. Furthermore, the US government flushing out bail-package money to rope in the inflationary pressure is also expected to provide further strength to the USD on account of restricted USD demand and supply. Conversely, USD's major contemporary the Euro, is being battered on account of recent Greece's debt crisis. Although, Euro-zone includes countries like Germany and France that have the ability to meet Greece debt obligations easily, the crisis has exposed the inherit weakness of the Euro-zone arising out of the drag the under-developed economies impose on the more developed economies of the Zone.

Furthermore, USD gaining strength will also increase the opportunity cost of holding an additional barrel of crude oil keeping other factors constant. This in turn is also indicative of a bearish trend in crude oil prices. As per recent Bloomberg estimates, Euro is overvalued by 17.19% and 14.08% on Consumer Price Index and Producer Prices Index, respectively, which also supports our view.

Significance Of Future Spreads

Finally, the factor that plays its role on the crude oil prices is the Future-to-Spot price spreads. Investors usually associate futures contract prices to expected future price trends whereas future crude oil prices track current spot prices, Figure-15 reveals this behavior. Moreover, in the oil market future prices are primarily a function of the spot price and the cost incurred to store it, which commonly referred to as 'Contango' effect.

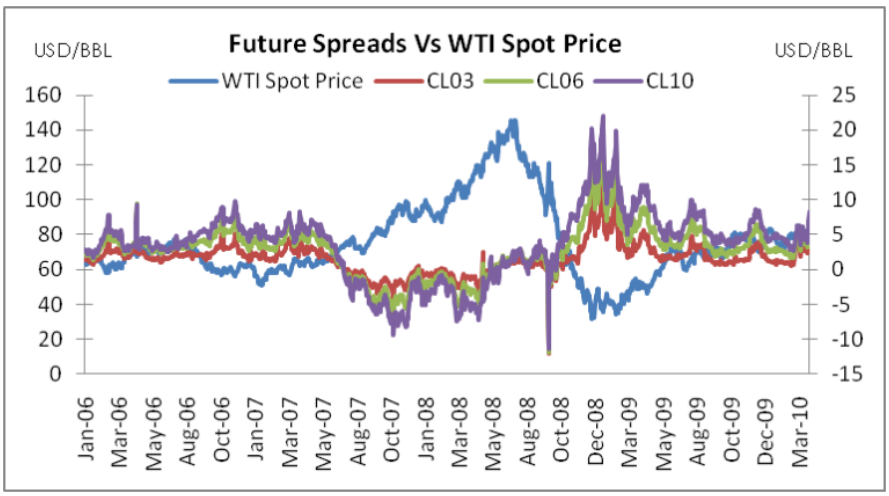
Figure 15



Source: Bloomberg, InvestCap Research

A more relevant measure of crude oil prices is the spread between the spot price and future prices as Figure-16 below explains the relationship between the spot prices of WTI and 3-month (CL03), 6-month (CL06) and 10-month (CL10) future rates. It is evident that spreads dipped to negative with spot oil prices touching record high, and reverting to their highest when spot prices slumped to their recent lowest at USD32/bbl.

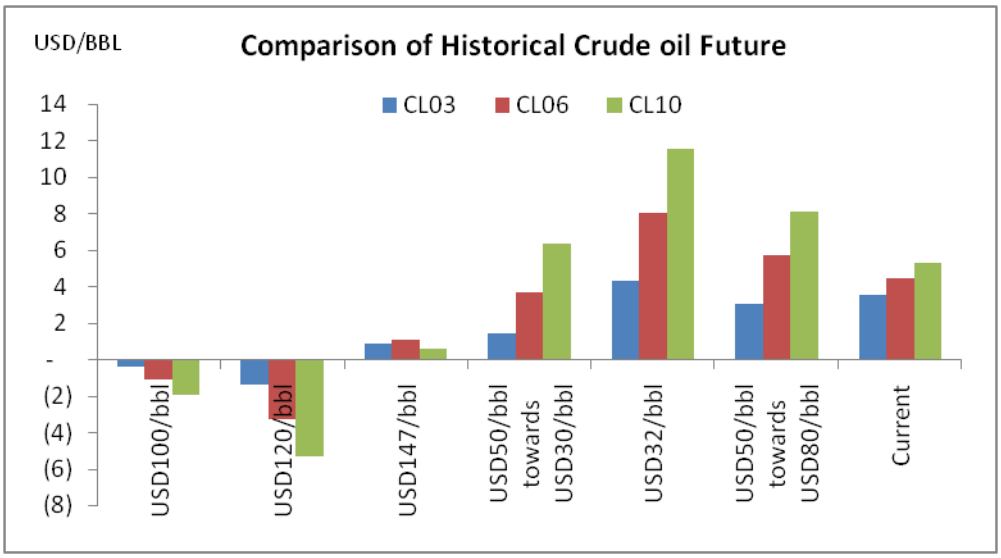
Figure 16



Source: Bloomberg, InvestCap Research

Figure-17 is a snapshot of the spread between the spot price and futures prices of crude oil as of 01 Apr-10, and future spreads for a prior month average when crude oil prices were at USD147/bbl and then USD32/bbl. Furthermore, we have also included average spreads for the prior month when crude oil moved towards USD100/bbl (25-Jan to 25-Feb '08), USD120/bbl (7-Apr to 4-May '08), USD50/bbl, heading towards USD30/bbl (20-Oct to 19-Nov '08) and USD50/bbl heading towards USD80/bbl (19-Feb to 19-Mar '09).

Figure 17



Source: Bloomberg, InvestCap Research

It is evident from the figure that future spreads have some predictive power with respect to future oil prices. Although future spreads at USD147/bbl stood positive, they however suggested a decline in the crude oil prices when at USD100/bbl and USD120/bbl, which eventually tumbled after touching USD147/bbl. Furthermore, when crude oil prices tumbled to near USD30/bbl, the run-up to the point shows an uptick in the crude oil prices particularly at USD32/bbl and USD50/bbl. At present, the crude oil spreads stand at USD3.53/bbl (CL03), USD4.45/bbl (CL06) and USD5.28/bbl (CL10). Taking into account holding cost with regards to future spreads, the trend indicates that market participations see uptick in crude oil prices in the short-run but expects them to wane down in to reflect a more realistic picture of demand-supply factors.

Oil Price Outlook

Table -1

Factors	Unit	CY08	Current	CY10P	CY11E	Trend
Global GDP Growth	%	-	3.8%	3.80%	3.20%	Bullish
Crude Oil Demand	mbpd	86.6	86.1	86.50	87.15	Bullish
Non-OPEC Supply	mbpd	50.7	50.27	50.82	50.73	Bullish
OPEC Surplus Capacity	mbpd	1.35	6.47	5.50	5.70	Bearish
Role of Financial Institutions	-	High	Low	Low	Low	Bearish
Spot to 3-mth Future Spreads before USD147/bbl	USD/BBL	(0.54)	0.71	-	-	Bullish
Spot to 3-mth Future Spreads before USD147/bbl	USD/BBL	(1.45)	1.63	-	-	Neutral
Spot to 3-mth Future Spreads before USD147/bbl	USD/BBL	(2.57)	2.69	-	-	Bearish
USD to EURO	USD	1.47	1.36	1.24		Bearish

The outlook regarding the future crude oil price is primarily dependent on the factors mentioned in the table above alongside the perception regarding the question asked earlier. The question falls under five dimensions i) crude oil demand ii) crude oil supply iii) market liquidity iv) USD parity against Euro and other currencies and v) future spreads.

In this report, we have presented our outlook of the same dimensions. The global economic recovery will engine the revival in crude oil demand stemming from emerging markets, particularly China and India. However, the demand will be roped in by subsidy elimination reform in said countries, and therefore, we have a downside bias to international energy agencies' crude oil projections. Furthermore, we believe that the surplus capacity being added by the OPEC countries on account of production enhancement in Iraq, will completely offset the bullish elements of demand growth and stagnant crude oil supply from the Non-OPEC circle. In a nutshell, surplus capacity of the OPEC is estimated to stand in the range of 5-6mbpd during 2010-11 which will offset the bearish elements arising from higher crude oil demand (86.5mbpd and 87.15mbpd in 2010 and 2011 respectively) and restricted supply from the Non-OPEC countries (expected to be 50.8mbpd 2010 and 50.73mbpd 2011). Therefore, demand and supply scenario of the crude oil market is indicative of relatively subdued oil prices going forward.

Moreover, we have also shed light on the role of financial institutions in the future crude oil market, and we believe that the introduction of new stringent regulations will limit the role of financial institutions in crude oil market. With the economic recovery picking pace in the US, USD is expected to gain strength against other major currencies. This in turn will increase the opportunity cost of holding oil in USD terms. Lastly, we have analyzed the spreads between the crude oil spot prices to 3-month, 6-month and 10-month future prices, which currently also indicate a reduction in the crude oil prices.

Collectively taking into account all of the above-said factors, we believe that crude oil market reveals weak price fundamentals where we expect the crude oil prices to wane down to around USD70/bbl and USD65/bbl by 30 Jun-10 and 31 Dec-10, respectively with 2010 prices ranging between USD70-75/bbl.

Abbreviation

AL	Arab Light
BLL	Barrel
BN	Billion
CFTC	Commodity Future Trading commission
EIA	Information Administration
GDP	Gross Domestic Product
GBP	Great Britain Pound
IEA	International Energy Agency (IEA)
IMF	International Monetary Fund
MBPD	Million barrel per day
MN	Million
OECD	Organization for Economic Co-operation and Development)
OPEC	Organization of the Petroleum Exporting Countries
UK	United Kingdom
USA	United State of America
USD	US Dollar
WTI	West Taxes Intermediary

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