April 14, 2020

Economic Research

Oil Market Update

Oil Supply Deal: Market Stability Desired

Events in the global crude oil market became more interesting last week Thursday, following the extraordinary OPEC and non-OPEC Ministerial Meeting which extended until Sunday, with OPEC+ adopting a production cut of 9.7mbpd from May to June, a reduction to 7.7mbpd cut from July to December 2020 and 5.8mbpd cut from January 2021 until April 2022. In the midst of the OPEC+ negotiation, G20 producers agreed to support the market rebalancing through production declines and stockpiling. Also, beyond the stipulated cuts, Saudi Arabia, Kuwait and the UAE expressed readiness to implement additional voluntarily cuts which would result in effective OPEC+ reduction by 12.5mbpd from May-June. As a result, the weekend-long agreement between OPEC+ and G20 producers is expected to usher in about 19-20mbpd cut in production from May-June.

Figure 1: OPEC+ Supply Cuts

	Old Quota	Q1 2020 Output	Baseline Production	New Quota
Algeria	1,013	1,010	1,057	814
Angola	1,481	1,372	1,528	1,177
Congo	311	302	325	250
Equatorial Guinea	122	123	127	98
Gabon	179	194	187	144
Iraq	4,462	4,534	4,653	3,583
Kuwait	2,669	2,677	2,809	2,163
Nigeria	1,753	1,766	1,829	1,408
Saudi Arabia	10,144	9,741	11,000	8,470
UAE	3,012	3,089	3,168	2,439
OPEC 10	***25,146***	***24,807***	***26,683***	***20,546***
Russia	10,323	11,516	11,000	8,470
Mexico	1,686	1,672	1,753	1,653
Kazakhstan	1,632	1,657	1,709	1,316
Oman	849	813	883	680
Azerbaijan	698	646	718	553
Malaysia	550	701	595	458
Bahrain	199	144	205	158
South Sudan	129	178	130	100
Brunei	99	110	102	79
Sudan	70	79	75	58
NOPEC	***16,235***	***17,517***	***17,170***	***13,525***
Total OPEC+	**41,381**	**42,324**	**43,853**	**34,071**

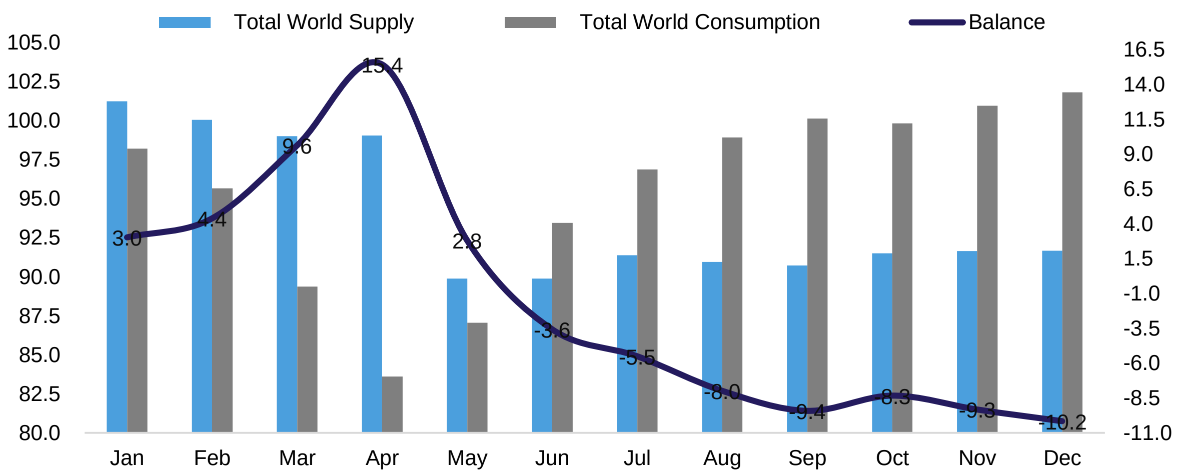
Source: EIA, OPEC, Bloomberg, NOVA Research

In our oil market report (Published 08 April, see report: Monthly Oil Market Report), we stated that the balance of demand and supply will leave the oil market with a net surplus of 3.9mbpd over 2020 compared to a deficit of 185kbpd in 2019, according to EIA forecasts. The net surplus is based on estimated production of 99.4mbpd (-1.25 YoY) and demand of 95.5mbpd (-5.2% YoY) over 2020.

On a quarterly estimate, the surplus position over Q2 20 is estimated to hit a historic high of 11.4mbpd due to the expectation of a much faster decline in demand (-6.4mbpd QoQ to 88mbpd) relative to supply (-700kbpd QoQ to 99.4mbpd). Recovery is expected over Q3 with market surplus estimated to soften to less than 100kbpd and a deficit in Q4 of 1.6mbpd. The estimated market balance is largely based on the assumption that the demand effects from COVID-19 will diminish by Q2 2020, with a pickup in consumption over Q3 2020.

With the OPEC+ cuts and other voluntary production management by other members (as agreed by US at the G-20 meeting), we see a change in market balance over the rest of the year. Adjusting modelled production from May to December for the expected OPEC+ cuts only, we estimate average production over 2020 of 93.9mbpd, which overlaid on consumption could result in market deficit of 1.6mbpd. On a quarterly breakdown, given the expected market surplus of 15.4mbpd in April alone, Q2 surplus will only narrow to 4.9mbpd, a switch to deficit of 7.6mbpd in Q3 and a wider deficit of 9.3mbpd in Q4. However, if the planned G20 cut is implemented starting May alongside OPEC+, the market could switch to a deficit of 6.5mbpd in May, with Q2 average deficit of 1.3mbpd. In arriving at the balance, we left modeled consumption unchanged, assumed demand effects from COVID-19 diminishes by Q2 2020 with consumption picking up over Q3 2020 and full compliance from core OPEC members and participants.

Figure 2: Forecast Oil Demand, Supply and Balance Over 2020 (mbpd)



Source: EIA, OPEC, NOVA Research

In all, given the extension of the market glut over April to May, we believe Brent prices will remain within the range of $26-$33/barrel in the interim. For context, Saudi official oil pricing template for May released yesterday offered Arab light delivery to Asia at a discount of $7.3/barrel to the Oman/Dubai average, U.S delivery at a discount of $0.75/barrel versus ASCI and a discount of $10.25/barrel to ICE Brent for delivery to Northwestern Europe. With the market expected to switch to a deficit starting in June, we expect reversal with Brent prices likely to trade close to $40/barrel. However, if the planned G20 production management, voluntary cuts by OPEC members (Saudi Arabia Kuwait and the UAE) and IEA stocks purchases start in May, the combined impact could see market move to a deficit earlier in May, with average pricing likely to inch close to $40/barrel.