Monthly Oil Market Update

Key Highlights

- Compared to the planned Phase 1 OPEC+ production cut of 9.7mbpd, the group only achieved 8.03mbpd in May with compliance rate of 82%.
- Coordinated cut back occasioned by lower prices resulted in additional production decline of 3.04mbpd, resulting in total supply contraction by 11.1mbpd to 89.6mbpd in May, with Brent crude spot price averaging $32.7/barrel in May, up $5.3/barrel from the average in April.
- The massive surplus of 21.5mbpd in April will push Q2 surplus to average 8.8mbpd, with a switch to deficit of 3.0mbpd in Q3 and a deficit of 3.1mbpd in Q4.
- EIA forecasts Brent crude oil price will increase from the lows of Q2 to average $37/barrel in Q3 and $38/barrel in Q4. With adjustment for the extension of the Phase 1 OPEC+ cut until July, we see upside for prices compared to the estimate, especially in Q3.

OPEC+ Cuts Could Be Deeper for Longer

In the first month of the Phase 1 OPEC+ output cut deal, the production by 10 OPEC members in the accord fell by 5.96mbpd in May to 21.8mbpd compared to 27.7mbpd in April. Despite the significant cut in production, the cartel’s output fell short of the agreed cap of 20.55mbpd due to compliance breaches by some members. While Saudi Arabia, UAE, Kuwait and Equatorial Guinea achieved over 90% compliance rate, Iraq, Nigeria, Angola and Algeria had compliance shortfalls of 62%, 49%, 21% and 15% respectively. Overall, compared to the expected cut of 6.14mbpd, the cartel only achieved 4.91mbpd when contrasted with the baseline production of 26.68mbpd, with estimated compliance rate of 80%. Excluding the OPEC 10, production in Venezuela and Iran remain constrained by US sanctions, while the blockade of export terminals in Libya has kept output below 100kbpd.

Figure 1: OPEC crude oil production based on secondary sources, tb/d

	May-19	Jan-20	Feb-20	Mar-20	Apr-20	May-20	New Quota
Algeria	1,029	1,012	1,009	1,030	1,007	850	814
Angola	1,474	1,375	1,387	1,402	1,312	1,250	1,177
Congo	326	294	305	294	281	280	250
Equatorial Guinea	112	125	122	122	127	100	98
Gabon	214	192	194	202	193	180	144
Iran, I.R.	2,367	2,082	2,070	2,022	1,969	1,975	Exempt
Iraq	4,745	4,508	4,604	4,571	4,521	4,250	3,583
Kuwait	2,710	2,658	2,670	2,873	3,132	2,200	2,163
Libya	1,170	793	147	91	82	80	Exempt
Nigeria	1,726	1,760	1,788	1,844	1,777	1,613	1,408
Saudi Arabia	9,687	9,739	9,671	9,997	11,550	8,550	8,470
UAE	3,060	3,027	3,065	3,507	3,839	2,500	2,439
Venezuela	750	756	760	660	622	525	Exempt
Total OPEC	**29,370**	**28,321**	**27,792**	**28,615**	**30,412**	**24,353**	**20,546**
OPEC 10	**25,083**	**24,690**	**24,815**	**25,842**	**27,739**	**21,773**	**20,546**

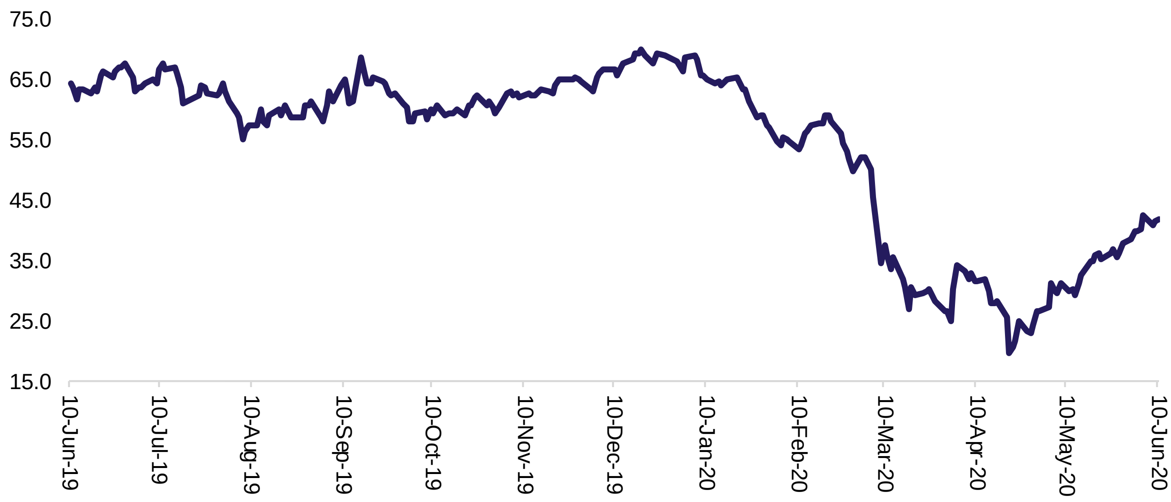
Source: U.S EIA, OPEC Monthly Oil Market Report, NOVA Research

For the OPEC+ allies, Russia (the key partner), kicked off the new deal with just 5% compliance shortfall. Compared to its planned production cut of 2.53mbpd, Russia delivered a cut of 2.41mbpd to 8.59mbpd in May. Beyond Russia, Mexico and Oman achieved compliance rates of 93% and 100% respectively, while Kazakhstan, Azerbaijan and other smaller producers fell short of the compliance rate. In all, compared to the planned Phase 1 OPEC+ production cut of 9.7mbpd, the group only achieved 8.03mbpd in May. At its meeting over the weekend, the group agreed to extend the Phase 1 deal until the end of July 2020, while members who fall short of the agreed output cut will have to compensate with lower production post the Phase 1 deal.

Rebound in Demand Pushed Prices Across $40/barrel

Beyond the cut back in production by OPEC and allies, coordinated cut back occasioned by lower prices resulted in additional production decline of 3.04mbpd (U.S. and Canada had a combined production decline of 1.64mbpd), which added to the OPEC cut resulted in total supply contraction by 11.1mbpd to 89.6mbpd in May. On the other hand, reflecting the partial reopening of some economies and industrial activities, crude oil consumption increased by 3.7mbpd in May to 82.87mbpd, leaving the market with a net surplus of 6.7mbpd compared to April surplus of 21.5mbpd. Accordingly, Brent crude spot prices averaged $32.7/barrel in May, up $5.3/barrel from the average in April. Also, the front-month futures price for Brent crude oil settled at $41.73/barrel on June 10, an increase of $15.3/barrel from May 1, 2020, while the front-month futures price for West Texas Intermediate (WTI) increased by $12.1/barrel over the same period to settle at $36.6/b on June 4.

Figure 2: Brent oil price in 2020 ($/bbl.)



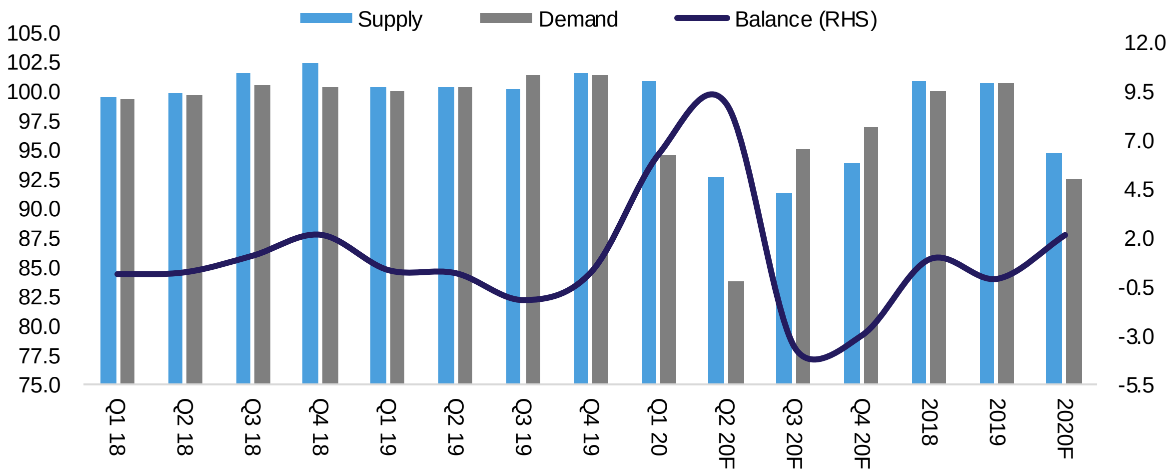
Source: Bloomberg, NOVA Research

Reflecting the gradual price recovery and expected switch in market balance to a deficit starting June (following additional voluntary cuts by Saudi Arabia, UAE and Kuwait of 1mbpd, 100kbpd and 80kbpd respectively starting June), Saudi Arabia official oil pricing template for July, offered Arab light delivery to Asia at a premium of $0.20/ barrel (compared to discount of $5.90/barrel in June) to the Oman/Dubai average, U.S delivery at a premium of $1.35/barrel (premium of $0.75/barrel in June) versus ASCI and a premium of $0.30/barrel (discount of $3.70/barrel in June) to ICE Brent for delivery to Northwestern Europe.

Economic Reopening to Spur Crude Oil Demand

With the gradual reopening of some economies, crude oil demand rebounded in May by 3.72mbpd, largely above consensus estimate. In its June Short-Term Energy Outlook (STEO), the EIA expects a switch in market fundamentals to a deficit of 1.89mbpd in June, with a wider deficit of 3.9mbpd in July to kick start Q3 on a good note. Notwithstanding, the Covid-19 associated shutdown will still keep global oil consumption lower by 8.2mbpd in 2020 to average 92.5mbpd from 100.7mbpd in 2019. Consumption in OECD is expected to decline by 5.2mbpd, and by 2.99mbpd in Non-OECD in 2020. In the OECD region, the decline is dominated by the US (-2.4mbpd to average 18.1mbpd) and Europe (-1.51mbpd to average 12.6mbpd). Also, Canada, Japan and Other OECD are expected to record declines in demand by 1.33mbpd to average 11.4mbpd in 2020 compared to 12.7mbpd in 2019. For the non-OECD, demand in China is expected to decline by 879kbpd in 2020 despite ongoing stabilization.

Figure 3: Historical and Forecast Oil demand and supply (mbpd)



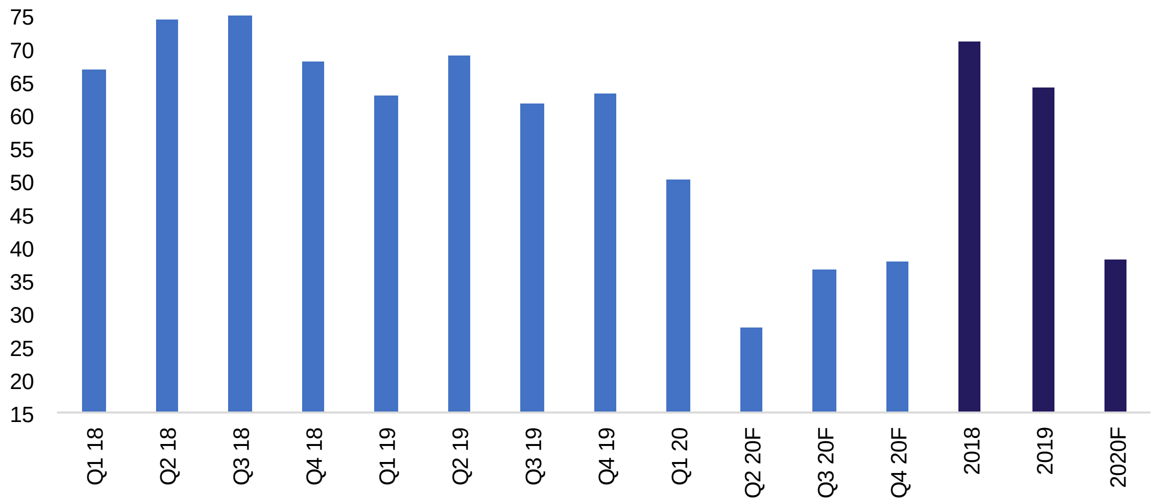
Source: EIA, NOVA Research

With confluence of voluntary and involuntary production cuts delivering decline in production by 11.06mbpd in May, we expect increased compliance by OPEC+ members who had significant shortfalls and production management by OECD producers to drive further moderation of supply in June. Going by EIA estimates, production is estimated to decline by additional 2.02mbpd in June. EIA now expects a steeper decline in crude oil production among non-OPEC members by 2.54mbpd over 2020 to 63.43mbpd, falling below 60.3mbpd in June. The largest declines are expected in Russia (-979kbpd to 10.5mbpd), the United States (-872kbpd to 18.58mbpd) and Canada (-410kbpd to 5.09mbpd). The decline in Russia will largely be in line with the agreed compliance to OPEC cuts, that of US will result from reductions in drilling in price-sensitive tight oil regions, while Canada production will largely reflect government-ordered production cuts in Alberta and economic shut-ins because of the effect of low oil prices. For OPEC countries, adjusting for additional voluntary cuts by Saudi Arabia, UAE and Kuwait of 1.2mbpd, production could fall below 23mbpd in June (a 7.5mbpd decline from April production). Overall, total world supply is expected to fall to a low of 87.56mbpd in June (2020 average of 94.6mbpd relative to 100.6mbpd in 2019), a 13.1mbpd decline from April production level.

Oil Prices Revised Higher

Notwithstanding the shift in market balance in June, the massive surplus of 21.5mbpd in April alone will push Q2 surplus to average 8.8mbpd, with a switch to deficit of 3.0mbpd in Q3 and a deficit of 3.1mbpd in Q4. EIA forecasts Brent crude oil will increase from the lows of Q2 to average $37/barrel in Q3 and $38/barrel in Q4, with average of $38/barrel over 2020 compared to average of $64.4/barrel in 2019. For us, while EIA did not factor the extension of OPEC+ until July into forecast production, we made the adjustment, which suggests upside potential for prices compared to estimate. Also, we believe the gradual opening of key economies and minimal infection rate across could result in a rebound in oil demand with further upside potential for prices. However, an escalation of Covid-19 beyond Q2 could further worsen the outlook for crude oil demand and a free-fall in prices. Another downside risk for us is the resumption of production in Libya and Venezuela, which could add additional 1.7mbpd to current output.

Figure 4: Historical and Forecast Brent Price ($/barrel)



Source: EIA, NOVA Research