

Monthly Oil Market Update

Key Highlights

- Compared to the planned Phase 1 OPEC+ cut of 9.7mbpd, the group achieved 9.23mbpd between May and July, with average compliance rate of 94%.
- Global oil consumption improved by 3.03mbpd in July to 93.4mbpd reflecting reopening of industrial activities and some form of mobility.
- Oil market recorded a net deficit of 4.7mbpd in July, with Brent crude spot prices averaging \$43.3/barrel, up \$2.5/barrel from the average in June.

Unprecedented Supply Cuts, Some Countries Still Faltered

OPEC compliance faltered in July, the last month of the first phase of the OPEC+ output cut deal. The production by 10 OPEC members in the accord increased by 0.979mbpd in July to 20.8mbpd compared to 19.8mbpd in June. As a result, compared to the resounding compliance rate of the cartel in June of 112%, compliance in July loosened to 96% as output fell short of the agreed cap of 20.55mbpd due to compliance breaches by some members and end of some voluntary cuts by Saudi Arabia, UAE and Kuwait. During the first phase of the deal (May to July), the cartel achieved average compliance rate of 97% (91% excluding excess cuts), helped largely by voluntary cuts by Saudi Arabia, UAE and Kuwait. Iraq and Nigeria continued to fall short of the agreed cut with compliance shortfalls of 16% and 19% respectively. 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

	Jul-19	Mar-20	Apr-20	May-20	Jun-20	Jul-20	New Quota
Algeria	1,027	1,030	1,007	819	807	808	814
Angola	1,395	1,402	1,312	1,275	1,224	1,173	1,177
Congo	325	294	281	285	302	284	250
Equatorial Guinea	121	122	127	90	114	110	98
Gabon	204	202	193	194	204	189	144
Iran, I.R.	2,218	2,022	1,969	1,954	1,947	1,936	Exempt
Iraq	4,736	4,571	4,521	4,160	3,714	3,752	3,583
Kuwait	2,670	2,873	3,132	2,198	2,085	2,158	2,163
Libya	1,078	91	82	80	92	100	Exempt
Nigeria	1,780	1,844	1,777	1,584	1,497	1,488	1,408
Saudi Arabia	9,687	9,997	11,550	8,479	7,540	8,406	8,470
UAE	3,074	3,507	3,839	2,478	2,332	2,430	2,439
Venezuela	755	660	622	558	336	339	Exempt
Total OPEC	25,019	25,842	27,816	21,562	19,819	20,798	20,546
OPEC 10	29,070	28,615	30,495	24,154	22,194	23,173	N/A

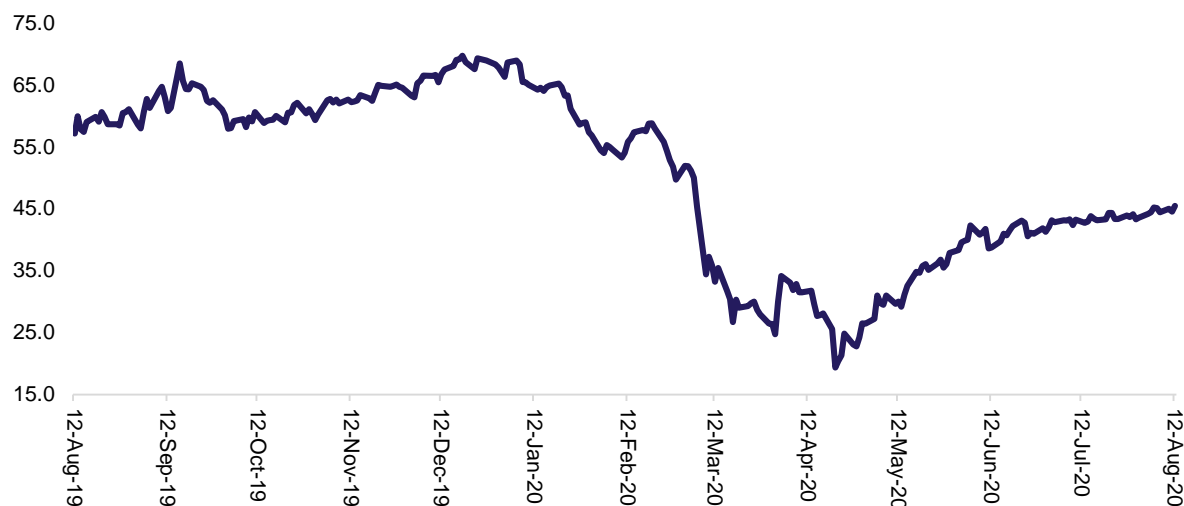
Source: U.S EIA, OPEC Monthly Oil Market Report, NOVA Research

For the OPEC+ allies, Russia (the key partner), achieved average compliance rate of 93% over the Phase 1 deal, with production averaging 8.65mbpd compared to its planned production cap of 8.47mbpd. Mexico, Oman and Bahrain exceeded the agreed cut, achieving compliance rates of 115%, 103% and 122% respectively, while Kazakhstan, Azerbaijan, Malaysia 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 9.23mbpd between May and July, with average compliance rate by OPEC+ of 94%.

Rebound in Demand Pushed Prices Above \$45/barrel

Global oil consumption improved by 3.03mbpd in July to 93.4mbpd reflecting reopening of industrial activities and some form of mobility. The consumption level in July, is an improvement of 12.9mbpd compared to April low of 80.5mbpd. The increases were more notable in US, Europe and China. Elsewhere, global production over July increased by 1.7mbpd to 88.7mbpd with OPEC, Russia and U.S accounting a large proportion of the increase. Overall, the market recorded a net deficit of 4.7mbpd compared to June deficit of 3.3mbpd. Accordingly, Brent crude spot prices averaged \$43.3/barrel in July, up \$2.5/barrel from the average in June. Also, the front-month futures price for Brent crude oil settled at \$45.4/barrel on August 13, an increase of \$3.4/barrel from July 1, 2020, while the front-month futures price for West Texas Intermediate (WTI) increased by \$2.8/b during the same period, settling at \$42.6/barrel.

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



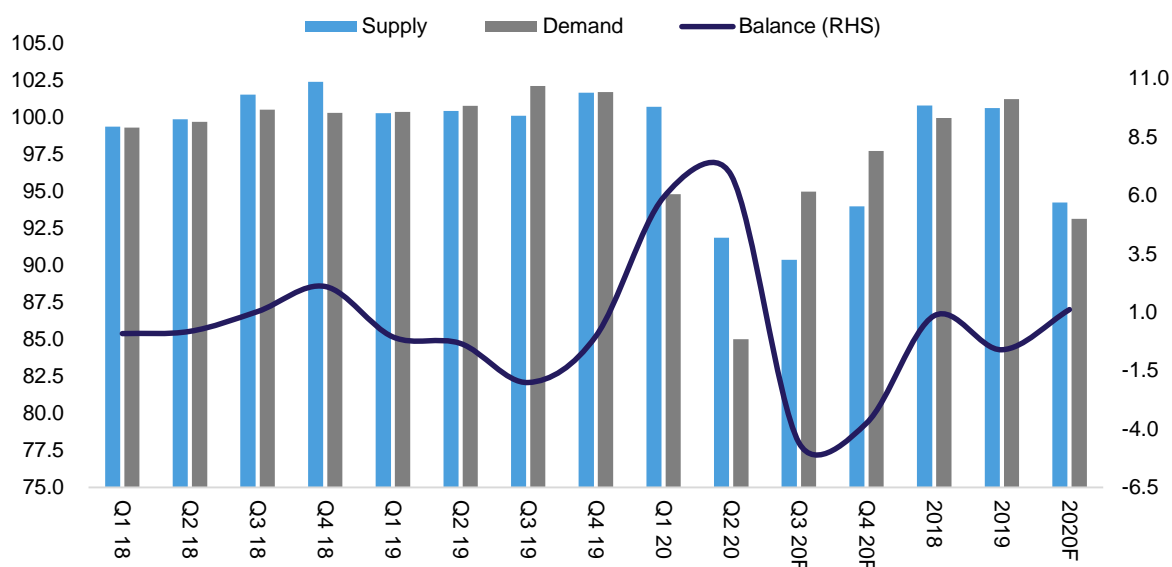
Source: Bloomberg, NOVA Research

Notwithstanding the gradual price recovery, the expectation of higher volumes from OPEC+ exporters (as the second phase of the quota of 7.7mbpd starts in August compared to 9.7mbpd in May to June) is already necessitating downward price adjustments by suppliers in a bid to maintain market share. Saudi Arabia official oil pricing template for September, offered Arab light delivery to Asia at a lower premium of \$0.90/ barrel (compared to discount of \$1.20/barrel premium in August) to the Oman/Dubai average, U.S delivery is maintained at a premium of \$1.65/barrel versus ASCI and a discount of \$1.80/barrel (premium of \$0.70/barrel in August) to ICE Brent for delivery to Northwestern Europe.

OPEC+ Production Scale Back Could Pressure Prices

In its August Short-Term Energy Outlook (STEO), the EIA raised its forecast for crude oil consumption in 2020 to 93.1mbpd (still below 2019 average of 100.7mbpd) from July estimate of 92.9mbpd. The increase emanated from relaxation of lockdown restrictions across industrial economies and the construction of a new petrochemical crackers in China during the second half of 2020. Particularly in China, consumption is forecast to increase over Q3 and Q4 average 12.94mbpd in 2020 (July estimate of 13.21mbpd), but still lower than 2019 average of 14.5mbpd. Consumption in OECD was raised to 42.71mbpd, representing a YoY decline of 4.8mbpd, dominated by upward adjustment in the US (average of 18.5mbpd vs July estimate of 18.3mbpd) and Europe (average of 12.7mbpd vs July estimate of 18.6mbpd). Total world consumption is expected to average 96.95mbpd over the rest of the year, an increase of 3.5mbpd from July consumption level of 93.4mbpd.

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



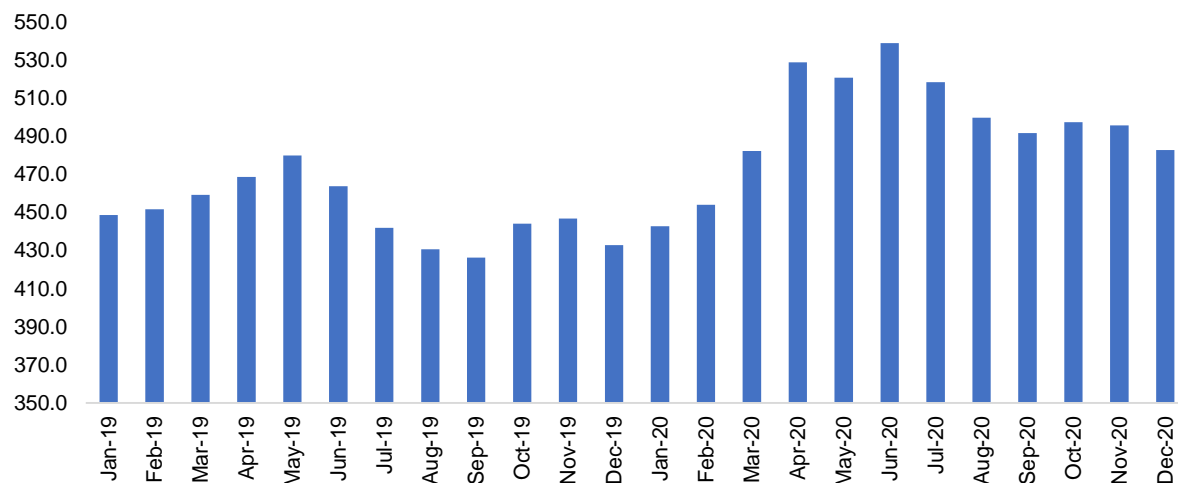
Source: EIA, NOVA Research

As mentioned above, the second phase of the OPEC plus agreement kicked off in August, with a planned production cut of 7.7mbpd compared to agreed production cut of 9.7mbpd over the last three months. Accordingly, compared to the agreed production between May and August of 34.1mbpd, the OPEC+ is expected to increase to 36.2mbpd starting August, which is an increase of 1.6mbpd compared to the production of July of 34.6mbpd. However, with the planned catch-up plans by members who overshot their production during the first phase of the deal, actual production over the first three months of the second phase is estimated at 35.5mbpd. Going by EIA estimates, global production is estimated to increase by 2.5mbpd in August, with crude oil production among non-OPEC members rising by 1.74mbpd in August. The largest increases are expected in the United States (805kbpd to 18.22mbpd), Russia (433kbpd to 10.04mbpd) and Canada (138kbpd to 4.78mbpd). Overall, total world supply is expected to average 92.88mbpd (2020 average of 94.24mbpd relative to 100.6mbpd in 2019) over the rest of the year, an increase of 4.2mbpd from July production level of 88.7mbpd.

Slower Rate of Inventory Decline Will Keep Prices Range Bound

Notwithstanding the expectation of the market remaining in a deficit over the rest of the year, with average of 4.1mbpd, crude oil prices are expected to be range bound due to the still elevated inventory levels occasioned by the cumulative market surplus of 38.3mbpd over H1 2020. Despite the gradual drawdown, U.S. commercial inventory are still 15% above the five-year average. According to EIA, compared to average of 6.4mbpd increase in inventories in H1, the drawdown over H2 will average 4.2mbpd.

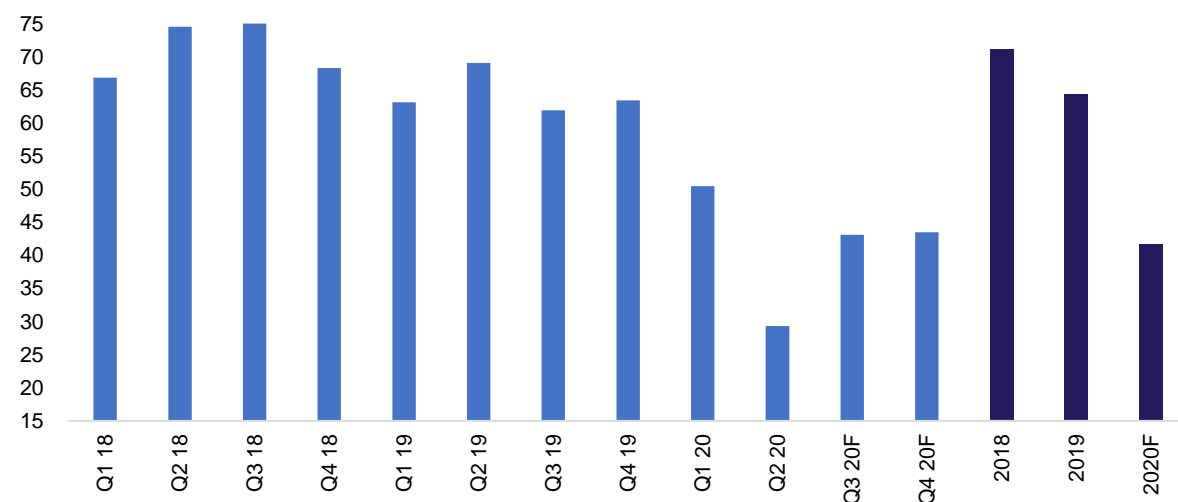
Figure 4: Historical and Forecast U.S. Commercial Inventory (Million barrels)



Source: EIA, NOVA Research

As a result, EIA forecasts Brent crude oil will average of \$43.3/barrel over the rest of the year with 2020 average of \$41.59/barrel (compared to year average estimate of \$40.7/barrel in July) compared to average of \$64.4/barrel in 2019. For us, 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 Q3 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 5: Historical and Forecast Brent Price (\$/barrel)



Source: EIA, NOVA Research