NEW THINKING. NEW OPPORTUNITIES.

September 11, 2020 **Economic Research**

Monthly Oil Market Update

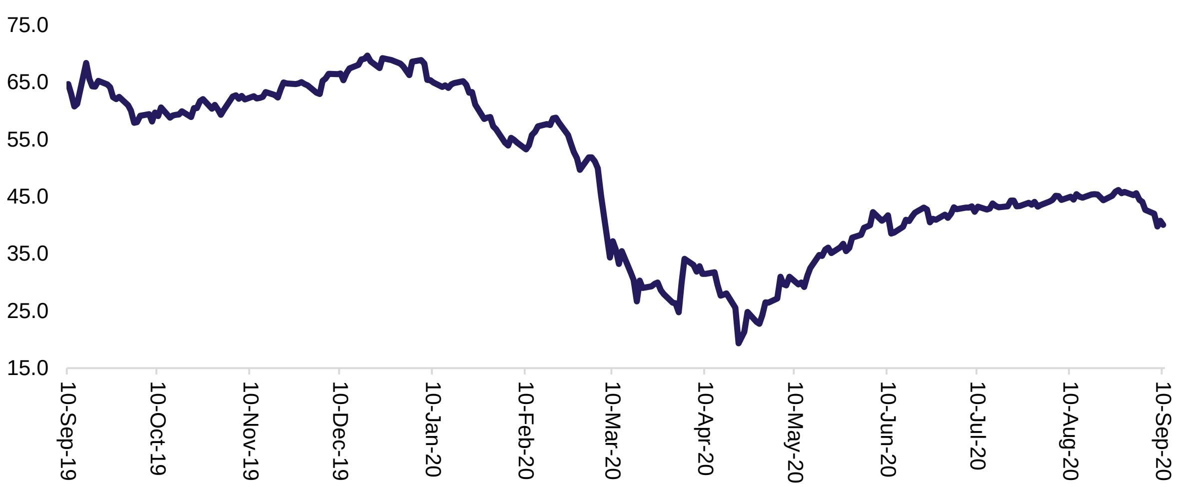
Key Highlights

- Global crude oil market to remain in a deficit over the rest of the year, with average of 3.56mbpd (Q3 and Q4 deficit of 3.7mbpd and 3.14mbpd respectively).
- Irrespective, prices will remain range bound due to slower inventory draws at a rate of 3.7mbpd and 3.1mbpd in Q3 and Q4 respectively compared to inventory buildup at a rate of 7.2mbpd in Q2.
- Brent crude oil price will average $44.13/barrel over the rest of the year with 2020 average of $41.99/barrel.

Production Scale Back Pressured Prices

The deficit in the global crude oil market narrowed in the month of August to 2.76mbpd following a faster increase in supply relative to demand. Global oil production over August increased by 1.84mbpd to 91.55mbpd with OPEC and Russia accounting for a large proportion of the increase. Excluding OPEC, global supply would have grown modestly by 0.830mbpd. Elsewhere, global oil consumption improved by 1.03mbpd in August to 94.31mbpd (compared to growth of 3.04mbpd in July) following increases in Canada (+8.2% MoM), Japan (+3.7%) and Eurasia (+3.4%). The consumption level in August, is an improvement of 13.44mbpd compared to the April low of 80.87mbpd. Accordingly, Brent crude spot prices averaged $45.10/barrel in August, up $1.8/barrel from the average in July. Also, the front-month futures price for Brent crude oil settled at $45.28/barrel on August 31, an increase of $1.98/barrel from July 31, 2020 while the front-month futures price for West Texas Intermediate (WTI) increased by $2.34/b during the same period, settling at $42.61/barrel.

Figure 1: Brent oil price in 2020 ($/bbl.)



Source: Bloomberg, NOVA Research

With the rising supply occasioned by scale back of OPEC+ cuts in August, amidst slower growth in consumption, crude oil prices have retracted to trade at $40.06/barrel, $5.05/barrel lower than the August average. As a result, Saudi Arabia official oil pricing template for October, offered Arab light delivery to Asia at a discount of $0.50/ barrel (compared to premium of $0.90/barrel premium in September) to the Oman/Dubai average, U.S delivery premium is lowered to $1.05/barrel (compared to $1.65/barrel in September) versus ASCI and a discount of $2.00/barrel (discount of $1.80/barrel in September) to ICE Brent for delivery to Northwestern Europe.

Still A Lot of Catching Up…

Compliance to the second phase of the OPEC cut agreement fell short of expectation in the month of August, when adjusted for the expected catch-up cuts by countries who overproduced during the first phase of the deal. While the OPEC 10 production was expected to scale up to 21.815mbpd in August, compared to 20.798mbpd in July, compensatory cuts from defaulting countries during Phase 1 was expected to keep production at 20.988mbpd in August and September. The production by 10 OPEC members in the accord increased by 0.714mbpd in July to 21.512mbpd compared to 20.798mbpd in July. Overlaying the production in August on expected cut based on the Phase 2 agreement, the group achieved compliance rate of 106%, adjusted for the expected compensatory cuts neutered the August compliance rate to just 91%. The lower adjusted compliance was further magnified due to overproduction by the UAE and persistent non-compliance by Gabon, Equatorial Guinea, and Congo in August. Nigeria and Iraq made significant progress in August, but still fell short of the catch-up adjusted production of 1.338mbpd and 3.379mbpd with actual compliance rate of 89% and 94% 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 150kbpd

Figure 2: OPEC crude oil production based on secondary sources, tb/d

	Aug-19	Apr-20	May-20	Jun-20	Jul-20	Aug-20	New Quota
Algeria	1,016	1,007	819	807	808	860	864
Angola	1,385	1,312	1,275	1,224	1,173	1,210	1,249
Congo	320	281	285	302	284	286	266
Equatorial Guinea	117	127	90	114	110	118	104
Gabon	204	193	194	204	189	214	153
Iran, I.R.	2,193	1,969	1,954	1,947	1,936	1,950	Exempt
Iraq	4,781	4,521	4,160	3,714	3,752	3,460	3,804
Kuwait	2,638	3,132	2,198	2,085	2,158	2,291	2,297
Libya	1,074	82	80	92	100	120	Exempt
Nigeria	1,870	1,777	1,584	1,497	1,488	1,390	1,495
Saudi Arabia	9,851	11,550	8,479	7,540	8,406	8,990	8,993
UAE	3,082	3,839	2,478	2,332	2,430	2,693	2,590
Venezuela	735	622	558	336	339	340	Exempt
Total OPEC	**25,264**	**27,816**	**21,562**	**19,819**	**20,798**	**21,512**	**21,815**
OPEC 10	**29,266**	**30,495**	**24,154**	**22,194**	**23,173**	**23,922**	**N/A**

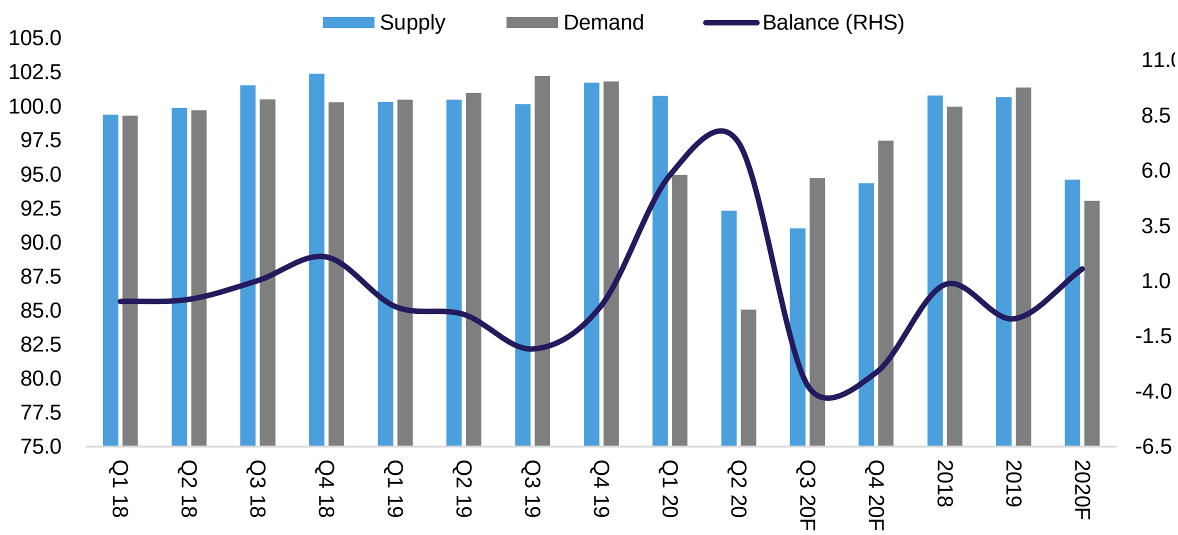
Source: U.S. EIA, OPEC, Energy Intelligence, NOVA Research

For the OPEC+ allies, Russia (the key partner), achieved compliance rate of 96% (84% when adjusted for compensatory cuts) in August, with production rising 5.5% MoM to 9.08mbpd compared to its planned production cap of 8.99mbpd. Other Non-OPEC members also stepped up compliance in August, except Azerbaijan. However, when adjusted for expected compensatory cuts, they overshot expected production in August. In all, while OPEC+ production of 34.15mbpd (with compliance rate of 103%) fell below August planned cut of 34.42mbpd under the Phase 2 deal, it is still above the 33.26mbpd level expected due to compensatory cuts, resulting in adjusted compliance rate of just 90% in August.

Full Compliance Could Change the Price Narrative

In its September Short-Term Energy Outlook, the EIA lowered its forecast for crude oil consumption in Q3 and Q4 by 0.240mbpd to 94.72mbpd and 97.50mbpd, with full year 2020 consumption now revised lower by 0.070mbpd to 93.07mbpd (below 2019 average of 100.7mbpd). While the relaxation of lockdown restrictions across industrial economies and the construction of a new petrochemical crackers in China during the second half of 2020 are expected to support demand, EIA lowered demand projection in OECD by 0.123mbpd to 42.60mbpd. Consumption in Non-OECD was adjusted modestly higher by 0.041mbpd to 50.47mbpd dominated by upward adjustment in the Eurasia and Other Non-OECD which more than offset moderate downward adjustments across other regions.

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



Source: EIA, NOVA Research

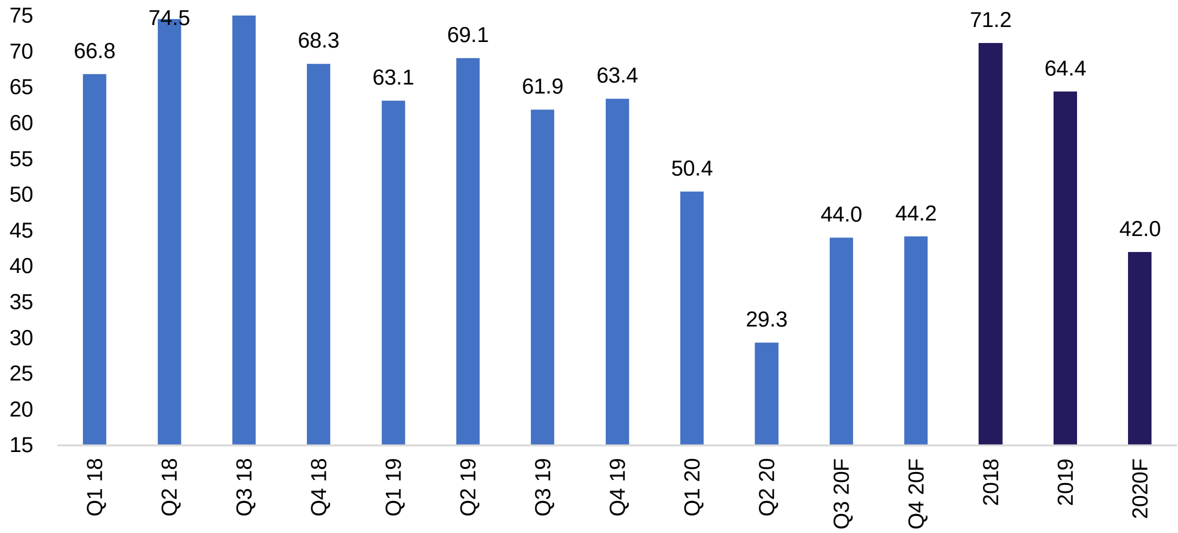
As mentioned above, while OPEC produced 0.303mbpd below its Phase 2 planned cut, August production is still 1.35mbpd above the level expected to meet up with the overproduction during the Phase 1 of the accord. Assuming a full compliance by all members to the Phase 2 deal and the compensatory cuts (including over production by UAE, Congo, Gabon and Equatorial Guinea in August), OPEC production should decline by 1.55mbpd in September alone for all members to fully comply. Going by EIA estimates, global production is estimated to increase by 0.288mbpd in September, dominated by increase production among non-OPEC members (+0.297mbpd). The largest increases are expected in the United States (0.416mbpd to 18.22mbpd) and Other Non-OECD

(0.121mbpd). Overall, total world supply is expected to average 91.03mbpd and 94.35mbpd in Q3 and Q4 respectively, with full year 2020 average supply of 94.62mbpd (compared to 100.6mbpd in 2019), an increase of 3.07mbpd from August production level of 91.55mbpd.

Slower Rate of Inventory Draw Will Keep Prices Range Bound

Notwithstanding the expectation of the market remaining in a deficit over the rest of the year, with average of 3.56mbpd (Q3 and Q4 deficit of 3.7mbpd and 3.14mbpd respectively), crude oil prices are expected to be range bound due to the still elevated inventory levels occasioned by the cumulative market surplus of 39.2mbpd over H1 2020. Despite the gradual drawdown, U.S. commercial inventory are still 15% above the five-year average. EIA expects inventory draws at a rate of 3.7mbpd and 3.1mbpd in Q3 and Q4 respectively compared to inventory build-up at a rate of 7.2mbpd in Q2. As a result, EIA forecasts Brent crude oil will average $44.13/barrel over the rest of the year with 2020 average of $41.99/barrel (compared to year average estimate of $41.59/barrel in August) which is lower than average of $64.4/barrel in 2019. For us, we believe the gradual opening of key economies and minimal infection rate could result in a rebound in oil demand, which coupled with full compliance by OPEC+ will provide further upside potential for prices. However, a renewed lockdown due to second wave of the Cvid-19 could see prices slide further to the bottom.

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



Source: EIA, NOVA Research