جدوى للإستثمار
Jadwa Investment

January 2019

Quarterly Oil Market Update

Oil price roller coaster

Summary

- Lower OPEC output and hopes of some progress over the US-China trade dispute have helped Brent prices recover to around $60 pb recently (Figure 1), although the outlook on oil demand remains subdued. According to latest OPEC forecasts, global oil demand will grow by 1.29 million barrels per day (mbpd) in 2019, the lowest rate of growth since 2013.

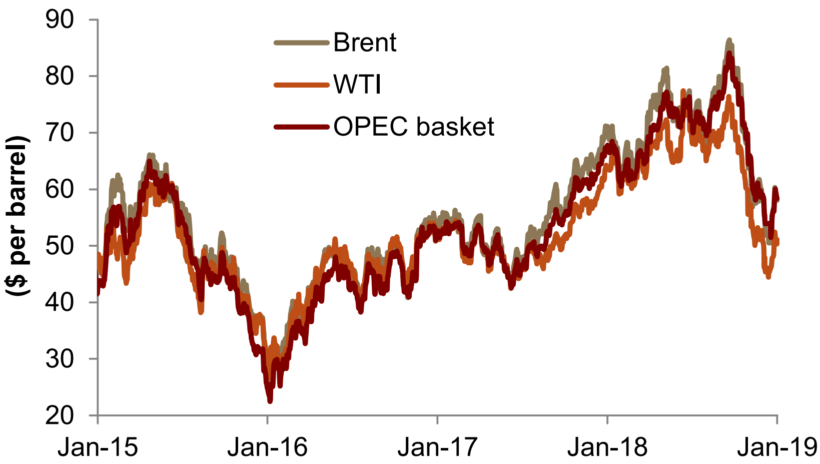
- That said, there have been encouraging signs in trade talks between the US and China over tariffs recently, and any agreement between the two countries could provide an upside to oil demand, and indeed oil prices, going forward.

- Meanwhile, OPEC data shows that whilst Q4 2018 oil output was flat quarter-on-quarter, there was a sizable decline in output in December, by 750 thousand barrels per day month-on-month. This decline came prior to the commencement of an OPEC+ agreement to reduce 1.2 mbpd in output during the first half of this year.

- During the remainder of Q1 2019, we expect a gradual lift in prices as OPEC data confirms compliance to the agreement and OECD oil stocks begin fall to lower than the five year average. Later in the year, we expect markets to remain fairly balanced due to a combination of waivers expiring for importers of Iranian oil, and because of a roll-over of the OPEC+ agreement into H2 2019.

- Taking all the above into consideration, we have revised down our Brent price forecast to $66 pb for 2019, compared to $75 pb previously.

Figure 1: Brent oil prices have rebounded to around $60 pb



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Released: January-20-2019, 17:00 UTC+3

Global oil demand will grow by 1.29 mbpd in 2019, the lowest rate of growth since 2013.

Weak oil demand growth:

According to the latest OPEC monthly report, global oil demand will grow by 1.29 million barrels per day (mbpd) in 2019, down 14 percent, or 21 thousand barrels per day (tbpd) compared to 2018, and the lowest rate of growth since 2013 (Figure 2). Lower demand is attributable to weaker yearly growth from China, as a result of a slowing economy. Overall, OPEC expects US, China and India to be the main contributors to yearly oil demand growth during Q1 2019, and indeed the remainder of the year. The above three countries are expected to make up a bulk of the demand growth, at 59 percent, in 2019.

US, China and India oil demand stable:

Based on EIA's current forecasts US liquid consumption is expected to rise by 2 percent year-on-year in 2019.

Latest data from the Energy Information Administration (EIA) shows that overall US liquid consumption rose by 2 percent year-on-year in Q4 2018. Despite WTI prices declining by 15 percent quarter-on-quarter in Q4 2018, this was not reflected in pump prices until late November, and therefore did not raise gasoline consumption. In fact, gasoline consumption declined by 1 percent year-on-year in the last quarter. Looking ahead, based on EIA's current forecasts of WTI price averaging $50 pb in Q1 2019, overall liquid consumption is expected to rise by 2 percent year-on-year over the same period. Whilst a gradual recovery in WTI prices is being forecasted by the administration during the year, to an overall average of $54 pb, consumption is expected to rise 2 percent year-on-year (Figure 3).

Chinese oil demand is expected to slow marginally to around 2.7 percent in 2019, slightly lower than growth in 2018 as a whole, at 3.2 percent.

China's crude oil imports rose to record levels in Q4 2018, averaging 10 mbpd during the quarter, up a staggering 25 percent year-on-year (Figure 4). Chinese imports were supported by a decline in Brent oil prices during the quarter and by a surge in buying by independent refiners filling their import quotas before the end of the year. Chinese oil demand is expected to slow marginally to around 2.7 percent in the Q1 2019, slightly lower than growth in 2018 as a whole, at 3.2 percent. The outlook for the rest of 2019 is the same, with OPEC forecasting oil demand growth at 2.7 percent as well, due to demand from industrial sectors and rising passenger car sales.

In Q4 2018 Indian oil imports were down marginally by 1 percent year-on-year, as Iranian sanctions disrupted refineries intake of oil, especially so in November. Nonetheless, Indian oil imports did rise

Figure 2: Global oil demand growth in 2019 expected to be the lowest in six years

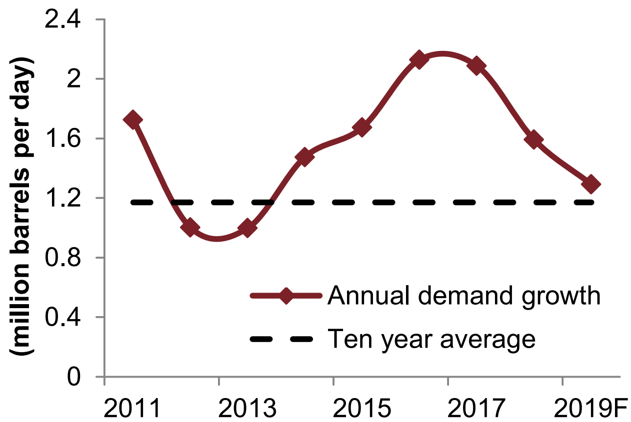
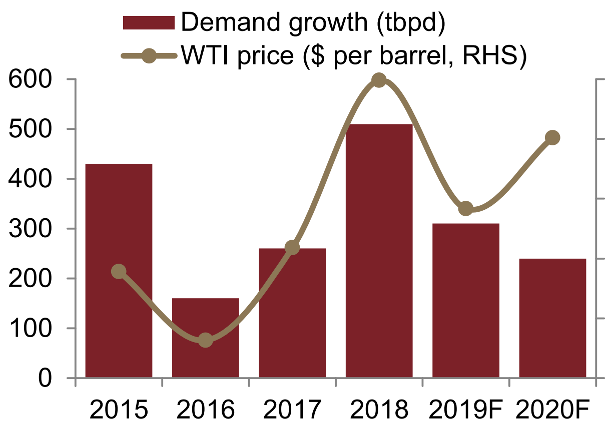


Figure 3: EIA's US WTI price and oil consumption growth forecast



Indian oil consumption is expected to rise by 4 percent year-on-year in 2019, according to OPEC.

by a sizable 7 percent in 2018 as a whole. This growth was seen as a result of a rise in refined product consumption, especially LPGs, which was driven by increased residential consumption. Indian oil imports are expected to rebound in Q1 2019, whilst overall oil consumption is expected to rise by 4 percent year-on-year in 2019, according to OPEC.

Another OPEC+ agreement:

OPEC+ agreed to reduce oil output by 1.2 mbpd compared to October 2018 levels, for six months…

OPEC and its partners (OPEC+) recently agreed to reduce oil production by 1.2 mbpd compared to October 2018 levels, for an initial period of six months, commencing January 2019. Of this total, OPEC agreed to lower output by 800 tbpd, with Iran, Venezuela and Libya exempt from any reductions. Meanwhile, non-OPEC partners agreed to reduce by a total of 400 tbpd, with Russia making up 57 percent, or 228 tbpd, of this decline. Latest OPEC data shows that whilst Q4 2018 oil output was flat quarter-on-quarter, there was a sizable decline in output in December, by 750 tbpd month-on-month. Russia, on the other hand, saw crude oil production hit post soviet highs in Q4 2018, but the Russian oil minister did state that oil production would decrease by 50 tbpd month-on-month in January 2019. That said, there is doubt over Russia's ability to achieve reductions over the next six months, given publicly stated growth ambitions of the privately-owned oil companies.

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Holding all other factors constant, and assuming OPEC+ countries revert to their October 2018 production levels after the current deal expires in June, global oil surpluses would balloon to an average of 1.5 mbpd in H2 2019, compared to mild surplus of 500 tbpd in H1 (Figure 5). That said, with the US recently signaling there will be no further waivers for countries importing oil from Iran, after the waivers expire in May, this could tighten markets by Q2 2019. By the end of last year, China and India remained the only major buyers of Iranian oil, resulting in exports dropping circa 1 mbpd year-on-year, to 800 tbpd (Figure 6). Once the waivers expire, and if Iranian oil imports are reduced to zero, as per US's intentions, OPEC would not technically need to roll-over the agreement into H2 2019.

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Saudi oil production

Saudi crude oil production totaled 10.6 mbpd in October 2018, meaning compliance to OPEC+ agreement would see oil output

Figure 4: Chinese oil imports hit record highs in Q4 2018

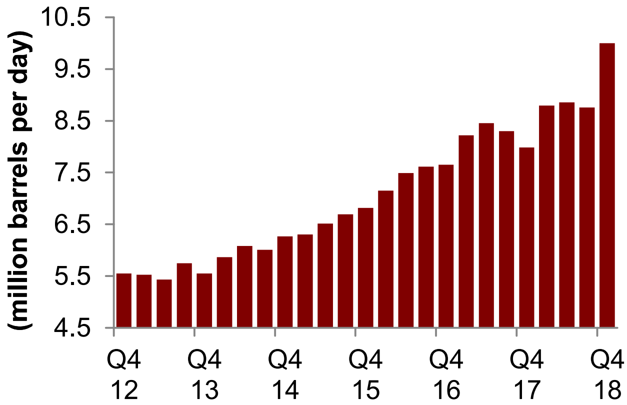
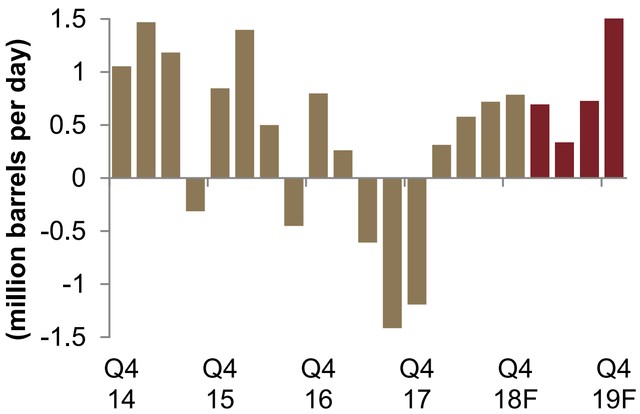


Figure 5: Large global oil surplus in H2 2019 if OPEC+ agreement is not rolled over



Saudi crude oil production totaled 10.6 mbpd in October 2018, meaning compliance to OPEC+ agreement would see oil output decline to 10.3 mbpd…

...we expect Saudi oil production to remain at around 10.3 mbpd over the course of 2019, down from our previous forecast of 10.5 mbpd.

Latest available data shows that Saudi domestic oil and refined products consumption is expected to decline by around 7 percent year-on-year.

The EIA expects total US oil output to rise by 1.1 mbpd or, 10 percent, year-on-year, to 12 mbpd, in 2019.

decline to 10.3 mbpd in the first half of 2019. At the same time, recent statements from the Saudi Energy Minister point to lower oil exports to around 7.2 mbpd in most of Q1 2019, compared to 7.7 mbpd in October. Overall, we expect Saudi oil production to average around 10.3 mbpd in 2019 as a whole, down from our previous forecast of 10.5 mbpd. Besides the OPEC+ agreement, two other factors will help keep production levels down. Firstly, latest available data shows that Saudi domestic oil and refined products consumption is expected to decline by around 7 percent year-on-year, or 170 tbpd, in 2018. This decline is directly a result of energy price reform implemented at the start of last year, and frees up more oil for export going forward (*for more on this please see our Outlook on Crude Oil Refining* report published *March 2018*). Secondly, whilst domestic consumption is expected to rise in 2019, as a result of higher refinery intake related to the start up of the Jazan mega refinery (*for more on this please refer to our macroeconomic update published November 2018*), the rise should be mitigated by higher gas output. Specifically, the Fadhili gas complex, which will process 2.5 billion cubic feet per day (bcf/d) of raw gas from onshore and offshore fields, is expected to come on-line during 2019. Since most Saudi petrochemical companies' gas allocations have already been finalized, we believe the additional gas from Fadhili will be used in generating electricity, hence freeing up even more oil.

US oil output still growing:

The latest EIA monthly report shows that US oil supply has been accelerating in recent months, with production averaging around 11.7 mbpd in Q4 2018, up 18 percent year-on-year with Q1 2019 forecast to see similar levels of growth. It comes as no surprise that unconventional (or shale oil) has been behind the rise in US crude oil production. In fact, the Permian shale play has contributed 55 percent of growth in total US oil output alone in 2018. Looking into 2019 as a whole, the EIA expects total US oil output to rise by 1.1 mbpd or, 10 percent, year-on-year, to 12 mbpd, with Permian expected to constitute an even larger portion of this growth, at around 70 percent. Accordingly, EIA forecasts have been gradually revised upwards, with January's edition of the short-term energy outlook (STEO) showing 36 tbpd higher output versus mid-year 2018 forecasts (Figure 8).

Figure 6: Many countries have reduced Iranian oil imports to zero

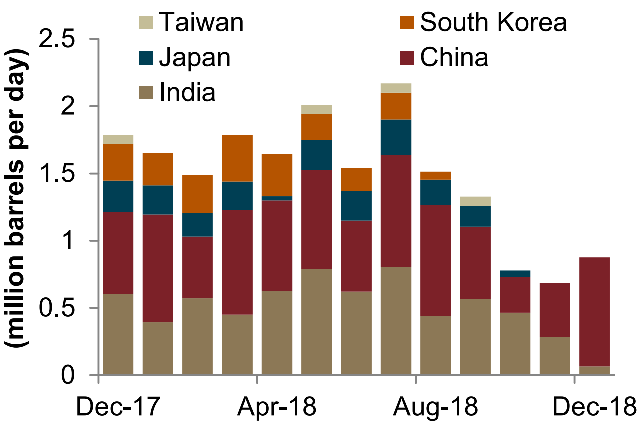
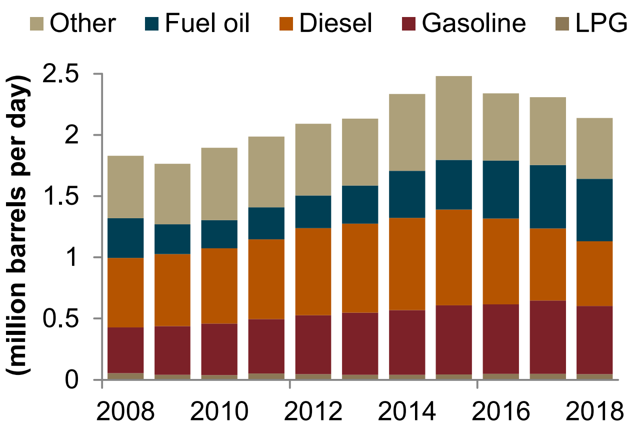


Figure 7: Saudi domestic oil and refined product demand*



*2018: year-to-October average

Brent oil prices averaged $67pb in Q4 2018, down 10 percent on a quarterly basis.

Whilst some positives in a trade deal between the US and China have been reported recently…

...it is quite clear that negotiations between China and US is going to be crucial, yet unpredictable, factor in overall demand growth in the weeks ahead.

We have revised down our Brent price forecast to $66 pb for 2019.

<u>Oil price forecast:</u>

Brent oil prices averaged $67pb in Q4 2018, down 10 percent on a quarterly basis as the US granted waivers for importers of Iranian oil. At one point during Q4, Brent oil prices dipped to a daily average $50 pb, as negative sentiment over the continued trade dispute between the US and China added more pressure on prices. Since then, the combination of lower OPEC output in December and hopes of some progress over US-China trade talks have helped push Brent prices back to around the $60 pb (Box 1).

Box 1: US-China Trade Dispute

Whilst some positives in a trade deal between the US and China have been reported recently, this has yet to be officially confirmed. A pause in mutual increases of new tariffs back in December is set to expire in March, and any resolution before then could be a boon for oil prices, whilst a continued deadlock in negotiations could have the opposite effect. Given that OPEC sees anywhere between 20 to 300 tbpd variation in the impact on oil demand as a result of higher tariffs, it is quite clear that negotiations between China and US is going to be crucial, yet unpredictable, factor in overall demand growth in the weeks ahead.

Looking ahead to Q1 2019, we expect a gradual lift in prices as OPEC data confirms compliance to the agreement and OECD oil stocks begin fall to lower than the five year average (Figure 9). Later in the year, we expect the markets to remain fairly balanced either as a result of waivers ending on Iranian oil imports, or through a roll-over of the OPEC+ agreement, or indeed a combination of the two.

Overall, taking all the above into consideration, we have revised down our Brent price forecast to $66 pb for 2019, compared to $75 pb previously.

Figure 8: EIA's US crude oil production growth in 2019 has been revised upwards

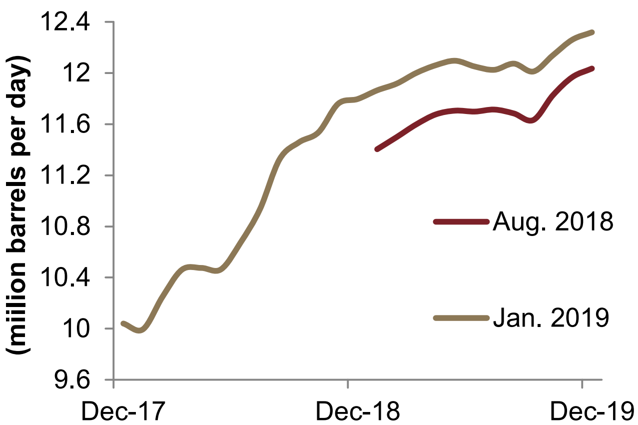
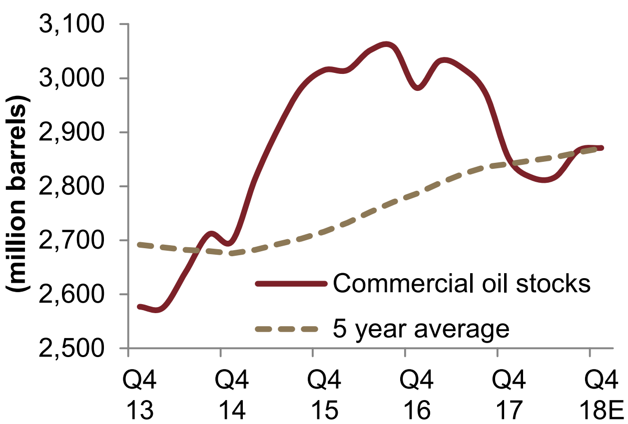


Figure 9: OECD commercial oil stocks and five year moving average



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