جدوى للإستثمار
Jadwa Investment

July 2020

Quarterly Oil Market Update

Recovery in demand beginning to take shape

Summary

- According to latest OPEC forecasts, the worst seems to be over with respect to global oil demand. Whilst H1 2020 saw an average yearly decline in oil demand by nearly 12 percent, H2 2020 is expected to see declines of around 6 percent year-on-year. Overall, oil demand is expected to decline by 9 million barrels per day mbpd (or 9 percent) year-on-year in 2020.

- More promisingly, OPEC forecasts yearly oil demand in 2021 to rebound by 7 mbpd (or 8 percent) to an annual average of 97.7 mbpd, although it will still be below the pre-pandemic level of 99.7 mbpd seen in 2019.

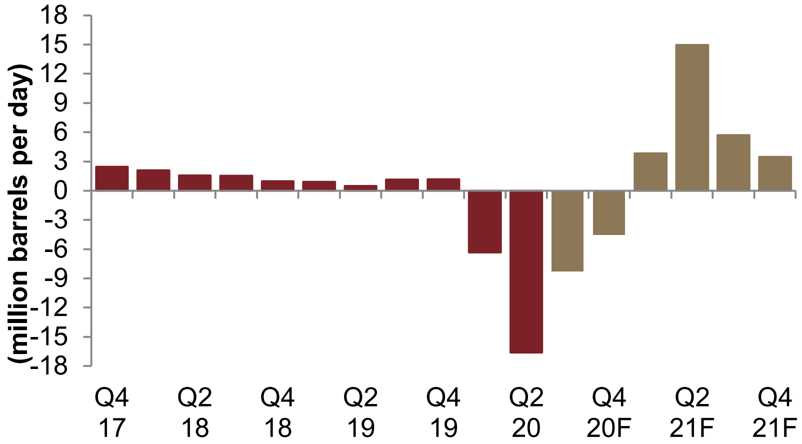
- On the supply side, OPEC and partners (OPEC+) historic crude oil production agreement back in April was followed through with exceptional levels of compliance. May and June average compliance stood at 99 percent. Following last week's Joint Ministerial Monitoring Committee (JMMC), OPEC+ decided to raise output gradually over the course of this year on the back of encouraging signs of improvement in oil demand.

- Meanwhile in the US, whilst the current level of oil prices seems to be encouraging shut-in oil wells to be brought back on-line, higher prices will be needed for drilling of new oil wells. As such, current forecasts from the US's Energy Information Administration (EIA) point to oil output declining on both a quarter-on-quarter and year-on-year basis until end of next year.

- Looking ahead, we see some upside to prices going forward, especially as oil demand progressively rises during H2 2020. That said, the upside will be capped by i) the existence of large commercial oil inventories and ii) the risks associated with rising cases of COVID-19 or indeed a second wave.

- Taking into account all the above considerations, we have cautiously raised our Brent oil forecast to $43 per barrel (pb) for 2020, versus $39 pb previously.

Figure 1: Yearly oil demand growth is expected to remain negative in H2 2020, but improve significantly in 2021



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According to latest OPEC forecasts, the worst seems to be over with respect to global oil demand.

Whilst H1 2020 saw an average yearly decline in oil demand by nearly 12 percent, H2 2020 is expected to see declines of around 6 percent year-on-year.

Overall, oil demand is expected to decline by 9 mbpd (or 9 percent) year-on-year in 2020.

In the US, energy consumption will decline by 10.4 percent year-on-year (or by 2.1 mbpd) in 2020.

Q2 2020 Chinese oil imports up 16 percent year-on-year with June imports at an all time high of 12.9 mbpd.

Oil demand recovering unevenly:

The latest monthly oil market report from OPEC still makes for bleak reading, even though some improvement in oil demand growth is expected in H2 2020 and 2021 (Figure 1). That said, according to OPEC data, the worst seems to be over. Whilst H1 2020 saw an average yearly decline in demand by nearly 12 percent or 12 million barrels per day (mbpd), H2 2020 is expected to see declines of around 6 percent or -6.4 mbpd year-on-year. As a result, for 2020 as a whole, OPEC expects oil demand to decline by just over 9 mbpd (or 9 percent) year-on-year. On a country/regional level, the five of largest oil consuming countries/regions (US, China, India and Europe) are expected to make up 57 percent of the expected year-on-year declines in 2020. More promisingly, OPEC forecasts yearly oil demand in 2021 to rebound by 7 mbpd (or 8 percent) to an annual average of 97.7 mbpd, although it will still be below the pre-pandemic level of 99.7 mbpd seen in 2019.

In the **US (20 percent of global oil demand)**, the US Energy Information Administration (EIA) forecasts energy consumption will decline by 10.4 percent year-on-year (or by 2.1 mbpd) in 2020. A drop of this magnitude would push US consumption to roughly the same level seen back in 2012, at 18.5 mbpd. When looking at consumption by product, gasoline, which makes up 45 percent of total demand in the US, is expected to decline by 10 percent, the equivalent of nearly 1 mbpd. Unsurprisingly, jet fuel, which makes up 7 percent of total demand, is expected to see the steepest decline by 31 percent year-on-year. Whilst the sizable decline in gasoline and jet fuel are reflective of travel restrictions as a result of COVID-19 mitigation efforts, the EIA sees the largest declines in US consumption to be behind them.

OPEC's expectations over **China's (13 percent of global oil demand)** consumption declining by 7 percent year-on-year contrasts sharply to the outlook presented by a research think-tank affiliated with the national oil company China National Petroleum Corporation (CNPC). According to the think tank, lower yearly oil prices will spur oil consumption to rise by 1 to 2 percent year-on-year, and raise oil imports by 2 percent in 2020. Certainly, latest Chinese oil import data does lend credence to CNPC's outlook, with Q2 2020 Chinese oil imports up 16 percent year-on-year (Figure 2) with June imports at an all time high of 12.9 mbpd. Whilst this huge rise may in part be due to China's post-lockdown recovery, it probably also reflects China's habit of large oil purchases during periods of low oil prices to build up its strategic crude oil stocks.

Figure 2: Chinese oil imports up 16 percent year-on-year in Q2 2020

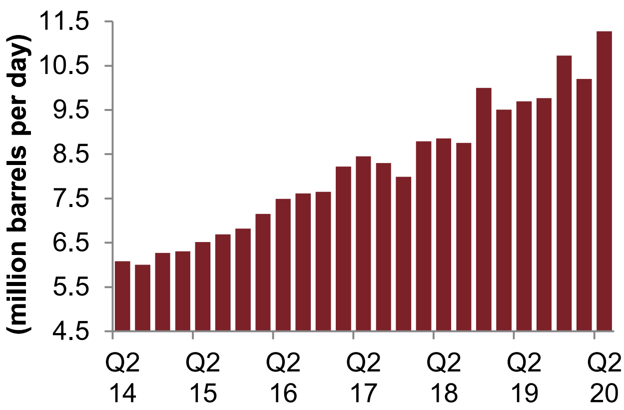
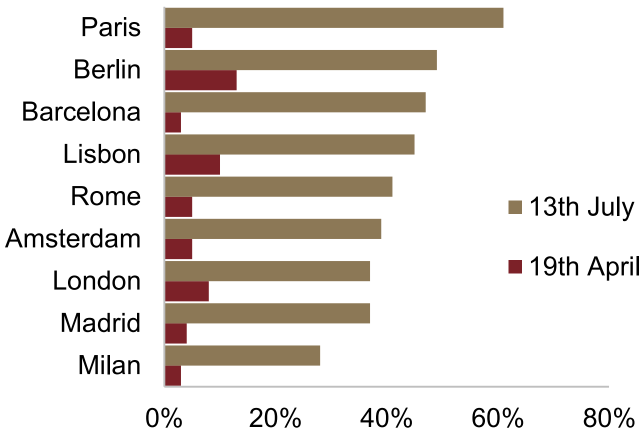


Figure 3: Public transport usage
(% of city moving in April & July versus Jan. 2020)



OPEC expects the OECD Europe region (including EU) to record the steepest yearly declines (by 12 percent year-on-year) in 2020.

Most of **Europe (14.4 percent of demand)** began progressively lifting their economies from lockdown in the latter half of the second quarter which has translated to higher levels of mobility (Figure 3). That said, the knock-on effect of the lockdowns and the associated economic fallout will have a sizable impact on demand growth in the region. For example, according to the European Automobile Manufacturers Association (ACEA), April new vehicle registrations in the European Union (EU) fell by more than 76 percent year-on-year, the largest fall on record, contributing to a 60 percent decline in gasoline over the same period. In fact, OPEC calculates that the OECD Europe region saw the largest yearly oil demand declines (by 28 percent) during Q2. Accordingly, when stripping out the relatively minor 'Other Europe' category, OPEC expects the OECD Europe region (including EU) to record the steepest yearly declines (by 12 percent year-on-year) in 2020.

India's demand outlook is clouded by rising number of COVID-19 cases, with authorities in several cities recently reinstating strict lockdowns due to a surge in the number of cases.

India (5 percent of global oil demand) saw demand rise sizably in June as lockdown measures were lifted at the beginning of the month. Indian fuel product consumption rose 11 percent month-on-month in June, although on a year-on-year basis consumption was down by 8 percent. Looking ahead, India's demand outlook is clouded by rising number of COVID-19 cases, with authorities in several cities recently reinstating strict lockdowns due to a surge in the number of cases. Overall, OPEC expects Indian yearly oil demand growth to decline by 11 percent year-on-year.

OPEC+: A+ for compliance:

On the supply side, OPEC and partners (OPEC+) historic crude oil production agreement back in April was followed through with exceptional levels of compliance…

OPEC and partners (OPEC+) historic crude oil production agreement back in April was followed through with exceptional levels of compliance. Average output over May and June shows that OPEC+ compliance averaged 99 percent. Gulf producers exhibited the highest level of compliance, with Bahrain (108 percent) Saudi Arabia (106 percent) UAE (103 percent) and Kuwait (102 percent), which is unsurprising since these are also the same countries (with the exception of Bahrain) that implemented further voluntary reductions of 1.25 mbpd during June. At the other end of the spectrum, the lowest compliers were South Sudan, Gabon, Sudan and Congo (Figure 4).

...May and June average compliance stood at 99 percent.

Looking ahead, following last week's Joint Ministerial Monitoring Committee (JMMC), OPEC+ decided to loosen the level of output reductions, as per the previous agreement (*please refer to our* [Oil Update]() *published in April*). In addition, the JMMC recommended that countries who undershot compliance in May and June would make

Figure 4: OPEC+ crude oil production for May and June 2020 showed very high levels of compliance

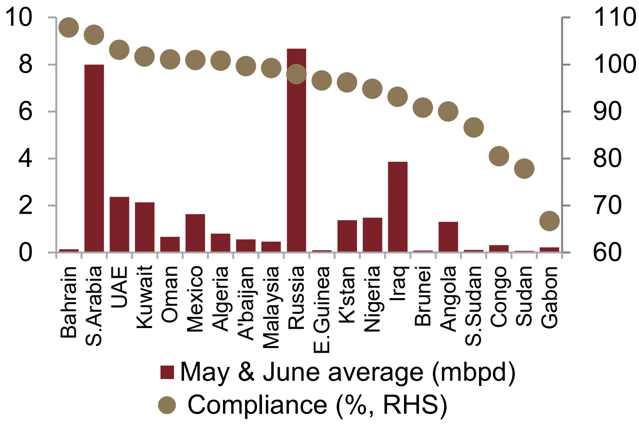
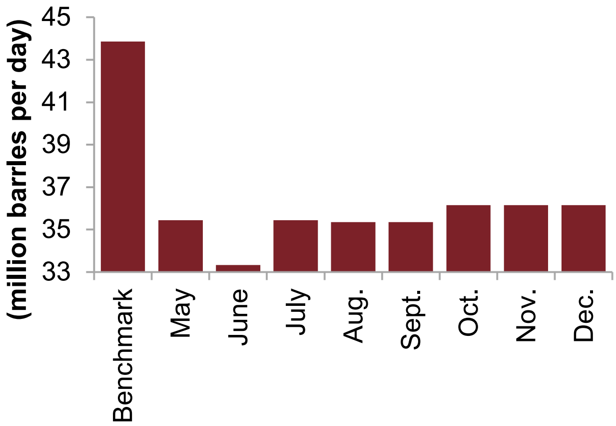


Figure 5: OPEC+ to raise output from August 2020 onwards due to improving demand outlook



Following last week's Joint Ministerial Monitoring Committee (JMMC), OPEC+ decided to raise output gradually over the course of this year.

up for their over production in the following two months (August and September), resulting in a further 840 thousand barrels per day (tbpd) not being supplied. As a result, assuming full compliance, OPEC+ would produce 8.5 mbpd less than the benchmark output of 43.9 mbpd in August and September, and 7.7 mbpd less than the benchmark in Q4 2020 (versus on average of 9.5 mbpd less in May and June, Figure 5). Overall, OPEC+ stated that the decision to gradually raise oil output over the course of H2 2020 was based on encouraging signs of improvement in oil demand as economies around the world opened up from lockdowns.

US shale oil recovery?:

Meanwhile in the US, whilst the current level of oil prices seem to be encouraging shut-in oil wells to be brought back on-line…

According to EIA data, US crude oil production averaged 11.4 mbpd in Q2 2020, down 4 percent year-on-year. That said, the recent rebound in oil prices, at around $40 per barrel (pb), presents a life-line to some US oil producers and could result in a faster recovery in output than envisaged by the EIA. In fact, around a third of the 162 producers and oil-field service firms in the Federal Reserve Bank of Dallas' energy survey stated that prices of $36-40 pb would be sufficient to restart shut-in oil wells (wells where oil production is below maximum capacity), whereas circa 19 percent stated prices below $35 pb were sufficient.

... higher prices will be needed for drilling of new oil wells…

...with US output declining on both a quarter-on-quarter and year-on-year basis until end of next year.

Whilst the current level of oil prices seem to be encouraging shut-in oil wells to be brought back on-line, higher prices will be needed for drilling of new oil wells. Overall, the majority of US shale exploration and production companies need WTI prices consistently over $50 pb to bring new oil volumes to market. As such, EIA's current forecasts of WTI at $39 pb in H2 2020 and $47 pb in 2021, means US oil output will decline on both a quarter-on-quarter and year-on-year basis until end of next year (Figure 6).

Oil price outlook:

Looking ahead, we see some upside to prices going forward, especially as oil demand progressively rises during H2 2020.

Brent oil prices averaged a lowly $28 pb during Q2, but has recovered significantly during the last couple of months as a number of economies have lifted severe lockdowns and OPEC+ has followed through with agreed output reductions. Brent oil is currently trading around $44 pb, with the year-to-date average at $40 pb.

Looking ahead, we see some upside to prices going forward, especially as oil demand progressively rises during H2 2020. That said, the upside will be capped by i) the existence of large commercial oil inventories, (3.2 billion barrels at the end of Q2,

Figure 6: US oil output not expected to see yearly rises until end of 2021

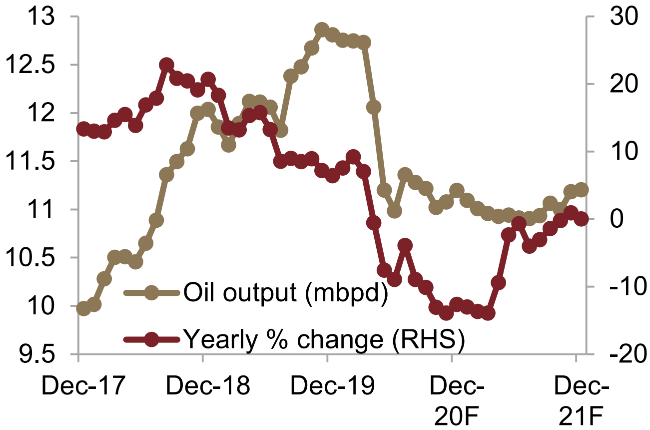
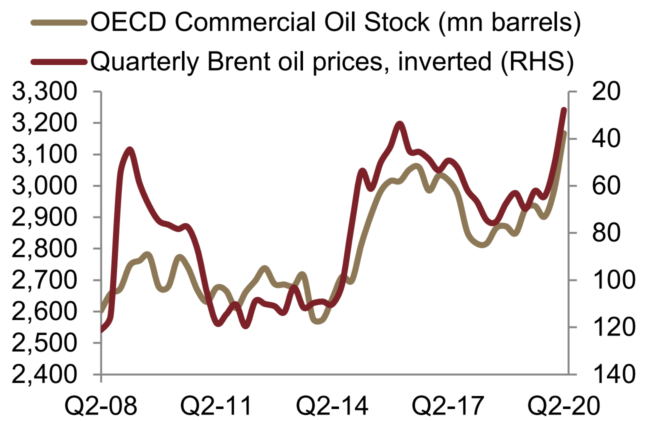


Figure 7: OECD commercial oil stocks hit record highs in Q2 2020



That said, the upside will be capped by i) the existence of large commercial oil inventories and ii) the risks associated with rising cases of COVID-19 or indeed a second wave.

Figure 7) and ii) the risk associated with rising cases of COVID-19 or indeed a second wave of cases later in the year. For example. South America has seen a large number of cases recently, whilst various states in the US are also seeing higher numbers, whilst India has yet to hit a peak. All these areas represent a sizable portion of global oil demand. Additionally, the risk of second wave in COVID-19 is ever present, although initial experiences from China, UK and Germany suggest localized lockdowns might be more common rather than national lockdowns seen in many economies earlier in the year.

We have cautiously raised our Brent oil forecast to $43 pb for 2020, versus $39 pb previously.

Taking into account all the above considerations, we have cautiously raised our Brent oil forecast to $43 pb for 2020, versus $39 pb previously.