جدوى للإستثمار
Jadwa Investment

January 2021

Quarterly Oil Market Update

The only way is up?

Summary

- The recovery in global oil demand continued through the last three months of 2020, with OPEC reporting rises of 3 percent quarter-on-quarter in Q4 2020. Looking ahead, oil demand will continue rising in Q1 and during the rest of the year on a quarterly basis (Figure 1), but still end up 3 percent lower than pre-COVID-19 levels by the end of 2021.

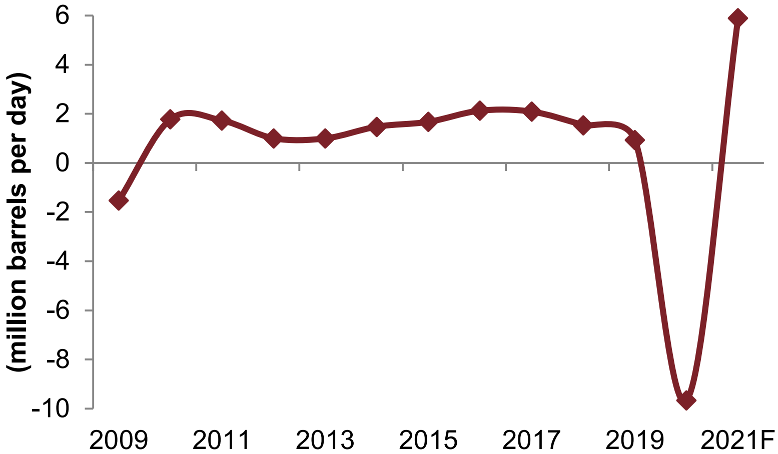
- On the supply side, OPEC and partners (OPEC+) maintained strong levels of commitment to the production agreement in Q4, with average compliance at around 100 percent. That said, differentiated levels of compliance between the two blocs (OPEC/non-OPEC) has been a reoccurring theme of the last seven months.

- Looking ahead, OPEC+'s initial decision (late last year) to raise oil output by only 0.5 million barrels per day (mbpd) for the month of January, together with a unilateral cut by Saudi Arabia to the tune of 1 mbpd in both February and March, means the alliance's output should decline marginally in Q1 2021. Beyond that, we expect OPEC+ to raise oil output by 1.4 mbpd at some point during Q2.

- Brent oil prices averaged $44 per barrel (pb) during Q4, showing a modest rise of 2 percent quarter-on-quarter, although this masks the fact that prices rose sharply (by 19 percent month-on-month) in December, to an average of $50 pb. Overall in full year 2020, Brent oil averaged $42 pb, down 36 percent over 2019 levels, and just slightly lower than our forecast of $43 pb.

- Brent oil has risen further during the initial weeks of 2021, with Saudi Arabia's unilateral reduction in output lifting prices circa 10 percent. Looking ahead, the recovery in oil prices during the remainder of the year will not be linear, not least because of the risks still associated with COVID-19. Bearing this in mind, we have left our full year 2021 Brent oil price forecast of $55 pb unchanged.

Figure 1: Oil demand expected to rise by 5.9 million barrels per day in 2021



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Oil demand: not out of the woods just yet:

The recovery in global oil demand continued through the last three months of 2020…

The recovery in global oil demand continued through the last three months of 2020, with OPEC's monthly oil market reporting rises of 2.6 million barrels per day (mbpd) or 3 percent quarter-on-quarter in Q4 2020. That said, the recovery was not uniform, with 'Europe', a major oil consuming region, accounting for circa 14 percent of global oil demand, seeing quarterly declines. More specifically, due to another round of lockdowns and restrictions following a second, more severe, wave of COVID-19 cases, European demand fell by 820 thousand barrels per day (tbpd) during Q4. The 'Middle East' (down 440 tbpd) and 'Latin America' (down 12 tbpd) regions also contributed to lower demand, although seasonally observed changes in demand (due to cooler weather) likely contributed to the former's decline. On the other hand, US demand rose by 1.1 mbpd, despite the country also witnessing continued rises in COVID-19 cases during the quarter. Additionally, stronger demand was registered amongst the largest oil consumers in Asia, including India (up 600 tbpd), the 'Asia-Pacific' region (up 540 tbpd) and China (up 510 tbpd).

...with stronger demand registered amongst the largest oil consumers in Asia.

Looking ahead, oil demand will rise by 600 tbpd in Q1 2021 quarter-on-quarter…

Looking ahead, according to OPEC forecasts, oil demand will rise by 600 tbpd in Q1 2021 quarter-on-quarter and will continue rising on a quarterly basis during the rest of the year, but still end up 3 percent lower than pre-COVID-19 levels by the end of 2021 (at 97.4 mbpd versus 100.8 mbpd at the end of 2019). For full year 2021, on a country/regional level, the four largest oil consuming countries/ regions (US, China, India and Europe) are expected to account for just under two thirds (or 3.6 mbpd) of oil demand growth of 5.9 mbpd in full year 2021.

...and will continue rising on a quarterly basis during the rest of the year.

In the **US (21 percent of global oil demand)**, the Energy Information Administration's (EIA) data shows that total energy consumption rose by 1 percent quarter-on-quarter (or 130 tbpd) in Q4 2020, but was 10 percent lower than the same period last year. Looking at consumption on a product basis, gasoline (45 percent of total US demand), declined by 4 percent, or 380 tbpd, quarter-on-quarter, but was down a sizable 11 percent on a year-on-year. Pandemic induced lockdowns and curfews (such as in the state of California and North Carolina) reduced mobility, with partial Q4 data showing total vehicle miles traveled declining 12 percent nationwide compared to same period last year. As a result, US commercial gasoline stocks climbed to multi-year highs in Q4 2020, when compared to similar periods in previous years (Figure 2). Unsurprisingly, jet fuel, which makes up 6 percent of total demand,

In the US, pandemic induced lockdowns and curfews reduced mobility…

...and impacted demand for transportation fuel.

Figure 2: US commercial gasoline stocks at multi-year highs in Q4 2020 (vs. similar periods)

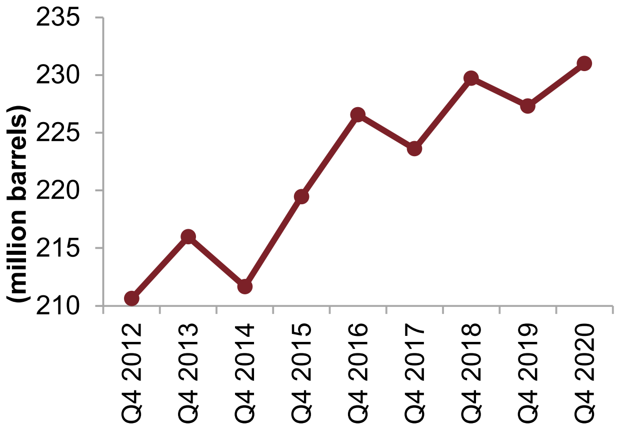
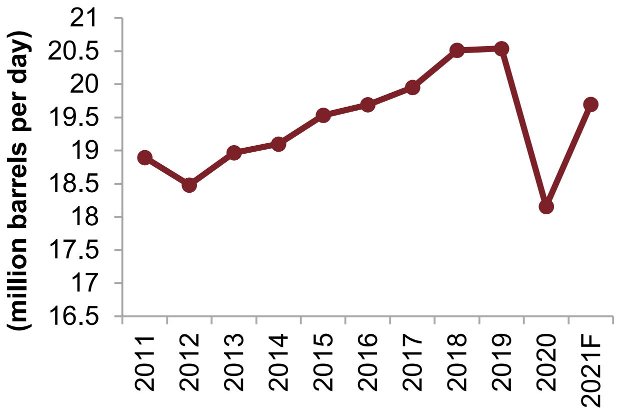


Figure 3: US liquid consumption expected to recover in 2021, but below pre-COVID-19 levels



remained pressured, and was down 38 & 12 percent year-on-year and quarter-on-quarter, respectively.

On a full year basis, US consumption averaged 18.1 mbpd in 2020…

According to the EIA data, on a full year basis, US consumption averaged 18.1 mbpd in 2020, similar to levels last seen back in 2012. Looking ahead, the EIA expects Q1 2021 consumption to be 2 percent lower on a year-on-year basis, but to rise by 2 percent on a quarterly basis, supported by a rebound in jet fuel and gasoline. In 2021 as a whole, consumption is expected to average of 19.5 mbpd, albeit 5 percent less than pre-COVID 2019 levels (Figure 3).

...and in 2021, consumption is expected to average of 19.5 mbpd, 5 percent less than pre-COVID levels.

According to OPEC data, **China (14 percent of global oil demand)**, continued to post quarterly rises (of 4 percent) in oil demand during Q4 2020, and 5 percent on a yearly basis. Overall in full year 2020, Chinese oil demand declined 3 percent (or 440 tbpd) compared to the same period last year, with the majority of this drop concentrated in Q1 2020, when the country saw a peak number of cases. Meanwhile, despite Q4 data showing yearly declines, Chinese oil imports rose by a sizable 8 percent year-on-year during 2020 as a whole, averaging 10.7 mbpd, and almost double the quantity imported in 2013 (Figure 4).

Overall in full year 2020, Chinese oil demand declined 3 percent compared to the same period last year.

Looking ahead, Chinese oil demand is projected to improve in-line with continued economic recovery, with OPEC expecting a rise of 1.1 mbpd (or 9 percent) year-on-year in 2021, primarily as a result of higher consumption in transportation fuel. At the same time, China's Ministry of Commerce (MOFCOM) recently announced a 20 percent year-on-year rise in import quotas for domestic refiners, which should result in oil imports rising on an annual basis yet again in 2021.

Looking ahead, Chinese oil demand is projected to improve in-line with continued economic recovery.

A resurgence in the number of COVID-19 cases in **Europe (14 percent of demand)** resulted in oil demand growth falling into the negative territory in Q4 2020. OPEC data shows that Q4 oil demand declined by 6 percent on a quarter-on-quarter basis, reversing the positive trend seen in Q3. Partial Q4 data shows that demand in Europe's Big 4 (Germany, France, Italy and the UK) fell in all fuel types, with the largest declines seen in transportation fuel such as kerosene and diesel. Overall, in full year 2020, Europe saw the largest yearly decline in oil demand (in percentage terms) amongst the various OPEC geographical categories. More specifically, oil demand fell by 14 percent (or 1.95 mbpd) in full year 2020 compared to 2019, pushing total demand in the region to multi-year lows (Figure 5). Looking ahead, whilst OPEC does expect a decent level of recovery in 2021, at 6 percent (or 700 tbpd) year-on-

A resurgence in the number of COVID-19 cases in Europe resulted in oil demand growth falling into the negative territory in Q4 2020.

Overall, in full year 2020, Europe saw the largest yearly decline in oil demand (in percentage terms) amongst the various OPEC geographical categories.

Figure 4: Chinese oil imports up 8 percent year-on-year in 2020

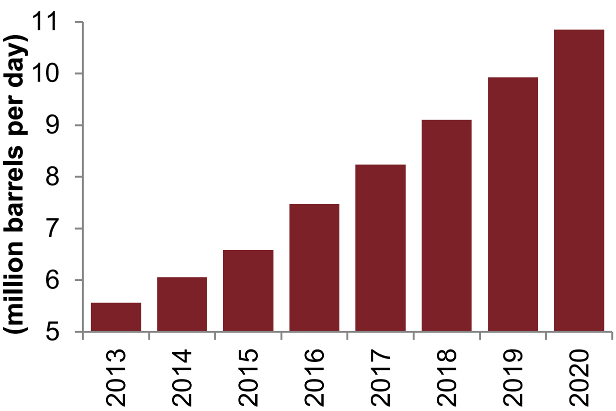
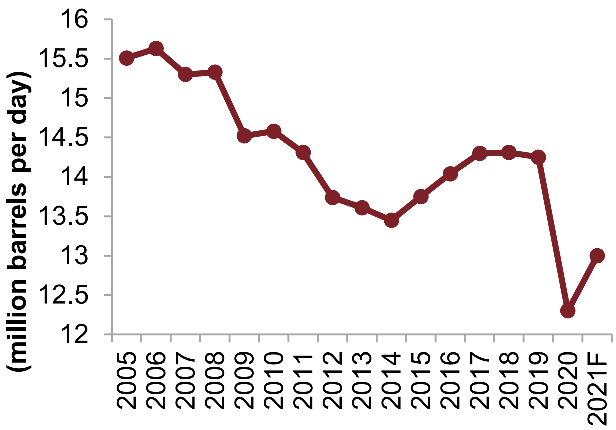


Figure 5: European demand hit a historic low in 2020, but is expected to recover in 2021



Looking ahead, the near-term outlook during Q1 2021 is extremely uncertain.

year, the organization also notes that the near-term outlook during Q1 2021 is extremely uncertain.

India saw a sizable recovery in oil demand in Q4 2020…

...with demand in 2021 expected to finish 2 percent higher than pre-COVID-19 levels.

India (5 percent of global oil demand) saw a sizable recovery in oil demand by 15 percent quarter-on-quarter in Q4 2020, as a relaxation of lockdown measures across the country, and a drop in COVID-19 cases, supported demand. That said, demand remained 11 percent lower than Q4 2019. In fact, full year 2020 Indian oil demand dropped by 13 percent year-on-year, which, in turn, translated into a 6 percent decline in oil imports last year (Figure 6). Looking ahead, OPEC expects oil demand to continue showing quarterly and yearly gains in Q1 2021, especially as an improving economy leads to a recovery in the transportation and industrial sectors. Overall in 2021, OPEC expects Indian oil demand to rise by a sizable 14 percent year-on-year, finishing the year 2 percent higher than pre-COVID-19 levels.

OPEC+: Complying

OPEC+ maintained strong levels of commitment to the production agreement in Q4…

...that said, differentiated levels of compliance between the two blocs (OPEC/non-OPEC) has been a reoccurring theme of the last seven months.

OPEC and partners (OPEC+) continued to exhibit strong levels of commitment to the production agreement in Q4, with average compliance at around 100 percent, albeit with varying degrees of amongst participating countries. Within OPEC, some of the larger producers (such as Nigeria and UAE) instituted ‘catch up’ reductions as a result of previous over-production, which pushed compliance well over 100 percent. At the same time, non-OPEC compliance averaged around 97 percent during the quarter. In fact, differentiated levels of compliance between the two blocs (OPEC/non-OPEC) has been a reoccurring theme of the last seven months. For example, from May to December of last year, OPEC compliance averaged just above 100 percent, but weaker compliance was observed amongst non-OPEC producers. This was most noticeable with Russia (the largest producer in the alliance), where compliance is expected to have averaged around 95 percent last year, with overproduction hitting the equivalent of around 100 tbpd in the period question (Figure 7).

Looking ahead, OPEC+’s initial decision (late last year) to raise oil output by 500 tbpd…

Looking ahead, OPEC+’s initial decision (late last year) to raise oil output by 500 tbpd (rather than 1.9 mbpd) for the month of January, together with a unilateral cut by Saudi Arabia to the tune of 1 mbpd in both February and March, means the alliance’s output should decline by 100 tbpd quarter-on-quarter in Q1 2021. Beyond that, we expect OPEC+ to add the remaining 1.4 mbpd (1.9 mbpd less January's rise of 500 tbpd) at some point during Q2. According to our calculations, whilst an additional 1.4 mbpd of OPEC+ oil would

Figure 6: Indian oil imports fell in 2020

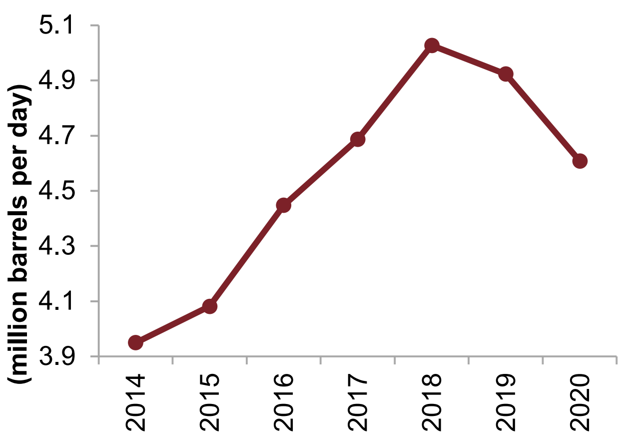
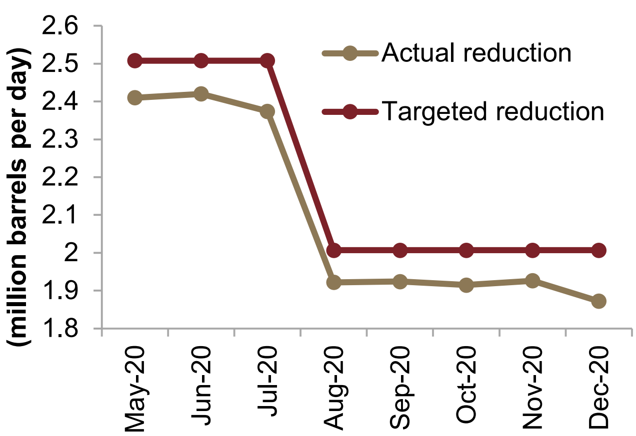


Figure 7: Russian output ended up below targeted levels in 2020



...together with a unilateral cut by Saudi Arabia to the tune of 1 mbpd in both February and March…

...means the alliance's output should decline by 100 tbpd quarter-on-quarter in Q1 2021.

That said, any discord and disunity among the alliance as oil markets seemingly improve in H2 2021...

...would likely relocate risk from the demand to the supply side of the market.

In 2020, US output declined by 8 percent compared to 2019, to an average of 11.3 mbpd.

Looking at 2021, EIA's current forecast (based on WTI at $49.7 pb) sees US oil output declining by a further 2 percent on a year-on-year basis.

result in a gradual tightening in global daily oil balances, it would still result in an average deficit of 1.1 mbpd over the course of 2021 (Figure 8). The persistence of a deficit would, in turn, help push down the overhang in commercial oil inventories that developed last year, which currently stands at around 130 million barrels above its five year average (Figure 9).

Of course, there is no guarantee that there will be a smooth and linear path towards raising output, not least because of the risks associated with COVID-19 and/or vaccination roll-out delays (see Oil Price section below). Additionally, the OPEC+ alliance may also have to contend with itself in the months ahead. More specifically, in the near-term, the main challenge relates to ensuring that compliance at current high levels is maintained, especially so if oil prices rise further. Secondly, the medium term challenge relates to whether the alliance can react quickly (and collectively) to demand dynamics as they play out during the year, and beyond. It is worth noting that volatility in oil markets has dropped significantly (whilst it has persisted within other asset classes) since OPEC+ banded together under the current production agreement back in May of last year. Thus, any discord and disunity among the alliance as oil markets seemingly improve in H2 2021, would likely relocate risk from the demand to the supply side of the market.

<u>No imminent change in US oil policy:</u>

According to EIA data, US crude oil production averaged just over 11 mbpd in Q4 2020, down 15 percent year-on-year but showed no change on a quarterly basis. During 2020 as a whole, output declined by 8 percent compared to 2019, to an average of 11.3 mbpd. Looking at 2021, EIA's current forecast (based on WTI at $49.7 pb) sees US oil output declining by a further 2 percent on a year-on-year basis (to an average of 11.1 mbpd) at the end of the year.

Meanwhile, with the Democrats winning the recent US presidential election, there will be a change in domestic oil policy agendas. The new US administration is expected to promote regulation aimed at reducing greenhouse gas emissions and addressing climate change. It remains to be seen to what extent this will impact the US oil sector, with the roll-out of a number of regulations (such as the cessation of oil drilling permits on federal lands and waters) or indeed an oil export ban, all possible. However, as we highlighted in our previous update, such policies would not be considered in the near-term, but would likely materialize later this year or in 2022, if at all.

Figure 8: Daily global oil balance assuming additional 1.4 mbpd OPEC+ oil from Q2 onwards

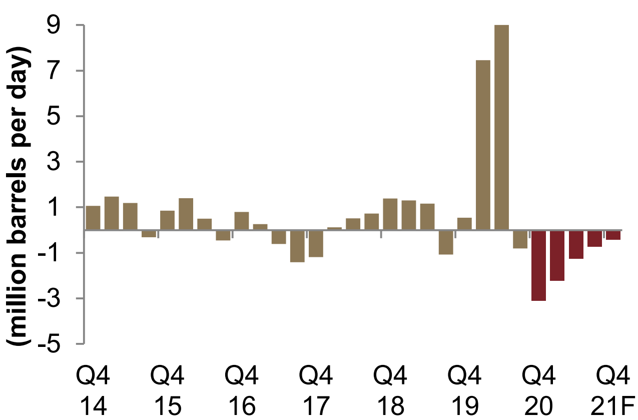
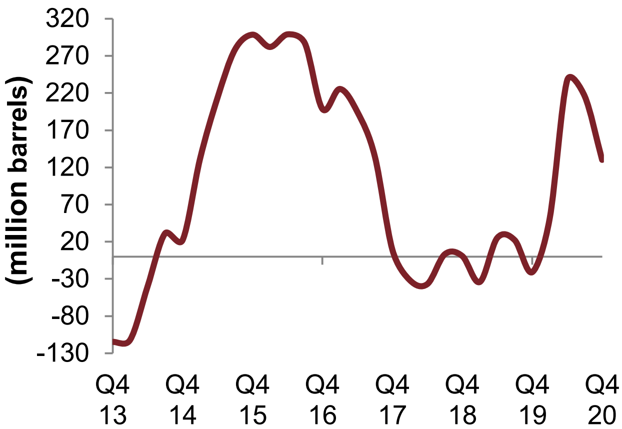


Figure 9: Commercial oil stocks versus five year moving average



Oil price outlook:

Overall in full year 2020, Brent oil averaged $42 pb, down 36 percent over 2019 levels…

...and just slightly lower than our forecast of $43 pb.

Brent oil prices averaged $44 pb during Q4, showing a modest rise of 2 percent quarter-on-quarter, although this masks the fact that prices rose sharply (by 19 percent month-on-month) in December, to an average of $50 pb. Oil prices were lifted by i) OPEC+'s agreement not to raise oil output as much as originally planned and ii) by the approval and roll-out of a number vaccines in many countries. Overall in full year 2020, Brent oil averaged $42 pb, down 36 percent over 2019 levels, and just slightly lower than our forecast of $43 pb (*see our latest Chartbook for more details*).

Looking ahead, the recovery in oil prices during the remainder of the year will not be linear…

…not least because of the risks still associated with COVID-19.

Brent oil rose further during the initial weeks of 2021, with Saudi Arabia's unilateral reduction in output lifting prices circa 10 percent, to around $55 pb. We expect the Kingdom's reduction in output to help sustain prices at around current levels during the rest of Q1. Looking further ahead into the rest of 2021, current OPEC forecasts suggest a progressive pick-up in oil demand during the year, and a deficit in daily oil balances, all of which should help lower record high commercial oil inventories and provide support to prices.

Bearing this in mind, we have left our full year 2021 Brent oil price forecast of $55 pb unchanged.

Of course, the main risk in the outlook comes from a more prolonged and serious outbreak of COVID-19, possibly through a variant of the disease, or due to a slower roll-out of the vaccine than currently anticipated. In this context, the recovery in oil prices during the year will not be smooth, and the possibility of a 'correction' cannot be ruled out. Bearing this in mind, we have left our full year 2021 Brent oil price forecast of $55 pb unchanged for now.