

Oil caught between geopolitics and global growth concerns as OPEC+ extends accord

Highlights

- Oil prices gain in June, to \$66.6/bbl (Brent) and \$58.5/bbl (WTI), but weak global growth sentiments persist.
- OPEC+ extends production cut agreement for a further 9 months to March 2020.
- OPEC+ achieves 151% compliance in May, led by further declines in Saudi and Russian crude output.
- World oil demand growth estimates for 2019 revised down, however, by 100 kb/d to 1.2 mb/d by the IEA.
- Nevertheless, 2019 on the whole should see demand and supply roughly balanced, with prices remaining close to their current levels.

Oil prices rebound in June but face pressure from weakening global economic fundamentals

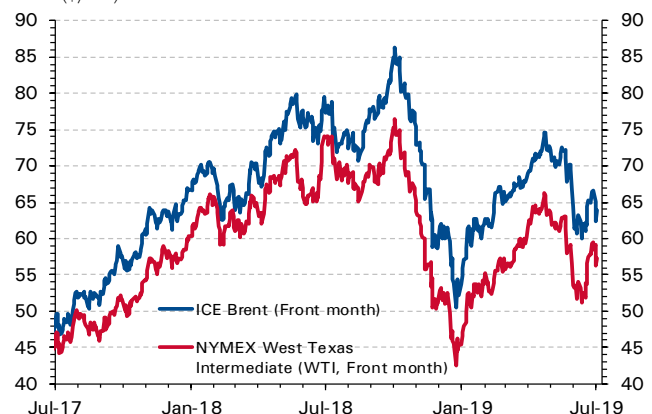
June saw oil prices whipsawed by opposing bullish and bearish forces, falling earlier in the month to their lowest levels since late January before rising to end higher at \$66.6/bbl (Brent) and \$58.5/bbl (WTI). (Chart 1.) Brent and WTI's year-to-date gains stood at 24% and 29%, respectively, by June's close.

Brent initially fell to a low of \$59.97/bbl in early June largely on concerns about weakening global economic growth, catalyzed by the deteriorating US-China trade tariff dispute. Prices were also under pressure by above-seasonal crude stock builds in the US, which came despite Saudi Arabia's efforts to curb crude exports to that market. Past mid-month, oil prices then posted two consecutive weeks of gains, propelled by a combination of heightened geopolitical tensions relating to the attack on Saudi and international tankers off the Strait of Hormuz and by easing global trade anxieties as Presidents Trump and Xi resumed trade negotiations. The downing of a US drone by Iran and the subsequent abortive US airstrike and sanctioning of Iran's Supreme Leader Ali Khamenei served to further raise oil's geopolitical risk premium.

Going into July, however, market sentiment appears to have weakened at a time when it was expected to turn more bullish. While prices were indeed buoyed by the long-awaited drawdown of US crude stocks by US refineries ahead of the summer driving season, the reaction to the OPEC+ decision on 1-2 July to extend the production cut agreement for a further nine months to March 2020 was lukewarm initially before turning negative. Brent declined the next day by 4% to \$62.4/bbl, likely due to a combination of still high global inventories (16.3 mb above the 5-year average in April according to the IEA—see Chart 2), record US shale production

growth and weakening global economic growth. These are the very reasons that influenced the OPEC+ decision to extend.

▶ Chart 1: Benchmark crude oil prices (\$/bbl)



Source: Refinitiv

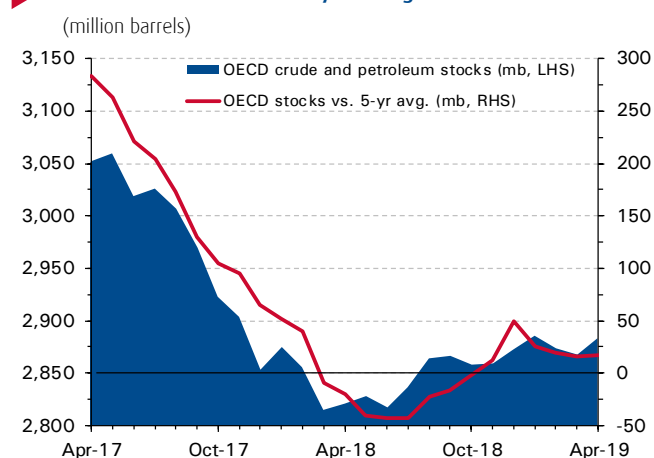
Moreover, while the crude inventory decline in the US was more than expected (-12.8 mb), pointing to strong domestic demand, the EIA's data release also revealed an eye-catching year-to-date increase in US crude exports of 69%, to a record high of 3.7 mb/d. US shale therefore appears to be challenging OPEC and its allies' traditional market dominance as these oil producers continue to hold down their own output, a concern frequently expressed by Russia and others.

Softer data leads to oil demand growth downgrade

Concerns about the trajectory of the global economy have been fueled partly by softer data and by the continuing US-China trade dispute. The International Energy Agency (IEA) downgraded in June, for the second month in a row, its estimate for global oil demand growth. It now expects growth to be 1.2 mb/d, 100 kb/d lower than its May estimate. The agency cites slower

economic growth—a nod to the recent global economic outlook downgrade, in which trade tensions were a significant factor, to 3.2% for 2019.

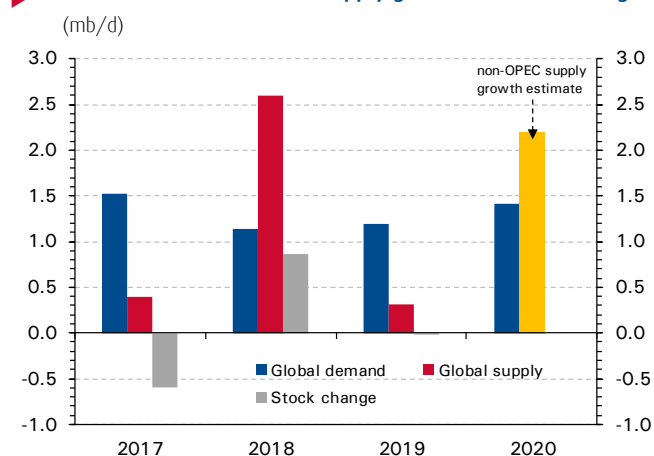
▶ Chart 2: OECD stocks vs. 5-yr average



Source: International Energy Agency (IEA)

Slower petrochemicals activity and warmer northern hemisphere weather were also contributory factors. Oil demand growth will rebound, though, to 1.4 mb/d in 2020. (Chart. 3) This will be partially offset by robust non-OPEC supply growth, which the IEA expects to accelerate from an estimated 1.9 mb/d in 2019 to 2.2 mb/d in 2020.

▶ Chart 3: Global demand & supply growth and stock changes



Source: IEA, NBK; assumes OPEC+ output continues at May's levels

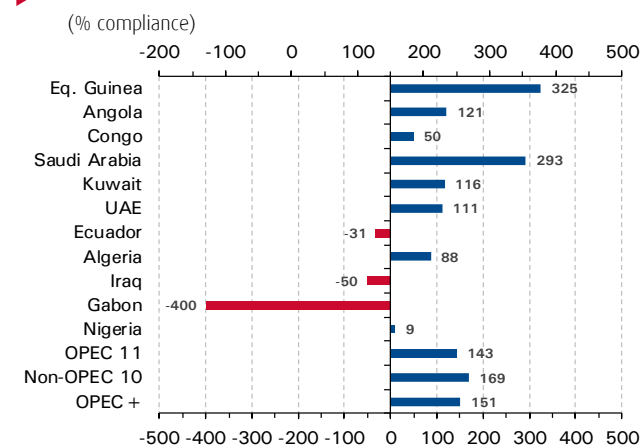
This year, even in the context of weaker oil demand, there is a good chance that supply growth will lag demand growth with OPEC+ extending its cuts. This should lead to a roughly balanced market, with a marginal crude stock draw on average for the year, according to our calculations. (See Chart 3.)

OPEC supply falls to lowest level in 5 years

OPEC, for its part, has commendably stuck to its task of paring back output in an attempt to clear the supply overhang. According to OPEC secondary sources, aggregate production fell to 29.9 mb/d in May, the lowest level since 2014, led by continued declines in Saudi Arabia, Venezuela and Iran. Saudi

Arabia continues to do the heavy lifting for the OPEC-11 nations, cutting its production for the sixth consecutive month in May, to a low of 9.69 mb/d, a cut of 621 kb/d more than is required by its allocation (achieving record 293% compliance). (Chart 4.)

▶ Chart 4: OPEC and non-OPEC compliance in May 2019



Source: OPEC, Bloomberg, IEA

For other OPEC countries, Kuwait and the UAE also continue to overcomply, by 116% and 111%, respectively. In contrast, Iraq has yet to achieve its quota obligation and has, in fact, been increasing production in recent months. Output in Iran and Venezuela, meanwhile, continues to decline due to the impact of US sanctions and/or economic mismanagement.

Overall OPEC+ compliance was 151% compared to OPEC-11 compliance of 143% in May. Among the large non-OPEC oil producers, Russia finally hit its target during the month to join over-compliers Mexico and Kazakhstan. Russia's reduced output of 11.4 mb/d in May (132% compliance) was also partly a result of the Druzhba pipeline contamination.

OPEC+ agreeing to extend until March 2020 could establish a price floor. As we have seen over the last several months, the geopolitical context does have the capacity to raise the risk premium on oil prices. Looking ahead, though, it seems likely that it will be the global economy narrative and once again the US shale growth story that will command most of the markets' attention.

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