Pandemic-linked oil demand concerns continue to weigh on oil prices

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Summary

Oil prices (Brent) have settled in the $62-63/bbl range following the OPEC+ decision to unwind production cuts in May-July. Another rally in oil prices will likely hinge on positive oil demand news. The IMF's upgrade to global economic growth augurs well for oil demand in 2021, but gains are not likely until 2H21 and the summer season, after which the drawdown in stocks from still-elevated levels should accelerate.

- Oil prices appear to have come off their surprising post-OPEC+ meeting gain last week and look to be settling into an oil demand-sensitive holding pattern, with the international benchmark, ICE Brent, closing on Wednesday up slightly at $63.2/bbl (+0.7% d/d; +21.9% ytd). US marker West Texas Intermediate (WTI) was up by the same amount to $59.8/bbl (+24.5% ytd). (Chart 1.)

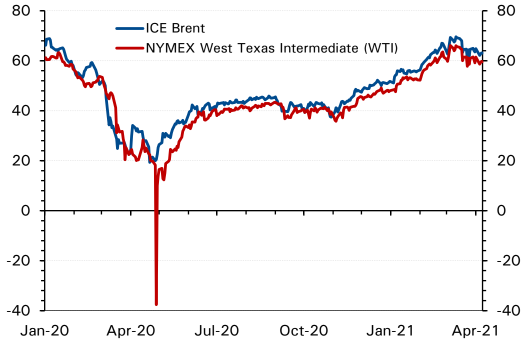
- The Brent forward curve continues to point to near-term supply tightness, with front month prices higher than later-dated prices (backwardation). However, the curve has flattened considerably since early March as supply looks more accommodating, while expectations for more robust demand growth are pushed back (Chart 2.) This is also reflected in the decline in speculative net length (the difference between the number of 'long' contracts bought on the expectation of the price increasing and the number of 'short' contracts bought on the expectation of the price falling), which has fallen from its late February high of around 348k contracts to 289k contracts. (Chart 3.)

- Concerns over near-term oil demand have increasingly weighed on market sentiment of late, especially after Europe and India re-imposed mobility restrictions to contain rising coronavirus infections. The markets were, however, encouraged on Tuesday by the International Monetary Fund's (IMF) upgrade to global economic growth this year to 6.0% (from 5.5%). The US Energy Agency's forecast of increased gasoline consumption in the US this summer as more consumers take to the roads also buoyed the markets.

- Nevertheless, the market's cautious stance appears to be more in tune with the current reality of somewhat uncertain oil demand. The market's reaction following the announcement of the OPEC+ supply increase on 1 April was surprising, with Brent gaining more than 2% on the day. The OPEC+ decision itself was surprising given that only a day before, the group seemed to acknowledge the oil demand uncertainty when it downgraded its own oil demand forecasts for 2021 by 300 kb/d to 5.6 mb/d, with the weakness centered on 2Q21. Markets could therefore have been forgiven for expecting OPEC+ to roll over its output cuts for at least another month, to June. Instead, the group will increase supply, albeit gradually, over the next three months.

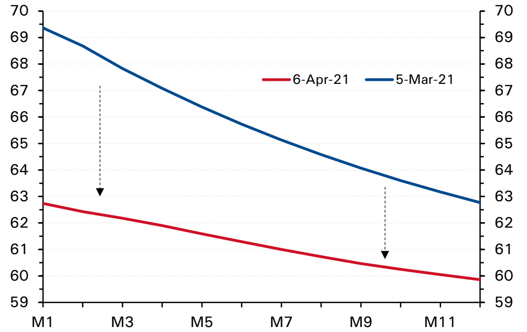
- OPEC+ production cuts will ease by 350 kb/d in May, 350kb/d in June and 450kb/d in July. (Chart 4.) Saudi Arabia will also restore its 1 mb/d of output cuts at the rate of 250 kb/d in May, 350 kb/d in June and 400 kb/d in July. By July, total OPEC+ supply will increase by a cumulative 2.1 mb/d to 36.34 mb/d, the production ceiling that was originally supposed to be reached last January. This level will endure until April 2022 as per the original OPEC+ schedule from April 2020, although OPEC+ could opt to either pause or deepen the cuts (by no more than 500 kb/d) when it meets again on 22 April.

Chart 1: ICE Brent crude price
($/bbl)



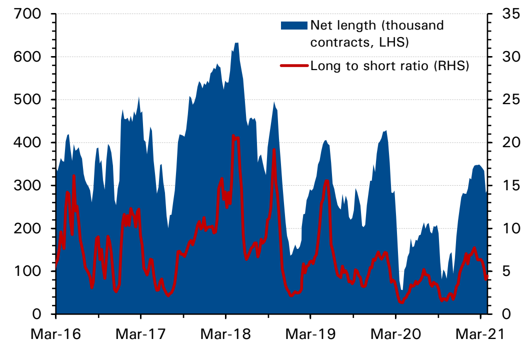
Source: Refinitiv

Chart 2: ICE Brent forward curve
($/bbl))



Source: Refinitiv

Chart 3: Money manager net length



Source: Bloomberg

- The OPEC+ decision to unwind the production cuts was especially good news for the UAE. Futures trading in ADNOC's flagship Murban crude (1.7 mb/d) went live on 30 March on the newly inaugurated ICE Futures Abu Dhabi exchange (IFAD) and ADNOC will be keen to boost volumes to meet demand. The Murban futures contract is a physically deliverable contract, and ADNOC hopes to establish the grade as a regional benchmark for crude oil pricing.

- The news that indirect negotiations were about to commence between the US and Iran on a possible reinstatement of some version of the 2015 nuclear agreement (JCPOA) has had a limited impact on oil prices. Ever since President Biden secured the US presidency, markets have been anticipating a potential renegotiation of the JCPOA. Moreover, in defiance of US sanctions, Iranian barrels have already been a feature of global crude oil supply. Many Chinese refiners, especially the independent refineries ('teapots'), have been avid importers of the heavily discounted Iranian crude, which has increasingly displaced crude bought from conventional sources including Angola, Norway and Brazil. Were JCPOA negotiations to lead to a lifting of sanctions, perhaps around 2.5 mb/d of Iranian crude exports could be expected, though this is not likely until 2022 at the earliest. Rapid progress is unrealistic with the US and Iran far apart in their demands.

- The International Energy Agency (IEA), in its March oil market report, pegged oil demand growth this year at 5.46 mb/d, a massive improvement on 2020's decline of 8.68 mb/d. (Chart 5.) Despite upwardly revising its 1Q21 oil demand estimates, most of the growth in 2021 will materialize in the second half of the year. Demand should reach 99.2 mb/d in 4Q21. With the IEA taking its cues from the IMF's projections for global economic growth, which were revised up, it is likely that the IEA's forecast for global oil demand growth will also be raised in its next oil market report.

- While improved demand projections will come as welcome news for OPEC+, there is still a lot for work for the group to do to bring global stock levels down to the 5-year avg. According to the IEA, inventories in January were still 63.2 mb above target. The IEA's expectation that non-OPEC supply will take longer to recover will, however, offer OPEC producers a window in which to meet rising demand. The 'call on OPEC' is expected to rise to 29.3 mb/d in 4Q21, the highest in more than two years.

- The US EIA, in its April Short Term Energy Outlook (STEO), appeared to back up the IEA's assertion of slower than expected non-OPEC supply growth this year; forecasts for the rebound in US crude supply in 2021 were reduced by 0.9% (110 kb/d) to 11.04 mb/d. Output fell to 10.9 mb/d in the week-ending 2 April, according to the EIA's weekly figures. US crude production is little changed so far in 2021, and remains 2.2 mb/d (-16.8%) below its high of 13.1 mb/d from early 2020. (Chart 6.) But future gains in production look increasingly likely even if the timeline has been extended, since US oil rig count increases—which precede crude output increases by several months—have been fairly consistent. 337 rigs were in operation as of 1 April, a gain of 26% in 2021.

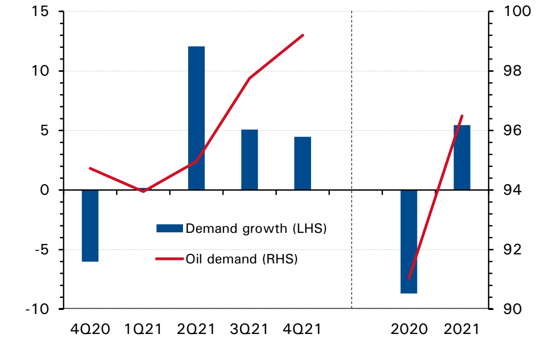
- Looking ahead, notwithstanding near term oil demand uncertainty and the rising OPEC+ supply, oil price risks appear roughly balanced, with a slight upwards bias. The global vaccination drive is expected to accelerate in the coming months, bringing with it gains in economic activity and therefore oil demand. Fiscal stimulus, such as the $1.3 trillion package approved by US Congress, will also support consumer spending.

Table: OPEC+ crude production allocations
(kb/d)

	Reference	May-21		Jun-21		Jul-21	
	Production	Adjust.	Prod.	Adjust.	Prod.	Adjust.	Prod.
Algeria	1,057	-170	887	-159	898	-145	912
Angola	1,528	-245	1,283	-230	1,298	-209	1,319
Congo	325	-52	273	-49	276	-44	281
Eq. Guinea	127	-20	107	-19	108	-17	110
Gabon	187	-30	157	-28	159	-26	161
Iraq	4,653	-748	3,905	-699	3,954	-637	4,016
Kuwait	2,809	-451	2,358	-422	2,387	-384	2,425
Nigeria	1,829	-294	1,535	-275	1,554	-250	1,579
Saudi Arabia	11,000	-1,768	9,232	-1,653	9,347	-1,505	9,495
UAE	3,168	-509	2,659	-476	2,692	-433	2,735
OPEC-10	26,683	-4,287	22,396	-4,010	22,673	-3,650	23,033
Russia	11,000	-1,582	9,418	-1,543	9,457	-1,505	9,495
Non-OPEC	17,170	-2,263	14,907	-2,190	14,980	-2,109	15,061
OPEC+	43,853	-6,550	37,303	-6,200	37,653	-5,759	38,094

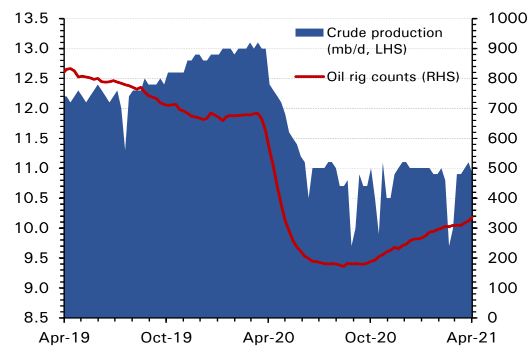
Source: OPEC

Chart 4: Global oil demand
(mb/d)



Source: International Energy Agency (IEA)

Chart 5: US oil production and rig counts



Source: US Energy Information Administration (EIA), Baker Hughes

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