Economic Update

NBK Economic Research Department I 9 November 2020

Oil Markets

Oil hit by resurgent coronavirus; pressure increases on OPEC+ to delay easing cuts

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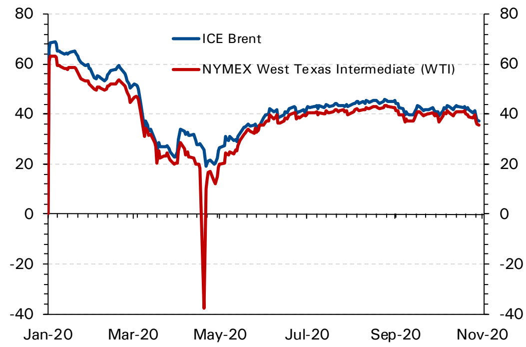
Summary

With many countries entering lockdown once more amid resurgent autumn coronavirus infections the oil markets have turned noticeably bearish, fearful of the negative impact on economic and oil demand growth. Prices have fallen back to late May levels, with pressure increasing on OPEC+ to delay if not reverse course on the scheduled easing of production cuts from January 2021.

- Oil prices are once again under pressure as the outlook for oil demand grows murkier with the autumn resurgence in coronavirus infections. The return of Libyan crude and a bigger than expected US crude stock-build were also bearish for oil. In addition, markets were disappointed by the failure of US congress to pass the coronavirus stimulus bill before the US presidential election. Brent crude, the international benchmark, was back below the $40 price floor at $37.5/bbl at October's close—a level last seen in late May.
- Brent recorded its largest weekly decline (-11.3% w/w) since late April and posted its second consecutive monthly loss (-8.5% m/m) as Europe braced for a return to lockdown amid the second pandemic wave. (Charts 1 & 2.) US benchmark West Texas Intermediate (WTI) also ended the month down around 11%, at $35.8/bbl. Prices are down more than 40% in 2020 so far.
- Market anxieties over demand/supply imbalances were reflected in the deepening contango structure (i.e. lower near-term contract prices compared to later-dated prices) of the Brent forward curve. Three-month time spreads widened to $1.46/bbl on 29 October, their widest since mid-September, which usually indicates concerns about oversupply. (Chart 3.)
- Regional oil exporters largely carried over into November their October official crude selling prices (OSPs, as differentials to benchmarks). For sales to the key Asian markets, the OSP of Kuwait Export Crude (KEC) was kept at a discount of 50 cents vs. Platts Dubai/Oman. Iraq's Basra Light stayed at 30 cents above the benchmark for the second month in a row, while Saudi Aramco raised the price of Arab Light by 10 cents to -40 cents vs. Platts Dubai/Oman. (Chart 4.)
- The International Energy Agency (IEA), in its October oil market report, expressed its concern about the worsening oil demand outlook in view of tighter mobility restrictions. It lowered its estimate of oil demand growth in 3Q20 by 0.2 mb/d on weaker oil consumption in the US and India especially but revised upward for 1Q20 data. 2020 oil demand growth is therefore unchanged at -8.4 mb/d, but should rise by 5.5 mb/d next year to 97.2 mb/d. Risks are overwhelmingly tilted to the downside. (Chart 5.)
- The IEA reported that OECD industry stocks, a proxy for global oil stocks, fell by 22.1 mb in August to 3,194 mb, which is still 209.1 mb above the 5-year avg for that time of the year. Global stocks for 3Q20 declined by 3.2 mb/d and are expected to fall by 4.1 mb/d in 4Q20. In this estimate, the IEA assumes that Libya's oil output averages 0.63 mb/d.

Chart 1: International crude oil prices

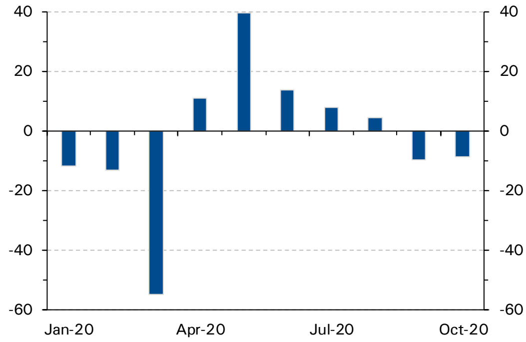
($/bbl)



Source: ICE, Eikon

Chart 2: ICE Brent monthly performance in 2020

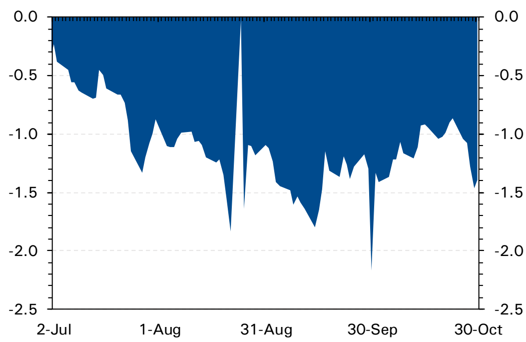
(% m/m, closing month price)



Source: ICE, Eikon

Chart 3: ICE Brent 3-month time spreads

($/bbl)

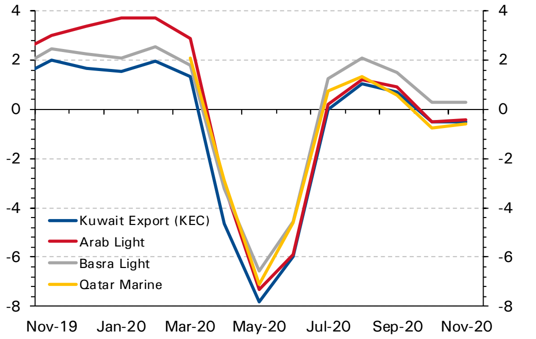


Source: ICE

- OPEC+, meanwhile, notched up another month of overcompliance in September, reaching 102% thanks largely to the efforts of OPEC-10 (105%); the non-OPEC group, led by Russia, saw its compliance slip to 97%. (Chart 6.) Also, September was the first month since the start of the agreement in May in which Iraq (113%), Nigeria (111%) and the UAE (110%) all managed to comply, cutting crude production to well within their quotas to make up for overproduction in previous months.
- For OPEC+, which meets again officially on 30 November to assess the state of the market and plan a course of action for 2021, pressure to delay the expected 1.9 mb/d of additional supplies from 1 January has grown considerably. The alliance acknowledged the "precarious' outlook; in the current depressed economic environment, if output cuts taper as planned then the drawdown in global oil stocks will almost certainly end. OPEC+ has not made any decision yet, but an additional complicating factor that could force their hand is the return of Libyan oil.
- Libya's output reached 500 kb/d recently following the ending of force majeure in September and could hit 1 mb/d within a few weeks if the cease-fire between the warring factions holds. The country is exempt from the OPEC+ cuts, so unless other producers come to an agreement to collectively lower output to accommodate Libya's return, then the market will likely face even more oil than it can absorb.
- Looking ahead to 2021, Iran could represent another supply headache for OPEC+ and clear downside risk for oil prices in the next year or so. Iran's fate hinges on the outcome of the US presidential election, since challenger Joe Biden, who is ahead in most polls, has indicated that he would like to bring Iran back to the negotiation table and reinstate the 2015 Iran nuclear agreement (JCPOA) that President Trump effectively nullified. This is not a done deal, though, since Trump's hardline anti-Iran stance has supporters in congress. It is also unclear how quickly and by how much Iran could ramp up its production; it added around 1 mb/d within a year of the 2015 agreement.
- Still, there remains more than 2 mb/d of compensatory OPEC+ cuts that still need to be actioned before year-end. This is an obvious route for OPEC to relieve some of the pressure and explains why the group has been quite united and vocal in pushing offenders towards compensatory cuts and compliance. Further cuts to prop up prices are a possibility, but a slim one at this juncture, since there is considerable resistance to reverse course, especially from Russia.
- US oil production showed a sizeable w/w increase of 1.2 mb/d to 11.2 mb/d by 23 October, recovering after several weeks of stop-start activity due to bad weather, Output, using weekly data, is still down more than 15% from its peak in February, but oil rig counts have rebounded almost 29% since their August low to reach 221. (Chart 7.)

Chart 4: Regional medium/light sour crude OSPs

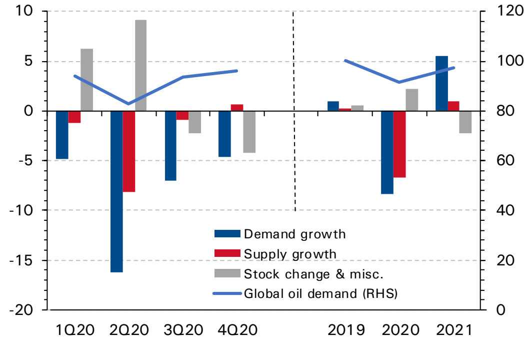
($/bbl vs. Platts Dubai/Oman benchmark for Asia deliveries)



Source: MEES

Chart 5: Oil demand/supply & stock change

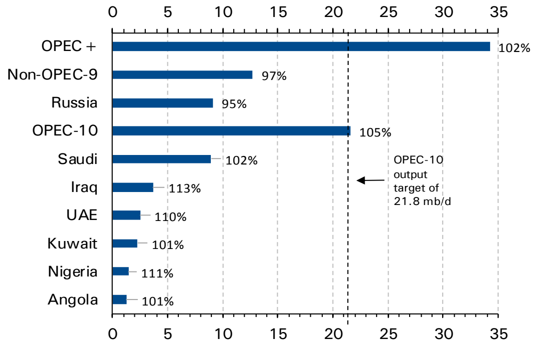
(mb/d)



Source: IEA, NBK estimates

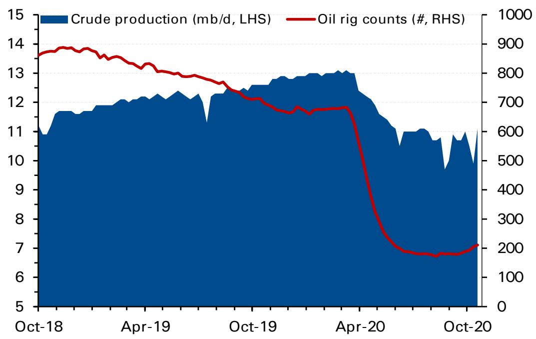
Chart 6: OPEC output and compliance in September

(mb/d, % compliance indicated above bars)



Source: OPEC, IEA

Chart 7: US oil production and rig counts



Source: EIA, Baker Hughes

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