جدوى للإستثمار
Jadwa Investment

July 2019

Quarterly Oil Market Update

Trade tensions continue to cloud outlook

Summary

- OPEC revealed a modest level of global oil demand growth for 2020, in its latest monthly oil report. According to the organization, next year will see growth of 1.14 million barrels per day (mbpd), which is exactly the same level of growth expected in full year 2019.

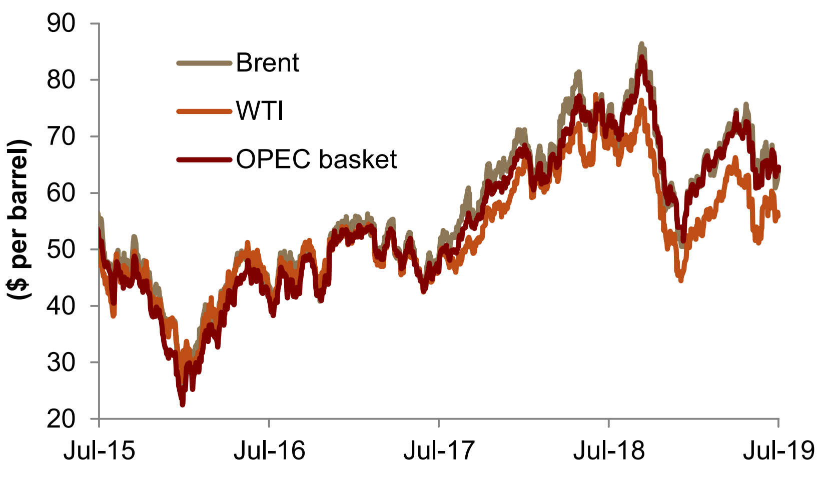
- Partly as a result of global trade tensions, OPEC now expects to see oil demand growth from US, China (and India) declining on a yearly basis in 2020. Whereas in 2019, the above three countries' contribution to yearly demand growth is expected to make up 67 percent of the total, this will decline to 56 percent in 2020.

- In a recent OPEC (and non-OPEC) meeting, an extension to the voluntary output reduction agreement was confirmed until March 2020. That said, based on current OPEC demand and non-OPEC supply forecasts to 2020, it is likely that another roll-over in output will be required until the end of next year, and that the level of agreed output may need to be even lower than prevailing levels.

- Meanwhile, Brent oil prices are trading just below the $65 per barrel (pb) mark at the moment, similar to levels seen during Q1 2019. Looking ahead, despite rising regional geo-political tensions, the main factor currently weighting on oil prices remains global trade related issues, and, more broadly, how such issues are clouding the outlook of the global economy.

- Overall, with a number of non-economic factors directly impacting the outlook on oil, and with Brent oil prices averaging $66 pb so far this year, we have left our forecast for 2019 and 2020 unchanged at $66 pb and $68 pb respectively.

Figure 1: Brent oil prices trading around $65 per barrel



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Oil demand growth remains subdued to 2020:

OPEC revealed a modest level of global oil demand growth for 2020, in its latest monthly oil report.

According to the organization, next year will see growth of 1.14 mbpd..

OPEC revealed a modest level of global oil demand growth for 2020, in its latest monthly oil report. According to the organization, next year will see growth of 1.14 million barrels per day (mbpd), which is exactly the same level of growth expected in full year 2019 (Figure 2). It is important to highlight that OPEC's forecast for next year assumes no further escalation in trade-related issues between China and US.

...which is exactly the same level of growth expected in full year 2019.

Despite a cessation of hostilities in the recent G20 meeting, no definitive breakthrough on trade between China and US has yet been made. At the same time, global manufacturing indices have recently hit multi-year lows, having been on a downward trend since early 2018, which, in turn, has pressured the oil market. In fact, oil prices have seen three consecutive monthly losses since April 2019 (see oil price outlook section below), in-line with renewed escalation in trade tensions. Market sentiment remains bearish over the impact of trade dispute on the global economy, the threat of which was underlined by the recent World Economic Outlook (WEO) report by the International Monetary Fund (IMF). In the July WEO update, the IMF trimmed global economic growth by 10 basis points for both 2019 and 2020, to 3.2 & 3.5 percent respectively, citing further trade tensions as the main risks to global growth.

Partly as a result of these trade tensions…

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Partly as a result of these trade tensions, OPEC now expects to see oil demand growth from US, China (and India) declining on a yearly basis in 2020. Whereas in 2019 as a whole, the above three countries' contribution to yearly demand growth is expected to make up 67 percent of the total, and this should decline to 56 percent in 2020. OPEC sees a recovery in demand in both Latin America and Middle East making up for lower growth in the three major consuming nations (Figure 3).

OPEC + output agreement in perpetuity?:

In a recent OPEC (and non-OPEC) meeting, an extension to the voluntary output reduction agreement was confirmed until March 2020.

OPEC crude oil production was down 7 percent year-on-year and 2 percent quarter-on-quarter in Q2 2019 as a moderation in output was maintained as per an agreement outlined late last year. Total oil output from the organization averaged 29.9 mbpd in Q2 2019, a sizable 3 mbpd (9 percent) lower than the October 2018 output which is used as a benchmark. In a recent OPEC (and non-OPEC)

Figure 2: No rise in yearly oil demand growth in 2020...

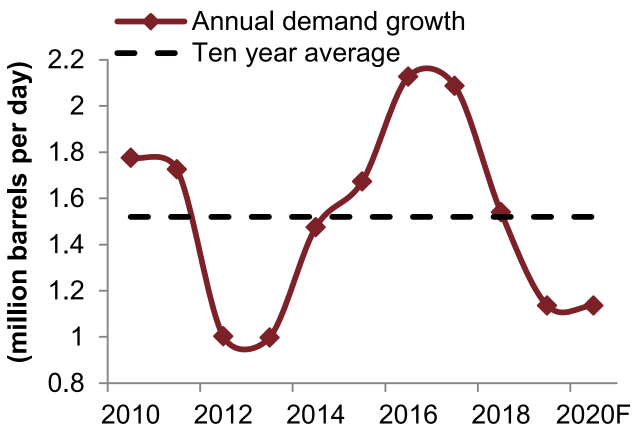
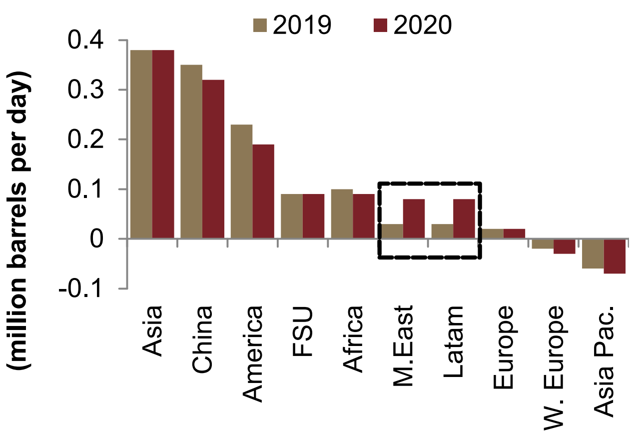


Figure 3:...but noticeable change in oil demand by country/region



Based on current OPEC demand and non-OPEC supply forecasts to 2020…

...not only will another roll-over be needed until the end of next year…

...but the level of agreed output may need to be even lower than current levels.

Of course, output challenges faced by certain OPEC members may negate the need for additional roll-over agreements.

According to EIA data, US crude oil production recently surpassed 12 mbpd, with 13 mbpd expected to be reached by early 2020.

The EIA expects Permian oil to contribute 72 percent to total yearly rises in US oil output in 2019, and 77 percent in 2020.

meeting, an extension to the voluntary output reduction agreement was confirmed until March 2020. That said, based on the latest OPEC demand and non-OPEC supply forecasts to 2020, not only will another roll-over be needed until the end of next year, but the level of agreed output may need to be even lower than current levels. When holding OPEC Q2 2019 output of 29.9 mbpd constant until end of 2020, and applying OPEC demand and non-OPEC supply forecasts, we can see oil markets, whilst being mildly in deficit during 2019 as a whole, move into surplus of 700 thousand barrels per day (tbpd) in 2020. As OPEC itself points out, demand for its crude oil (or the call on OPEC) is expected to average 29.3 mbpd in 2020 (Figure 4).

Of course, output challenges faced by certain OPEC members may negate the need for additional roll-over agreements. For example, Iranian output has declined by 500 tbpd since the start of the year, prior to re-implementation of US sanctions in May 2019, and it could sink further than the most recent 2.2 million barrels per day (mbpd) registered in June. Meanwhile, in Venezuela, a socio-economic and political crisis coupled with sanctions from the US has resulted in oil output plummeting to lows of 734 tbpd in June, equivalent to a 37 percent reduction since the start of the year (*please refer to our recently published Macroeconomic update for more details*).

Permian basin set to lift US oil to new heights:

According to the US Energy Information Administration's (EIA) data, US crude oil production recently surpassed 12 mbpd, with 13 mbpd expected to be reached by early 2020. The main source of rises in US output has been, and will continue to be, the Permian Basin (Figure 5). In fact, the EIA expects Permian oil to contribute 72 percent to total yearly rises in US oil output in 2019. Looking into 2020, the EIA expects total US oil output to rise by 910 tbpd or, 7 percent, year-on-year, to an average of 13.3 mbpd, with Permian expected to continue being the main proponent of this growth, at 77 percent of the total.

Oil price outlook:

Although Brent oil prices averaged $70 per barrel in Q2 2019, up 11 percent on a quarterly basis, this disguises the fact that prices have followed a downward trajectory since April, when US Chinese trade

Figure 4: Based on current OPEC forecasts and output, oil markets will move into surplus in 2020

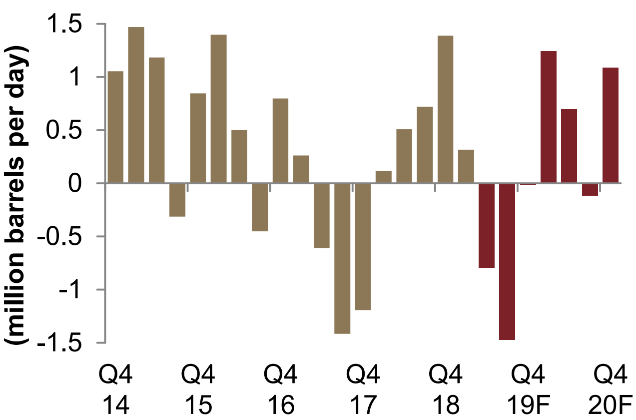
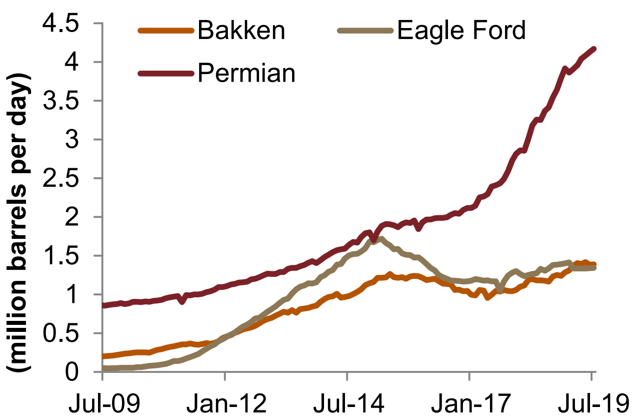


Figure 5: US oil output being driven by Permian basin



Currently, Brent oil prices are trading just below the $65 pb mark, around the same level seen during Q1 2019.

tensions resurfaced. What is even more surprising is that the combination of longer than expected roll-over in OPEC+ output agreement and mounting regional geopolitical tensions, with the recent seizure of a UK-flagged tanker by Iran, have not had a sustained impact on prices. On the contrary, despite temporary spikes in spot Brent prices, the overall trend has been downwards in the last few months (Figure 6).

Looking ahead, despite rising regional geo-political tensions…

...the main factor currently weighting on oil prices remains global trade related issues.

Currently, Brent oil prices are trading just below the $65 pb mark, around the same level seen during Q1 2019. Looking ahead, despite continued rising regional geo-political tensions, the main factor weighing in on oil prices at the moment remains global trade related issues, and, more broadly, how such issues are clouding the outlook of the global economy. Whilst a serious escalation in regional geo-politics could see a more sustained rise in Brent oil prices, this has to be balanced with the fact that there are still risks of an escalation in global trade tensions, which would have the opposite effect on prices.

All-in-all, at this moment in time, with a number of non-economic factors directly impacting the outlook on oil, and with the year-to-date Brent oil average price at $66 pb, we have left our forecast for 2019 and 2020 unchanged at $66 pb and $68 pb respectively (Figure 7).

Figure 6: Brent oil prices declining as regional geo-political tensions continue escalating

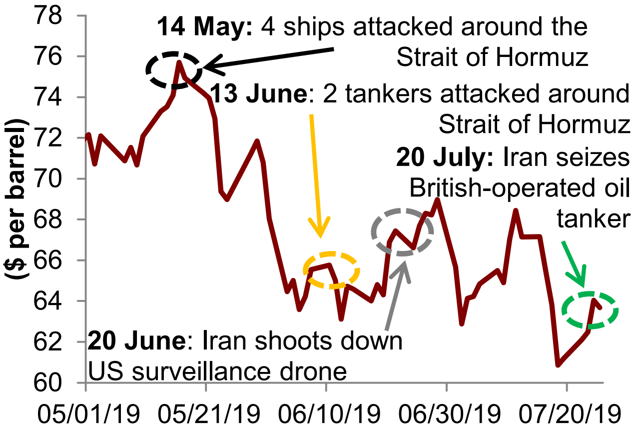
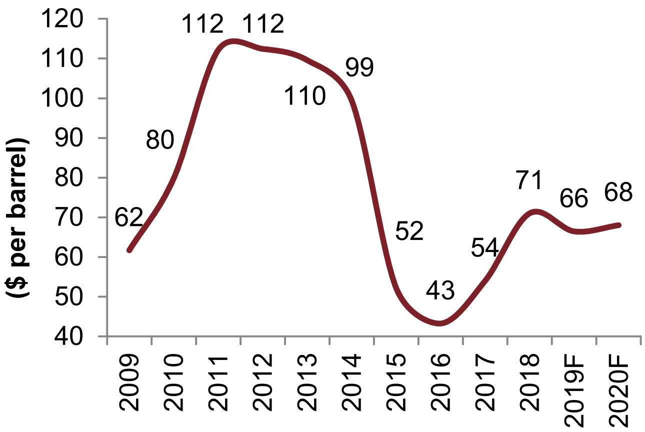


Figure 7: Jadwa's Brent oil price forecast



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