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Energy Monitor

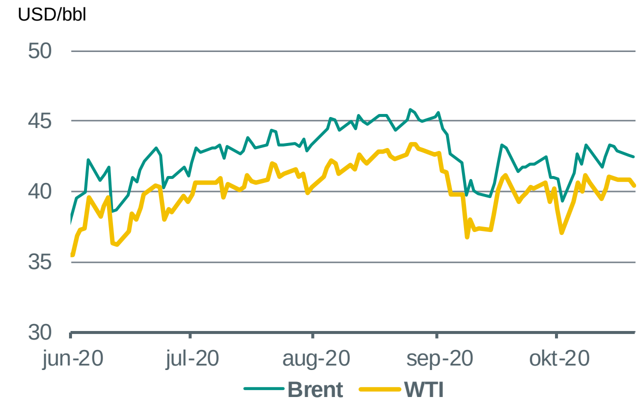
Hans van Cleef, Sr. Energy Economist
Tel: +31 (0)20 343 46 79 / hans.van.cleef@nl.abnamro.com

Silence before the storm

- **Oil prices have been understandably volatile this year…**
- **…although, the prices have still moved with a narrow trading range**
- **The US elections and OPEC+ are the two key "storm" events for the remainder of this year**
- **Gas prices have risen sharply, but the upward price potential is easing**

Oil prices are caught between several conflicting market drivers
Oil prices have shown significant price movements on a daily basis this year. On one side; price gains have arisen at times based on; hopes for economic recovery, stimulus package discussions from central banks and governments, and declining stocks in the US. Meanwhile, during this period, on the other side, periods of price decreases have also arisen on fears of the economic impact of new (partial) lockdowns to combat the COVID-19 virus and, for example, reports of increasing oil production in Libya. Nevertheless, despite these clearly diverging narratives, if we zoom out and look at a graph showing the longer term price trend, it appears that oil prices have actually been moving in a relatively narrow trading range for months already.

Oil prices: volatile but range bound



Source: Bloomberg

At the moment, there is little that seems to change this playing field for the oil market. However, two crucial events – namely the US elections on 3 November as well as the OPEC+ meeting at the end of November – may cause the oil market to move significantly in the coming weeks. These two "storm" events could cause the oil price move out of its recent sideways range.

A Biden win could cause shifts in the energy markets

If Joe Biden wins the American elections as we assume in our base case scenario, see here, this could lead to major shifts in the energy market on both the supply and demand sides. The demand for oil could be negatively affected by his planned investments in making the energy mix more sustainable. Energy efficiency and greater use of electric vehicles will reduce the demand for oil in the US. Although the actual transition will take years to complete, current investments may already accelerate the developments we are seeing in some states.

In addition, a Biden administration will issue fewer permits for shale oil and gas production, especially on federal land (both onshore and offshore). Less local production - or less growth - will again increase the import dependency of the US. Biden will also pursue a different policy towards Iran (renegotiating a nuclear deal that will go hand in hand with lowering sanctions against Iran), and reconsider relations with Russia, Iraq, Saudi Arabia and Mexico, among others. As these are all oil-producing countries, this could have an impact on the oil trade, and therefore on oil prices.

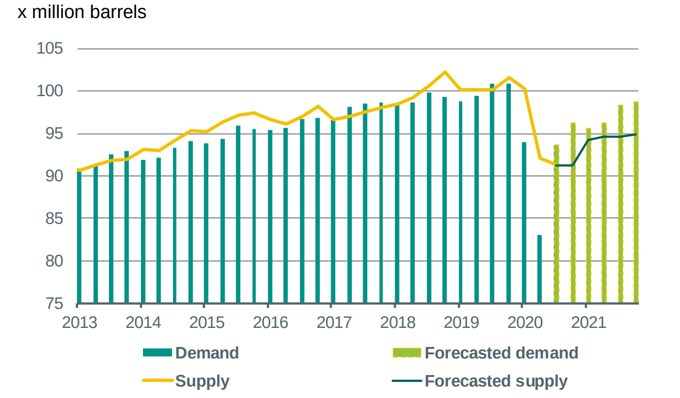
In terms of timing, as stated the US elections are on 3 November. However, the final results may take somewhat longer, depending on how close the preliminary results are. Any period of uncertainty about the results could trigger negative sentiment among investors, something that could also affect oil prices. For more information on our scenarios for the elections here.

OPEC+ faces a tough dilemma

Earlier this week, the OPEC Technical Committee's regular consultations with partners led by Russia (OPEC+) took place. These monthly consultations are used to evaluate the market and to see if they need to advise the OPEC+ policy makers to adjust their production levels. No advice to adjust policy has been given this time. The committee did, however, indicate that it will be proactive in preventing a further fall in oil prices if demand picks up less than expected or even declines further. As such, OPEC (or OPEC+) is indeed prepared to act if oil prices fall, which acts as a support for oil price dynamics.

At the same time, another interesting issue was highlighted. Russian Energy Minister Novak indicated that investments in upstream activities are currently some 18-20% lower than in 2019. In doing so, he hinted at possible supply problems in the longer term. If investments remain too low, at some point this will result in shortages and thus higher oil prices. Based on this announcement, oil prices hardly reacted because the current market is focused on the short-term issue of oversupply triggered by weak demand.

IEA: Expected supply and demand; small differences



Source: IEA

The technical committee will meet again on 17 November. The outcome of that consultation will be seen as decisive for the advice to be given to the OPEC and OPEC+ on 30 November and 1 December respectively. According to the existing production agreement between the oil producers, the current production limitation of 7.7 million barrels per day (mv/d) would be reduced from January to 'only' 5.8 mv/d until April 2022. However, a slower recovery in oil demand and Libya's ability to resume production and exports together lead to a higher than expected supply of oil on the market and a slower reduction in stocks. This is already leading to possible price pressure. An additional boost of oil production of 1.9 mv/d from January could put further pressure on oil prices.

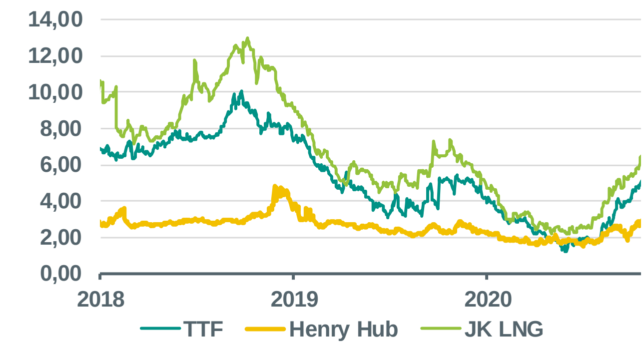
As a result, the OPEC+ coalition faces a difficult dilemma. The question that needs to be answered by OPEC+ is whether production should be increased - or better, less reduced - now that the demand for oil falls under additional pressure and crude inventories are still considerably high. And if there is no increase in production, whether each member will be given an equal percentage of this 'additional' reduction in production, as is currently the case. It seems to be becoming increasingly difficult for two reasons. Firstly, in order to get all members at the same page and to make everyone bear their fair share of the reduction in production; and secondly, at a time when the effects of low oil prices are increasingly being felt by the oil-producing countries. Producing less will lead to higher oil prices but, on balance, not necessarily higher net profits. Many OPEC+ countries are facing lower revenues and higher expenditures to 1) support the economy to absorb the impact of COVID-19, and 2) invest in the energy transition to diversify their economies. It is therefore not surprising that there are oil producing countries that, because of the pressure not to overburden the fiscal budget, do not want to reduce oil production, but rather increase it. OPEC and its partners have some tough discussions ahead of them. The direction of oil prices largely depends on the outcome of these discussions. The high volatility will persist for a while, while the oil price will at most be able to rise slightly.

Gas prices have risen sharply

All gas prices have risen sharply in recent weeks. The prices of LNG in Asia (Japan/Korea LNG) and those of Title Transfer Facility (TTF, the Netherlands) and Henry Hub (US) all quoted higher which is usual during this season. However, the build-up of stocks seems to be coming to an end now that winter - i.e. the heating season - is approaching. Other external factors, such as severe weather conditions like hurricanes in the Gulf of Mexico, are putting some pressure on production and this also provides upward support for gas prices. At the same time, we see (right-hand graph) that the prices of the monthly contract show a stronger movement than the annual contract. In other words, the seasonal pattern is more pronounced in the monthly contract. As a result, the price of TTF gas with delivery in November is higher than that of TTF gas with delivery in 2021.

Gas prices on the rise

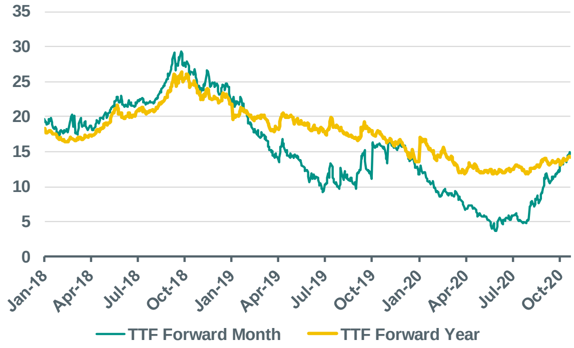
x USD/mmBtu



Source: Bloomberg

TTF: Cal 21 versus November 20

EUR/MWh



Source: Bloomberg

Seasonal patterns hint at a possible price drop

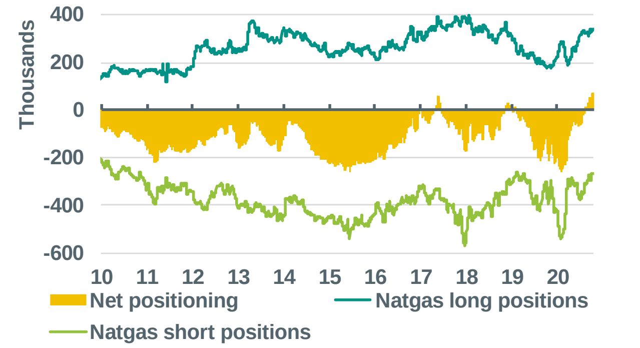
The Henry Hub gas price almost always rises towards November. The fact that market speculators currently have a net long position (speculating on price increases) makes us wary. As can be seen in the right graph below, the market is rarely net-long. It is therefore a matter of time for these speculators to take a profit after the recent strong price rises and build up new short positions (speculating on price decreases). These market positions in combination with the traditional price spike around this time of year means that a drop in gas prices for the monthly contract is lurking.

However, if the current signals are already being used to switch positions, a speculator can get on the wrong footing if a period of harsh weather unexpectedly passes the US and indicate that the long positions are sold too early. The price chart of Henry Hub (bottom left) shows that there is often a peak when there is a period of extreme cold. Such a period usually lasts 1-3 weeks and is accompanied by a high consumption of gas. This can take place between November and February. Therefore we recommend to remain cautious.

Henry Hub: price spikes during extreme cold

Source: Bloomberg

Speculative positioning Henry Hub



Source: Bloomberg

Forecasts oil and gas prices

End of period		21-okt	dec-20	mrt-21	jun-21	sep-21	dec-21	mrt-22	jun-22	sep-22	dec-22
Brent *	USD/bbl	*42,61*	45	50	45	45	50	55	55	55	55
WTI *	USD/bbl	*41,13*	40	45	42	41	45	50	50	50	50
Natural Gas (HH) *	USD/mmBtu	*2,96*	2,00	2,10	2,00	2,00	2,30	2,50	2,20	2,30	2,50
TTF *	EUR/MWh	*14,20*	15	15	14	15	17	18	17	18	18

Average		2019	Q4 20	2020	Q1 21	Q2 21	Q3 21	Q4 21	2021	Q1 22	Q2 22	Q3 22	2022
Brent	USD/bbl	64,17	40	40	48	48	45	48	47	53	55	55	55
WTI	USD/bbl	57,00	36	37	43	44	42	43	43	48	50	50	50
Natural Gas (HH)	USD/mmBtu	2,53	2,00	1,90	2,10	2,10	2,00	2,20	2,10	2,40	2,40	2,30	2,40
TTF	EUR/MWh	14,55	15	14	15	15	15	16	15	18	18	18	18

* Brent, WTI and Henry Hub: active month contract; TTF: next calendar year