ABN·AMRO

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Energy Monitor

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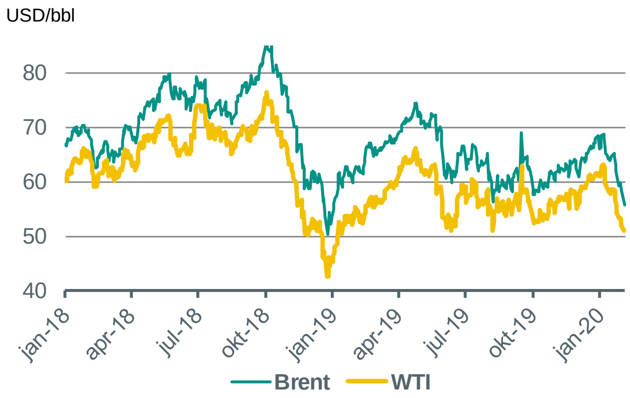
Oil prices under pressure due to coronavirus

- **The coronavirus will possibly lead to less demand for oil, especially from China**
- **OPEC+ may be willing to balance the market again, but is unlikely to overreact**
- **ABN AMRO oil price forecasts unchanged**

Under the spell of the coronavirus outbreak

Since the world first heard of the coronavirus in December 2019, the consequences for the oil market have become increasingly visible. The new coronavirus is still mainly concentrated in China, and mainly around the Wuhan region. Yet people have already been infected with this virus in 25 different countries. To prevent further spreading of the virus, China has closed several cities, limited flights to and from China, and has even completely shut down some regions. Hong Kong and Macau are also considering far-reaching measures. However, it is important to remain cautious about making assumptions. After all, it is unclear how quickly the virus will continue to spread given the Chinese authorities are taking rigorous measures to prevent transmission as much as possible.

Brent and WTI oil price developments



Source: Bloomberg

A comparison with the SARS virus – justified or not?

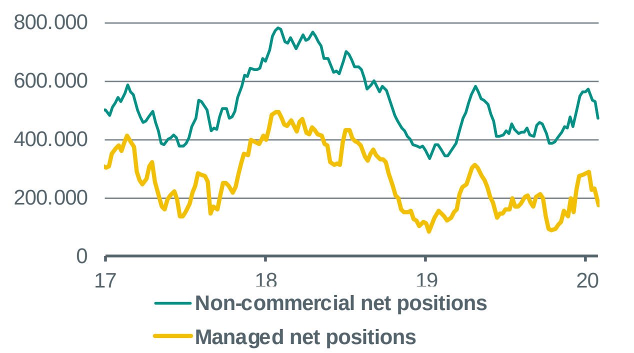
Making a comparison between the current coronavirus and SARS – a predecessor to this – may seem to be logical. The consequences of the SARS virus for the economy and the demand for oil appeared to be limited to a few months of less economic growth and less demand for oil. The negative effect was largely compensated for by catch-up demand and therefore additional economic growth in the period thereafter. The spread of the SARS virus was less rapid in 2003 than the current virus though.

There are some other reasons why such a comparison is not fully justified. Firstly, financial markets – including the commodities market – are now driven much more by market speculation than in 2003. Fear and hope not only set the tone, but also determine a large part of the direction of the financial – and thus oil – markets. There is a considerable risk that speculators can overestimate a situation, and that the price falls too far too fast. A second significant difference with SARS is that the number of Chinese traveling is now many times greater than in 2003. This increases the chance of a more rapid and far-reaching spread of the coronavirus than with SARS in 2003. But the most important and third reason is that the Chinese economy itself has become a larger part of the global economy now than in 2003. Negative consequences for the Chinese economy can therefore have greater consequences for oil demand today. Please find the earlier analysis of our macro economists regarding the coronavirus and its impact on the economy here.

Possibly lower demand for oil has a depressing price effect

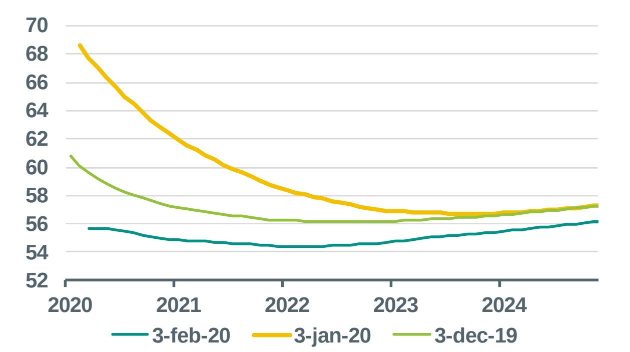
Oil prices have been under considerable pressure in recent weeks. The Brent oil price – active monthly contract – has fallen to USD 54/barrel (from USD 68/bbl early January) and WTI even fell below USD 50/barrel. Although the coronavirus consequences are still difficult to estimate, market speculators have reduced their long positions (speculation on price rises), and short positions (speculation on further price falls) have increased. As a result, the net position of the outstanding contracts has also decreased to a neutral position (see left-hand chart).

Non-commercial net long positions



Source: Bloomberg

Brent oil forward curve



Source: Bloomberg

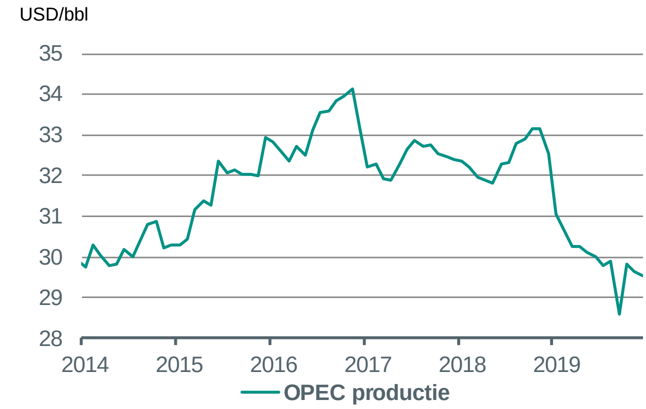
In the forward curve (series of current prices for future delivery – right-hand graph) we have seen considerable shifts in recent weeks. Particularly at the front of the curve, prices have risen since the beginning of December due to the turmoil in the Middle East. After that, the oil price fell sharply after the unrest calmed, in combination with the current uncertainty regarding expected demand from China.

The difference between the tensions in the Middle East and the possible consequences of the coronavirus can be seen mainly at the end of the forward curve. The tensions in the Middle East following the attack on Iranian General Soleimani at Baghdad Airport in Iraq had a particular impact on the front of the curve. With the coronavirus we see a negative effect on the entire forward curve. There are various reasons for this. Firstly, the attack in Iraq has led to uncertainties regarding the supply of oil. For the time being, the coronavirus mainly leads to (a temporary) failure of the demand for oil. The supply of oil has been ample for some time and, despite frantic attempts, OPEC has not been able to keep the oil price structurally high. The effect of a decrease in demand seems to be greater than that of possible disruptions in production, because the latter exacerbates the existing "problem" of oversupply.

OPEC has to get back to work

Nonetheless, market parties are looking again at OPEC and its partners (led by Russia) to see if the efforts to reduce production and thereby support the price should be stepped up. The OPEC+ technical committee is meeting this week to research all the options. The official extraordinary meeting of OPEC is scheduled for 5-6 March. During that consultation, the current production reduction agreement of a total of 2.1 million barrels per day will be evaluated. This agreement expires at the end of March. The options for a similar or an even larger production cut for a longer period (possibly until the end of 2020) are still open. Market talks suggest that OPEC must even bring its meeting forward to respond to the current situation. An even larger and faster production reduction to balance the market is therefore possible.

OPEC crude production



Source: Bloomberg

We wonder whether it would be wise for OPEC to already respond to potentially lower oil demand with an additional production reduction. Such an emergency measure of even further production reductions could be counterproductive should the situation for the oil market turn out not to be as bad as feared now. And since we do not yet know how big the impact is on demand for oil from China (and how temporary that effect is), such a measure looks premature. The first consequences are now seen in a decrease in the demand for oil-related products such as gasoline and kerosene, but the extent to which this affects the import of oil is not yet clear. There is also a real possibility that the effect of such an OPEC decision to further reduce production will be ineffective in raising oil prices. It would put further pressure on the already falling market share of OPEC. The OPEC crude production has already been temporarily lower in recent weeks due to production disruptions in Libya. A further extension of the current production agreement is wise. That could be announced during the planned meeting in March, but an earlier confirmation of an extension may also have a calming effect on the market. The current signals from OPEC can therefore, in our opinion, also be seen as a form of verbal intervention, in the hope of laying a floor below the oil price without actually further limiting production.

ABN AMRO price forecasts unchanged for now

It is still too early to estimate the precise impact of the coronavirus on oil markets. The demand for oil-related products in China is under pressure. This mainly concerns oil products like gasoline and kerosene. A lesson from the past is that a temporary fall in the demand for oil can be compensated for by a catch-up later in the year. In our baseline scenario (set on 12 December), we have already factored in a fall in demand for oil in a well-supplied market. The current price fall therefore fits in with the outlined picture, but only comes a little earlier than we had anticipated in December. We therefore see no need to adjust our price estimates at this time. We do see further downside risks in the short term. These downward price risks compared to our baseline scenario are mainly seen in a faster and wider spread of the virus that leads to a strong impact on the Chinese and therefore global economy. The demand for oil could then grow less in 2020 than previously expected.

We see possible upward price risks if the virus comes under control earlier than expected and the negative consequences turn out to be overestimated. Another possibility is that OPEC intervenes more strongly than expected in the supply of oil to compensate for the lower demand for oil.

Forecasts oil and gas prices

End of period		4-feb	mrt-20	jun-20	sep-20	dec-20	mrt-21	jun-21	sep-21	dec-21	mrt-22	jun-22	sep-22
Brent	USD/bbl	*55,77*	60	55	55	60	60	60	65	65	60	65	65
WTI	USD/bbl	*51,13*	55	50	50	55	55	55	60	60	55	60	60
Natural Gas (HH)	USD/mmBtu	*1,85*	2,50	2,25	2,25	2,75	2,50	2,50	2,50	2,75	2,50	2,50	2,50
TTF	EUR/MWh	*9,32*	13	13	14	15	15	14	15	17	18	17	18
Average		**2019**	**Q1 20**	**Q2 20**	**Q3 20**	**Q4 20**	**2020**	**Q1 21**	**Q2 21**	**Q3 21**	**Q4 21**	**2021**	**2022**
Brent	USD/bbl	64,17	63	58	55	58	58	60	60	63	65	63	65
WTI	USD/bbl	57,00	58	53	53	50	53	55	55	58	60	58	60
Natural Gas (HH)	USD/mmBtu	2,53	2,25	2,50	2,25	2,50	2,40	2,75	2,50	2,50	2,75	2,60	2,60
TTF	EUR/MWh	14,55	12	13	14	15	14	15	15	15	16	15	19