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Energy Monitor

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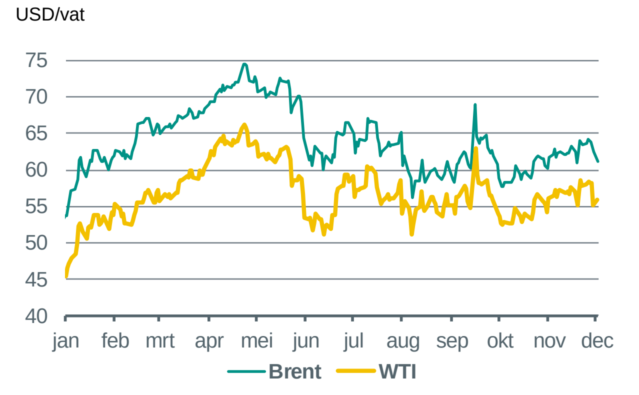
OPEC fails to convince

- **OPEC has formalised its policy, but the action by Saudi Arabia was needed to surprise markets**
- **Oversupply to remain, mainly because of weakening oil demand**
- **Oil price forecasts 2020 and 2021 revised lower**

Last week, the OPEC has decided, together with her partners (combined OPEC+), to increase its production cut agreement. The existing agreement to lower crude production by 1.2 million barrels per day (mb/d) was raised with another 503 kb/d to a total of 1.703 mb/d. In March 2020, the OPEC+ will re-evaluate the market situation. The biggest share of the increase will be handled by OPEC members (372 kb/d) while the rest of the production will be lowered by the non-OPEC oil producers (131 kb/d). This headline seems to be good news for oil market and oil prices. Lower production to stabilize the oil markets should lead to a balance between global supply and global demand. As a result , oil prices should be supported. However, there are two important dynamics to keep in mind.

Brent and WTI oil prices



Source: Bloomberg

In the first place, OPEC already produced significantly less than originally agreed. Especially Saudi Arabia lowered its production by an extra 400 kb/d to give support to oil prices. The IPO of Saudi Aramco seems to be an important factor. With the announcement of an extra 503/b production cut, the OPEC now formalised the policy it unofficially adopted already months ago. But all member countries will have to comply more strictly than they have done so far.

Despite this announcement, the actual news was only revealed after the OPEC+ meeting. The new Energy Minister of Saudi Arabia Prince Abdulaziz bin Salman promised that the kingdom will continue to over-comply by another 400 kb/d.

In other words: as Saudi Arabia will lower its production by an extra 400 kb/d, on top of its new official quota, the net production cut agreement was increased to 2.1 mb/d compared to 1.7mb/d. The official quota for Saudi Arabia was lowered from 10.331 kb/d to 10.164 kb/d and the voluntary production cut of 400 kb/p would bring this to levels slightly above 9.7 mb/d. All in all, Saudi Arabia will produce almost 900 kb/d less in 2020 than before the initial production agreement. The recent gains of the oil prices are the direct result of Saudi energy policy, rather than OPEC's.

The second remarkable point is that the OPEC+ alliance was not able to officially succeed in lowering production together. This is because of the differences of opinion and the lack of unity within the organisation. In recent months, there was almost no single producer who kept to the agreement. Some produced too much (such as Iraq) or another country less such as Saudi Arabia. As a result, the need to signal unity will become stronger. However, the last-minute cancellation of the originally scheduled OPEC meeting on Thursday in order to wait for the OPEC+ meeting on Friday shows vulnerability. After all, it indicates that OPEC needed to wait for Russia to approve its policy. Also the extra needed single action taken by Saudi Arabia can be seen as a sign of weakness. The inability to cope accurately with the new market situation, which emerged after the strong growth of shale oil in the US and the changing political stance of the US towards the Middle East, indicate that the position of the OPEC apparently is getting weaker.

Abundant supply to remain

As described above, global supply will be 2.1 mb/d less than would be possible during the coming months. Nevertheless, this is not the complete picture. After all, crude oil production in Venezuela and Iran also dropped significantly in recent months due to the US sanctions. And although both countries are OPEC-members, these production declines are not part of the production cut agreement.

The growth inf oil production in non-OPEC related countries is larger than the net production cut agreement of the OPEC+ alliance. Especially in the US, but also in Norway, Canada, Mexico and Brazil, oil production is growing. In the US we do see a decline in the number of active drilling rigs. A part of the production growth comes from earlier drilled-but-uncompleted-wells. The International Energy Agency (IEA) expects that non-OPEC production will grow even faster in 2020 (by +2.3 mb/d) than in 2019 (+1.8 mb/d). If these forecasts materialize, the announced OPEC policy will not lead to a tightening of the global supply-and-demand balance.

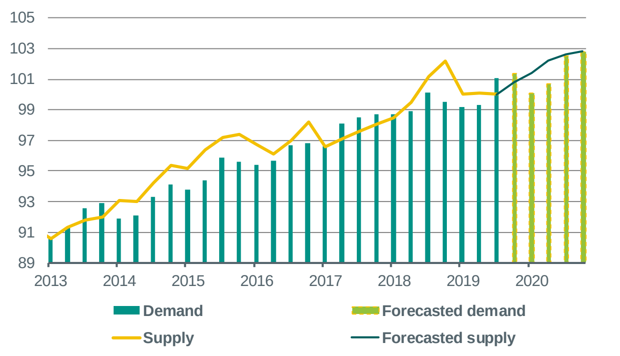
Demand may fall under pressure

A larger supply of oil will not automatically have to lead to lower oil prices as long as oil demand will increase in a similar pace. However, this may not be the case. The IEA expects a net global growth of demand of 1.2 mb/d in 2020 (versus +1.0 mb/d in 2019). This scenario takes into account moderate global economic growth. This is in line with our own forecasts. Furthermore, the IEA scenario takes into account a stable increase of oil demand by China. This is where we disagree.

In 2019, Chinese oil imports has grown again by more than 10% y-o-y. Chinese oil demand for consumption will, similar to last year, grow further in 2020. The build-up and policy of Chinese strategic reserves will however cloud the horizon . Although China never releases exact data regarding its strategic reserves, there are indications that The build-up of these reserves will come to an halt. China imports around 10.5 mb/d. On top of that, China produces 3.8 mb/d.If we subtract the total demand from Chinese refineries from the total imports and local production, there is roughly 800 kb/d which can be used to build strategic reserves. Recently, the National Energy Administration indicated that it is well on track to reach the by the IEA advised 90 days of strategic reserves. When this level will be reached is unclear. Nevertheless, this is an important risk for the oil markets. After all, when the Chinese crude demand drops with 800 kb/d and 'only' imports 9.7 mb/d to meet demand for consumption, global oversupply will increase even further.

Global supply and demand of oil

x million barrels per day



Source: IEA

Downward adjustment oil price forecasts

The expected oversupply in the first and second quarter of 2020 will possibly be somewhat smaller than anticipated earlier. The OPEC+ policy as well as the extra action taken by Saudi Arabia to cut the production with an extra 400 kb/d will bring the market closer to a balance. Nevertheless, as we think that oil supply from non-OPEC countries will rise even stronger. As a result, total supply will remain ample. On top of that, we see that oil demand growth stays under pressure. Not only modest global economic growth but also the risk of less crude imports by China on behalf of strategic reserves, could lead to increased pressure on crude demand.

The market is neutral positioned. This means that there are no specific positions taken to benefit from either price gains of price declines. This will thus not trigger a lot of direction for oil prices. On top of that , the forward curve is rather flat. Technical analysis learns us that we are already trading within a neutral USD 50-70 bbl trading range since the start of the year. Initially, we expected oil prices to gain some support towards the upper band of this trading range. Currently we judge that downside price risks have been risen. We think that it is more likely that we will continue to trade at the lower side of the trading range. As a result, we have lowered our price forecasts for the second half of 2020 and 2021. Please see the table below for our new forecasts.

Forecasts oil and gas prices

End of period		**11-dec**	**mrt-20**	**jun-20**	**sep-20**	**dec-20**	**mrt-21**	**jun-21**	**sep-21**	**dec-21**
Brent	USD/bbl	*63,98*	60	55	55	60	60	60	65	65
WTI	USD/bbl	*58,92*	55	50	50	55	55	55	60	60
Natural Gas (HH)	USD/mmBtu	*2,28*	2,50	2,25	2,25	2,75	2,50	2,50	2,50	2,75
TTF	EUR/MWh	*14,50*	17	18	20	23	19	21	23	25

Average		**2019**	**Q1 20**	**Q2 20**	**Q3 20**	**Q4 20**	**2020**	**Q1 21**	**Q2 21**	**Q3 21**	**Q4 21**	**2021**
Brent	USD/bbl	64	60	58	55	58	58	60	60	63	65	63
WTI	USD/bbl	58	55	53	53	50	53	55	55	58	60	58
Natural Gas (HH)	USD/mmBtu	2,50	2,75	2,50	2,25	2,50	2,50	2,75	2,50	2,50	2,75	2,50
TTF	EUR/MWh	17	19	18	19	22	20	21	20	22	24	22