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Flash Note: 15/04/2020

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Oil price finished down 10.3% yesterday. Why?

Oil price finished down 10.3% yesterday, mainly because of one reason: The agreement reached by OPEC + seems insufficient to prompt a recovery in the price of crude this year.

Others may argue that the price drop is due to other reasons such as: 1) Reports that Saudi Arabia continues to flood the market with oil ahead of the new production cut agreement. This trend will continue until the agreement enters into force on May. 2) In the US, the API weekly showed a crude build of 13.14M barrels. 3) While main producers are flooding the market with oil, the lack of global storage continues to be a key theme, as facilities to storage surplus will be exhausted as early as June. 4) From the demand side, the IEA projected crude demand will drop in April by around 29% of the world's total daily consumption (some 29M bpd during the lockdown). Levels not seen since 1995.

Actually, the only reason for the sharp drop is the first one: The OPEC+ agreement is insufficient. Let me explain it to you

It seems impossible to forecast anything in this environment. Unfortunately, this is the awkward task that I have to face. To answer the question of whether the price of crude oil will stabilize and then rise again after the OPEC+ cut a deal, we must understand whether the agreement is sufficient. Which means that we need to know first how oil demand will perform for the ret of the year. To this end I will carry out a brief exercise:

1. ***Demand side:*** The experts in the International Energy Agency (IEA) have just said in its monthly oil report that global oil demand is expected to fall by a record 9.3M bpd this year. Knowing that projections are for April demand to fall by 29M bpd, then to reach the annual aggregate figure of 9 million less barrels per day, it is necessary that May also have a drop similar to that of April, and June have a drop of about 10Mbpd. **This would leave me with a total FY2020 oil global demand of 33.3 billion barrels (or 91 mbpd),** which would correspond to that drop that the IEA predicts.

2. ***Supply side:*** Producers have been producing in excess (around 1-2 mbpd). If 100 mbpd is consumed globally, it means that they have been producing between 101-102 mbpd during the January-April period. The agreement establishes a cut of 10 mbpd during May and June and 8mbpd between July and December. **This means a FY2020 production of 34.3 billion barrels (or 95 mbpd).** A figure that continues to be clearly above the FY demand (projected by the IEA), in more than 4 mbpd (see the table below)

In summary.

1. The agreement reached by OPEC + **seems insufficient** to prompt a recovery in the price of crude this year.

2. To reach a global output compatible with the projected -9 mbpd fall in annual demand it would be necessary the OPEC+ to reach the following agreement:

    a. For the May-June period: **15 mbpd output cut** (well above the 10 mbps agreed)
    b. For the July-December period: **13 mbpd output cut** (well above the 8 mbps agreed).

Month	Demand Milion barrels / month	Supply Milion barrels / month	OPEC+ cut (mbpd)
1	3000	3030	
2	3000	3030	
3	2400	3030	
4	2100	3030	
5	2100	2730	10
6	2700	2730	10
7	3000	2790	8
8	3000	2790	8
9	3000	2790	8
10	3000	2790	8
11	3000	2790	8
12	3000	2790	8
	33300	**34320**	8
mbpd (year)	91,23	95	
Excess supply (per day)		**4,10**	

Source: Andbank, OPEC, IEA

Saudi oil to continue to flood market until output pact begins: Bloomberg reported that Saudi Arabia's crude exports in the first two weeks of April were around 9.3M bpd, up from 6.8M bpd in the same period in March. Saudi Aramco pledged to boost output to 12.3M bpd in April following the collapse of the OPEC+ agreement last month, with no signs that Saudi Arabia will close the taps before May. Saudi Arabia agreed to trim production to 8.5M bpd in May and June as part of this past weekend's new OPEC+ agreement.

Producers pin hopes on emergency stockpiles, but coordinated purchases never attempted: Reuters noted that the OPEC+ output cut agreement is set to depend partly on purchases by consumer countries for their strategic stockpiles on a scale not before seen. However, the IEA, which requires its 30 members to hold strategic petroleum reserves equivalent to at least 90 days of net oil imports, has never before mandated its members to make coordinated stock purchases. Sources said that the decision is completely down to individual countries, and that there isn't a mandate member nations must buy more when they are already at the required 90 days worth of oil demand. The article noted that there are around 200M barrels of global storage available, though some analysts pointed out that purchases would require funds at a time when there are far larger economic problems.

Managers close out shorts ahead of OPEC+ agreement: Hedge funds and other managers increased purchases of crude in the week ended 7-Apr. Reuters noted that managers made net purchases of 47M barrels of Brent and 4M barrels of WTI. Net purchases across the six most important futures and options contracts were the largest since Christmas, though managers bought back 42M barrels of previous short positions, compared to adding 10M barrels of fresh longs. The shift pushed total short positions to 309M barrels, down from a peak of 365M on 10-Mar.

United States:

Texas regulators consider constraining output in the top oil-producing state: WSJ reported that Texas regulators debated on Tuesday whether to curtail oil output in the state in response to the coronavirus-driven drop in demand. However, the industry was divided over taking such a step, with some arguing that the industry could disappear if it is not regulated long-term, while others noted that supply-and-demand imbalances will always occur and that such a move would toss aside free-market principles. The article noted that the Texas Railroad Commission last decided to limit production in the 1970s, and while US antitrust laws limit the federal government's ability to curtail oil production, Texas' commission can do so independently when production exceeds market demand.