VANDA insights

Energy markets & beyond.

BULLS & BEARS

Sentiment on Oil

24 June 2020

Next few weeks: **MILDLY BULLISH**

BULLISH

OPEC+ cuts crunching supply

OPEC/non-OPEC output cuts of 9.7 mil b/d got off to a strong start in May, with overall conformity pegged at 87%. Saudi Arabia, UAE, Kuwait and Oman are together cutting an additional 1.2 mil b/d in June. Russia delivered high compliance with its 2.5 mil b/d of pledged cut in May. Globally, oil in floating storage was down to 259 mil bbl by mid-Jun from a peak of 291 mil bbl on May 20, according to Vortexa. US EIA expects global demand to surpass supply by 1.9 mil b/d in Jun.

BULLISH

North American output slump

US crude production is sliding since Apr. Shale output is thought to have slumped by 810,000 b/d in May versus Apr. Canadian output has tumbled by around 1 mil b/d.

BULLISH

Reopening supports demand revival

Sentiment is being supported by signs of oil demand recovery gaining momentum in Jun after economies across Asia, Europe and the US began reopening in May. Though oil came under selling pressure in the week of Jun 8 from fear of a "second wave" of the pandemic, the market regained confidence seeing that a rise in cases was not prompting a reversion to widespread restrictions and economic shutdowns.

SUPPORTIVE

Failed Libyan restart; more curbs on Venezuela

Libya's efforts to restart the 300,000 b/d Sharara oil field after a multilateral peace deal on Jun 7 failed as civil strife continues. Meanwhile, there is a further squeeze on Venezuelan crude exports after the US this month blacklisted oil tankers, companies and individuals involved in transporting the Latin American country's oil.

MILDLY BEARISH

Rising infection levels in recent weeks

New daily cases of infection have been rising in the US and Brazil, while China and Germany have seen fresh outbreaks. Though the oil market has set aside worries over renewed lockdowns and another demand slump, this element is keeping bullish sentiment in check.

BEARISH

Initial burst of pent-up demand won't sustain

A bullish turn to sentiment since end-Apr, which lifted crude to three-and-a-half-month highs on Jun 22, was helped by a faster-than-expected rebound in demand. The start of OPEC+ output cuts on May 1 was also a major factor. But the demand recovery from here on could be much slower, as economies will need time to trudge out of a sudden recession. Economic activity is not expected to normalise until a vaccine or cure is found, which could take 12-18 months. Once the pent-up demand from the Apr/May lockdowns is exhausted, consumers may tighten their purse strings and retail spending may go into a slump. There will be belt-tightening in the corporate sector too. Air travel, holidays and leisure activities are expected to remain subdued for a long time, keeping a lid on oil demand.

3-6 months: **MILDLY BULLISH**

BULLISH

OPEC+ to maintain deep cuts through July

OPEC+ agreed on Jun 6 to extend its deep cuts by a month through July instead of tapering them to 7.7 mil b/d as envisaged earlier, which translates to a bullish start to Q3. There is also stricter enforcement of quotas this time around. Over-producers such Nigeria, Iraq and Kazakhstan are expected to make deeper cuts in Q3 to compensate for excess output in May-June.

MILDLY BULLISH

OPEC+ supply curbs likely to continue after Jul

OPEC and its allies are expected to continue output curbs beyond July, but given an expected tapering to 7.7 mil b/d or lower, we see this as only mildly bullish. We expect continued strict enforcement of discipline. Russia has been signalling a dovish tilt again in recent days and may be content with $40-50/bbl crude.

SUPPORTIVE

Oil demand likely to rise through H2

Assuming a slow but steady resumption of more economic activity, global oil demand would continue rising through H2 2020. This expectation is already priced in, plus some of the growth will be offset by a rise in OPEC+ and US output, so we regard this as price-supportive rather than an outright bullish factor.

NEUTRAL

US production likely to stabilise

Shale output is likely to stabilise through Q3, coming out of the price shock of Q2. Some of the wells shut in over Apr and May will be back online in Q3. But deep capex cuts and paltry new drilling will keep output on a downward slope, though not as steep as in Q2. On balance, we regard this as neutral for the market.

MILDLY BEARISH

US-China tensions

Political tensions between the US and China could start flaring up again once the pandemic challenges take a back seat. We expect President Donald Trump to try and keep the limited trade deal signed in Jan on an even keel and avoid re-igniting another trade war until the Nov US presidential elections are done.

MILDLY BEARISH

Threat of a second wave in winter

Revolving Covid-19 outbreaks across the world could become the norm, sustaining anxiety over a "second wave" in winter. That could dampen market sentiment and discourage non-essential activity as well as curb retail spending, becoming a drag on economies.

BEARISH

Global economic recovery may be very slow

In the absence of a vaccine/cure until H2 2021, global economic recovery may be sluggish and interrupted by spells of restrictions imposed to manage sporadic outbreaks. Sustained weakness in the job market would crimp consumption. A full-fledged second wave would be devastating for global economic and oil demand recovery, though a return to widespread lockdowns is a tail risk, not our base case at present.