Crude oil: Further OPEC+ cuts needed?

There is a clear battle going on in the oil market- uncertainty over demand growth versus a constructive supply picture in the near term. But which will prevail? For the remainder of this year, the market should tighten, but moving into 2020 we see a looser balance once again

Source: Shutterstock

ING price forecasts

Current	2019				2020				2021			
	1Q	2Q	3QF	4QF	1QF	2QF	3QF	4QF	1QF	2QF	3QF	4QF
ICE Brent (US$/bbl)	64	68	65	68	63	61	65	70	68	73	73	71
NYMEX WTI (US$/bbl)	55	60	57	60	56	54	58	63	61	66	66	64
Previous												
ICE Brent (US$/bbl)	64	68	69	73	70	74	76	74	72	77	77	74
NYMEX WTI (US$/bbl)	55	60	61	65	63	67	69	67	65	70	70	67

Source: ING Research

Constructive in the short term

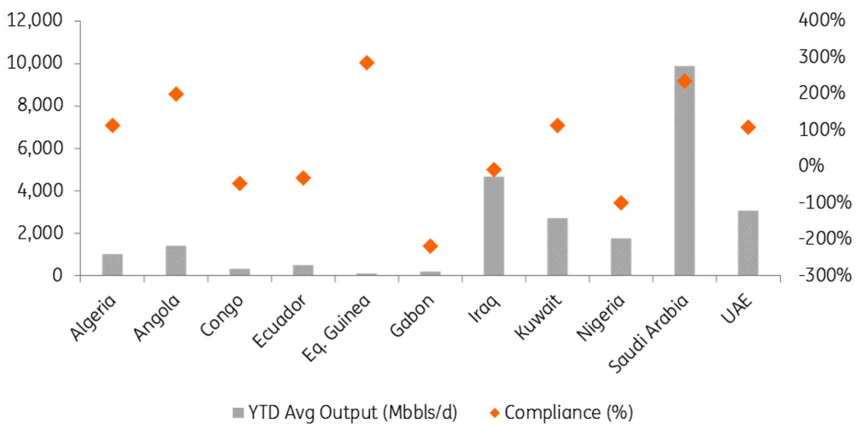
OPEC+ cuts should do a good job in drawing down global inventories for the remainder of this year.

Overall, members have over-complied with the deal, and this is largely due to Saudi Arabia producing more than 500Mbbls/d below their quota level. Although there are other producers, such as Iraq and Nigeria, who have failed completely to comply with the production cut deal. Under the deal, Iraq was meant to produce a little over 4.5MMbbls/d, down from 4.65MMbbls/d in October 2018- the reference month for cuts- however the country has in fact increased output, pumping on average 4.7MMbbls/d since the start of the year.

However, strong overall compliance, along with falling Iranian oil supply, coupled with stronger seasonal demand over the latter part of the year should see global inventories fall by around 1MMbbls/d in 3Q19, and a little over 700Mbbls/d in 4Q19. Therefore we continue to believe that prices should trade higher from current levels. Although in the current macro environment it is likely to be a bumpy ride.

Time spreads continue to suggest a tighter physical market. While the prompt ICE Brent spread has been volatile in recent weeks, it remains firmly backwardated along with much of the front end of the curve. Even the US market has tightened up recently. The prompt WTI timespread has swung into backwardation this week, after the front end of the curve was largely in carry. US crude oil inventories continue to decline- they have fallen for seven consecutive weeks, with stocks now down almost 49MMbbls since early June. This has also seen WTI strengthen relative to Brent, with the WTI/Brent discount narrowing from more than US$7/bbl in late July to almost US$5/bbl currently. US inventories should continue to edge lower over the next couple of months, which would be in line with seasonal trends, although keep an eye on US exports- a further narrowing in WTI/Brent could see exports slow.

OPEC-10 YTD compliance



Source: OPEC, Bloomberg, ING Research

A more bearish 2020

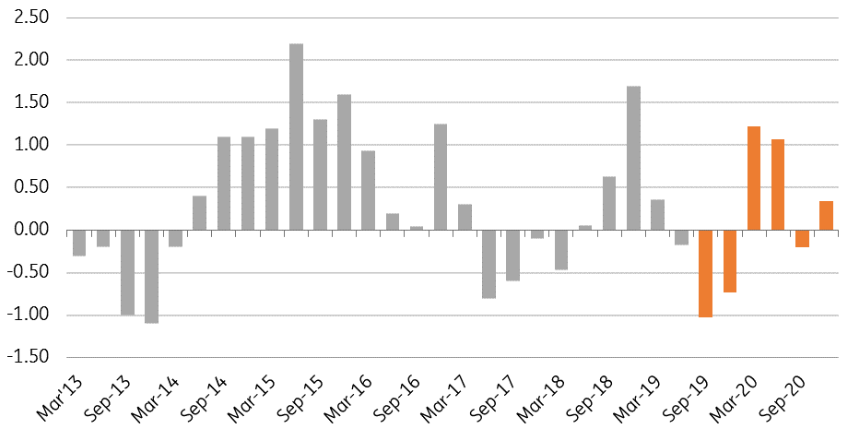
However, the balance changes drastically as we move into 2020, and as a result we have revised lower our price forecast for next year. While OPEC+ cuts are set to run through until the end of 1Q20, weaker seasonal demand in the first quarter of the year means that the global balance is set to see sizeable stock builds over 1Q. This is even assuming that Saudi Arabia keeps production at 9.8MMbbls/d over the period- which is 500Mbbls/d below their quota. As a result of strong non-OPEC supply and weaker seasonal demand, we estimate that the call on OPEC production in 1Q will be around 28MMbbls/d, which is 1.9MMbbls/d lower than estimates for the group's production in

July, and 1.2MMbbls/d lower than what we are currently forecasting for 1Q20. This does suggest that we would need to see further action taken by OPEC+. A starting point would be to ensure all members are at least in compliance with the deal, and then look at whether deeper cuts are needed over 1Q20.

At the moment, given the deal is set to end in in 1Q20, the market is also set to see a sizeable surplus in 2Q20. As a result, we believe that OPEC+ will likely have to extend the current deal through until at least the end of the second quarter or risk lower prices. However, such a decision will likely only be made at the OPEC+ meeting in December at the earliest- assuming market moves don't force OPEC+ to act sooner.

Looking at 2020 as a whole, we estimate the call on OPEC will be 29.1MMbbls/d- which is almost 800Mbbls/d lower than estimated production in July.

Global oil market set to return to surplus in 1H20 (MMbbls/d)



Source: IEA, EIA, OPEC, ING Research

Demand concerns linger

Clearly, the current weakness in the market reflects concerns over demand growth for the remainder of this year, as well as 2020, particularly given the current macro environment, and a ratcheting up in the trade war. There is a large degree of scepticism around demand growth forecasts moving forward. The IEA is currently estimating that demand will grow by 1.8MMbbls/d over 2H19, this is up from around 300Mbbls/d in 1Q19 and 800Mbbls/d in 2Q19. Therefore given the current macro climate, this number might be a bit too ambitious for the remainder of the year. Furthermore, the longer the trade war drags on, the more downside risk there is around the demand growth number of 1.4MMbbls/d in 2020.

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