بنك الإمارات دبي الوطني
Emirates NBD

Commodities

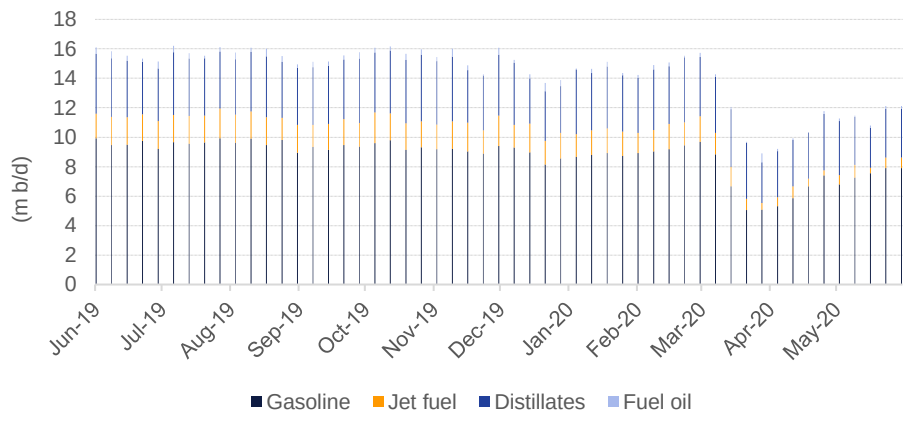
14 June 2020

Oil market highlights

Oil markets snapped their weekly winning streak last week as anxiety over the health of demand overpowered the OPEC+ decision to extend deep cuts for an additional month. Brent futures ended the week at USD 38.73/b, down 8.4%, after having hit an intra-week high of USD 43.41/b. WTI futures gave up 8.3% to close at USD 36.26/b. Most of the week's decline was concentrated in a broad risk off move on June 11th which took equity and other risk assets lower despite some stabilization at the end of the week. Rising cases of Covid-19 in US states that have recently opened up apparently were the catalyst to shake markets but the situation in emerging markets remains even worse: case numbers in Brazil, Russia and India continue to escalate with Brazil having the second highest death count and converging on 1m confirmed cases.

Both the IEA and OPEC will deliver their monthly oil market assessments this week which may see the agencies again revise up their demand expectations (or lower their projections for how badly demand will decline, based on your point of view). While there have been signs of recovery from the absolute trough of demand in April, product supplied data from the US show gasoline demand down 20% y/y in mid-June while jet fuel consumption is off by nearly 60% on year-ago levels. The US encapsulates a large, but individual, picture of global oil demand but as economies remain hampered by social distancing and economic contraction, we would expect a roughly analogous demand profile across most major markets.

US product demand way off pre-crisis levels



Source: EIA, Emirates NBD Research.

OPEC+ will also hold a meeting of its joint market monitoring committee (JMMC) to assess oil market conditions and potentially advise on near-term changes to production policy. The OPEC+ decision to extend its deep cuts by an additional month was a relatively short-term action in the history of OPEC (or OPEC+) intervention in the market and the JMMC may be a catalyst for advising on more short-term targets. However, unlike a central bank carrying out open market operations in a financial system that is regulated and may be required to buy or sell assets in response, OPEC+ does not regulate the oil market and buyers may not exactly track changes in OPEC+ policy. Short-term decisions related to immediate pricing signals can disrupt flows of tankers, refining programmes, and as we saw in March, can feed back violently into other asset classes. OPEC+ countries—based on physical lifting costs—are not the marginal producers of oil but rather are more akin to baseload producers, providing volume at the lowest costs. Targetting short-term price targets, or market structures, with the full volume of OPEC+ production and exports will act as a significant destabilizing force on oil markets.

In sympathy to the drop in spot prices, market structures also weakened last week. Front month spreads for both Brent and WTI futures closed the week in a contango of USD 0.25/b while Dec spreads widened their contago in both benchmarks. Still weak refining margins globally along with inflows of crude filling inventories in the US will act as a firm barrier for futures structures to move into backwardation even as OPEC+ keeps its production restrained at deeper levels for longer.

The number of rigs drilling for oil in the US fell below 200 last week, its lowest level since Q2 2009, the depths for the Global Financial Crisis. The enormous drop in rigs will make any recovery in US production this year near impossible, even if prices were to stabilize in a USD 40-50/b range for WTI, still nearly 25% higher than where prices closed at the end of the week.

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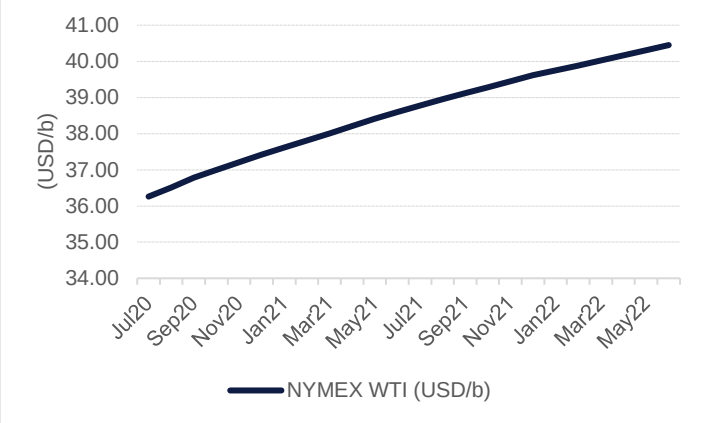
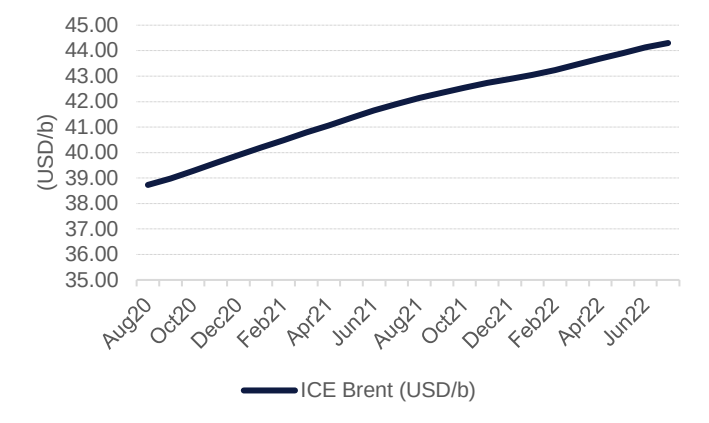
WTI forward curve



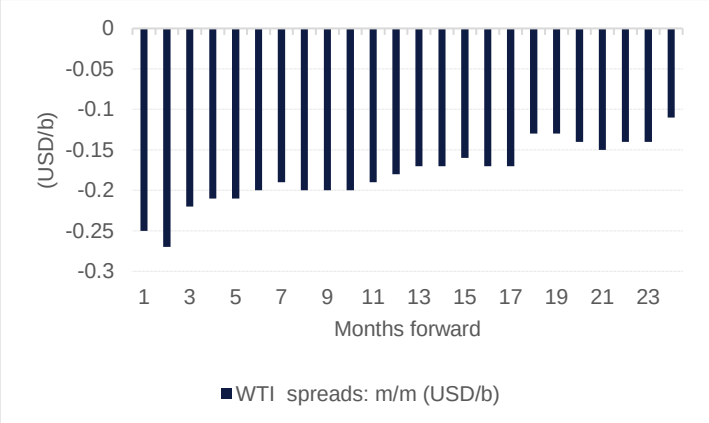
Source: Bloomberg, Emirates NBD Research. Note: USD/b.

Brent forward curve



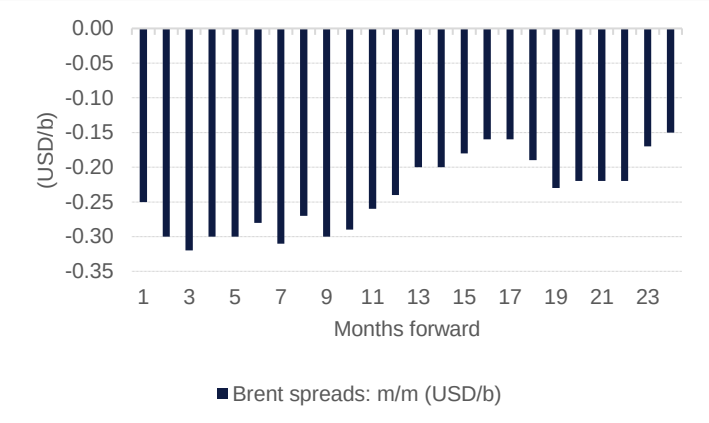
Source: Bloomberg, Emirates NBD Research. Note: USD/b.

WTI time spreads



Source: Bloomberg, Emirates NBD Research. Note: USD/b.

Brent time spreads

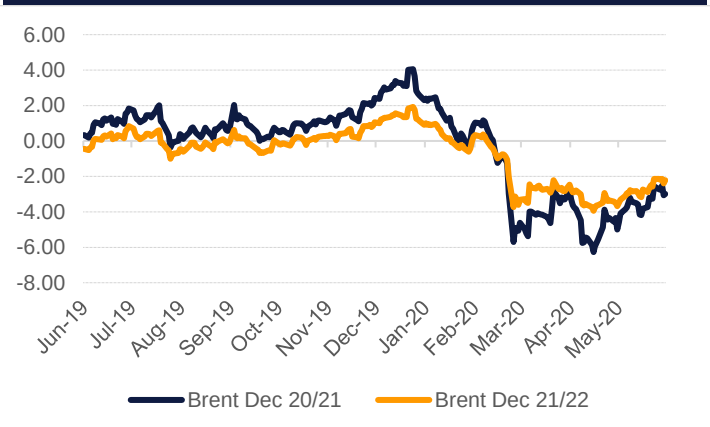


Source: Bloomberg, Emirates NBD Research. Note: USD/b.

WTI December spreads

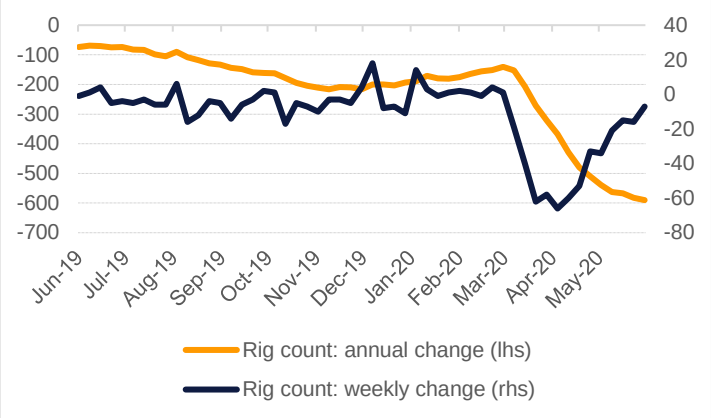
Source: Bloomberg, Emirates NBD Research. Note: USD/b.

Brent December spreads



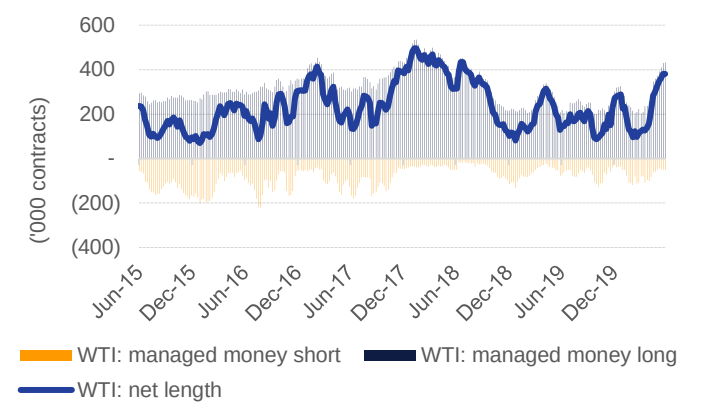
Source: Bloomberg, Emirates NBD Research. Note: USD/b.

US drilling rig count



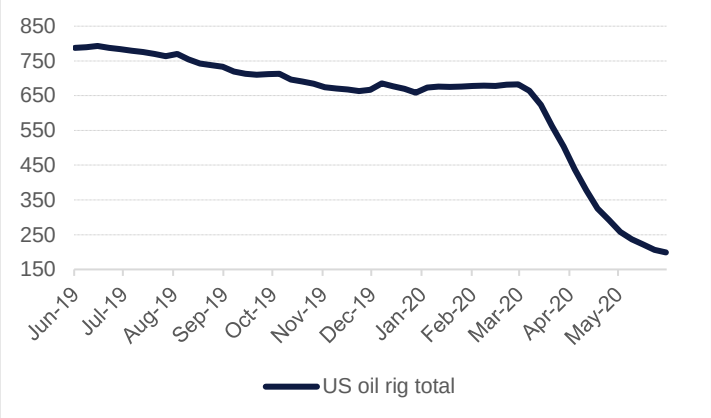
Source: Bloomberg, Emirates NBD Research.

WTI net length managed money



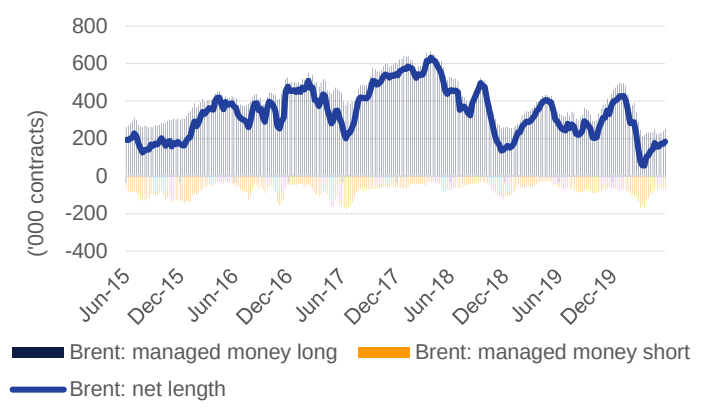
Source: Bloomberg, Emirates NBD Research. Note: NYMEX futures and options only.

US drilling rig count (1 year)



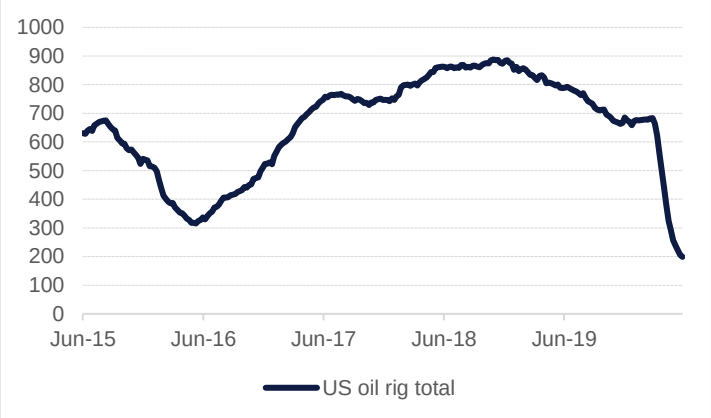
Source: Bloomberg, Emirates NBD Research.

Brent net length managed money



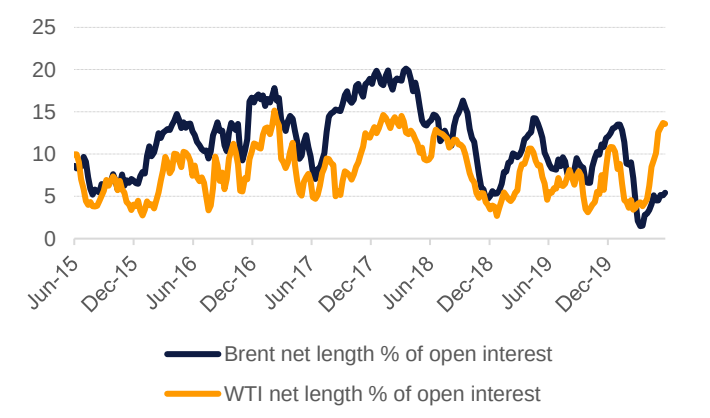
Source: Bloomberg, Emirates NBD Research.

US drilling rig count (5 year)



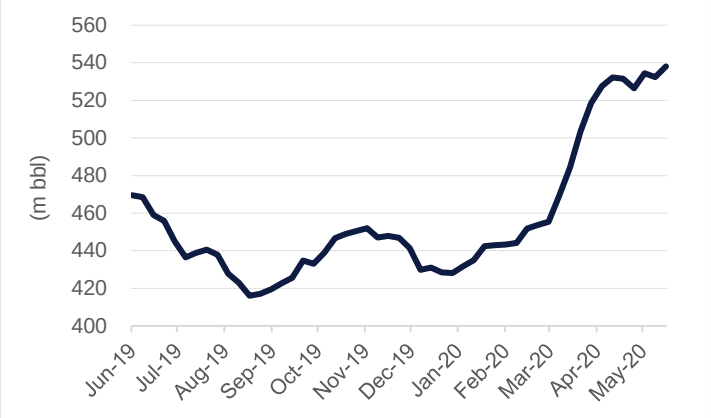
Source: Bloomberg, Emirates NBD Research.

Net length managed money/open interest



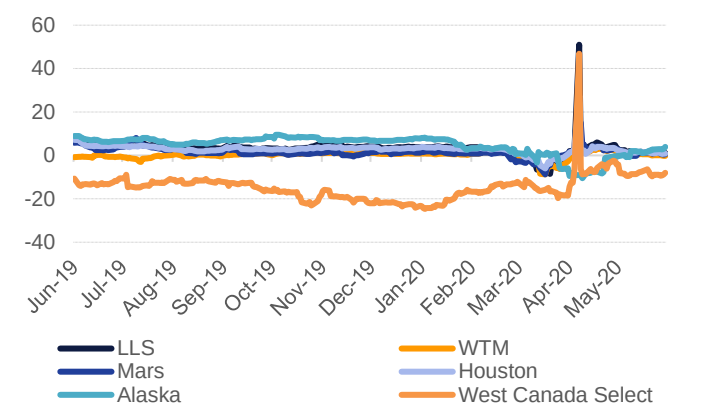
Source: Bloomberg, Emirates NBD Research.

Total crude stocks: US



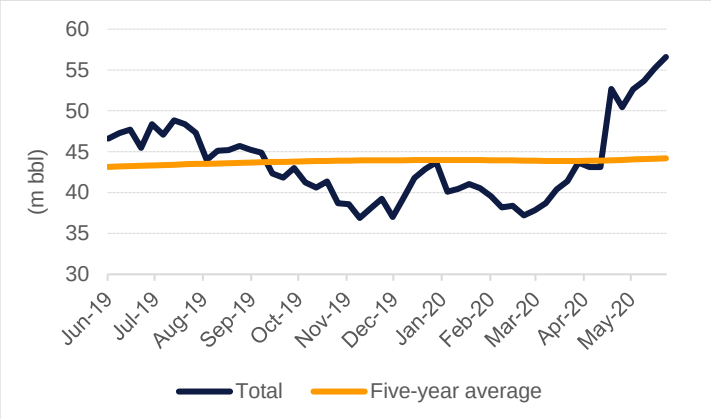
Source: Bloomberg, Emirates NBD Research.

North America prices



Source: Bloomberg, Emirates NBD Research. Note: spread to WTI USD/b

Total inventories: ARA

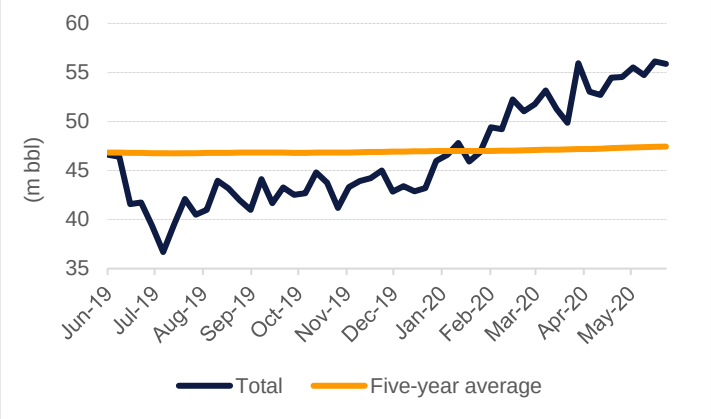


Source: Bloomberg, Emirates NBD Research. Note: products only.

Brent/Dubai spread

Source: Bloomberg, Emirates NBD Research. Note: USD/b.

Total inventories: Singapore



Source: Bloomberg, Emirates NBD Research. Note: products only.

Dubai market 1-3 month spread

Source: Bloomberg, Emirates NBD Research. Note: USD/b.

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