



بنك الإمارات دبي الوطني
Emirates NBD

Commodities

7 June 2020

Oil market highlights

OPEC and its allies agreed to extend their deeper level of production cuts by an additional month, keeping output restrained by 9.6m b/d from baseline levels until at least the end of July. According to the terms of the OPEC+ agreement reached in April, production would have increased by 1.8m b/d from July and hold at that level for the rest of 2020. But spurred on by the tremendous gains in oil prices over the past two months, OPEC+ countries likely saw the benefit of holding production lower for longer—even if for just an additional month.

While an additional month of deep production cuts may not have an enormous impact on headline oil market balances it will still help to reinforce positive sentiment around oil prices and should dispel any short-term concerns about a break down in oil diplomacy between Russia and Saudi Arabia, the architects of the deal. A more significant development from the new arrangement is a pledge by countries that didn't hit 100% compliance to make up for their short-comings with additional production cuts over the coming months. Compliance across the OPEC members was reasonably good in May but both Iraq and Nigeria fell well short of hitting their targets, at just 42% and 33% compliant respectively. OPEC+ still doesn't hold any official enforcement capability but the calling out of non-compliant members is at least a message that the producers' bloc expects all members to bear the cuts together. There was also no official comment from OPEC as to whether Saudi Arabia, the UAE and Kuwait would extend their own additional cuts beyond June (Saudi Arabia for example pledged an additional 1m b/d this month on top of its OPEC+ agreement targets).

The OPEC+ cuts have been a big part in helping oil prices recover in the last two months. Brent futures settled at USD 42.30/b last week, up nearly 20%, while WTI was up by 11% to close at USD 39.55/b. This weekend's deal will also help to keep a bid under oil prices in the near term as will a broad rally in risk assets.

Forward curves for both Brent and WTI have also improved steadily. The front month spread in WTI closed in a contango of just USD 0.25/b last week compared with more than USD 1.60/b a month ago. Calendar strips for 2021 WTI futures are also trading above USD 40/b and at USD 44/b for Brent.

Your move, Texas

If we were to build a recipe for the return of shale production in the US then extended OPEC+ production cuts, a risk-on rally and improving forward curves would easily be among the first ingredients. To be fair there is a long way to go before shale producers represent a meaningful threat to oil market balances. Rigs continue to come out of operation—another 16 last week—while banks may be reluctant to extend credit while oil market conditions remain volatile. However, WTI futures are not far off prices that allow production to stabilize in some large plays—such as the Permian—meaning a levelling off in declines could emerge over the coming weeks. Prices would need to push higher, and on a sustained basis for companies to take capex decisions and add production, rather than keep existing projects intact.

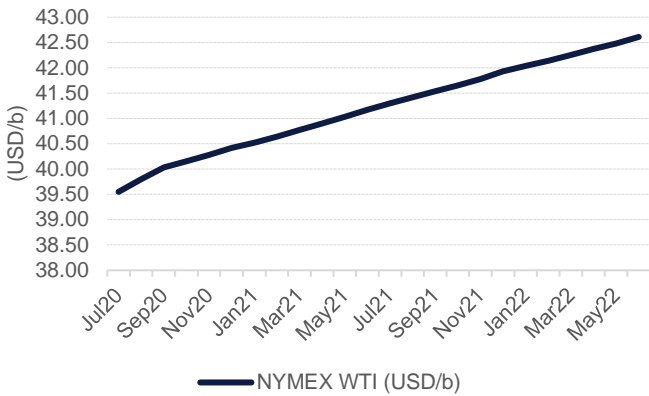
OPEC+ did encourage restraint in the official communique from this weekend's meeting, calling on "all major oil producers to proportionally contribute" to market rebalancing. However, we see little impetus for an official, government-mandated restriction on output in the US, particularly as the economy is only tentatively emerging from its Covid-19 shutdown. The unemployment rate among workers in mining, quarrying and oil and gas extraction improved in May according to the latest US non-farm payrolls but at 8.4% remains near multi-year highs. Mandatory production cuts that benefit OPEC+ but threaten the job market in pro-Trump states would find short shrift with the incumbent administration.

Libya waits in the wings

As an additional sign of worry for balances, Libyan production is reportedly resuming from Sharara, the country's largest field. A cease-fire between competing factions in the country should allow output to bounce back quickly and we would doubt any authorities in the country would be prepared to accept production limits recommended by OPEC+. For reference Libya produced more than 1m b/d in December 2019 while recent estimates peg the country's output closer to 90k b/d. However, the political dynamics in the country remain fluid and we would be very hesitant to assume stable output of around 1m b/d for the rest of 2020.

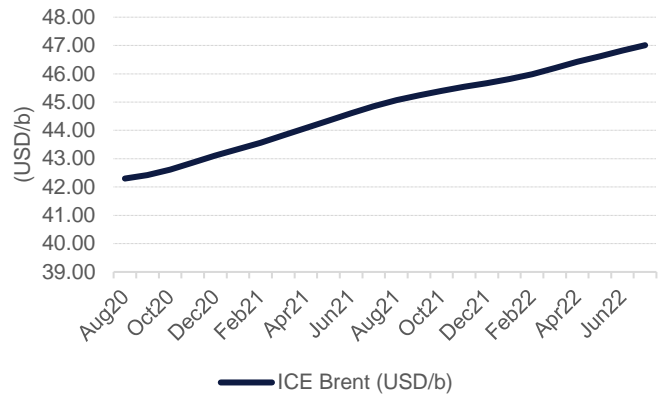
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WTI forward curve



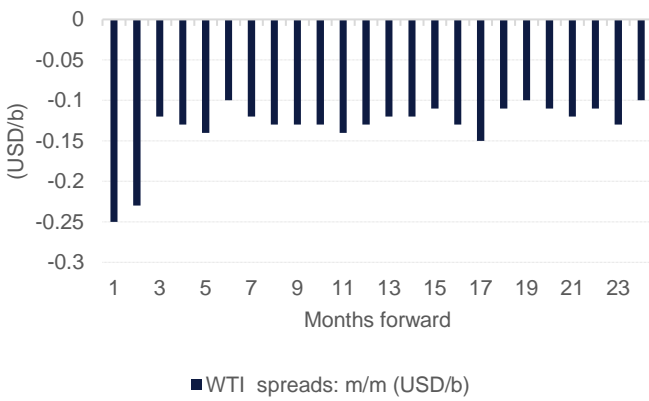
Source: Bloomberg, Emirates NBD Research. Note: USD/b.

Brent forward curve



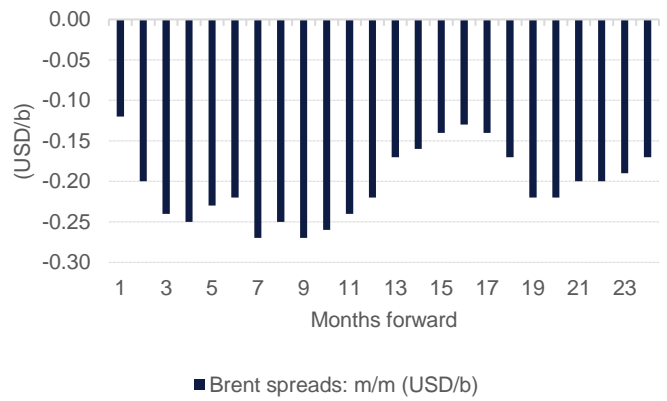
Source: Bloomberg, Emirates NBD Research. Note: USD/b.

WTI time spreads



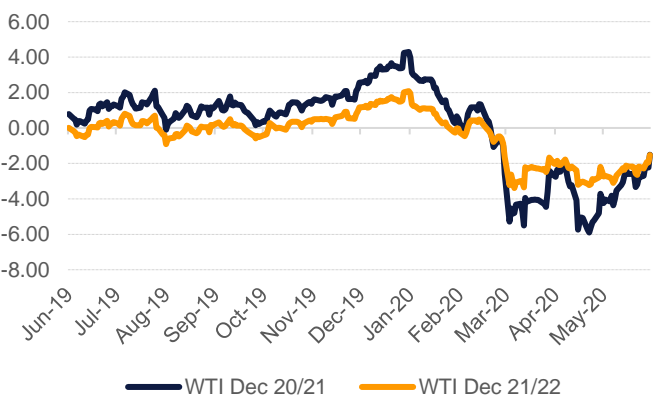
Source: Bloomberg, Emirates NBD Research. Note: USD/b.

Brent time spreads



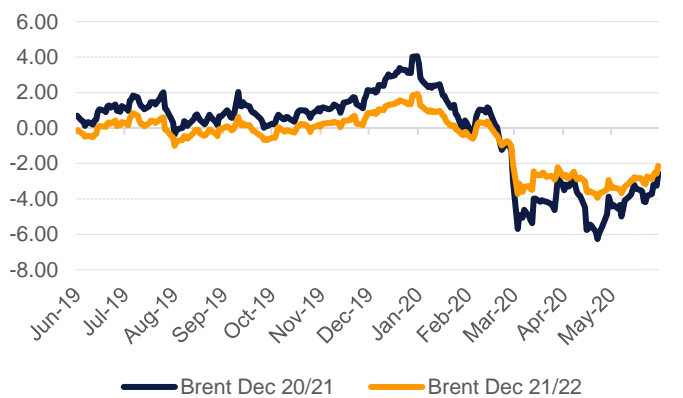
Source: Bloomberg, Emirates NBD Research. Note: USD/b.

WTI December spreads

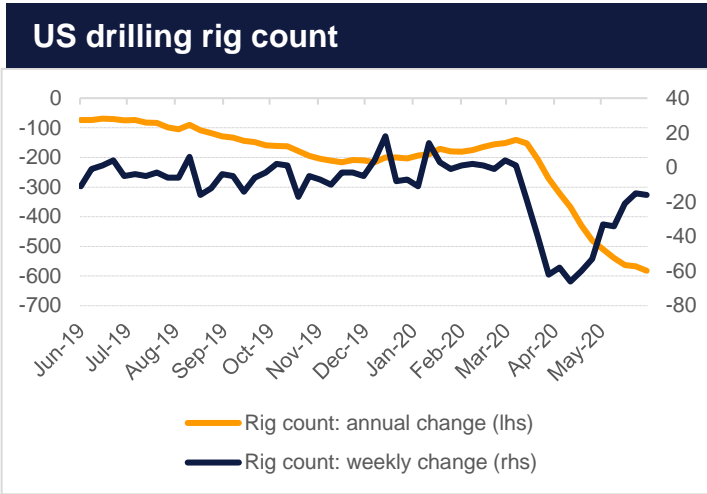


Source: Bloomberg, Emirates NBD Research. Note: USD/b.

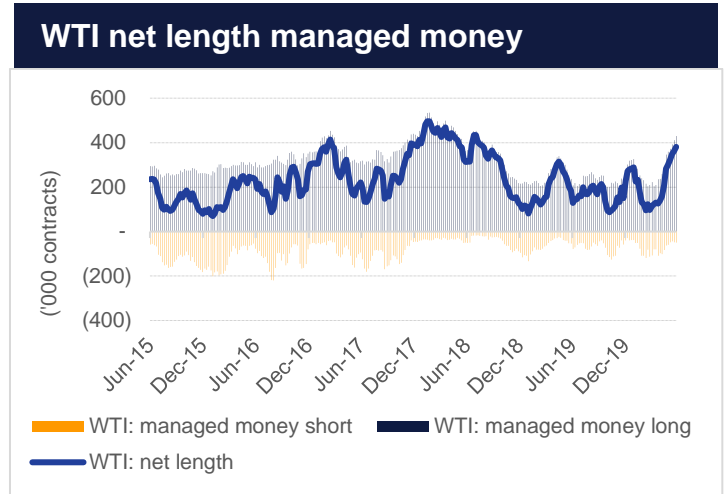
Brent December spreads



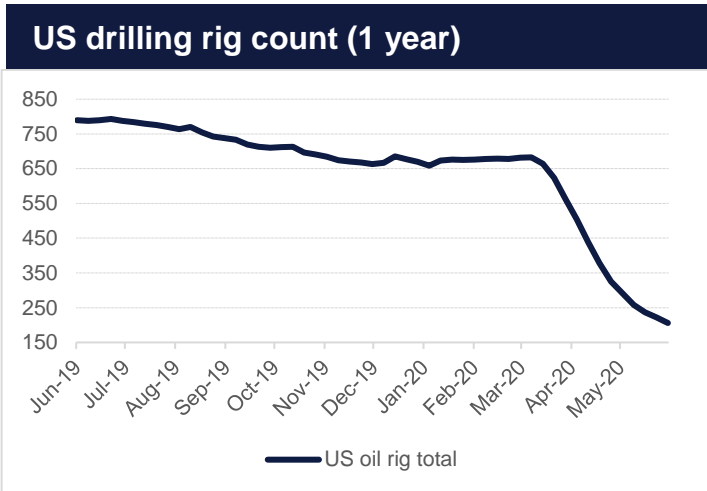
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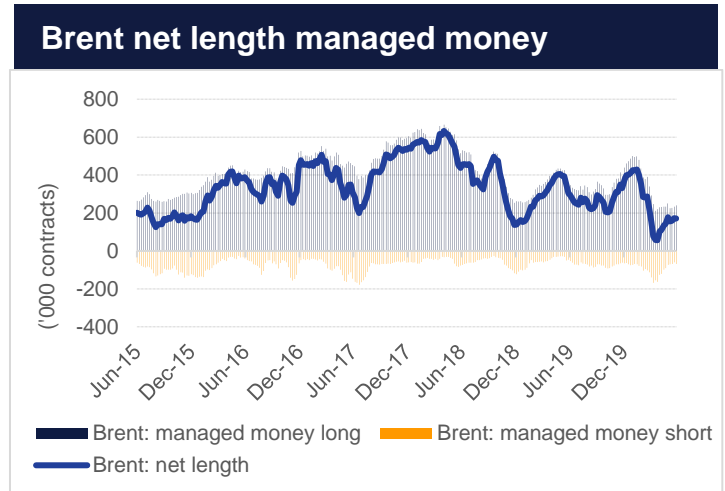
Source: Bloomberg, Emirates NBD Research.



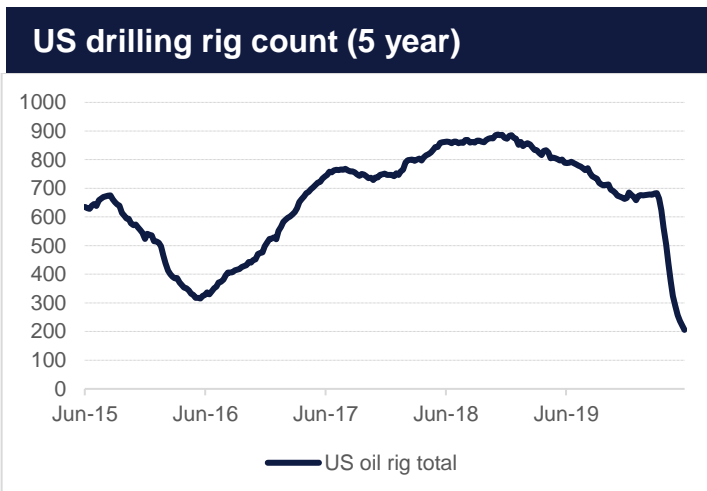
Source: Bloomberg, Emirates NBD Research. Note: NYMEX futures and options only.



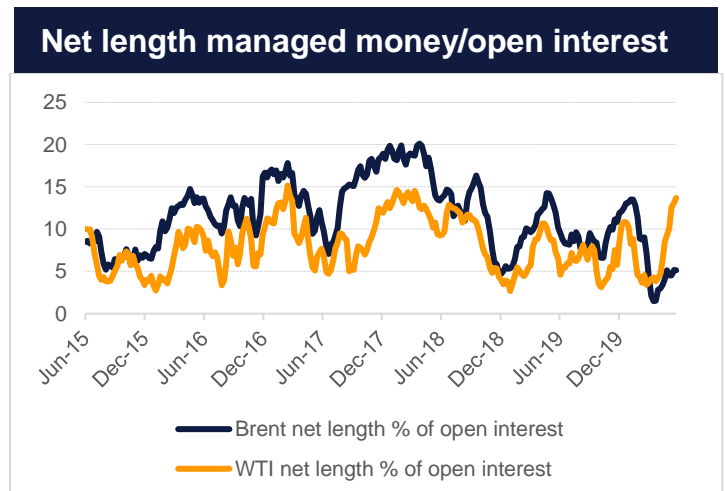
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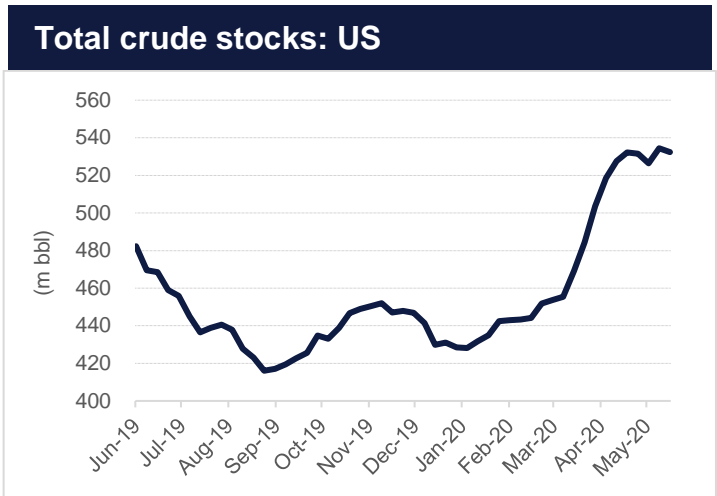
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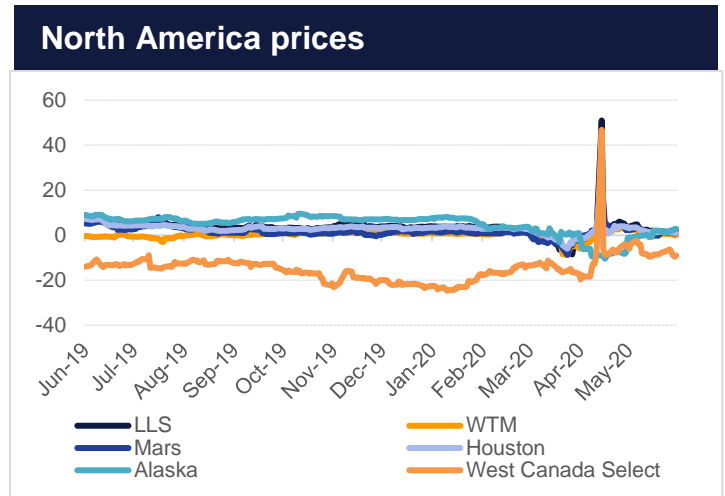
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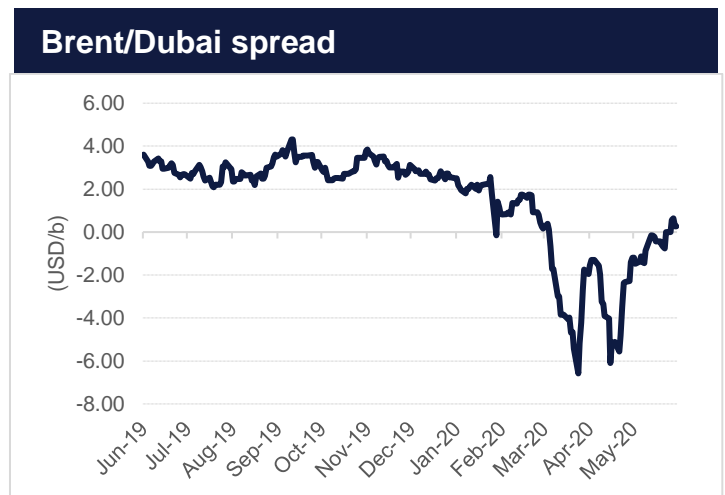
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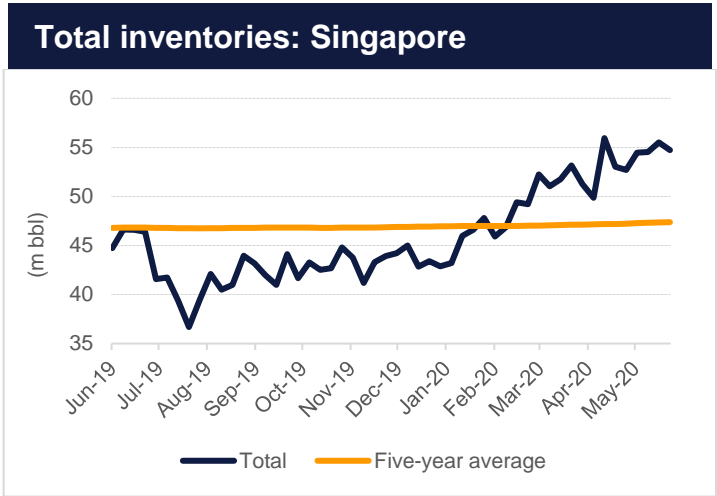
Source: Bloomberg, Emirates NBD Research. Note: spread to WTI USD/b



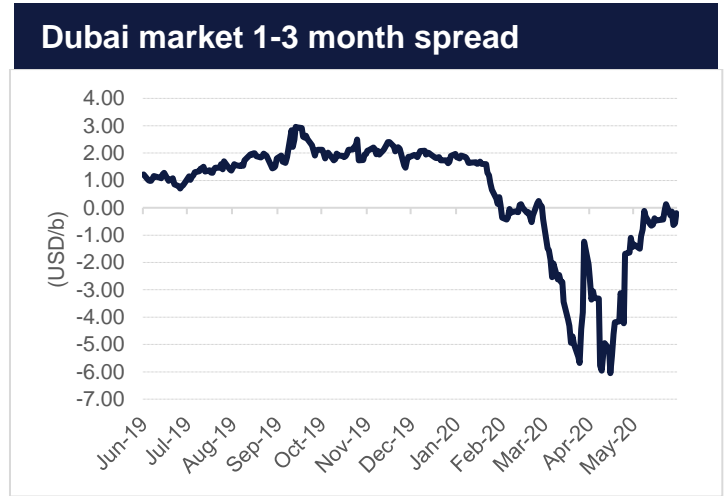
Source: Bloomberg, Emirates NBD Research. Note: products only.



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