Uncertainty ever present

Summary

- Q3 2020 oil demand rose by 8.4 million barrels per day (mbpd), or 10 percent, quarter-on-quarter, but was 9.5 mbpd (or 9 percent) lower than the same period last year. Looking ahead, whilst OPEC expects to see four out of five quarter-on-quarter rises in oil demand for now until Q4 2021, demand is still expected to be 3 percent lower than pre-COVID-19 levels by the end of 2021.

- On the supply side, OPEC and partners (OPEC+) continued to exhibit high levels of compliance in Q3. Average output over the quarter shows that OPEC+ compliance averaged 100 percent, albeit with varying degrees of compliance amongst participating countries.

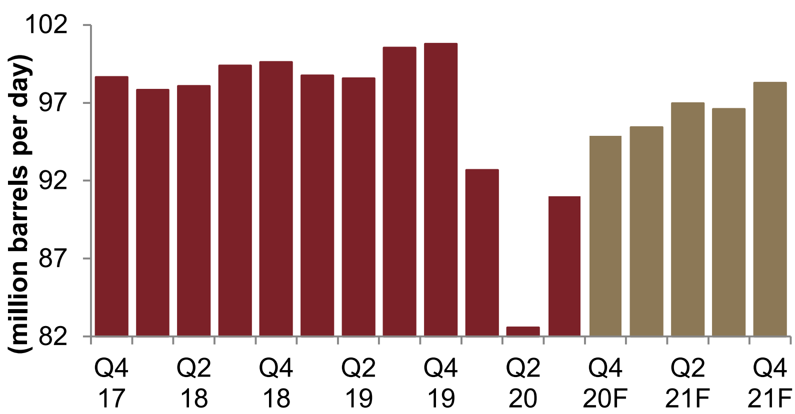
- Looking ahead, OPEC+ is expected to add an additional 1.9 mbpd to total output in January 2021, in-line with May's agreement, but the final decision to go ahead with the planned rise will likely be taken when the alliance next meets later this year in December.

- Meanwhile in the US, the upcoming presidential election pits two candidates with very different domestic oil policy agendas. Whilst a victory for the Republican incumbent would, in many ways, be 'business as usual' for shale oil producers, a victory for the Democratic party could be more bearish, with a roll-out of a number of regulations potentially restricting supply.

- Brent oil is currently trading around $40 per barrel (pb), with the year-to-date average at $41 pb. We expect Brent oil to trade around current levels during the remainder of Q4, with little upside to oil prices as many countries around the world continue to grapple with a second wave in COVID-19 cases.

- Looking further ahead into 2021, current OPEC forecasts suggest a progressive pick-up in oil demand during the year, and a deficit in daily oil balance, all of which should help lower record high commercial oil inventories and provide support to prices.

Figure 1: OPEC expects quarter-on-quarter rises in oil demand from Q4 2020 until the end of 2021



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No return to pre-COVID oil demand anytime soon:

Whilst OPEC expects to see four out of five quarter-on-quarter rises in oil demand for now until Q4 2021…

….demand is still expected to be 3 percent lower than pre-COVID-19 levels by the end of 2021.

The latest monthly oil market report from OPEC shows that whilst oil demand improved on a quarter-on-quarter basis, it was still significantly lower on a year-on-year basis. More specifically, Q3 2020 oil demand rose by 8.4 million barrels per day (mbpd), or 10 percent, quarter-on-quarter, but was 9.5 mbpd (or 9 percent) lower than the same period last year. Looking ahead, whilst OPEC expects to see four out of five quarter-on-quarter rises in oil demand for now until Q4 2021, demand is still expected to be 3 percent lower than pre-COVID-19 levels by the end of 2021 (Figure 1). For 2020 as a whole, OPEC still expects oil demand to decline by 9.5 mbpd (or 9 percent) year-on-year, but then expects a rebound of 6.6 mbpd (or 7 percent) to 96.8 mbpd in full year 2021. On a country/regional level, the four largest oil consuming countries/regions (US, China, India and Europe) are expected to make up 53 percent of the expected year-on-year declines in 2020, with the same group accounting for just over two thirds of oil demand growth in full year 2021.

When looking at consumption by product, gasoline, declined by 12 percent, or 1 mbpd, year-on-year…

...with partial Q3 data showing total vehicle miles traveled in the US declining 9 percent compared to same period last year.

In the **US (20 percent of global oil demand)**, the Energy Information Administration's (EIA) data shows that total energy consumption declined by 12 percent year-on-year (or 2.6 mbpd) in Q3 2020. When looking at consumption by product, gasoline (45 percent of total US demand), declined by 12 percent, or 1 mbpd, year-on-year, with partial Q3 data showing total vehicle miles traveled in the US declining 9 percent compared to same period last year (Figure 2). Unsurprisingly, jet fuel, which makes up 7 percent of total demand, was down 46 percent year-on-year. Whilst the sizable declines in gasoline and jet fuel are reflective of travel restrictions as a result of COVID-19 mitigation efforts, the EIA sees the largest declines in US consumption to be behind them, with Q4 consumption expected to improve to -7 percent year-on-year. Overall, the EIA sees full year 2020 consumption averaging 18.2 mbpd, roughly the same level seen back in 2012, at 18.5 mbpd. Looking further ahead into 2021, consumption is expected to rise by 10 percent on a yearly basis, to an average of 19.9 mbpd, albeit still 3 percent less than pre-COVID 2019 levels.

Chinese oil imports have not declined at all during 2020, with Q3 oil imports up 18 percent year-on-year.

Top line economic indicators (such as manufacturing PMIs) suggest that **China (13 percent of global oil demand)** is recovering steadily from the impact of COVID-19. In line with this, year-to-August data shows that Chinese oil demand only declined by 6 percent (or 800 thousand barrels per day (tbpd), compared to the same period last year, with the majority of the declines being seen during the peak number of cases during Q1 2020 (Figure 3). Meanwhile, Chinese oil

Figure 2: US total vehicle miles traveled declined 9% y-o-y in Q3 2020E (12 month moving average)

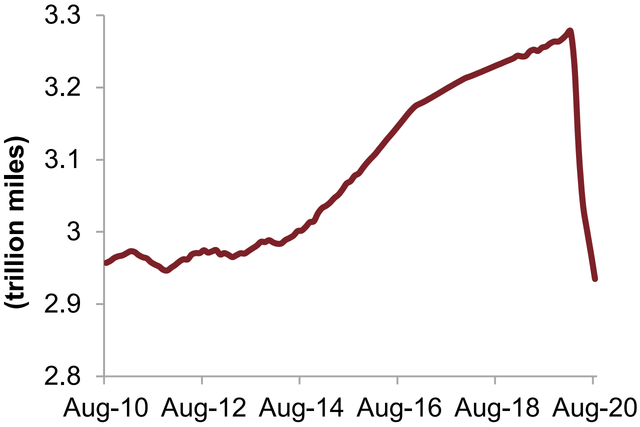
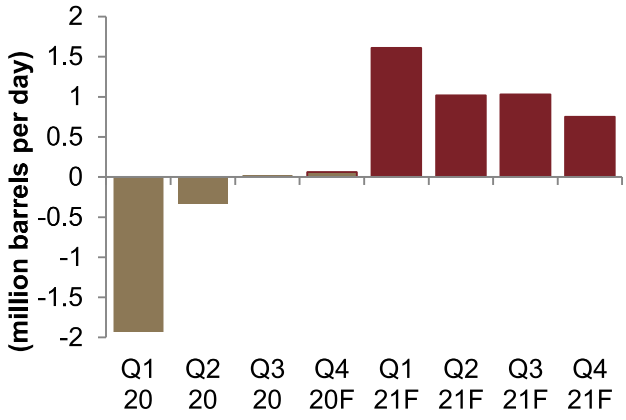


Figure 3: Chinese oil demand showing minor yearly rises in Q3 2020



Chinese oil demand is projected to improve in line with continued economic recovery…

...with OPEC expecting oil demand to rise by 1.1 mbpd (or 9 percent) year-on-year in 2021.

imports have not declined at all during 2020, with Q3 oil imports up 18 percent year-on-year (Figure 4). Whilst this huge rise in imports may, in part, be due to China's post-lockdown recovery, it probably also reflects China's habit of large oil purchases during periods of low oil prices to build up its strategic crude oil stocks. Looking ahead, Chinese oil demand is projected to improve in line with continued economic recovery, with OPEC expecting oil demand to rise marginally during the final quarter of this year. Looking further ahead into 2021 as a whole, OPEC expects a rise of 1.1 mbpd (or 9 percent) year-on-year in 2021, with the recovery being led by an improvement in transportation fuel, according to the organization.

In recent weeks, the big 4 oil consuming countries (Germany, France Italy and UK), have seen localized lockdowns…

...which will continue to have a sizable impact on oil demand growth in the region.

Whilst the progressive lifting of lockdown measures in **Europe (14.4 percent of demand)** during Q3 helped raise oil use in road transportation and industrial sectors, yearly oil demand in the region was still 1.9 mbpd (or 13 percent) lower year-on-year (versus -23 percent in Q2 2020). In recent weeks, the big 4 oil consuming countries (Germany, France Italy and UK), have seen localized lockdowns, as infections and hospitalizations have surged, just as the colder season approaches. Looking ahead, therefore, it seems a resurgence of number of COVID-19 cases in Europe will continue to have a sizable impact on oil demand growth in the region. For example, besides jet fuel, diesel and gasoline are also likely to be severely impacted as car sales in the region plummet, with the European Automobile Manufacturers Association's (ACEA) forecasting car sales in the European Union (EU) declining by 3 million units (or 25 percent) year-on-year in full year 2020 (Figure 5). Bearing this in mind, it is unsurprising that OPEC expects OECD Europe (including EU) to contribute around 17 percent of total yearly oil demand losses in 2020, although the organization does expect a strong recovery in 2021, by 9 percent (or 1.1 mbpd) year-on-year.

Question marks over the pace of recovery in demand in India still remain…

...with oil demand not expected to hit pre-COVID levels till at least the end of Q1 2021.

India (5 percent of global oil demand) saw demand fall by a huge 21 percent year-on-year in Q3, following an equally sizable drop in Q2, by 26 percent year-on-year. Although some improvements have been observed recently (such as monthly rises in fuel product consumption in September), question marks over the pace of recovery in demand still remain. Indeed, recent comments from Indian petroleum ministry officials suggest that oil demand is not expected to hit pre-COVID levels till at least the end of Q1 2021. Overall, OPEC expects Indian Q4 oil demand to continue showing sizable declines, at 15 percent year-on-year, (similar to full year 2020 declines), before recovering by 14 percent year-on-year in 2021.

Figure 4: No yearly decline in Chinese oil imports so far in 2020

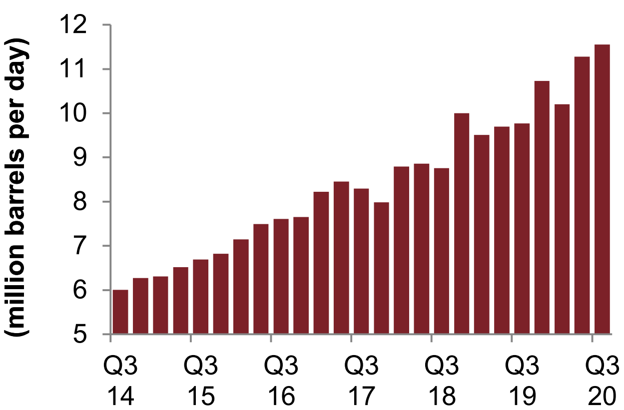
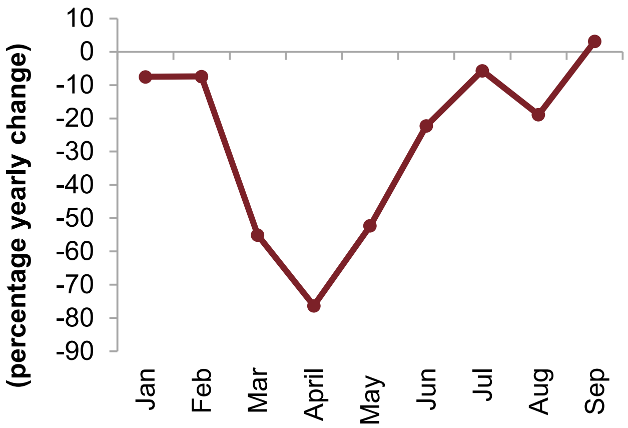


Figure 5: Passenger car sales have declined massively in the EU



OPEC+: Catch-ups needed

Both Iraq and Nigeria's balance stands in excess of agreed levels.

OPEC and partners (OPEC+) continued to exhibit high levels of compliance in Q3. Average output over the quarter shows that compliance averaged 100 percent, albeit with varying degrees of compliance amongst participating countries. More encouragingly, when looking at some of the larger OPEC producers (such as Nigeria and Iraq), who had undershot compliance in May and June, there was significant improvement. That said, when looking at average oil output from the start of the current agreement, in May, through to September 2020, both Iraq and Nigeria's balance stands in excess of agreed levels (Figure 6).

As it stands, OPEC+ is expected to add an additional 1.9 mbpd to total output in January 2021

...in-line with May's agreement…

….but the final decision to go ahead with the planned rise will likely be taken when OPEC+ meets later this year in December.

During Q4 2020, the main task for OPEC+ will be two-fold. The first of these is to maintain compliance at current high levels. The second relates to ensuring that 'catch-up' reductions in output from OPEC+ laggards are enacted in the last two months of this year. The implementation of these two tasks will aid the alliance in making a somewhat bigger decision related to raising oil output in the new year. As it stands, OPEC+ is expected to add an additional 1.9 mbpd to total output in January 2021, in-line with May's agreement, but the final decision to go ahead with the planned rise will likely be taken when OPEC+ meets later this year in December. According to our calculations (which are based on the latest OPEC projections on oil demand and non-OPEC oil supply), an additional 1.9 mbpd of OPEC+ oil would still leave global daily oil balances in deficit by an average of around 3 mbpd during 2021 (Figure 7). In addition, such a deficit would also easily accommodate potential higher oil supply from Libya (which is not subject to the OPEC+ agreement). Whilst there are still a number of challenges in restoring Libyan oil output to previous highs of circa 1 mbpd, recent reports suggest that oil production is currently at around 600 tbpd, compared to September's output of 150 tbpd.

US elections upcoming:

The upcoming US presidential election pits two candidates with very different domestic oil policy agendas.

According to EIA data, US crude oil production averaged just over 11 mbpd in Q3 2020, down 9 percent year-on-year. Looking ahead into Q4 2020 and beyond, EIA's current forecast (based on WTI at $45 pb in 2021) sees US oil output declining by a further 3 percent on a year-on-year basis (to an average of 11.1 mbpd) at the end of next year. Meanwhile, it is worth noting that the upcoming US presidential election pits two candidates with very different domestic oil policy agendas. Whilst a victory for the Republican incumbent would, in many ways, be 'business as usual' for shale oil producers, a victory

Figure 6: Largest OPEC overproducers
(average overproduction from May-September 2020)

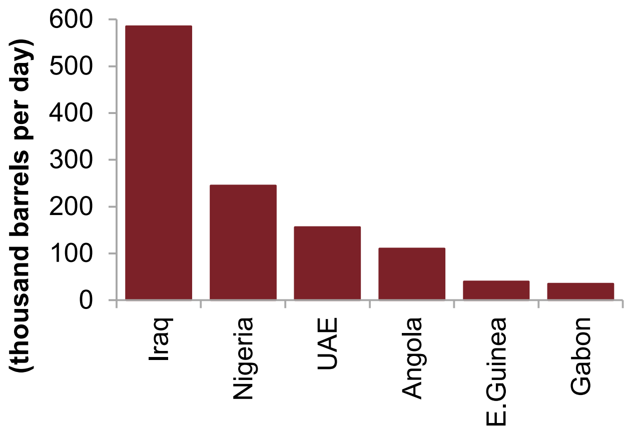
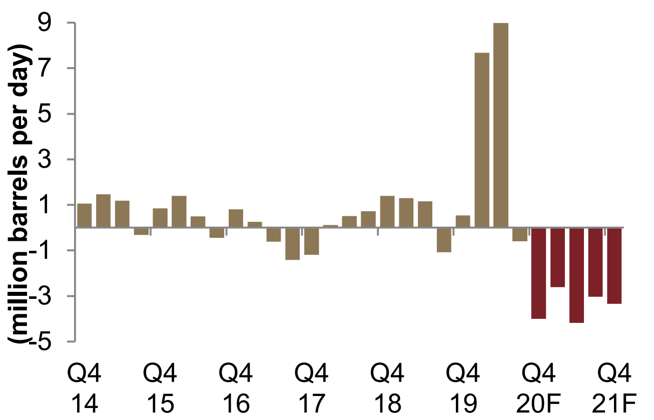


Figure 7: An additional 1.9 mbpd of OPEC+ oil would still result in a deficit in oil balances in 2021



That said, any change in domestic US oil policy is not expected to be pushed through in the near-term.

for the Democratic party could be more bearish, with a roll-out of a number of regulations (such as the cessation of oil drilling permits on federal lands and waters), potentially restricting supply. That said, any change in domestic US oil policy is not expected to be pushed through in the near-term, but would likely be implemented towards the end of 2021 or thereafter.

Oil price outlook:

Brent oil is currently trading around $40 pb, with the year-to-date average at $41 pb.

Brent oil prices averaged $43 pb during Q3, showing a sizable 56 percent quarter-on-quarter improvement as a number of economies lifted severe lockdowns and OPEC+ followed through with agreed output reductions. Brent oil is currently trading around $40 pb, with the year-to-date average at $41 pb.

The recovery in oil demand in the next year or so will not be smooth or easy…

...bearing this in mind, whilst our full year 2021 forecast is currently at $55 pb, the risks, on balance, are skewed to the downside.

We expect Brent oil to remain around current levels during the remainder of Q4, with little upside to oil prices as many countries around the world continue to grapple with a second wave in COVID-19 cases. Looking further ahead into 2021, current OPEC forecasts suggest a progressive pick-up in oil demand during the year, and a deficit in daily oil balances, all of which should help lower record high commercial oil inventories (standing at 3.2 billion barrels at the end of Q3) and provide support to prices. Of course, the main risk in the outlook comes from a more prolonged and serious outbreak of COVID-19 during the year coupled with a delay in providing an effective vaccine that can be distributed relatively quickly. In this context, the recovery in oil demand in the next year or so will not be smooth or easy. Bearing this in mind, whilst our full year 2021 Brent oil price forecast is currently at $55 pb, the risks, on balance, are skewed to the downside.

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The data contained in this research is sourced from Reuters Eikon, JODI, Bloomberg, EIA, CityMapper, Energy Intelligence and OPEC unless otherwise stated.