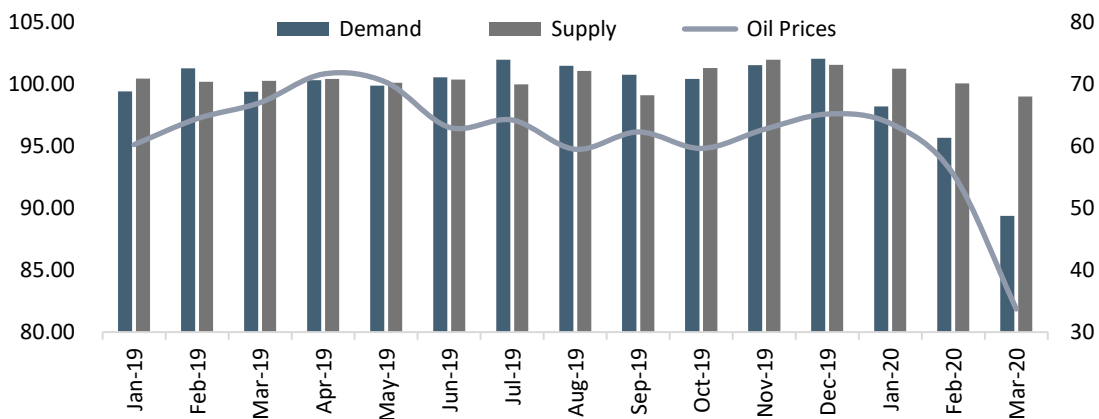


**Crude Oil Market Update**

*The Crude Oil Circus and the new Ring Master*

Oil prices crashed 65% from the start of the year to a year’s low of \$22.7/bbls in March, as the global oil market went in shambles. The COVID-19 outbreak led to a shut down in global economic activities and a plunge in demand. Meanwhile, the disintegration of the OPEC+ cartel, after failed resolutions at the March meeting, could not have occurred at a more dire time. The rift among the producers (especially Saudi Arabia and Russia) led to surge in supply as producers scrambled for measly existing demand. As a result, the oil market surplus spiked to 9.6mbpd in March from a deficit of 0.5mbpd in December, according to the EIA, as demand dropped 12% YtD to 89mbpd in March, while supply dropped only 2% to 99mbpd. As at today, average oil price for the year prints at \$48.9/bbl.

**Figure 1: Monthly Oil price vs market balance**



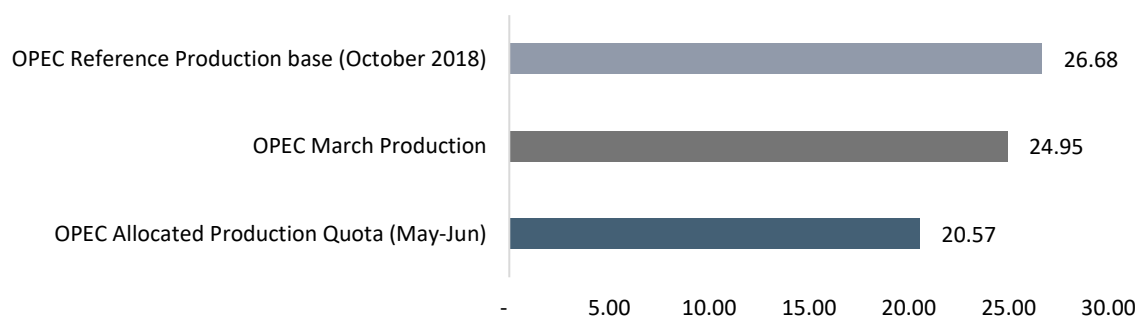
SOURCE: EIA, Bloomberg, ARM Research

**Trump to the rescue.** In a dramatic move, the US President called for the resolution of the Saudi-Russia rift and the unity of the OPEC cartel to reduce the excess supply and shore up oil prices. This came as many US producers, with average break-even price of \$50/bbl (According to Dallas Fed Energy Survey in 2019), bordered on the shores of bankruptcy in light of \$20 WTI oil. US oil rigs were in a free fall, dropping 26% YtD to 602 rigs, compared to drop of 5% in similar period last year. However, following Trump’s intervention, the OPEC+ producers held series of meetings and finally reached a resolution over the weekend to cut production by 9.7mbpd effective May 1st. Meanwhile, Saudi Arabia, Kuwait and the UAE have also announced plans to voluntarily cut by an additional 2mbpd.

The 9.7mbpd cut for the cartel is to last till June, before it is revised down to 7.7mbpd over July-December 2020 and then 5.8mbpd over 16 months from Jan-21 to April-22. The agreement is subject to review in December 2021. The agreement excludes 0.3mbpd to be taken on by US on behalf of Mexico. Asides OPEC, oil producing members of the G-20 are also said to take on additional cuts of ~3.7mbpd. In the US, the Texas Railroad Corporation is also scheduled to meet today to reach an agreement on production cuts.

***Our concerns and why price is still king.*** As cheery as the historic cuts sound, there are big questions on the viability and effectiveness of the cartel’s cuts agreement. First, it is worth noting that the reference production used as a base in allocating the production quotas is higher than the current production levels of some of these producers. For context, a production base of 26.7mbpd (largely reflecting production levels as at October 2018) was used as the production base for OPEC, meanwhile production as at March stood at 25mbpd<sup>1</sup>, according to latest EIA data. Thus, based on our estimate, rather than the 6mbpd allocated to the OPEC members (excluding the OPEC+), only 4.4mbpd would be cut from current production levels if all members stick to the production quotas allocated.

**Figure 2: OPEC vs Reality Production cuts**



Source: EIA, OPEC, ARM Research

Another major cause for concern rests on the fact that **irrespective of the ambitious cuts planned by the producers, the concern on demand lingers** as major economies are set to remain shut down for the greater part of H1 2020. EIA estimates, that average demand will print at 91.4mbpd over H1 2020 compared to 100.8mbpd average over 2019 and 101.4mbpd over H2 19. Thus, while the voluntary supply cuts will soften the impact of the plunge in demand it will hardly be enough.

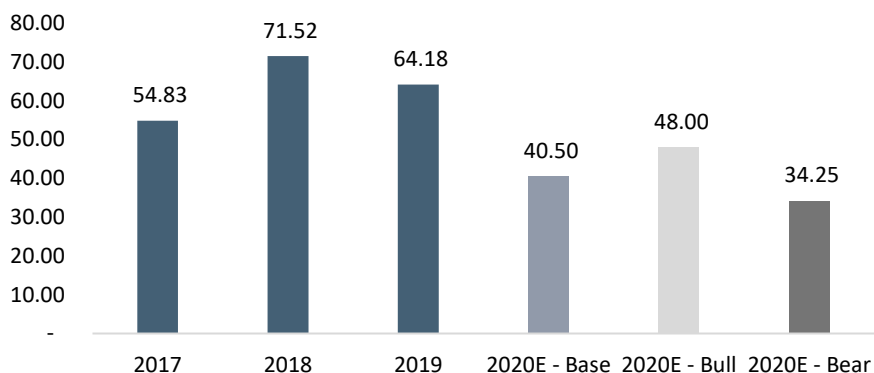
***Oil Price forecast revised lower to \$40.5 from \$47.5\$.*** Going forward, we have revised our oil price forecast lower to largely reflect our revisions to demand forecast. In line with EIA’s forecast, we estimate demand will print at 95.5mbpd over 2020 – 91mbpd over H1 20 before recovering to 100mbpd over H2 20. The recovery in H2 largely reflects assumption that the impact of the COVID-19 dissipates over the

<sup>1</sup> Excluding Iran, Libya and Venezuela who have been exempted from the cuts.

second half of the year. It is worth stating that, H2 typically holds stronger seasonal demand thanks to the summer driving season and the winter seasons in Q4.

On the supply leg, we assumed a decline in supply by 3.7mbpd YoY to average 97mbpd over 2020. Bulk of the decline in supply stems from US and members of OPEC+ -- particularly Saudi Arabia and Russia. We estimate US production will average 11.7mbpd this year, compared to 12.2mbpd last year. You will recall that coming into the year, average US supply was expected to be under pressure this year, as US oil majors scaled down capex plans. However, in light of current low prices, we envisage the decline could be even steeper. We estimate OPEC supply will average 26.6mbpd over 2020; compared to 29mbpd in 2019 – in response to not just the agreed cuts, but also in light of scarce demand and the decline in prices. The foregoing will result in a net surplus of 1.34mbpd over 2020.

**Figure 3: Base, Bull and Bear case oil price forecast**



Source: Bloomberg, ARM Research

***The risks to our forecast.*** On the upside, a better than expected cut to production cut by OPEC and other producers could push supply lower to 95.6mbpd and reduce net surplus to 0.08mbpd. Our bull case forecast for prices prints at \$48/bbl.

On the downside, should the Coronavirus pandemic last beyond H1 20, and recovery start to creep in slowly from Q4, rather than Q3 as we, in line with EIA, estimate. This could bring demand average lower to 92.7mbpd in 2020. In addition, should producers fail to cut production as earlier envisaged, oil surplus could print at 6.7mbpd. This results in an oil price forecast of \$34 in our bear case scenario.

***ARM Securities can purchase Treasury Bills and Bonds on your behalf. Rates quoted are indicative and will be firmed up upon client's confirmation. For enquiries contact:***

**ARM Securities**

Research	234 (1) 2701653	research@armsecurities.com.ng
Institutional Sales & Trading	234 (1) 448 8833	trading@armsecurities.com.ng
Customer Service	234 (1) 4488282	customerservice@armsecurities.com.ng

[Please see our Disclaimer](#)