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Expectations behind Oil review in 2019

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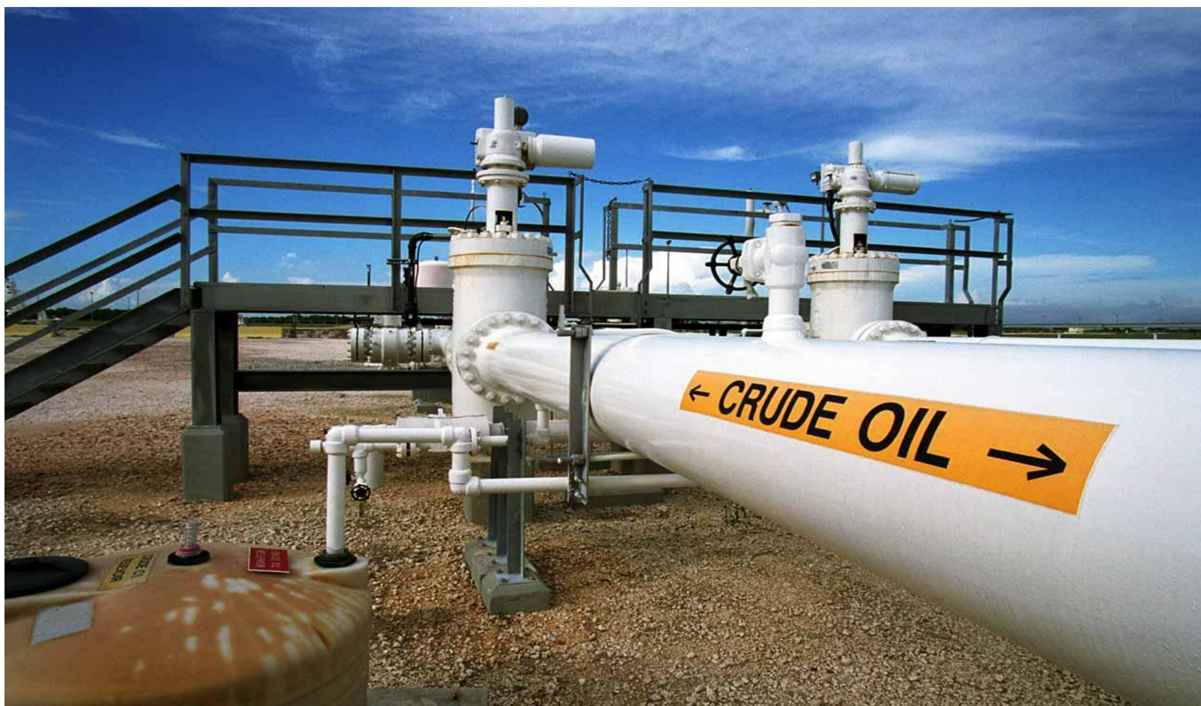

Dilshad Mwani

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Expectations behind Oil review in 2019

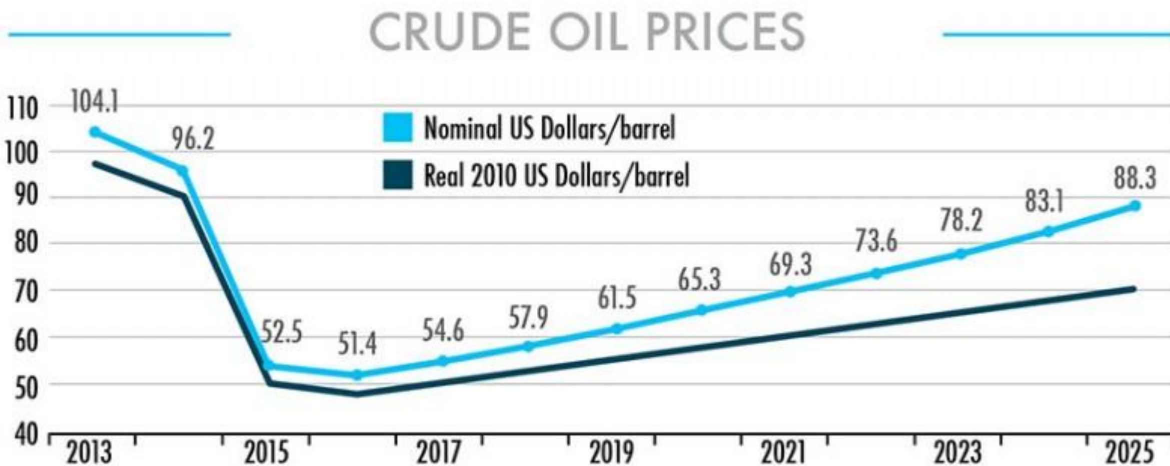
The Brent crude futures curve flattened significantly in the last quarter of 2018 as oil prices slumped to $50s per barrel by end-year compared to four-year highs in early October of $86 per bbl, as US sanctions on Iran went into force. At the time of writing, the market remains in ‘contango’–where forward prices exceed spot price–on anticipation of supply glut or rising levels of inventories (crudes and products).

The latest OPEC + agreement cutting output by 1.2mn in 2019 (Iran, Libya and Venezuela exempted) should at least put a ‘floor’ under prices and lead to a ‘balanced’ rather than ‘tight’ market. Although cuts might prevent inventory build-up, perhaps not visible until mid-year, which could force extending cuts until end of 2019.

“The global supply surplus is not resolved and would likely remerge if OPEC+ (notably Russia) let up on its production cuts,” noted the International Energy Agency (IEA). Emirates NBD Bank believed, “If the cartel really wanted to change the market and re-establish its dominance, would have been a production cut agreement to the tone of 1.4 to 1.8mn bpd.

Saudi Oil Minister ‘’Khalid al-Falih’’ tried to reassure the market that we would not see a repeat of the 2014-16 meltdowns. “We remain focused on fundamentals;

I can tell you we will achieve a balance between supply and demand in 2019," he stated.



However, much depends on relentless growth in non-OPEC supply (notably the US). The Energy Information Administration (EIA) expects US output to surge by one-tenth to 12mn bpd in 2019. Can the shale gas boom continue in a protracted bear market? Shale gas producers need $40 to $50 per bbl to pay the high-yield bonds used for financing. "If crude oil remains around current levels ($50 per bbl), US growth should start to slow," noted Morgan Stanley.

Important trends to watch over coming months is whether muted global output growth is reducing fuel consumption; will US shale gas production maintain its incredible pace; will chronic decline in Venezuelan output continue; what will full-brown US sanctions do to Iranian exports; and if OPEC+ partners (notably Russia) can satisfactorily enforce output discipline?

Furthermore, other factors such as geopolitics, global trade risks (i.e. US-China trade war), emerging markets currencies crises, higher US interest rates relative to other prime (OECD) economies, stronger US dollar and renewed supply outages amid shrinking global spare capacity (well-below 2mn bpd) can weigh heavily market's sentiment-causing greater price volatility.

The cost of oil imports becomes more expensive because oil is priced in dollars. Hence, a surging dollar hits fuel demand in countries with weaker currencies and pushing down oil prices. Fitch Solutions Macro Research (Fitch Group) wrote, "Loss of exports from Iran, low inventories, limited spare capacity and continued under-investment in the sector will drive the market into deficit from 2019. That

said, we note rising risks to demand, as emerging markets start to feel the pain of a stronger dollar, tighter liquidity, higher oil prices."

The IEA foresees supply continuing to outpace demand throughout 2019, as a "relentless" rise in output is swamps growth in consumption that is at risk from a slowing economy–posing dilemma for OPEC kingpin (Saudi Arabia) to sanction even deeper cuts to restore market balance.

The return of market stability, along with lower development and project costs led to the resumption of exploration and development (E&D) activity during year-ended, which may continue into 2019. Energy companies will spend a total of $425bn in upstream sector in 2019, up from $400bn in 2016-17, but significantly below the $770bn capital expenditure in 2014, before prices crashed from $100 per bbl, according to (Wood Mackenzie).

After collapsing between 2014-16 by more than 40 per cent amid the downturn, an upstream recovery that saw four per cent growth in 2017 accelerated five per cent last year, accounting for projects worth $472bn, the IEA said in its World Energy Investment 2018 Report.

The 2019 predictions indicate the price range of $60 to 65 rather than $70 to 80 per bbl. For market upturn, crude futures need to move back into a stronger 'backwardation' where near-term prices are higher versus those for later delivery–making it unprofitable to store crudes. That, in turn, reduces global oil stocks.

OECD commercial inventory totaled 2,872mn barrels last October (IEA data)– broadly in line with the five-year average.

This is an extract from an exclusive article by economist (Moin Siddiqi) which will be published in Oil Review Middle East issue January 2019.

There are plenty of variables that could inject a ton of uncertainty into the annual $2 trillion world petroleum market as we enter 2019.

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