Economics

DBS Flash

Oil price: Testing unknown territories

Strategy/Gold/Oil

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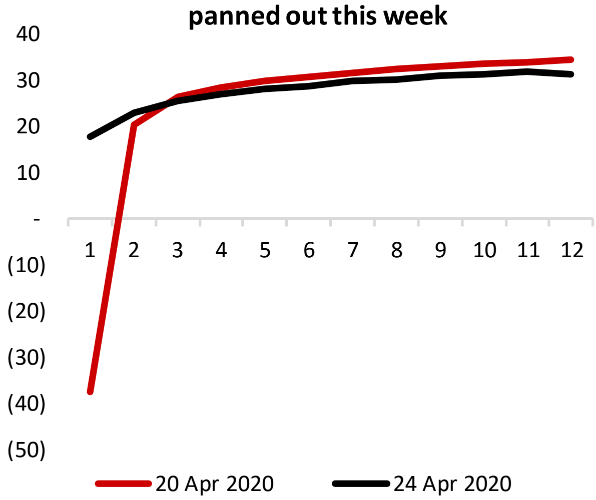
- *As WTI tests "negative" levels, we reiterate our views of continued downward pressure on oil prices in 2Q20*
- *Brent could test unchartered waters as well in coming days or weeks as storage levels worldwide under stress*
- *But we continue to expect strong oil price recovery towards end of 2020, though this will depend on timing of easing of lockdowns currently in force worldwide, as well as level of compliance to previously announced production cuts by OPEC+ members*

"Negative" oil prices for the first time ever

Oil prices, as represented by the WTI front month contract, briefly dipped into negative territory this week for the first time in history. Panic set in as traders desperately tried to avoid taking delivery of physical crude, with no access to storage, amid a highly oversupplied market reeling under the effects of a global lockdown, situation. Of course, the plunge was exacerbated by the increased participation of oil ETFs like USO in the front month WTI contracts, raising the volume of speculative trades with no intention ever to take physical delivery of oil.

WTI has since rolled over to June futures, which is currently around US$18/bbl, boosted to an extent by recent geopolitical noise over the US-Iran issue. The Brent-WTI spread has also normalised to more usual US$4-5/bbl levels, but it remains to be seen how the WTI index will behave again in about a month's time when the front month contract expires. One might wonder that if traders cannot access US storage for physical crude deliveries now, how will they find storage for June. The coming weeks are surely going to be interesting for the oil markets.

12-month WTI futures curve - how it panned out this week

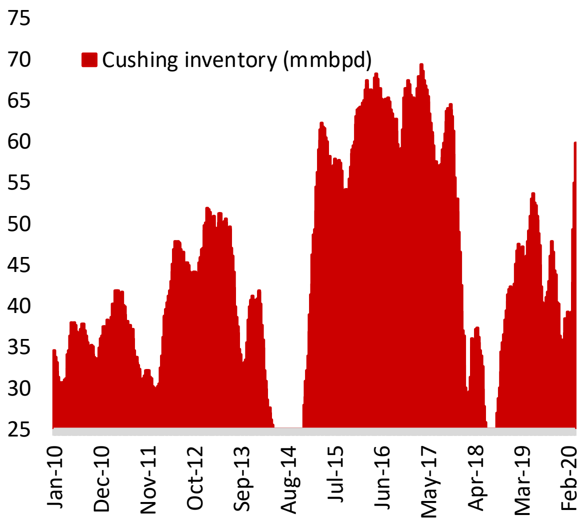


Source: Bloomberg, DBS Bank

How dire is the storage situation? On the back of consensus estimates from industry consultants, it appears around 1.5 billion barrels of oil storage capacity was available globally at the start of April 2020. Including floating storage of supertankers, it could be 10% higher. If the gap between demand and supply is around 30mmbls currently, we would need to store 900 million barrels in a month, which means by the end of May, the storage situation could be extremely dire, leading to further weakness in oil prices.

At Cushing, Oklahoma, effective peak capacity is estimated at 78mmbbls. Current estimates point to 60mmbbls of storage, which implies 77% utilisation levels. Remaining storage may have been booked already and not accessible to traders currently.

Cushing, Oklahoma, oil storage levels



Source: Bloomberg, DBS Bank

More downward pressure on oil prices in 2Q. The fact that WTI contract involves physical delivery at just one location – Cushing, Oklahoma, in the US, makes it more vulnerable to the kind of panic we saw this week if storage is not available. Brent futures, on the other hand, can be delivered at multiple locations worldwide, so could fare better than WTI. For now, international storage may be more readily available than storage in Cushing, though a few more weeks and that could change further.

Brent crude oil prices have fallen by more than 20% in a single trading session on three occasions this year, something that has happened on only one occasion ever before, demonstrating the kind of volatility we are getting used to in 2020. Hence, we expect continued pressure on WTI and Brent in coming weeks, though negative oil might be an anomaly reserved for the WTI benchmark.

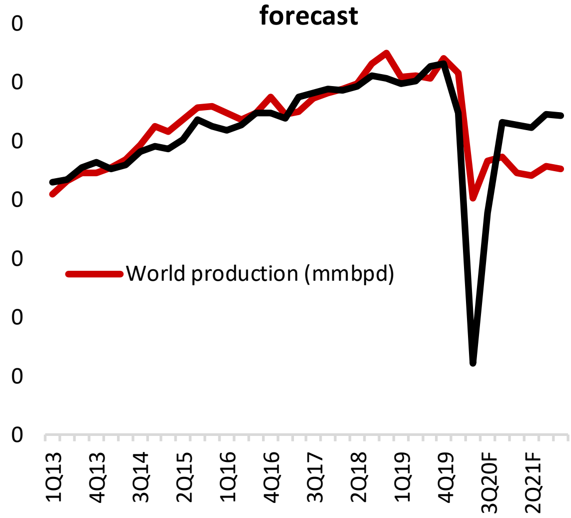
But 2Q will be the worst, long-dated OPEC+ supply cuts raises prospects for V-shaped recovery over the next 6-12 months. We expect 2Q20 to be the worst in terms of oil demand, followed by 3Q20, and demand returning to quasi-normal levels by 4Q20. Overall, we have lowered our 2020 global oil demand growth assumption to negative 11.0mmbpd, but this will be partly offset by a 7.0mmbpd y-o-y decline in oil supplies in 2020, a combination of OPEC+ cuts and and oil well shut-ins in other areas in response to low oil prices.

OPEC and non-OPEC allies have recently agreed to cut production by close to 9.7mmbpd for 2 months from May 2020, by 7.7mmbpd for the next 6 months till December 2020, and 5.8mmbpd for the next 16 months till April 2022. This sets the stage for a more balanced market 12-18 months in the future.

While the potential of easing of travel restrictions and removal of lockdowns put in place globally to tackle the spread of the COVID-19 outbreak will be keenly watched over the next couple of months, the long-dated spread of the supply cuts ensures inventories will be drawn down quickly once demand normalises and raises prospects of a V-shaped recovery towards US$55-60/bbl oil price by the end of 2021, in our view.

We are currently assuming lockdowns to be partially lifted by the end of 2Q20 in our base case scenario. If we look at a worse-case scenario, where lockdowns only begin to ease further on in 3Q20, a more conservative oil price forecast would see us exiting 2020 at around US$40/bbl and an average of US$40-45/bbl in 2021, still considerable upside from current levels.

Oil demand-supply balance trends and forecast



Source: US EIA, DBS Bank

Quarterly average oil price forecast – DBS

(US$ per barrel)	1Q20F	2Q20F	3Q20F	4Q20F	1Q21F	2Q21F	3Q21F	4Q21F
Average Brent crude oil price	47.5	23.0	36.5	52.0	52.5	54.5	58.5	60.5
Average WTI crude oil price	42.0	19.0	31.5	47.0	47.5	49.5	53.5	55.5

Source: DBS Bank

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)