DME

Issue 18 - October 2020

FUTURES INSIGHTS

The Road to Recovery, Oil Demand rebound seen stalling

Rest of the world lags China's demand bounce

OSP

$41.60

TOTAL DELIVERY

13.207 MILLION BARRELS

TOTAL EXCHANGE VOLUME

91,173 CONTRACTS

ADV

4,342 CONTRACTS

Introduction

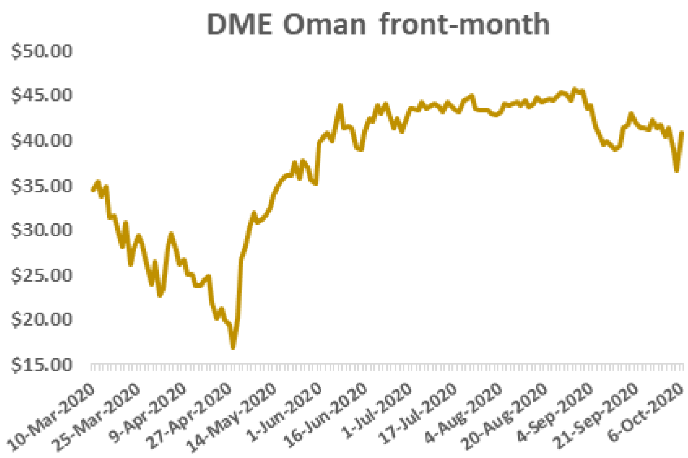
At the height of the coronavirus pandemic in the second quarter, global oil demand retreated by around a third as both oil prices and consumption retreated to multi-decade lows.

The OPEC+ producer group moved quickly to match output to the new demand outlook, while China led the initial recovery with record imports over the summer.

The overall demand outlook, however, still points to an uphill struggle to get back to pre-coronavirus levels.

Initial optimism for a strong bounce back, coupled with decisive action of the OPEC+ producer group, led to a sharp rebound in crude oil prices.

The DME Oman benchmark, which acts as a proxy value for medium sour crude trading in the Middle East and Asia, slumped to a low of $16.82 per barrel before rebounding sharply in May/June and briefly hitting $45/b by late August.



Oil prices have largely consolidated in the $40-$45/b range since the start of June, but fears of a second wave of covid-19 saw prices falter in September.

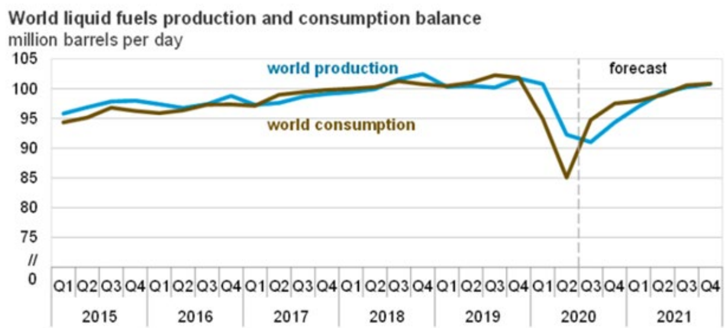
The question for the market now is how long before demand returns to pre-pandemic levels?

Prior to the Covid-19 pandemic, the world was consuming just above 100 million barrels per day (mbd) of oil, a figure that includes NGLs (natural gas liquids) and condensate.

In its most recent report, the U.S. Energy Information Administration (EIA) estimated that global consumption of petroleum and liquid fuels had recovered to 94.3 million b/d in August 2020 – down 8.2 million b/d from August 2019.

Factoring in the pre-covid 2020 analyst expected demand increase this year, we see demand is running close to 10 million b/d on where it would be without the pandemic.

EIA calculated demand at 85.1 million bpd during the second quarter of 2020 and will average 93.1 million bpd for all of 2020, down 8.3 million b/d from 2019, before increasing by 6.5 million b/d in 2021.



Industry leaders see sluggish demand recovery

Two major energy forums took place in September 2020; Singapore's long-standing Appec conference and the FT Commodities Global Summit, normally in London.

The virtual summits heard from a number of senior industry figures, mostly anticipating a slow recovery into next year.

Russell Hardy, CEO of the world's largest trading house Vitol, told the Commodities Global Summit that consumption would likely stay broadly flat until summer 2021.

Marco Dunard, co-founder and chief of Mercuria was equally downbeat though, saying he did not see oil consumption returning to pre-covid levels for several years.

Banks see slow return to 2019 demand levels

Goldman Sachs has perhaps been the most optimistic among the banks, expecting crude prices to rally in 2021, helped by a tighter oil market as the economic recovery picks up and the possibility of a vaccine.

The Wall Street bank sees demand rising by 3.7 million barrels per day from January to August next year.

Fellow investment bank Morgan Stanley has revised its timeline for when demand recovers to pre-pandemic levels from end-2021 to mid-2022; which effectively means that demand will have taken more than two years to recover to 2019 levels.

Standard Chartered sees demand in 2020 falling by 9.03 million bpd, with 5.57 million bpd of the losses returning in 2021.

Refined products - transport fuels and demand of the pre-covid 19 demand of 100+ million bpd, transport fuels account for the bulk of oil consumption.

Gasoline makes up over a quarter of global oil consumption and initial demand fell by 50% to 80% in major consumer countries.

Gasoline values slumped to discounts of $5-$7/b under crude during Q2 in the Singapore spot market, but have gradually improved.

The benchmark 92 RON climbed into positive territory against crude in Q3, but remains sluggish.

Not surprisingly, China has lead the recovery and the Price Reporting Agency ICIS expects Q3 gasoline demand to average just 3.3% lower on the year, compared to an 18% demand in the first five months of the year.

By contract, US gasoline is still down by around 9% on the year, but showing signs of improvement.

Likewise, the diesel market, which along with heating oil accounts for around 30% of global oil demand also succumbed to weak margins.

Benchmark 10ppm Singapore gasoil dropped to a record low at around $2/b over crude – a huge retreat given the 10ppm gasoil/diesel market regularly trades at premiums of $15/b and above crude.

China again leads the way and diesel demand is already back above pre-covid levels and on track for a record year of around 4 million b/d.

Much of Europe, however, has been running at below 90% of pre-pandemic levels, illustrating the rest of the world has largely lagged behind China.

While jet fuel accounts for around only 8% of global oil demand, the airline fuel has perhaps been hardest hit with air-passenger traffic obliterated by covid-19.

Jet fuel, which also regularly trades at a premium of $15/b to crude, has been largely at negative spreads vs crude since the collapse.

Singapore Jet cracks moved into positive territory at the start of October, but driven by kerosene buying ahead of winter.

Conclusion

Moving into the fourth quarter, there are some encouraging signs of further demand recovery, not just from China, though the road to full demand recovery is some way off.

Refined product values versus crude are also moving up, although analyst caution that the improvement in crack spreads is at least in part driven by reduced refinery runs.

While the rebound from the lows in April was initially robust, leading market watchers appear to in agreement that getting back to the psychologically-important 100 million b/d level is some way off, and that keeping the market in balance will take further concerted efforts on the supply side.

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