OIL MARKET FORECAST – DECEMBER 2020

Summary

This is the final issue for 2020 and so it is natural to both look back and look forward – looking back on A&D activity levels for the year and looking forward to the oil market for 2021.

If we start by looking back, 2020 saw a collapse in activity in the A&D market every bit as pronounced as the collapse in the oil market, with US activity at less than a quarter of the level of 2019. We can only hope that this marks the bottom of the industry's cycle; see the A&D section for more detail.

Looking forward global oil inventories should continue to draw down through the first few months of 2021 following the latest OPEC+ intervention. However, without a further extension of the OPEC+ production curbs, or a much stronger than anticipated recovery, the market will swing to surplus from May and oil inventories will be back to May 2020 levels by the end of 2021.

A few key points:

- Under current assumptions, the oil market returns to oversupply in 2021 and then a small supply deficit in 2022, which accelerates into 2023.
- Estimates of global crude stocks in 2021 support a further extension of OPEC+ production curbs.
- There is an increasingly urgent need to invest in production capacity beyond 2022 in order to safeguard supply.
- Brent crude futures for 2021 delivery broke above $50/barrel for the first time since March.
- US land oil rig counts have continued to rise, averaging 4% week on week growth since September.
- Global A&D spend fell from $48.4 billion in 2019 to $15.8 billion in 2020.

Oil Supply and Demand

Demand estimates from the latest IEA report[i] show a small demand increase for full year 2020 and a fall for the first quarter of 2021, with demand estimated at 91.2 MMbbl/day and 95.4 MMbbl/day for 2020 and Q1 2021 respectively. The latest EIA report[ii] has shaved approximately 0.5 MMbbl/day from its demand estimates for 2020 and 2021, with current estimates at 92.4 MMbbl/day in 2020 and 98.2 MMbbl/day in 2021.

Neither the IEA or the EIA have upgraded their demand forecasts following news that both the Pfizer and Moderna vaccines were approved for use in the US and that the Pfizer vaccine was approved for use in the UK. This suggests that there may be some potential upside in the demand figures, with the pace and extent of the return of air travel the biggest uncertainty.

New supply data is in line with last month's forecast. The latest EIA data for September showed US oil production rebounding to 16.2 MMbbl/day from 15.9 MMbbl/day in August. US supply is expected to stabilize at about 15.5 MMbbl/day through to the end of the year. The US onshore oil rig count continues to grow since bottoming out in August at 156 units; rigs have been added steadily since September, reaching 247 units as of this report.

Supply is expected to average 92.1 MMbbl/day through the last quarter of the year against average demand of 94.6 MMbbl/day. Libya continues to bring additional supply to market, reaching production levels of 1.25 MMbbl/day at the end of November, aiming for 1.3 MMbbl/day by year end.

Following, the OPEC and non-OPEC ministerial meeting on December 3rd, OPEC published an agreement to gradually phase in the 2 MMbbl/day of production that had been due to return in January 2021. This will now be returned in 0.5 MMbbl/day tranches, starting in January, reviewed monthly, with no more than 0.5 MMbbl/day being returned in any given month. This is a welcome development, as it means the oil market is now expected to remain in deficit for the first four months of 2021, as shown in Figure 1, below. May 2021 sees a steep jump in production as all OPEC and non-OPEC supply agreements expire.

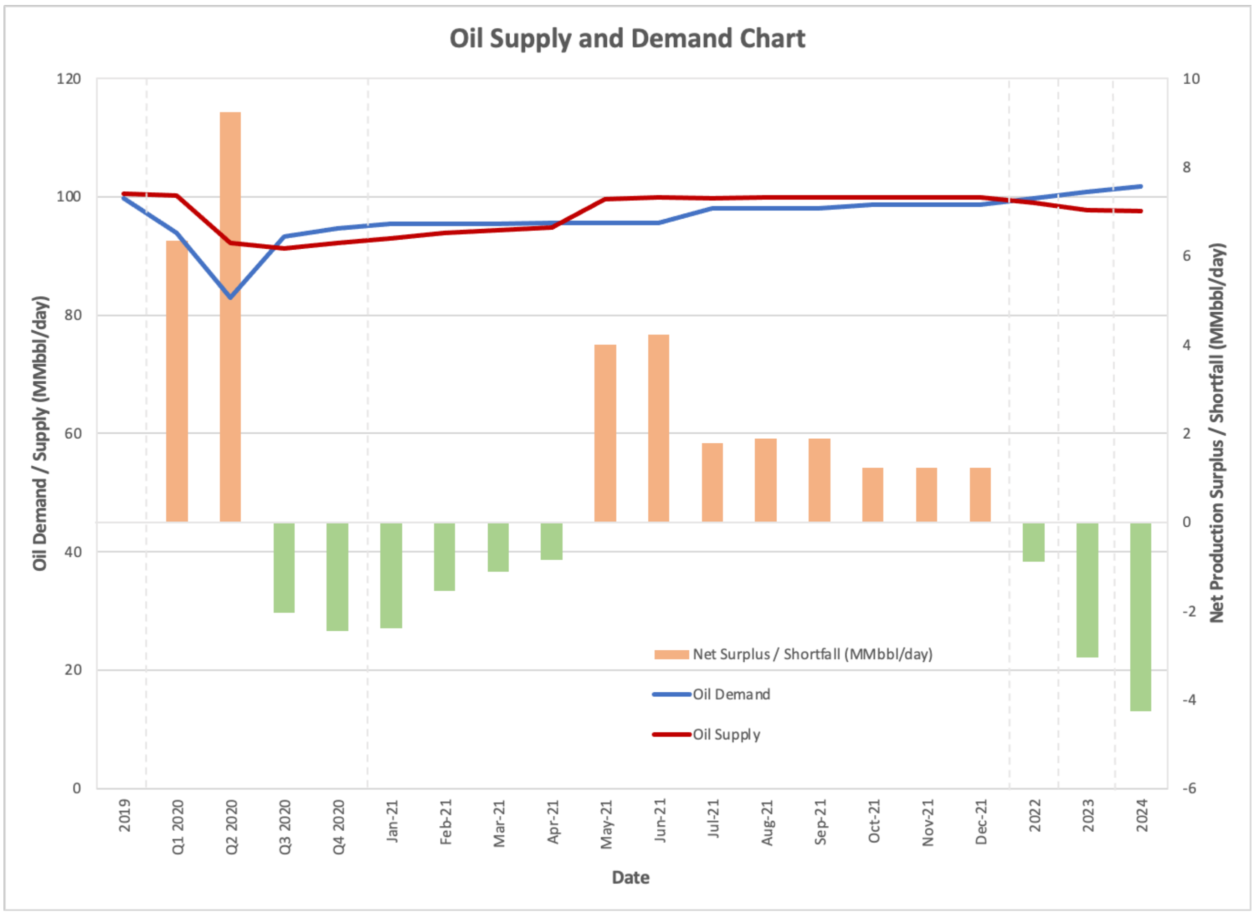

Figure 1 - Supply and Demand and Surplus Forecast

Even with the extended OPEC+ supply curbs, the market is expected to be in surplus for 2021 and essentially balanced through 2022 before moving into a sharp supply deficit. It may be reasonable to expect OPEC to continue to monitor the situation and further extend supply curbs if demand recovery follows its current trajectory.

Oil Storage

Global oil inventory drawdowns are estimated at 189 million barrels and 229 million barrels in the third and fourth quarter of 2020 respectively. While this may appear a large draw, it comes after an inventory build of 1.44 billion barrels in the first half of the year. Draws are forecast to continue at an average of 44 MMbbl per month for the first four months of 2021, as the OPEC+ supply curbs restrict supply and demand recovers.

Figure 2 shows global storage capacity and inventories. Global inventories peaked in May at 4.5 billion barrels, nearly half a billion barrels short of the operational limit on global storage. They are expected to decline to about 4 billion barrels in early 2021 and then start to build again from the spring of next year, back to 4.5 billion barrels by year end. From there, they are expected to fall sharply as recovering demand outstrips supply.

As Figure 2 shows, unless demand recovers more quickly than expected, the market would benefit from additional OPEC+ supply curbs through 2021. There is also an increasingly urgent need invest in additional production capacity to safeguard supply beyond 2022, something that OPEC+ action could encourage if a tighter market yielded higher prices.

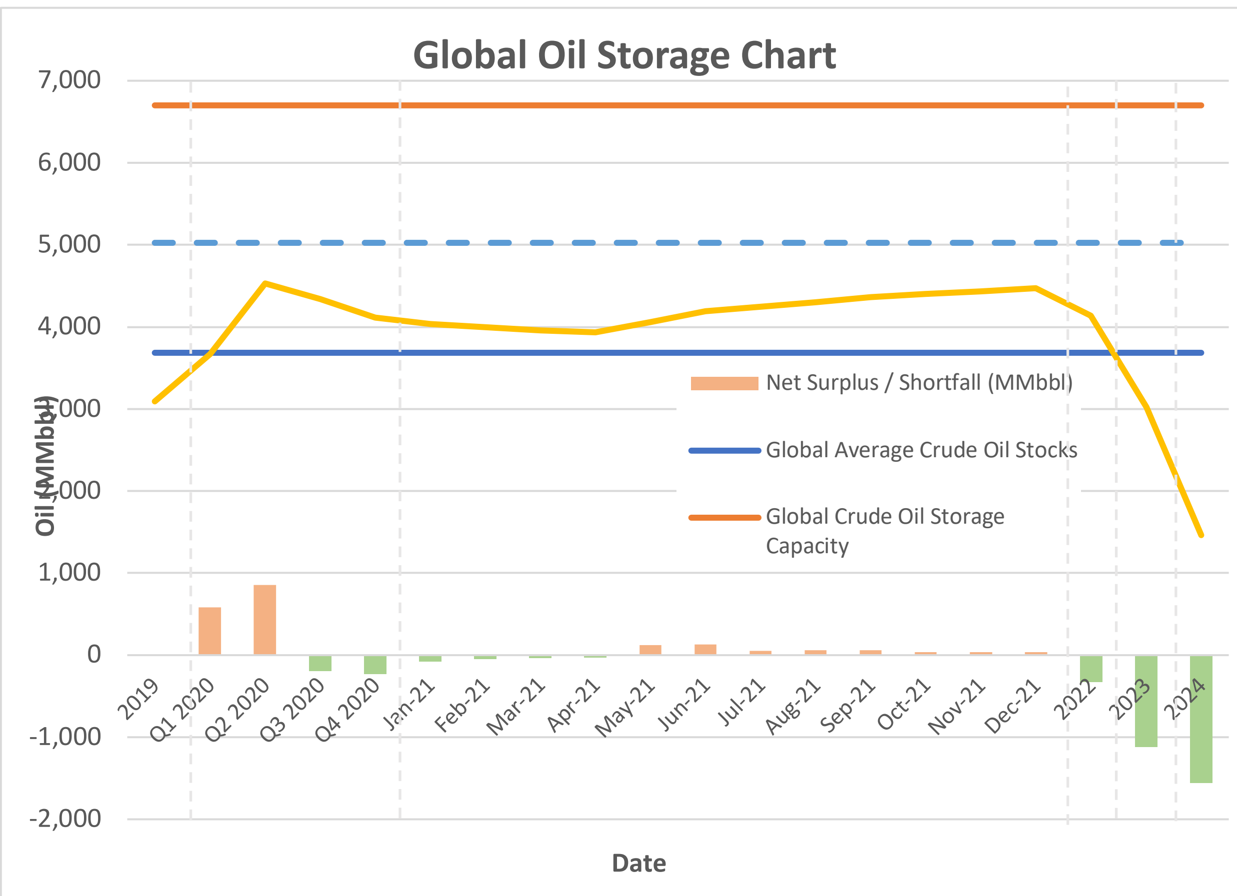

Figure 2 - Global Oil Storage Chart

While the IEA and EIA have not upgraded their demand forecasts following the approval of two COVID-19 vaccines, prices have risen appreciably since the announcement. Brent crude futures for 2021 delivery are now above $50/bbl., the first time this level has been reached since March. While WTI had fallen back below $40/bbl. per barrel in October on news of mounting COVID-19 it is now back above $47/bbl. Futures contracts beyond 2021 are priced below 2021 levels, meaning that the futures market appears to reflect the inverse of the physical market as a crude surplus is expected in 2021, with supply tightening further out.

Impact on US Investment and Oil Production

The recovery in US land oil rig count continues, with average weekly growth of 4% since September. Historic and forecast rig count for the year is shown in Figure 3. Land oil rig count is expected to reach 267 by the end of this year, and average 382 in 2021.

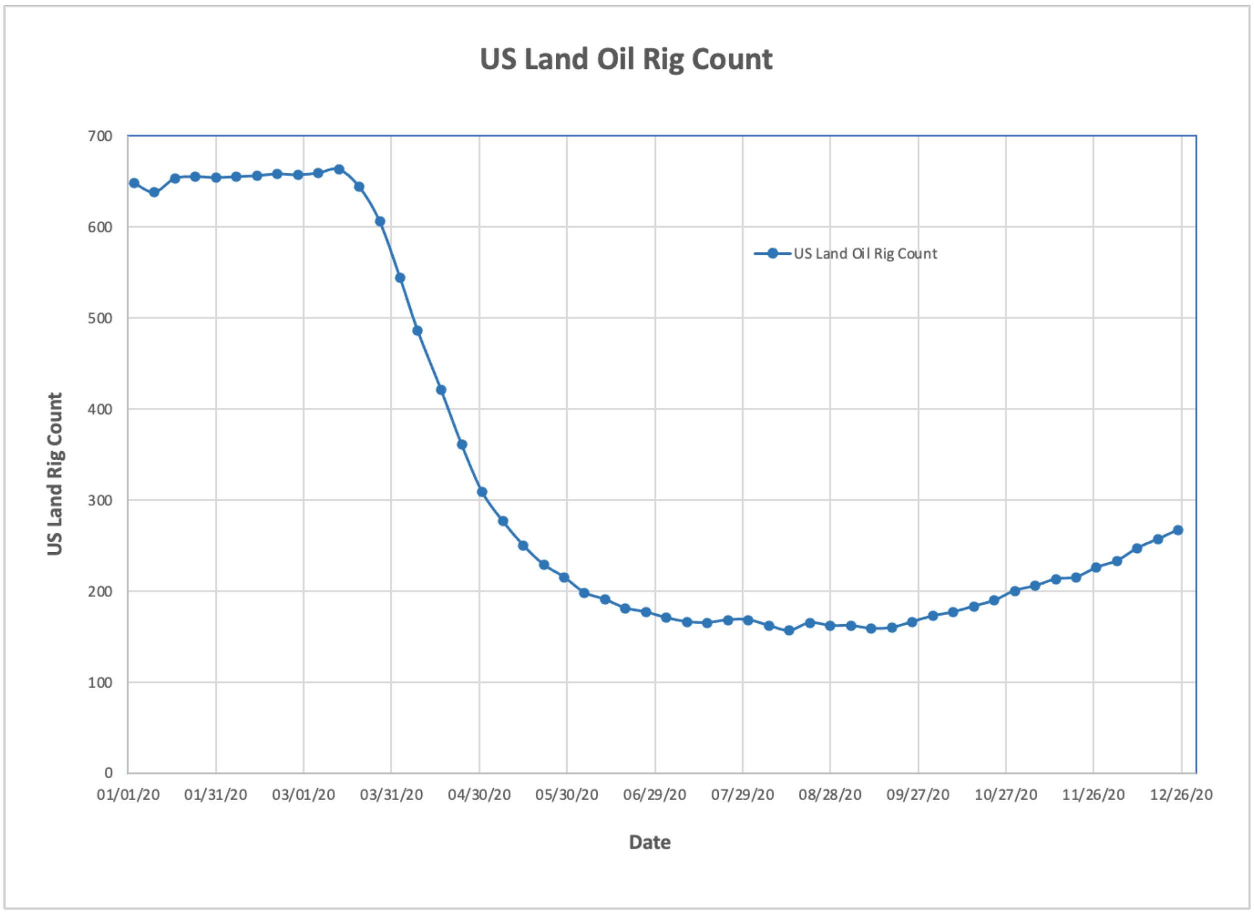

Figure 3 - US Land Oil Rig Count

A&D Market Lookback - 2020

The chilling impact of COVID-19 on 2020 oil demand was reflected in A&D market activity with global A&D spend falling from $48.4 billion in 2019 to $15.8 billion this year. The biggest component of this was US spend, which fell from $22.9 billion in 2019 to $5.6 billion this year, a drop from 45% of global spend to 35% year on year.

The most resilient A&D markets were Canada, falling from $1 billion on 2019 to $0.9billion in 2020 and Latin American, falling from $7.8 billion in 2019 to $5.5 billion in 2020. The biggest impact in percentage terms was felt in the former Soviet Union, where transaction value fell by 99%. A&D value by region is shown in Figure 4, below.

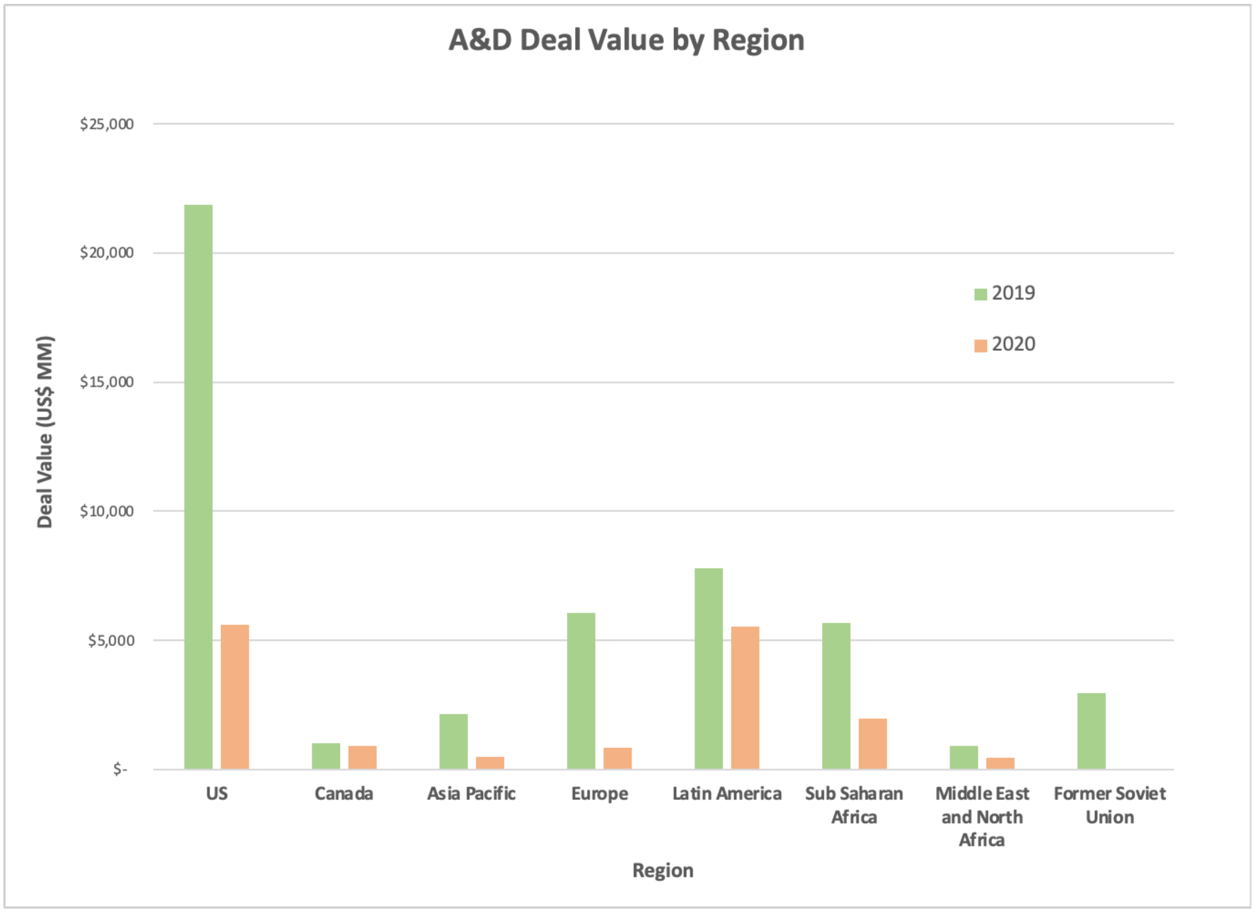

Figure 4 - A&D Value by Region

2020 saw a 35% fall in the number of transactions, but a 67% fall in total transaction value, reflected by a sharp fall in the number of deals above $500 million. These fell from 84 in 2019 to just 5 in 2020. While 2020 was undoubtedly quieter on the A&D front than recent years there were some notable transactions. The largest was Rosneft's exit from Venezuela, where it sold all its Venezuelan assets to the Russian government for 9.6% of its stock, in a deal valued at nearly $4 billion[iii]

There was some private equity activity in the third quarter of the year when The Carlyle Group announced its intention to acquire Occidental's Colombian assets for $700 million up front with some additional contingent payments. The acquisition covers 9 onshore assets: a mix of mature producing assets and exploration prospects. The transactions is expected to close by year end[iv].

Also, in the third quarter, Chevron announced the sale of some of its Appalachian properties to EQT for $735 million. The sale includes 335,000 Net Acres of Marcellus shale assets as well as its 31% ownership of its midstream joint venture, Laurel Mountain Midstream LLC[v]. In a similar move Shell had announced the sale of 400,000 net acres of Marcellus shale assets, together with its associated midstream business, to National Fuel for $541 million[vi]. Chevron had announced its intention to divest its shale gas assets in 2019, with dry gas assets having struggled to compete for capital due to depressed prices for several years.

With any luck 2020 will mark the low point for the industry and there are some grounds for optimism as we move into next year. The trauma of 2020 has forced all operating companies to shrink their organizations and cut budgets, meaning a growing list of assets that will fail to compete for a shrinking pot of capital. Coupled with the external pressure on large public companies to divest their fossil fuels business, this should provide a steady stream of high quality assets to slowly pull capital back into the sector.

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[i] IEA (2020), Oil Market Report - December 2020, IEA, Paris
[ii] Short Term Energy Outlook (STEO), December 2020, U.S. Energy Information Administration.
[iii] "Rosneft sells Venezuelan assets to Russia after U.S. sanctions ramp up", Reuters, March 28th, 2020
[iv] "Occidental Sells Onshore Colombia Assets", Oil & Gas Journal, October 1st, 2020
[v] "EQT Bids for Chevron U.S. Shale Gas Assets in Appalachia", Reuters, September 17th, 2020
[vi] "Shell Sells Appalachia Assets to National Fuel for $541 Million", Oil & Gas Journal, May 5th, 2020