OIL MARKET FORECAST – JUNE 2020

Summary

This paper presents an oil market forecast updated for June 2020 and analyses the impact on US land activity and production.

The oil demand picture in June 2020 is similar to May, indicating that the market is settling down after a turbulent few months. June will see the first draws on global oil storage in 2020, as demand exceeds supply, with a supply deficit expected for the balance of the year as a result of ongoing OPEC+ supply curbs and voluntary production shut ins. Other items to note:

- Oil inventories will fall to their long term average at around the end of the year.
- Average US land oil rig counts fall to 275 in 2020, average US oil production falls to 15.9 MMbbl/day in 2020.
- The oil market is broadly in balance in 2021 as oil demand fails to recover to pre-COVID levels, mainly due to a fall in air travel.
- A structural supply deficit emerges in 2022 and continues into 2023 as demand recovers while supply stagnates.

This forecast sees a strong rebound in 2022 and beyond as surplus inventory is worked off and supply falls short of demand. US onshore production growth would be unable to keep pace with rising demand, triggering the start of the industry's next investment cycle. Those companies that can weather the storm and survive into 2021 should be well positioned to capture this upswing.

Oil Supply and Demand

The latest IEA report is slightly more bullish on oil demand for 2020 than the May report, predicting average demand for the year at 91.7 MMbbl/day as opposed to 91.3 MMbbl/day in the May estimate[i]. This is due to a stronger than expected rebound in oil demand as economies have begun to emerge from lockdown, but still falls well short of the 99.8 MMbbl/day of average oil demand in 2019. The latest EIA report is in line with this, predicting average 2020 demand at 91.5 MMbbl/day[ii]. In general demand estimates for the year seem to be stabilizing and converging after several months of volatility.

The June IEA report also made its first estimate if oil demand for 2021, 97.4 MMbbl/day. This is sharply higher than 2020, but still below the demand levels seen in 2019. The IEA see demand recovering for all sectors by 2021, except for air travel. The EIA estimate is in line with this, with an average oil demand of 97.5 MMbbl/day for 2021.

While demand has been stronger than expected a month ago, supply cuts have been steeper. Oil supply is predicted to fall a further 1.6 MMbbl/day between May and June, to 87.8 MMbbl/day falling below demand for the first time this year.

Oil Market Balance and Storage

Oil inventories should start to draw down this month and oil demand should outstrip supply for the remainder of 2020. The oil market should achieve equilibrium in 2021, even with next year's lower estimate for demand, before demand outstrips supply again in 2022 and beyond, as demand recovers. A supply and demand and surplus forecast is shown in Figure 1, below.

The key uncertainties in this forecast are the impact of a second lockdown in the fall, adherence to production cuts and the underlying decline rate of US shale production.

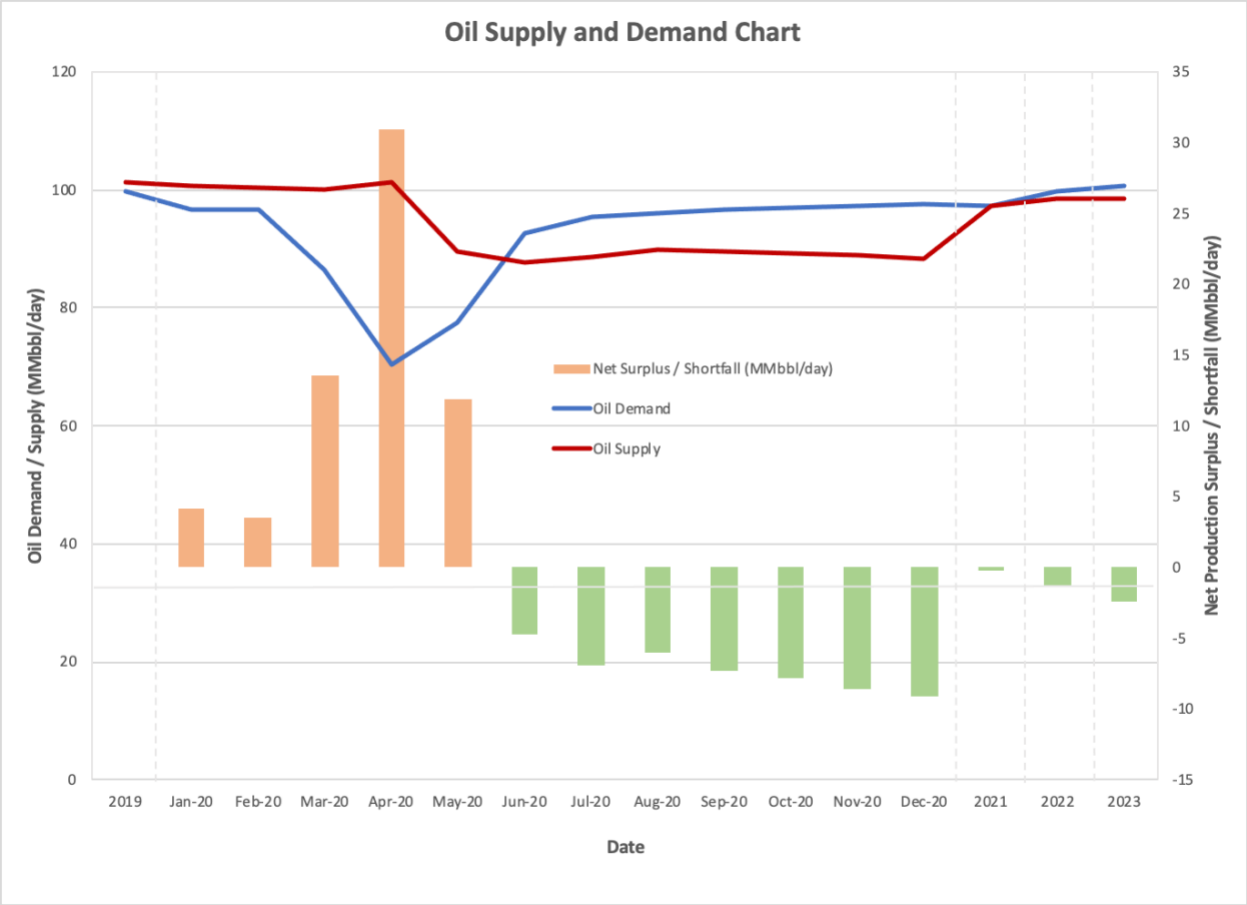

Figure 1 - Supply and Demand and Surplus Forecast

The May oil surplus is estimated at 11.9 MMbbl/day, with a June oil deficit of 4.7 MMbbl/day. The OPEC+ production cuts, together with better than expected demand have slowed the build in crude inventories, with crude oil inventories now unlikely to reach capacity this year.

The overall impact of higher demand and lower supply is that OECD crude storage should fall back to its 5-year average around the end of 2020. Supply and demand are predicted to balance in 2021 as the OPEC+ supply curbs are lifted, but demand is predicted to outstrip supply in 2022 and 2023. This is shown in Figure 2, below.

The emergence of a structural supply deficit is driven by the decline in US shale production caused by the fall in investment in the play. The underlying decline rates of us shale wells are much steeper than conventional wells and so production falls quickly unless investment is maintained. As US shale has been the major source of production growth over recent years, lack of investment in the coming years, couple with natural declines, creates a structural supply deficit.

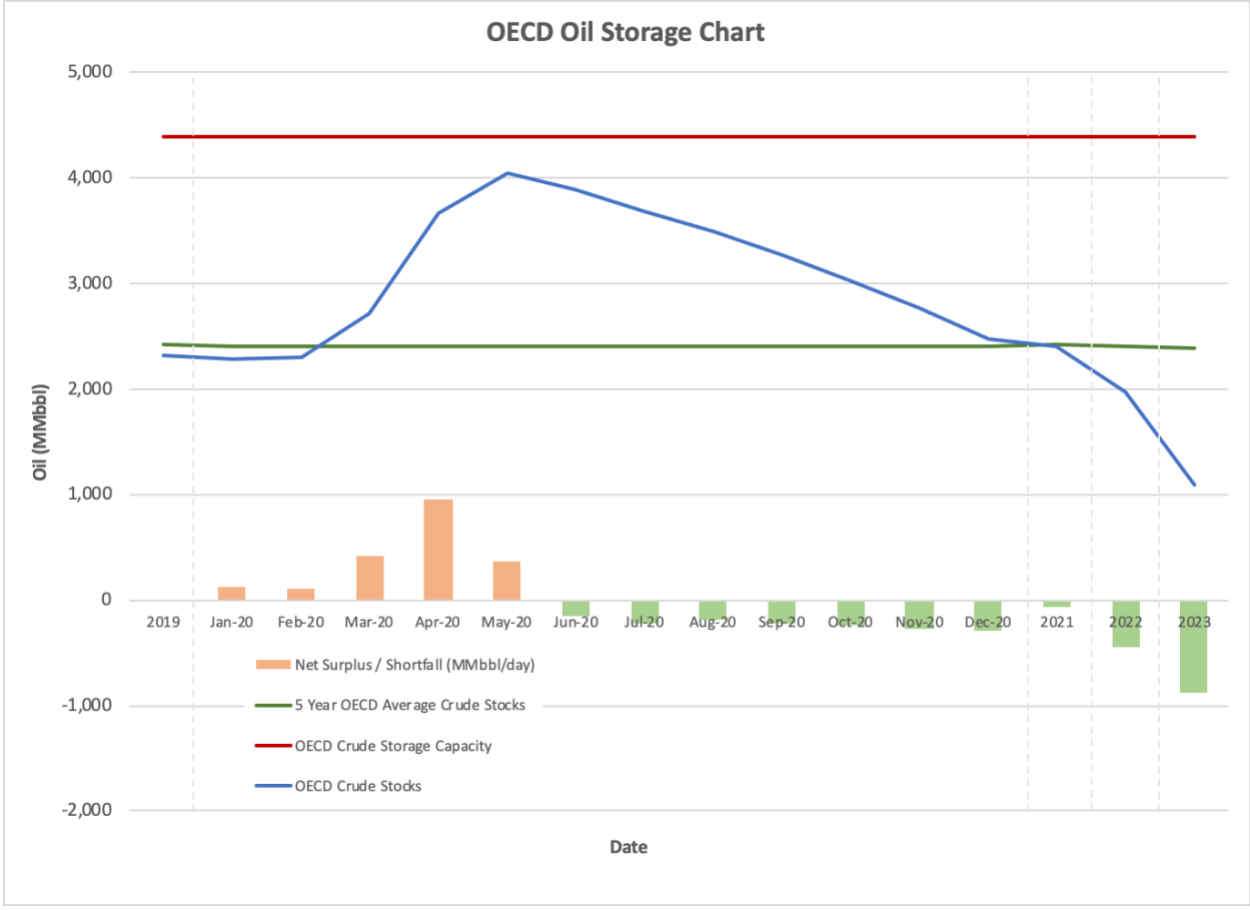

Figure 2 - OECD Oil Storage Chart

Impact on US Investment and Oil Production

The forecast sees average annual US oil rig counts falling to 275 in 2020, and 200 in 2021 before recovering. The 2020 rig count estimate is in line with last month's forecast.

The fall in the US land oil rig count over the last month has been steeper than predicted in last month's forecast – it was predicted to fall to 219 by the 12th of June, where in fact it fell to 199. This decline is set to continue, but as the fall has been steeper, the end point is higher, with a revised estimate of 70 land oil rigs in operation by year end, as shown in Figure 3. If gas rig counts remain flat for the remainder of the year, the total land rig count at year end would be about 148. A moderate rebound in rig activity is forecast for 2020, with an average US land oil rig count of 200 for the year, which implies 330 US land oil rigs active at the end of 2021.

US annual oil production is forecast to fall from a record 17.2 MMbbl/day in 2019 to 15.9 MMbbl/day in 2020 bottoming out at 14.6 MMbbl/day in 2021 before returning to growth. US oil production is shown in Figure 4, below.

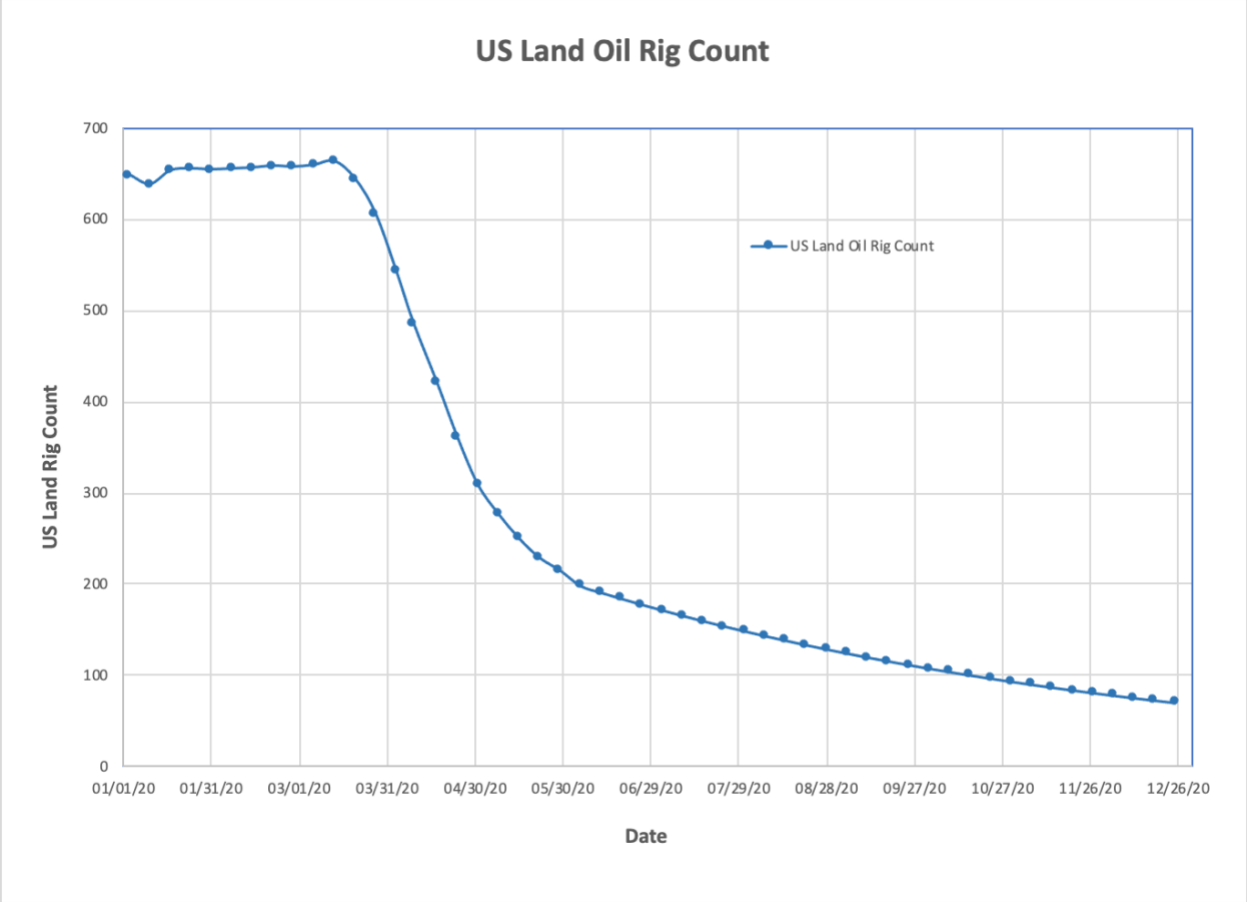

Figure 3 - US Land Oil Rig Count

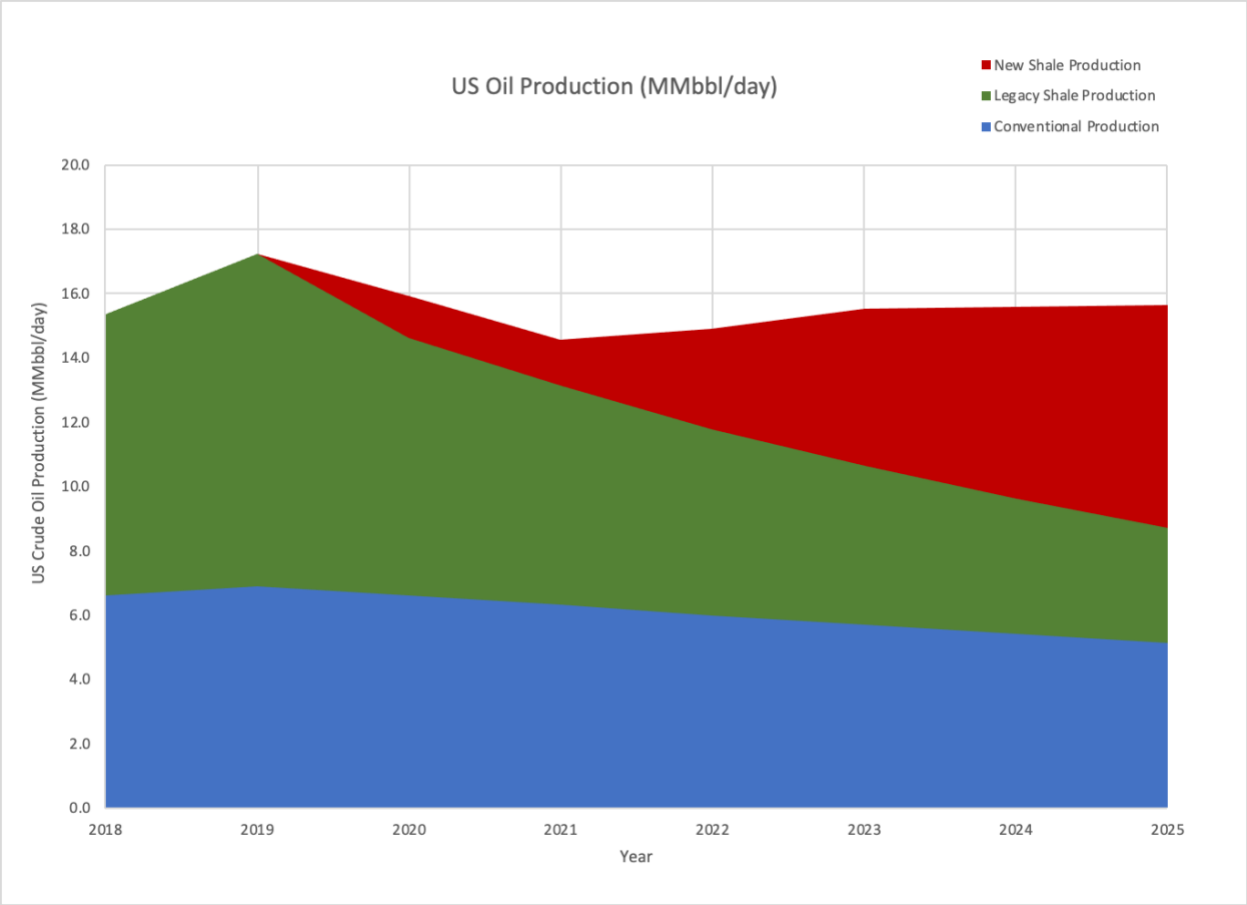

Figure 4 - US Oil Production Forecast

[i] IEA (2020), Oil Market Report - June 2020, IEA, Paris https://www.iea.org/reports/oil-market-report-june-2020
[ii] Short Term Energy Outlook (STEO), June 2020, U.S. Energy Information Administration.