Market Analysis

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Outlook for Global Oil Market Fundamentals and Prices in 2019-2020

Part IV: Price, Saudi Management, Shale Reactivity, and the New Bermuda Triangle of Oil Markets

Key Question: Can the Vienna Alliance Successfully Manage Prices Within the $65-$75/bbl Band?

An era of dangerous transition(s): In 2018, oil markets witnessed how swings in prices changed the US shale growth trajectory within months, and how external shocks complicated the Saudi-led market management effort even at a time when inventories were indicating market balance. This interplay between prices, shale growth and Saudi-led market management is only getting more complicated in 2019-2020, with decelerating global economic growth shaking the foundations underneath. The introduction of the IMO 2020 regulations will further muddy the outlook as they upend physical oil markets and create a surge in middle distillates demand likely to destabilize product markets and in turn dislocate crude oil markets. Finally, the re-negotiation of the trade terms between the US and China will disproportionally impact oil markets as rising Chinese demand remains the fulcrum of crude markets.

Barring a recession, we see oil market fundamentals progressively tightening this year, particularly during 2H2019. The compounding effect of renewed Saudi cuts and Iran sanctions will significantly tighten East of Suez crude supplies at a time when IMO tailwinds should lift crude demand. We also expect the 4Q2018 price collapse to cool US growth entering 2019 after a gargantuan 2018. All told, we see global liquids supply/demand balanced over the year on net, **albeit with global crude inventories drawing 0.8-1.0 MMb/d over 2H2019, as preparations for the IMO 2020 and associated margins uplift lead to a surge above seasonal crude demand patterns.** Even as decelerating global economic growth pressures net refined products demand growth, **we believe that the crude supply/demand forces should be sufficient to maintain annual average prices broadly in the 2018 price range with a potential upside breach heading into the summer as the crude tightening becomes clearer.**

A set of complex physical transitions are unfolding in the next two years. Even in a stable global market environment, the IMO 2020 changes would represent the largest "planned disruption" in the recent history of physical oil markets, upending a 3+ MMb/d global bunker fuel market overnight. For markets, the precise impact on refined product prices and crude price differentials is difficult to assess, as this sudden shift in demand patterns forces refiner adjustments that are likely to create product and regional dislocations with complex feedback loops. Simultaneously, the US' transition into the second largest global crude exporter over 2019-2020 and search for markets for ultra-light crudes, as global medium/heavy crude availability declines as a result of sanctions or voluntary cuts, is likely to compound the IMO effect and potentially exacerbate a nascent glut of gasoline. If global macro signals were confused in 2018, 2019 is likely to see physical market signals get even more disjointed.

Trade issues writ large will sit at the heart of the market environment in 2019-2020. The one common thread tying physical market transitions and the risks facing the global economy together is the issue of global trade, and in particular the path of the US-China trade war. Trade wars have stoked global demand fears over the past 6 months because the strength of