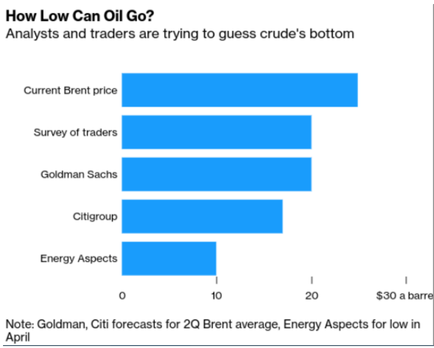
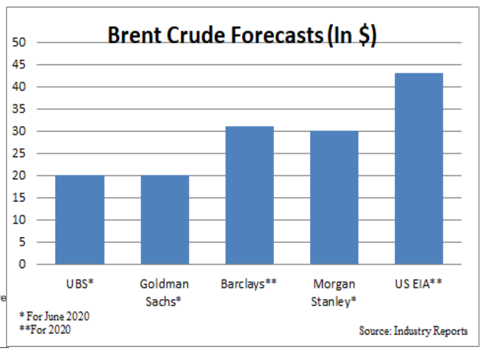
Crude Shock

‘Pandemic’ Recession

Crude Oil Prices plummeted to low 20’s after Saudi Arabia and Russia couldn’t agree on production cuts at the OPEC+ meeting earlier this month. Experts believe the overall crude price outlook remains low as long as travel restrictions are in place and governments across the globe curtail commercial activities to prevent the corona virus spread. On Tuesday, Barclays slashed by $12 a barrel its estimates for average WTI Crude price this year to $28 per barrel, and cut by the same amount -$12 a barrel - its outlook for the average Brent Crude price for 2020. Barclays now sees Brent Crude averaging just $31 a barrel this year, largely in line with other major banks that have already slashed their forecasts for Brent to the low $30s. "Prices are likely to remain under pressure until the virus situation turns the corner, and if we continue on the projected market balances path, even Saudi Arabia and Russia will not be immune from the price fallout," analysts at the bank wrote in a note. Last week, Morgan Stanley further cut its oil price forecast, expecting Brent Crude to average $30 a barrel during the second quarter, from $35 a barrel earlier. As early as March 9, Goldman Sachs had warned that $20 oil was on the horizon. According to EIA estimates, Brent crude is expected to average at $37/barrel in the second quarter of 2020 before setting at around $42/barrel in the second half of the year. EIA forecasts crude prices to average at $43 over the full year.



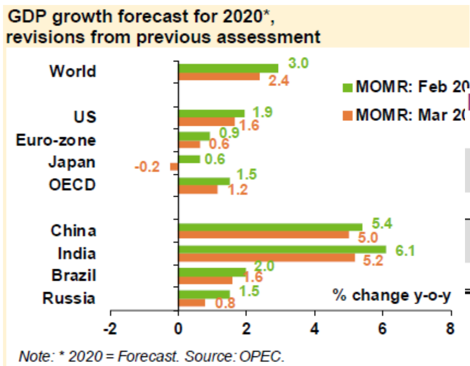


Source: https://rupertbumfrey.blogspot.com/

As the World tries to fight an epidemic, economies around the globe have tanked, it is still too early to put a number on the impact this could have globally. Economists say there is little doubt that America is headed into a recession because of the coronavirus pandemic, with businesses shutting down and Americans being shut in. According to a senior Federal Reserve official, US GDP could slump by up to 50% in Q2. But it is harder to foresee the bottom and how long it will take to climb back. Some preliminary numbers from U.S. give us an idea - Greg Daco, Chief U.S. economist at Oxford Economics, says the economy is assured of a recession - at least two consecutive quarters of economic decline - with output falling 0.4 percent in the first quarter and 12 percent in the second. “This is not just a blip,” Daco said of the outlook. “We’ve never experienced something like this.”

That would be the biggest quarterly contraction on record, but Goldman Sachs upped the ante recently, saying it expected a 24 percent drop in the second quarter. The abruptness of the descent - and the near-lockdown of major cities is unheard-of in advanced economies, more akin to wartime privation than to the downturn that accompanied the financial crisis more than a decade ago, or even the Great Depression. Even during previous recessions, nobody has been told not to go outside or not to gather at public places – this puts additional recovery risk on economies with no idea on when things could improve.

The result is an economy that has gone from full-speed-ahead in January to a full-on freeze. Economists have had to update their models daily as the pandemic increasingly throttles work, commerce and travel. “Economic data in the near future will be not just bad but unrecognizable,” Credit Suisse said in a note last week. On Thursday, the US Labor Department reported that initial jobless claims jumped 30 percent the previous week, to 281,000, the highest level since the aftermath of a hurricane in 2017. But even that number looks tiny next to the number of new claims that Goldman Sachs foresees in the next weekly report: 2.25 million.



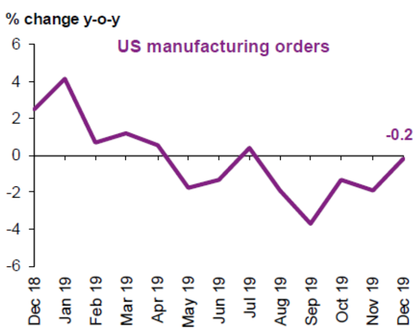
Note: * 2020 = Forecast. Source: OPEC.

Economic growth rate and revision, 2019-2020*, %

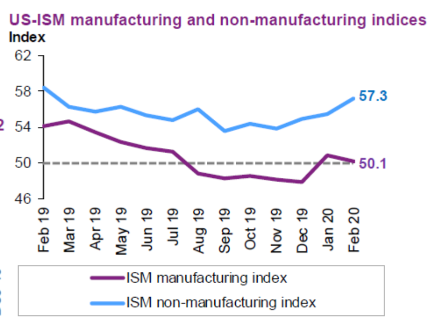
	World	OECD	US	Japan	Euro-zone	UK	China	India	Brazil	Russia
2019	**2.9**	**1.6**	**2.3**	**0.7**	**1.2**	**1.4**	**6.1**	**5.3**	**1.0**	**1.1**
Change from previous month	0.0	0.0	0.0	-0.4	0.0	0.2	0.0	0.1	0.0	0.0
2020	**2.4**	**1.2**	**1.6**	**-0.2**	**0.6**	**1.0**	**5.0**	**5.2**	**1.6**	**0.8**
Change from previous month	-0.6	0.3	-0.3	-0.8	-0.3	-0.2	-0.4	-0.9	-0.4	-0.7

Note: * 2019 = Estimate and 2020 = Forecast.
Source: OPEC Secretariat.

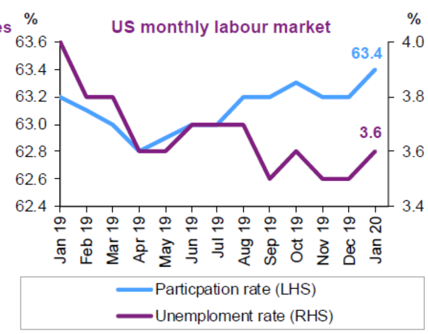
Daco says the unemployment rate could hit 10 percent in April, a level unseen since the nadir of the last recession, with the possibility of even higher jobless rates in the following months. Treasury Secretary Steven Mnuchin reportedly pointed to 20 percent unemployment in the absence of effective intervention. If Daco's 10 percent figure is borne out, 16.5 million people would be out of work, compared to 5.8 million in February - extrapolate those numbers to the rest of the world, and this could be a huge setback, one that we weren't remotely prepared for from an economic and monetary sense.



Sources: Census Bureau and Haver Analytics.

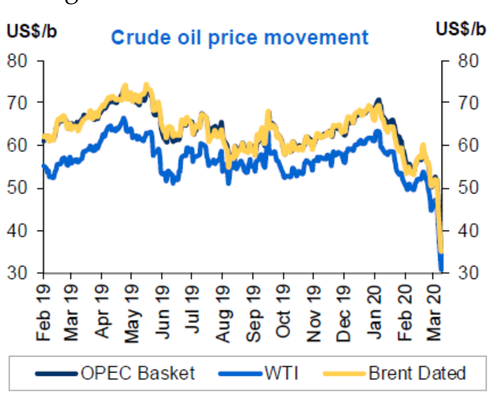


Sources: Institute for Supply Management and Haver Analytics.

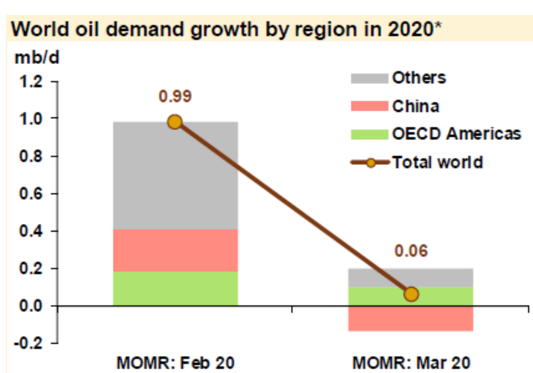


Sources: Bureau of Labor Statistics and Haver Analytics.

One reason that things could get so bad so quickly is that economic weakness feeds on itself, with demand falling as more businesses shut their doors and layoffs spread. To make matters worse, a dispute between Russia and Saudi Arabia has resulted in a flood of crude oil, depressing prices and hurting the domestic energy industry. Ultimately, the severity of the economy's slowdown depends on the length and seriousness of the pandemic. But TorstenSlok, Chief Economist at Deutsche Bank Securities, says consumers will continue to be cautious even after authorities signal the all clear. A strong rebound - what economists call a V-shaped recovery, as opposed to a U-shaped one with an extended low - would require a profound resurgence in confidence. But few see that on the horizon.



Sources: Argus, OPEC and Platts.



Note: * 2020 = Forecast. Source: OPEC.

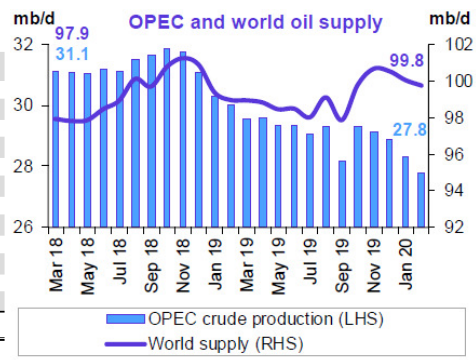
Russia and Saudi Arabia – A continuing enigma

Late in June 2019, OPEC reached an agreement to create an extended alliance known as OPEC+ which would include Mexico, Kazakhstan and Russia. Khalid Al-Falih, the Saudi Oil Minister, called the move "historic." He added that the charter "has created one of history's strongest producer partnerships, spanning the entire world from east to west. Our objectives related to market stability are now matched by the horsepower needed to deliver them."In July, OPEC agreed to extend production cuts up to March 2020 as the world's leading oil exporters fretted about a weakening outlook for global demand growth and the relentless rise in output from America's shale fields. Originally envisioned as a short-term fix in 2017 to drain excess global stockpiles, the repeated decision to keep rolling the cuts forward shows the challenge of controlling the oil market in the age of shale. While the strategy succeeded in raising prices, OPEC share of the global oil market fell to the lowest in August since 1991.

OPEC crude oil production based on *secondary sources*, tb/d

	2018	2019	2Q19	3Q19	4Q19	Dec 19	Jan 20	Feb 20	Feb/Jan
Algeria	1,042	1,022	1,019	1,021	1,022	1,019	1,012	1,007	-5
Angola	1,505	1,401	1,420	1,390	1,350	1,408	1,375	1,390	15
Congo	317	325	332	325	315	319	294	308	14
Equatorial Guinea	125	118	114	119	122	122	125	123	-2
Gabon	187	208	212	204	209	222	192	191	-1
Iran, I.R.	3,553	2,356	2,403	2,189	2,113	2,093	2,082	2,080	-2
Iraq	4,550	4,680	4,699	4,752	4,633	4,568	4,508	4,594	86
Kuwait	2,745	2,687	2,692	2,655	2,688	2,710	2,658	2,662	5
Libya	951	1,097	1,154	1,103	1,163	1,140	793	146	-647
Nigeria	1,718	1,786	1,786	1,842	1,777	1,750	1,760	1,789	29
Saudi Arabia	10,311	9,770	9,769	9,452	9,846	9,671	9,739	9,683	-56
UAE	2,986	3,094	3,076	3,096	3,135	3,117	3,027	3,040	13
Venezuela	1,354	793	776	714	714	735	756	760	4
Total OPEC	31,344	29,336	29,452	28,862	29,087	28,872	28,318	27,772	-546

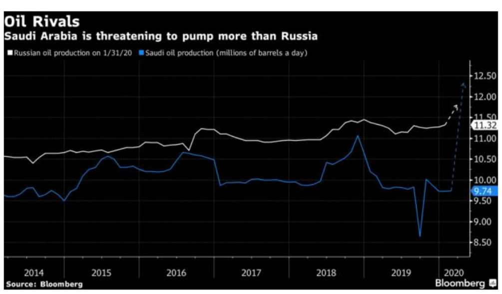
Notes: Totals may not add up due to independent rounding.
Source: OPEC Secretariat.

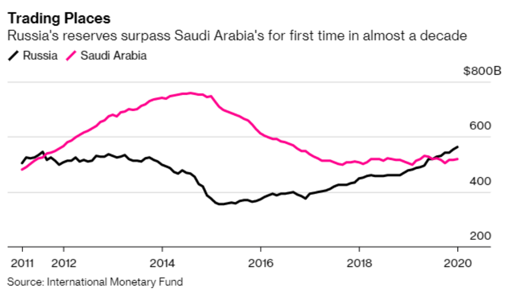


Source: OPEC Secretariat.

Saudi Arabia had earlier this month sought the support of OPEC and allies outside the cartel, such as Russia, for a substantial cut in production to stabilize the oil market, which has been reeling as the spread of coronavirus hits the global economy and saps demand for crude. But Russia torpedoed the plan, eyeing an opportunity to hit US shale producers, infuriating the kingdom and resulting in the countries removing all restrictions on their output from April. The kingdom plans to pump more than 10m barrels a day next month while announcing unprecedented discounts of almost 20 per cent in key markets, in an apparent attempt to punish Russia, while squeezing the US shale industry and other higher cost producers.

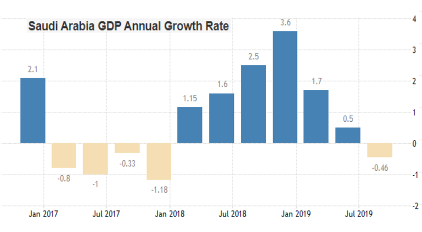
Production could eventually surpass 11m b/d, one of the people said, well above the roughly 9m Riyadh had previously proposed. The last price war in 2014 upended the global oil industry, inflicting pain on producers from the North Sea to North Dakota, and forcing them to adapt to the decisive end of the $100-oil era. Higher output from Saudi Arabia would again hit the US shale sector, the rapid growth of which over the past decade has made US the world's top producer and forced rivals to restrict output in a bid to prop up the price.

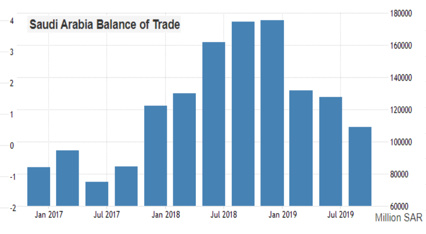


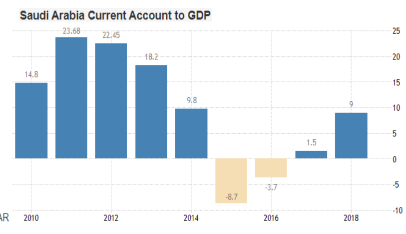


The Kingdom “has taken measures to reduce the impact of low prices of oil, and additional measures will be taken to deal with the expected drop in prices,” Saudi Arabia says, noting that additional expenditures could be re-evaluated and potentially cut. Fitch Ratings said last week –Saudi Arabia needs oil prices at $91/barrel in 2020 to balance its budget, all else being equal. “For countries in the Gulf Cooperation Council (GCC), we estimate that a change of USD10 in the price per barrel of oil tends to affect government revenues by 2%-4% of GDP.” The rating agency’s statement came a day after oil prices crashed by 25 percent as Saudi Arabia – a GCC member, OPEC’s top producer, and the world’s top oil exporter – vowed to significantly boost supply and slashed the price for its oil in a dramatic shift in its oil price-fixing policies of the past three years.

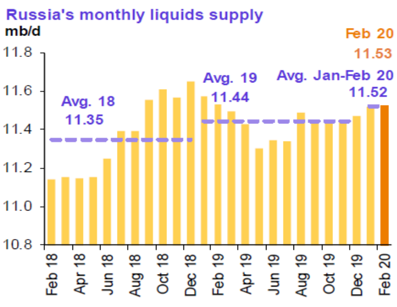
The Kingdom is signaling that it can adapt to today's lower oil prices, but analysts are not buying this claim. The longer-term damage is the lack of funds for the ambitious Vision 2030 plan of Saudi Crown Prince Mohammad bin Salman, which was already going downhill even before the oil price collapse as the promised multibillion foreign investments and Saudi investment in “diversifying away from oil” weren’t exactly flowing to the Kingdom. Saudi Arabia announced in March that it is reducing government expenditures by US$133 billion (50 billion Saudi riyals), or nearly 5 percent of its budget spending for 2020. These measures were approved in light of noticeable developments in public finance management, and the existence of the appropriate flexibility to take measures in the face of emergency shocks with a high level of efficiency, Saudi Minister of Finance and Acting Minister of Economy and Planning, Mohammad Al-Jadaan said commenting on the matter. He also added that the kingdom has taken measures to reduce the impact of low oil prices and additional measures will be taken to deal with the expected drop. According to the latest analysis by S&P Global, Saudi Arabia’s fiscal deficit could be as high as 7.4% this year and 8.1% next year.

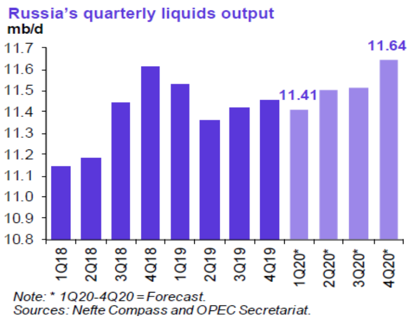


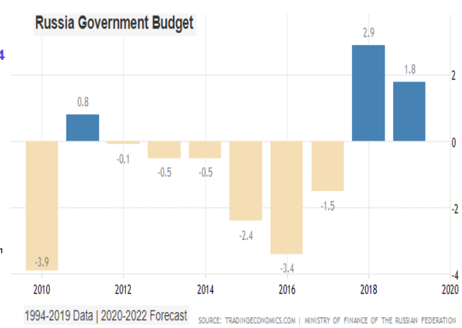




The Russians are also bracing for an oil price war, promising up to a 500,000 bpd production increase and assuring the market they have enough resources to cover budget shortfalls at $25-30 oil for six to ten years. The coronavirus pandemic and the lower economic activity, coupled with oil prices half the level before Russia and Saudi Arabia broke up the OPEC+ pact, will weigh on Russia’s revenues and budget, too. Russia’s revenues from oil and gas will be US$39.5 billion (3 trillion rubles) lower than planned in 2020, Russian Finance Minister Anton Siluanov said recently, adding that Moscow now expects a budget deficit. Analysts argue that Russia is in better fiscal, financial, and political leadership position than Saudi Arabia to win the oil price war. Yet, there will undoubtedly be economic pain for both sides in this war, which has yielded the first collateral victims - U.S. shale, Canada’s oil industry, and the UK’s offshore oil and gas sector. It’s now a game between Saudi Arabia and Russia of who will blink first, and in this game, the Saudis seem to have overestimated their fiscal buffers in the sense that they might not have the firepower to handle the current economic environment.

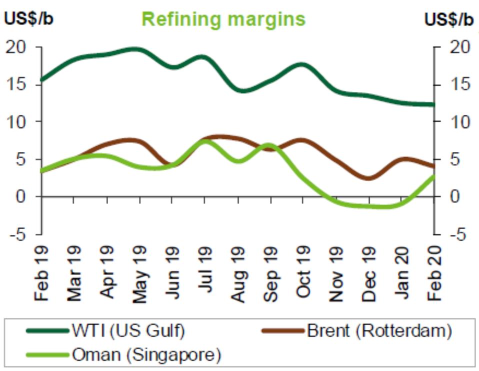




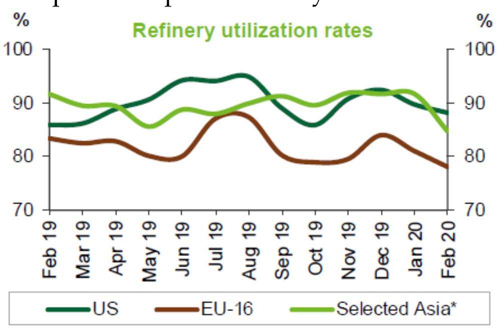


Confronted with a dizzying drop in prices, oil firms face a real challenge as they try to cut investment spending in order to survive a coronavirus-induced collapse in demand coupled with a Russia-Saudi Arabia price war. Investment in oil exploration and production was set to hit just over half a trillion dollars this year according to the French research body IFPEN, as firms sought to maintain and expand output. But the emergence of the coronavirus, which has seen nations across the world confine citizens at home and shutter businesses to slow its spread, has upended all forecasts."All companies in the sector will be seeing what more they can do to cut costs, shift their activities to the lowest cost fields they can, trim investment and think hard about what dividend they can pay," said Professor David Elmes at Warwick Business School.

US product markets lost ground, pressured by demand fears due to the widening Covid-19 outbreak that added to the prevailing market weakness. European product markets were not exempt from the repercussions of Covid-19 as major European airlines reduced flights, placing regional jet fuel markets under pressure. Refinery margins for Brent in Europe averaged $4.06/b in February, down by 90¢ compared to a month earlier but up by 64¢ y-o-y, much lower than those of WTI which averaged $12.23/barrel but both European and WTI refinery margins are likely to go down with the fall in prices. Asian product markets performed positively as a result of sizeable refinery intake cuts which restricted product output and kept prices supported despite damage to fuel demand, particularly in China due to the Covid-19 outbreak. During the month, Chinese refinery intakes were estimated to have dropped considerably compared to the previous month inresponse to the declining fuel consumption due to transport, industrial and service disruptions implemented by the local authorities tocontain the outbreak.



Sources: Argus Media and OPEC Secretariat.



Note: * Includes Japan, China, India, Singapore and South Korea.
Sources: Argus Media, EIA, Euroilstock, Petroleum Association of Japan, and OPEC Secretariat.

Impact on India

For every $1 decline in crude oil prices India's import bill is reduced by $1.5 billion according to the Confederation of Indian Industries. The industry chamber stated - "In 2020, international crude oil prices are expected to average $35 per barrel from $65 per barrel in 2019, a fall of about $30 per barrel.India is expected to save about $45 billion on oil imports for full year 2020-21."Amid the sharp fall in prices, the central government has announced a hike in the excise duty on petrol and diesel in order to shore up its coffers. It increased the levy on petrol and diesel by Rs 3 each starting March 14. With this increase, the total excise duty on a litre of petrol is Rs 22.98 and that on a litre of diesel Rs 18.83.Since 2014, the central government has hiked the excise duty on petrol and diesel several times. In 2014, when the Modi government took charge, the tax on petrol was Rs 9.48 per litre and that on diesel was Rs 3.56 a litre. In total excise duty has gone up sharply by Rs 13.5 per litre on petrol and Rs 15.2 on diesel since 2014.

EXCISE DUTY DETAILS	OLD		New	
	Petrol	Diesel	Petrol	Diesel
Basic excise duty	2.98	4.83	2.98	4.83
Special additional excise duty	8.00	2.00	10.00	4.00
Additional excise duty (road and infra cess)	9.00	9.00	10.00	10.00
Total duty	19.98	15.83	22.98	18.83

Source: PPAC, CBIC, Moneycontrol Research

	16-Feb-20		16-Mar-20	
Retail Price Buildup	Petrol	Diesel	Petrol	Diesel
Price charged to dealer	33.1	36.8	28.3	31.8
Excise duty	20.0	15.8	23.0	18.8
Dealer commision	3.6	2.5	3.5	2.5
VAT	15.3	9.5	14.8	9.2
Retail Price	**71.9**	**64.7**	**69.6**	**62.3**

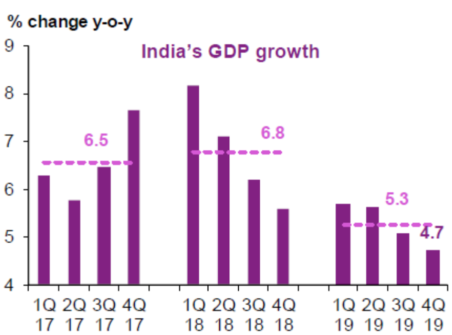
Source: IOC, Moneycontrol Research

The hike in excise will help strained government finances. The government is expecting to collect additional revenues of around Rs 39,000 crore in FY21. The benefit in the current year FY20 is, however, limited to under Rs 2,000 crore.The Union Budget had projected the fiscal deficit for FY21 at 3.5 percent of GDP. However, this was predicated on a portion of revenue targets being met by divestments in government enterprises. With volatile markets, these assumptions become very shaky.

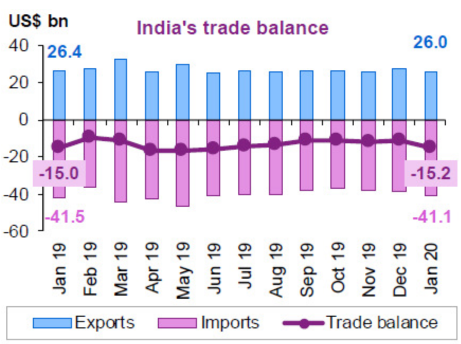
Remember that in the current year, the government has divested Rs 34,845 crore till date against a revised target of Rs 65,000 crore (original target Rs 1.05 lakh crore) and is expected to miss the revised target. The divestment target for FY21 is set at a steep Rs 2.1 lakh crore.Given the uncertainty in the divestment route and the tight fiscal position, additional revenues will provide some comfort to the exchequer.However, this hike in excise duty will naturally lead to higher fuel prices for retail customers.

India's crude imports averaged 4.7 mb/d in January, representing an increase of 6% or 0.3 mb/d m-o-m. Compared with the same month of the previous year, India's crude imports were broadly flat. In 2019, India's crude oil imports averaged 4.5 mb/d, broadly in line with the previous year. India's GDP growth expanded 4.7% y-o-y in 4Q19 which followed the revised 5.1% expansion in 3Q19. This was the weakest growth rate since 1Q13, driven mainly by slowing consumption and investment. The announced fiscal year 2021 (FY21) budget may not offer much support amid plans to limit government spending to reduce fiscal slippage in FY20, raising concerns about India's economic performance in 2H FY20.

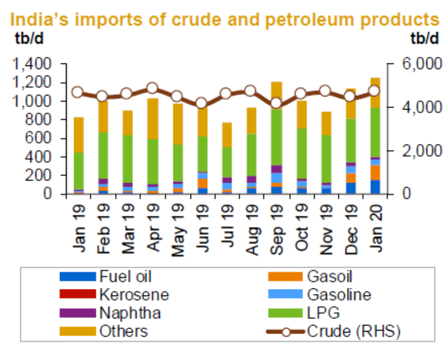
The government on Monday amended the law to get enabling powers to raise excise duty on petrol and diesel by Rs. 8/litre each in the future. Finance Minister Nirmala Sitharaman moved an amendment in the Finance Bill, 2020, to raise the limit to which the government can raise special excise duty on petrol and diesel to Rs. 18/litre and Rs. 12/litre respectively. The amendment passed in the Lok Sabha without a debate.



Sources: National Informatics Centre (NIC) and Haver Analytics.



Sources: Ministry of Commerce and Industry and Haver Analytics.



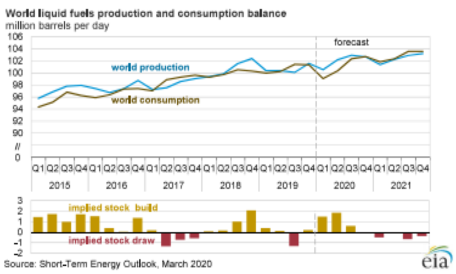
Sources: Petroleum Planning & Analysis Cell of India and OPEC Secretariat.

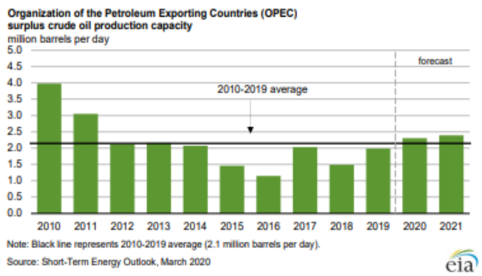
While crude prices have almost halved in the last one month, the retail prices of diesel and petrol have seen only a 3-4 percent dip. The table on the previous page explains how retail fuel prices are built.The crude price dip has resulted in a substantial flow of funds globally and has created ripples across markets. The dip is positive for the Indian economy as the country imports more than 80 percent of its crude oil requirement. The fall in prices will improve the balance of payments situation and also provides a cushion for Indian downstream marketing companies. Downstream companies usually use the marketing margin on retails fuels to adjust for low margins on the refining segment and provide for inventory fluctuation.

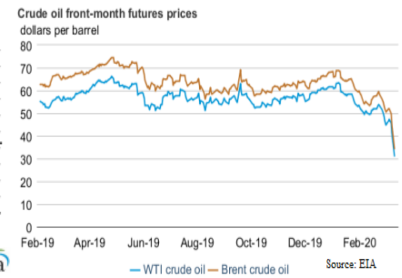
Outlook

The market has had to contend with the twin shocks of the demand destruction caused by the coronavirus pandemic and the unexpected oil price war that erupted between producers Russia and Saudi Arabia earlier this month.The current production cut deal expires March 31. "We believe oil prices will continue to fall into the teens in the short term amid disaster demand destruction, building global stocks and no production limits after April 1," said Joseph McMonigle, senior energy policy analyst at Hedgeye Potomac Research, in a note.

Almost a third of Americans are now under orders to stay at home as states took extra measures to stem the rising number of cases in the world's biggest economy. Globally, demand is expected to fall by more than 10 million barrels per day (bpd), or about 10 per cent of daily global crude consumption, said Giovanni Serio, Head of Research at Vitol, the world's biggest oil trader. Goldman Sachs estimated demand loss could total 8 million bpd, brought about by countries slowing economic activity to combat the coronavirus outbreak.Oil refiners worldwide are slashing production or considering cuts as the pandemic causes the evaporation of fuel demand







Slowing forecasts for global economic growth, primarily as a result of COVID-19, have led to significant downward revisions in EIA's global oil demand forecast. Reports of new cases of the virus in countries outside of China have led to restrictions on international and domestic travel as well as reduced activity among global manufacturers. Markets for oil, as well as other commodities and equities, have experienced significant volatility and price declines since the final week in February amid concerns over the economic effects of the 2019 novel corona virus disease (COVID-19). In addition, oil markets, in particular, have responded more recently to the outcome of the OPEC and partners meeting on March 6 with decreased oil prices that affected financial markets.

Brent and West Texas Intermediate (WTI) crude oil prices settled at $34.36 per barrel (b) and $31.13/b on March 9, respectively, declines of $20.09/b and $18.98/b from February 3, 2020. On March 9, Brent and WTI front-month futures prices declined by 24% and 25%, respectively, the second largest one-day decline in each of their respective futures price histories. EIA in its March 2020 STEO forecasts Brent crude oil prices will average $43/b in 2020, down from an average of $64/b in 2019. For 2020, EIA expects prices will average $37/b during the second quarter and then rise to $42/b during the second half of the year (although, with recent global events, these numbers are sure to be revised). EIA forecasts that average Brent prices will rise to an average of $55/b in 2021, as declining global oil inventories put upward pressure on prices.

While the major investment banks expect prices to be at or lower than the $30 mark atleast for the first half, EIA expects Brent prices to average $37/b in the second quarter of 2020, down from an average of $64/b in 2019. EIA forecasts the decline in liquid fuels demand combined with an increase in OPEC production during the next two quarters will contribute to significant increases in global liquid fuels inventories. EIA forecasts global oil inventory builds in the first half of 2020 to average 1.7 million b/d before moving to a balanced market in the fourth quarter. For 2020, EIA's WTI crude oil price forecast averages $38/b for the year, a decline of $19/b from 2019 levels, and $21/b lower than forecast in the January STEO. EIA models show about a six-month lag between changes in crude oil price and changes in wellhead production. Given that lag, EIA expects recent declines in price to lower production beginning in the third quarter of 2020. For 2021, EIA expects WTI prices will rise to an average of $50/b, which EIA expects will contribute to U.S. crude oil production rising again by the fourth quarter of 2020.

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