MOTILAL OSWAL
Investment Services

Energy Weekly

Monday, June 08, 2020

Market Commentary

Oil prices continue to surge for yet another week with Brent prices hitting a important physiological level of $40 last week, as the OPEC+ extended the output cut for one month and demand slowly recovered and supply has been reduced significantly. However, prompting several US shale operators to scale back their production curtailment plans, while Mexico is now free to resume its efforts to boost output. OPEC+ on June 6 approved a one-month rollover of their now 9.6 million b/d production cut accord, brushing aside Mexico's defection from the pact and receiving pledges of improved compliance from Iraq, Nigeria, Angola and Kazakhstan. The cuts originally 9.7 million b/d including Mexico had been scheduled to taper to 7.7 million b/d in July through the rest of the year.

The key question though is whether this extension is something that the market really needs? Prices have strengthened significantly over the last month, given the demand recovery and current supply cuts. The market was already set to transition from surplus to deficit as we move into the second half of this year, and so prices were set to strengthen over the remainder of the year. Clearly, even deeper cuts will speed up the process of rebalancing the market.

Saudi Arabia, Russia and their OPEC+ allies are adopting a more sophisticated approach: trying to flip shape of the oil price curve upside down, just playing the game the central banks are doing i.e. focus on the interplay between long- and short-term interest rates. OPEC+ wishes for mild backwardation, with spot prices higher than forward ones. The cartel's preference is a shallow backwardation of about 20-30 cents per barrel per month. Right now, WTI is on a mild contango of 15-20 cents per barrel per month.

Oil demand is improving along with global economic activity, as consuming nations ease COVID-19 pandemic lockdowns. However, a full market recovery is still not assured, ministers readily noted, in advocating for the production cut extension.

OPEC Meet:

The OPEC+ meeting fulfilled its objective with Ministers on June 6 approving a one-month rollover of their now 9.6 Mb/d production cut accord, brushing aside Mexico's defection from the pact and receiving pledges of improved compliance from Iraq, Nigeria, Angola and Kazakhstan. The cuts originally 9.7 Mb/d including

Crude Oil			
Exchange	MCX	NYMEX-WTI	ICE-Brent
Open	2825	37.33	39.84
Close	2990	39.55	42.30
1 Week Chg.	165	2.22	2.46
%change	15.80%	17.32%	17.40%
OI	3158	226353	263495
OI change	281	33768	-120058
Pivot	2936	38.76	41.50
Resistance	3051	40.47	43.28
Support	2874	37.84	40.52

Natural Gas		
Exchange	MCX	NYMEX-NG
Open		
Close	137.7	1.916
1 Week Chg.	135.8	1.89
%change	-1.9	-0.03
OI	-1.38%	-1.57%
OI change	9059	108166
Pivot	47.85%	33.55%
Resistance	137.4	1.91
Support	139.7	1.94

Front Month Calendar Spread		
Exchange	MCX	NYMEX($)
1st month	63	0.48
2nd month	-132	0.12

WTI-Brent spread$	
1st month	0.12
2nd month	0.20

Mexico had been scheduled to taper to 7.7 Mb/d in July through the rest of year.

Saudi Arabia and Russia called out the cheats at OPEC meeting for the countries that hadn't fully reduced oil output in May as agreed and extracted promises that they would compensate with even deeper reductions in the third quarter. Four countries, in particular, were held to account Iraq, Nigeria, Angola and Kazakhstan. Iraq and Nigeria have long histories of failing to make cuts they promised under previous OPEC+ agreements. Angola's production last year was well below its target, and Kazakhstan met its obligations on average over the period, thanks to maintenance and unexpected outages at its biggest oil fields. But neither cut quite as much as they had pledged last month. All four countries eventually agreed to the principle of making additional compensatory output cuts in the coming months. The real tests will be whether they do, and how Saudi Arabia reacts if they don't.

Meanwhile, the strength in oil prices is already seeing signs of some US producers bringing back shut-in wells. Parsley Energy Inc has said that it will bring back all of the 26Mbbls/d of output it cut earlier, whilst EOG Resources has said that it will start to bring back wells next month.

Inventory and Rig:

Finally, API numbers showed that US crude oil inventories declined by 483Mbbls over the last week, while stocks at the WTI delivery hub, Cushing fell by 2.2MMbbls. API numbers were more bearish on the product side, reporting builds of 1.7MMbbls and 5.9MMbbls in gasoline and distillate fuel oil respectively.

EIA showed that U.S. stock stockpiles unexpectedly fell last week, but diesel inventories surged as fuel demand remains impaired due to the coronavirus pandemic. The U.S. rig count is falling at the fastest rate on record. From March 13, the rig count was cut in half in just over six weeks and is now down 65% since that date. The only comparable period was when oil prices crashed in 2014. The number of operating drilling rigs in the U.S. fell below 300 for the first time, as energy companies continue to shut down oil-field operations amid low crude prices.

Natural gas:

Natural gas saw a choppy session with closing lower with every rally facing short covering with nothing much changing overnight in the background state for natural gas, with weather models still showing "a very warm pattern" into the second week of June.

On recent development, All eyes will be on Storm as Energy producers shut about 30% of the US Gulf of Mexico's crude oil production and more than 20% of natural gas supplies as Cristobal strengthened back into a tropical storm and began its projected trek from southern Mexico to Louisiana as 545,000 b/d of crude oil volumes and 601 MMcf/d of gas were shut with more expected to come offline late June 5 and through the weekend, roughly 10% of the US Gulf's total platforms with working personnel. This may or may not support prices. It's a balancing act between diminished supplies versus power outages (reduced demand).

Outlook:

Oil is currently bullish, and can go to levels of $43-45 but later markets can expect a slight pullback as there will be profit taking and seller pressure at this level to retest 36 level. A monitoring committee led by OPEC+ kingpins Saudi Arabia and Russia will meet June 18 and monthly thereafter through the end of the year to stay abreast of market developments and recommend any adjustments to the deal. The next formal OPEC meeting will be November 30 in Vienna, if the pandemic abates enough to allow ministers to travel and the wider OPEC+ alliance will gather December 1. Concerns remains for Iraq's ability or willingness to rein in any more production is in doubt, and Libya's state oil company is in talks with tribal groups controlling key fields that could lead to an imminent 400,000 b/d production revival. Though an OPEC member, Libya is exempt from its cuts.

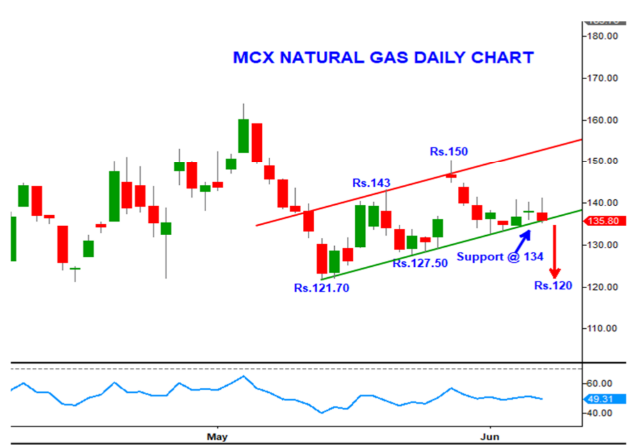
Technical Views

Crude Oil

MCX Crude Oil traded on a positive note last week and closed higher by approximately 16% at Rs.2990 level. Going ahead the commodity has got strong short term support in the range of Rs.2680 - 2700 levels and short term trend is likely to remain positive as long as the it is trading above the support zone. On the higher side crude oil is likely to test Rs.3350 level. The counter has got good intermediate support in the range of Rs.2830-2850 level and any dips towards the same should be used as an opportunity to buy the commodity. On the higher side the Crude oil is likely to test Rs.3350 level. Also 14-period RSI is sustaining well above 50 mark which is signaling strength in the prices of the commodity. Buying in dips towards intermediate support zone is thus advised. Major Support for Nymex crude oil is placed at $35.50 level whereas critical resistance is placed at $44 level.

Natural Gas

MCX Natural gas traded in a narrow range last week and closed almost unchanged from previous week at Rs.135.80 level. The commodity has been making lower tops and lower bottoms since past few days on daily chart which indicates that short term trend remains bearish. However at present the commodity has been consolidating within the range and the breakdown of the same is likely to occur once it manages to give daily close below Rs.134 level. Once the breakdown happens, the the commodity is likely to gain further bearish momentum and is likely to test Rs.125 - 120 levels on the lower side. Post breakout, Rs.142 level is likely to act as strong resistance for the commodity. Till breakdown happens, the commodity is likely to continue to trade in consolidation zone ranging from Rs.134 and Rs.144 level.



For any details

	Analyst- Energy	shweta.vshah@motilaloswal.com

For any details contact:
Commodities Advisory Desk - +91 22 3958 3600
commoditiesresearch@motilaloswal.com

Commodity Disclosure&Disclaimer: