# Oil update: Upside capped by an uncertain demand outlook

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## A quick review:

Crude oil prices are consolidating in narrow range of USD 39/bbl to USD 42/bbl driven by ongoing concerns about weakening global demand and rising new supplies. The upshot is that oil markets are still over-supplied.

**First, the demand recovery is facing a substantial headwind as "second wave" of coronavirus infections are picking up across Europe and a similar uptick of coronavirus infections is being seen across the United States.** The net result is that demand for crude is being curtailed. The UK government is implementing restriction basis three tier system, with major cities in "high" tier zone that is likely to weaken the momentum of growth. The similar restrictions like night curfew, ban on large gatherings and parties are imposed across all major cities in Europe. Hence effectively denting further crude oil demand recovery in the world's second major oil consuming region.

Secondly, **minor setbacks have been seen in the race to secure COID-19 vaccines and treatments**, with trials of several vaccine and therapies temporarily halted amid safety concerns but will resume next week, even as other studies advance. However, there has been some favourable announcements with Mordena indicating that they could get emergency sanction to distribute its vaccine later in November/December if the phase three trials pass successfully. A similar announcement was made by Johnson and Johnson that has indicated that they could get emergency clearance for distribution in January-2021 if all tests are passed. Until a vaccine or medical solution presents itself credibly, the demand outlook is unlikely to change substantially.

**Lastly, the fear of over supply runs high from: (a) rising Libyan crude output, (b) ending of oil worker's strike in Norway and (c) restoration of offshore US Gulf of Mexico production that was hit by hurricanes.** OPEC member Libya, which is exempt from the scheduled production cuts that OPEC has imitated since April that is expected to remain in place until December-2020, is ramping up production in major oilfields after armed conflict shut almost all of the country's output in January. This is adding downside pressure on crude oil prices.

Hence, **the struggling demand headwind and tailwind of excess supply are putting pressure on crude oil prices.** Brent crude oil price and WTI are currently trading at USD 42.48/bbl and USD 41.00/bbl respectively.

## Data Highlights:

**EIA weekly data:** The US crude oil inventories decreased by 1.0 mn barrels for the week to 16-Oct-2020 from previous week but is still at 488.1 mn barrels that represents a level that is excess of about 11% the five-year seasonal average. Total gasoline inventories increased by 1.9 mn barrels last week and is at about 2% above the five-year seasonal average. However, total gasoline demand fell to 8.57 mn bpd last week (9.59 mn bpd last year). Hence raising concerns of further build-up of inventories.

**Baker Hughes Rig Counts:** As per Baker Hughes's report, the US oil and gas rig count, an early indicator of future output rose further to 282 (851 last year) in the week to 16-Oct-2020. The oil rigs rose by 12 to 205 (713 last year) and gas rigs remain rose by 1 to 74 (137 last year). Both indicating signs of the start of a rebound in the US production but still remains way below last year's count as oil prices struggle to overcome global oil demand concerns.

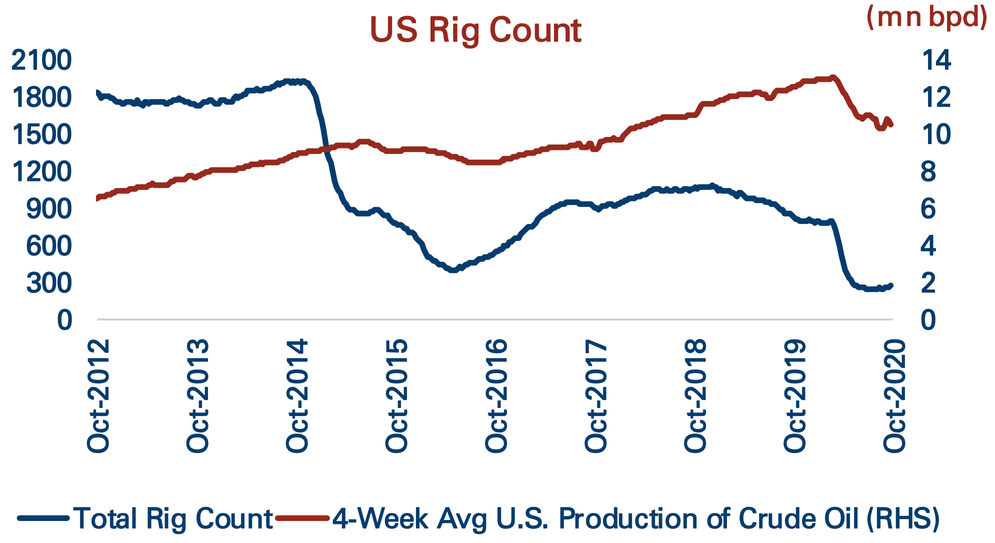
**CFTC Data:** Hedge funds added marginally to their net long positions last week. Total net long positions rose to 471.5k contracts in the week to 17-Oct-2020 from 461.9K contracts in the week to 03-October-2020, indicating a small build-up in long position as Brent crude prices consolidated near USD 42/bbl.

**Near term expectations:**

In the near term, **oil prices will continue to trade within relatively small ranges with a neutral to negative bias.** The upside is capped due to the lingering worries regarding the oil demand recovery and the economic impact of the COVID-19 measures, while the downside is protected by OPEC+ production cut agreement. The US elections (November 03) is main key event risk in the near term.

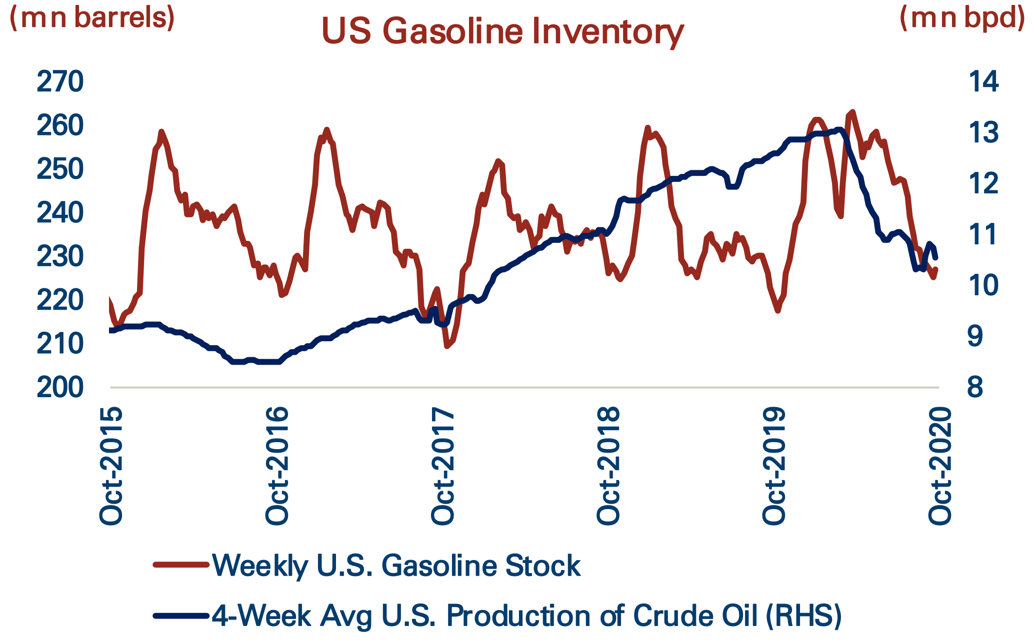
**A Biden victory along with a 'Democratic Sweep' is unlikely to change the energy landscape from both a supply and a demand perspective for oil markets in the near-term, although there could be some effects seen in the medium-term.** He would most likely renegotiate a nuclear deal with Iran resulting in lifting some sanctions and putting restriction on shale production with promotion of clean energy (~USD 2 tn) sources in the US. While he could boost the economy with a new larger stimulus package, excess supply-side concerns could continue to linger. Hence not changing the landscape even if a 'Democratic Sweep' scenario were to pan out. However, in case of an outcome in the US elections that is not in sync with a 'Democratic Sweep' scenario, there could be more downside pressures that could build-up as risk aversion might intensify. **Hence, we expect the oil prices to trade between a broad range of USD 38/bbl to USD 45/bbl in the near term with a downside bias.**

**Chart 1:** US rig count had shown signs of pick-up amid consolidation in WTI prices.




Source: Baker Hughes & ICICI Bank Research

**Chart 2:** US Gasoline inventory rose surprisingly, indicating signs of supply glut.




Source: EIA & ICICI Bank Research

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