Turbulent start of the year for oil

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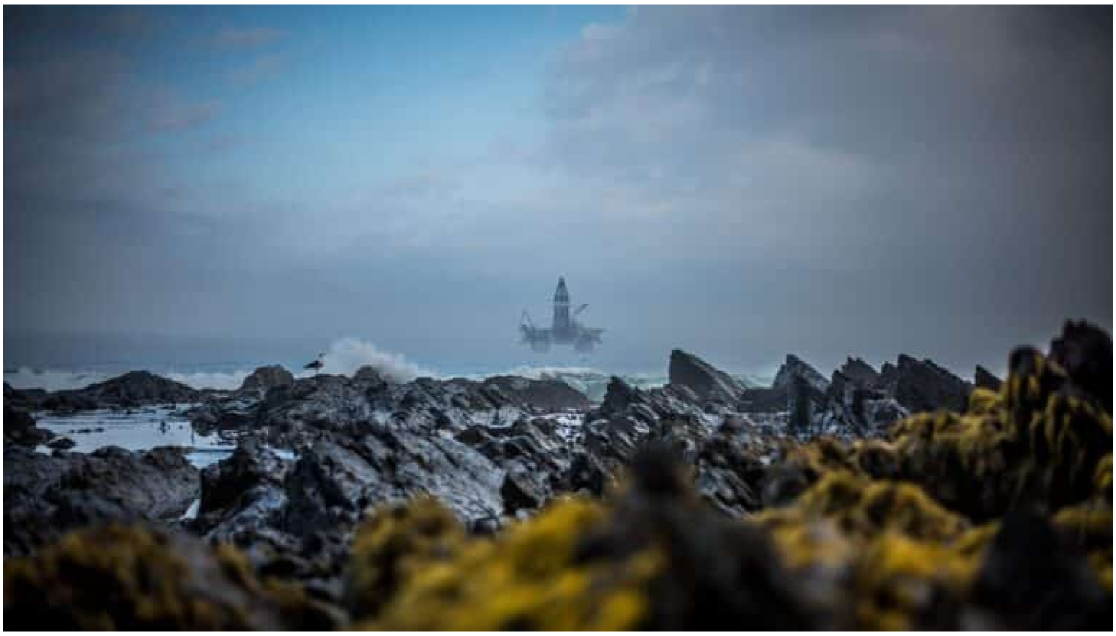

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Oil prices came under significant pressure at the outset of the year. Last week, the price for a barrel of North Sea Brent crude dropped to as low as USD 54 after peaking at nearly USD 70 in early January. The main reason cited by the markets for the price drop was concern about the coronavirus's impact in China. Fears are rising that the lung disease will affect the Chinese economy, lowering the demand for oil noticeably. An example of this was plants remaining closed even after the Chinese New Year celebrations in order to combat the spread of the virus. However, the situation in China is only one aspect of the current weak prices on the oil market.

Coronavirus is not the only challenging factor

In its latest monthly report, the US energy agency EIA significantly lowered its forecasts for oil demand. For Q1 2020, the EIA has reduced its expectations for daily demand by 900,000 barrels compared to its January estimate. It is interesting to note that only 320,000 barrels of this number is attributed to declining demand in China. This could indicate that a possible economic slump in the OECD countries (which are responsible for 500,000 barrels by which the forecast was lowered) is expected to be larger by comparison. The Organization of Petroleum Exporting Countries (OPEC) has also significantly lowered its forecast for global crude oil demand. In their view, demand in Q1 should average out to of 440,000 barrels per day less than previously forecast, according to OPEC's monthly report.

Will the oil price support hold?

Against this background, an OPEC committee has recommended to its members and other OPEC+ cooperating countries to cut the agreed production volumes by an additional 500,000 barrels per day until the end of June. The additional reduction is to be decided at a meeting in Vienna in early March. However, there are early signs of increased resistance to the price stabilisation measures: Russia initially blocked the expansion of production cuts and announced that it would "scrutinise" the OPEC Committee's proposal closely.

US oil reserves already grown significantly

It was only in December that important oil producing countries agreed to a stronger cutback of half a million barrels per day. It is questionable whether a new agreement can be reached in March, particularly as the US, gaining more and more significance as an oil producer outside OPEC+, continues to communicate no-holds-barred production. The responsible US authority has reduced its forecast for growth in global demand for oil this year by 300,000 to one million barrels per day. However, this is likely to lead primarily to increased build-up of reserves and thus to greater pressure on prices – which is also suggested by the official US crude oil inventories, which surprisingly grew twice as much as expected last week.

Legal note:

Prognoses are no reliable indicator for future performance.

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A blog post by APA Finance together with Erste AM Communications.