Energy Brief

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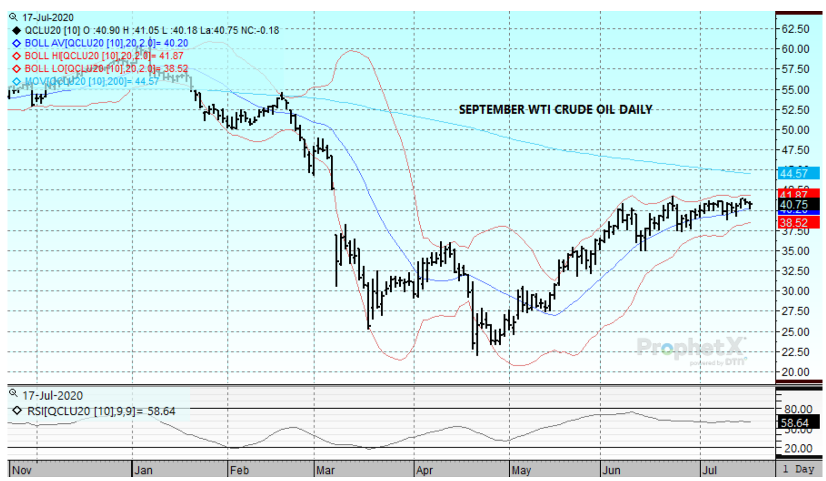
Price Overview



The petroleum complex traded under pressure initially as concern over demand reemerged following the increase in COVID cases in many areas of the US, India and Brazil. Fears that the easing of lockdowns without appropriate precautions to limit the virus spread will set back global demand from a decline of 9 mb/d projected to 11 mb/d appeared to encourage disappointed selling. Ideas that such a decline will necessitate even greater production cuts than currently planned or risk the crude and product markets becoming unbalanced helped support the more active selling interest. The outlook was reflected in comments from Royal Dutch Shells CEO, who suggested that the recovery will not be v-shaped and that the pandemic will curtail oil and gas demand for years to come, as demand linked to mobility is adversely affected. The early losses were pared late in the session on pre-weekend book squaring as equity values continue to show a firm tone.

Current estimates by the US EIA are for world demand to recover to 90.58 mb/d from 101.7 mb/d last year and 84.4 mb/d estimated in the 2nd quarter of 2020. These levels equate to a decline of 11 percent year over year and an increase of 17 percent over the 2nd quarter. Currently the 4 week average for implied disappearance in the US is 12.2 percent below year ago levels. With infection levels now at new highs in the US, the potential for secondary shutdowns remains high, implying that the recovery in disappearance at least in the US has likely run its course. If uncertainty exists, it might be regarding US totals falling short of current forecasts as we move through the summer and into fall. With global production expected to average 92.7 mb in the 2nd half of 2020, the ability of OPEC to reach a balanced market in the 2nd half is questionable. Whether they are willing to forego market share will be a key question going forward.

Although the fundamentals have shown improvement, the ongoing injection of liquidity into the global economy and fiscal support will remain a key consideration as we move forward. Despite the OPEC agreement, which has helped stabilize values, it appears producers remain cognizant of the impact of higher prices on production levels, particularly in the US where additional cuts are being delayed given the recovery in prices. The global economic recovery will need to show a steady improvement in order to move inventories down to more normal levels. For now we are unconvinced that the pace of recovery from the pandemic and OPEC's commitment to keeping production low is enough to avoid a further build in stocks, suggesting that valuations much above 41.00 to 42.40 basis Sept WTI are likely unsustainable.

Natural Gas

The market returned to its weakening ways after a minor recovery Tuesday and Wednesday. Today's action saw another weekly low put in at 1.69 before before prices scratched higher to settle NEAR unchanged at 1.718. Another below normal storage build was reported yesterday at 45 bcf, but the market was unable to garner any upside momentum after the release as prices quickly slipped to the days lows. The weakness followed through early this morning on another uptick in production, as early estimates at 88.8 bcf/d marked the third straight day of increases. Weather continues to offer underlying support as temperature expectations remain well above normal for the second half of July, although slightly lower CDD revisions over the last few sessions have not bolstered the bull case. With the Baker Hughes report at mid-session indicating a drop of 4 gas drilling rigs, some hope for a return to slowing production may provide underlying support. The market is trading dangerously close to the low end of our support range of 1.68-1.72, but we expect the potential record power burn over the next two weeks to ignite support that could build momentum to test the 2.00 level, which would surpass a 50 percent retracement of the May to June break.