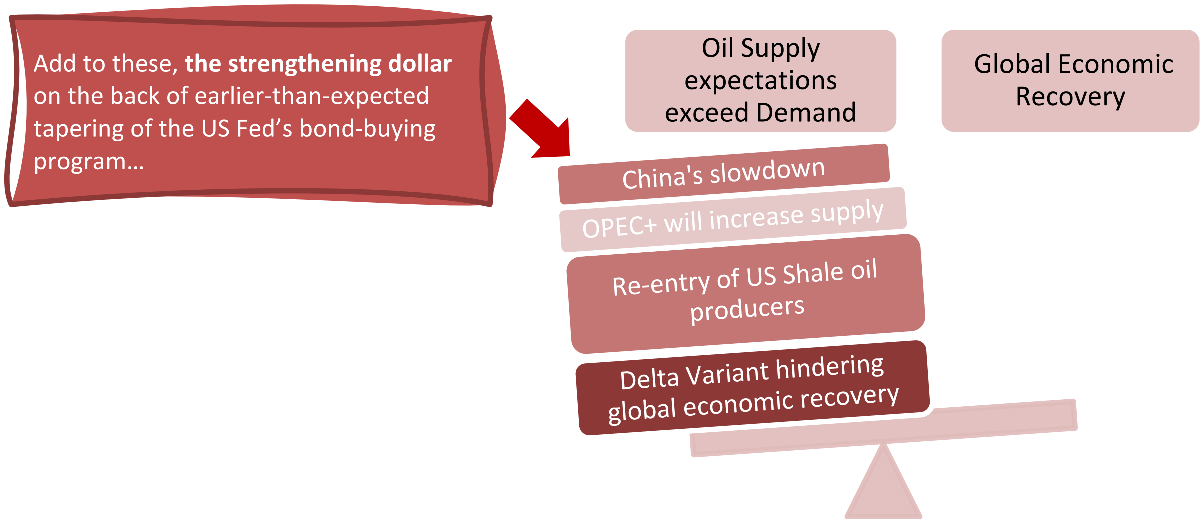
U Capital **Oil Market Update**

19 August 2021

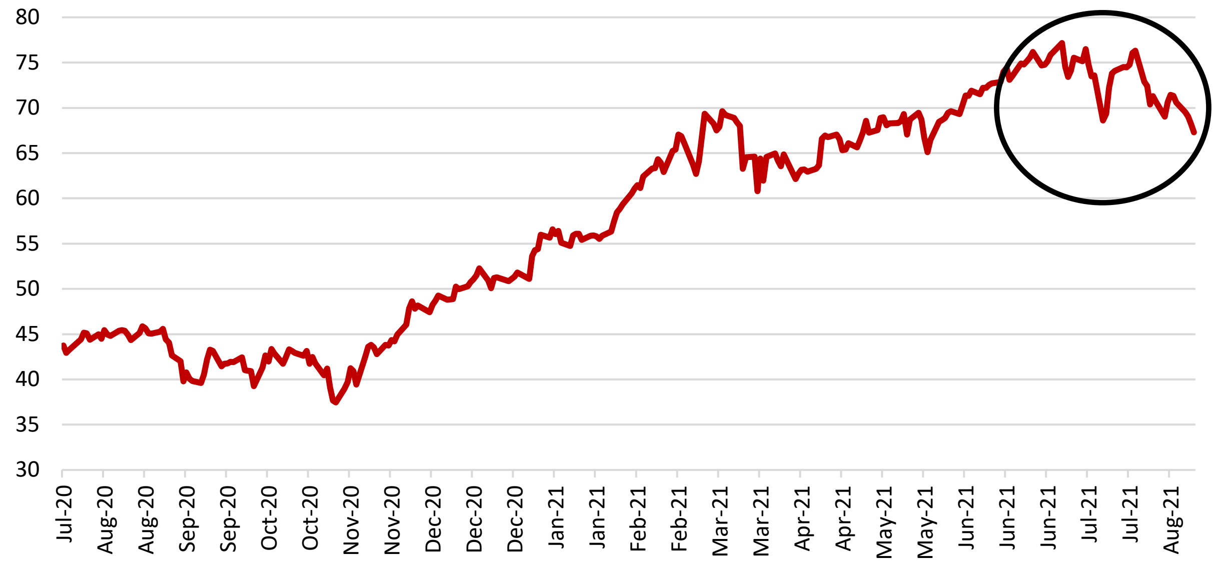
- **Oil price has been under pressure** since the start of July 2021 due to several reasons.
- First, the **International Energy Agency (IEA) sharply cut forecasts** for the global oil demand for the rest of this year as the Delta-variant reignites prolonged pandemic fears, hitting major consumers. The agency also predicted a new surplus in 2022.



Source: U Capital Research

- Until June, the IEA was urging the OPEC+ alliance to start producing more or risk an unsuitable increase in prices. Therefore, it was a negative surprise when it revised the oil demand outlook downward. As per the IEA, global oil demand "abruptly reversed course" in July, falling slightly after surging by 3.8mn barrels a day in June. The agency lowered estimates for consumption in the second half of the year by 550,000 barrels a day.
- However, the IEA expects that world fuel consumption will continue to increase as global economic activities continuing to show recovery. It is expecting an average of 98.9mn barrels a day in the last three months of 2021e.
- Second, **OPEC+ will hike supply**, which will arrive at a time when consumption has already begun to show signs of weakness.

Brent Crude (CO1 Comdty) Price, USD/barrel

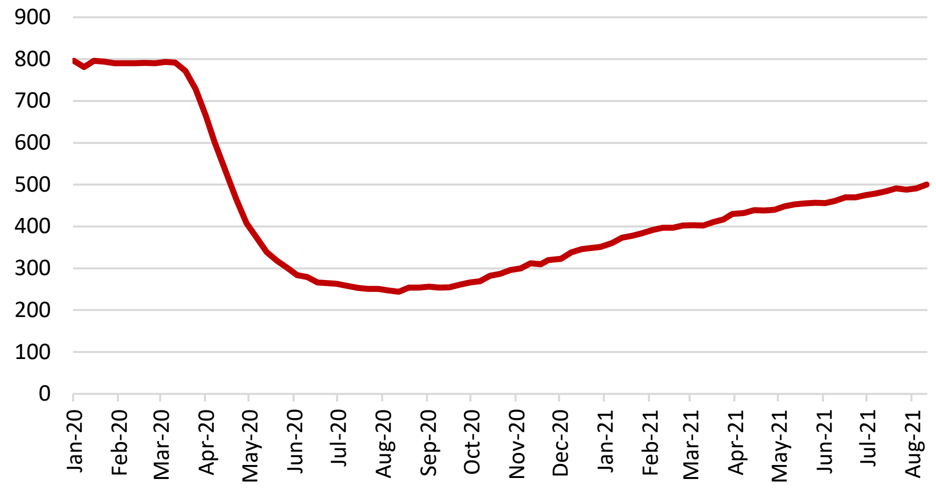


Source: Bloomberg

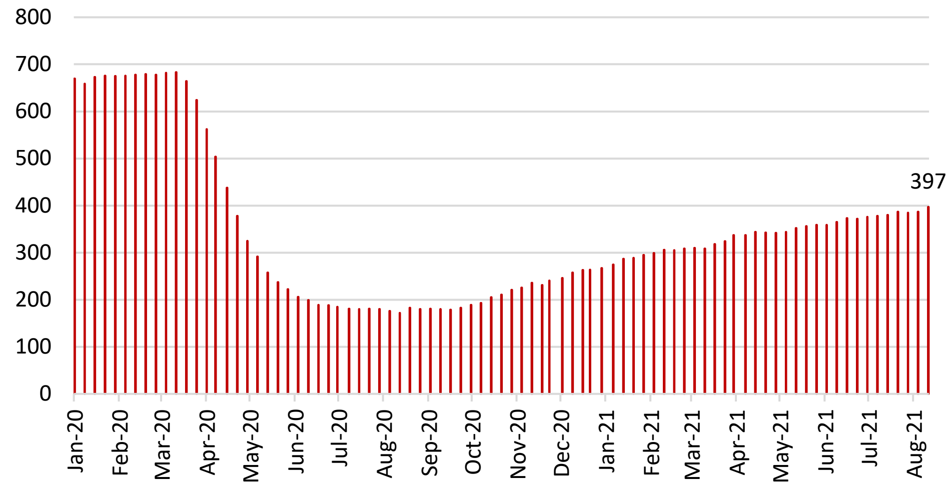
- Brent Crude Oil price has retreated about 10% from the high seen on 5th July (USD 77.2/bl) and has further fallen to below USD 65/bl at the time of writing this report, largely on account of Federal Reserve meeting minutes released a day ago, which show that a slowdown in asset purchases might start to happen earlier than expected. This tapering of asset purchases by the US Fed hurts commodities and lifts the dollar. The Fed has been buying USD 120 billion of assets every month to cushion the U.S. economy from the blow inflicted by the pandemic, supporting commodity as well as stock prices.
- Thirdly, the delta variant has triggered a series of lockdowns in China and other key Asian consumers.
- Fourthly, the **IEA and OPEC both significantly bolstered forecasts for supplies <u>outside of the cartel</u>** in 2022e as the U.S. and other producers recover from the slump caused by the pandemic. Both institutions boosted projections for non-OPEC output by 1.1mn barrels a day for 2022e. Subsequently, OPEC is already producing the volume of crude needed in 2022e, as per the IEA, pointing to a likely oversupply in 2022e. Signifying this risk is the US oil-rig count, which in August have jumped by

the most in four months and have been steadily climbing since Oct'20. The total number of rigs searching for oil across the country rose by 10 this week to 397, according to Baker Hughes Inc. data reported by Bloomberg.

North America Rig Count



US Rig Count



Source: Baker Hughes

- Lastly, **China's faltering economic recovery is adding to global growth risks,** with retail sales and industrial output both having slowed by more than expected. Retail sales were hit by tough new virus restrictions introduced toward the end of July to curtail number of infections. Flooding in central China and weak auto sales due to a chip shortage hurt manufacturing, while a slowing property market and environmental policies reduced output of steel and cement, hitting commodity demand, as per Bloomberg. China's outlook depends on how Covid restrictions unfold, going forward, and if the People's Bank of China (PBOC) will increase monetary and fiscal stimulus to prevent a sharper slowdown. So far, the Government is on a steady policy course with maintaining key interest rate unchanged while rolling over most of the policy loans coming due.

China's key economic data on a two-year average growth basis

	Jan.-Feb.	March	April	May	June	July
Retail Sales YoY	3.2%	6.3%	4.3%	4.5%	4.9%	3.6%
Industrial Production YoY	8.1%		6.8%	6.6%	6.5%	5.6%
Fixed-asset Investment (YTD)	1.7%	2.9%	3.9%	4.2%	4.4%	4.3%

Source: Bloomberg; Jan-Feb data is reported in a clubbed manner due to Chinese New Year Holiday Season in January

- China has embarked on a decarbonization drive as the country embraces the "Blue Skies" challenge, which together with uncertainty surrounding the pandemic-related lockdowns and closures, has negatively affected most economic indicators.

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