Energy Brief

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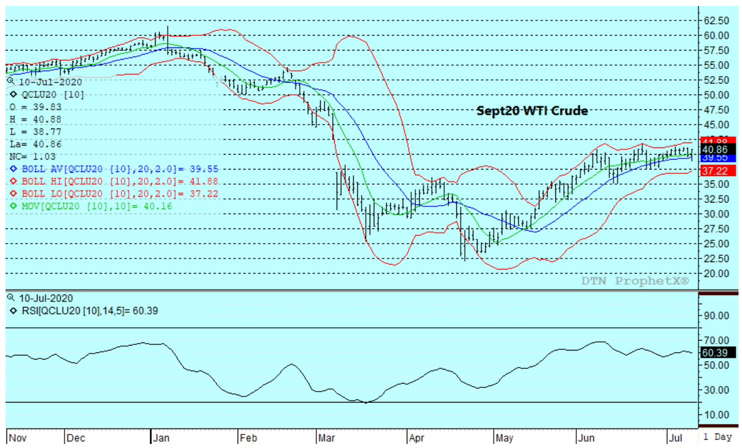
Price Overview



The petroleum complex recovered from early losses and closed higher as concerns over renewed lock-downs and rising COVID cases in the US were offset by a more constructive view of the global supply/demand situation by the IEA in their July monthly report. They suggested that demand, which fell by 10.75 mb in the first half of the year, will show an improvement in the second half to only a 5.1 mb/d decline. For the year global demand is forecast to total 92.1 mb/d compared to 99.8 mb/d in 2019. Expectations for 2021 are still quite tentative given the impact of COVID-19, but generally it is expected to recover to 97.4 mb/d. The bulk of demand decline is expected to be attributed to the weakness to aviation demand. On the supply side, production responded to the weak price levels falling by 13.7 mb/d below the levels in April. The voluntary cuts by Saudi Arabia helped improve the compliance rate to the May OPEC+ agreement to 108 percent. Additional cuts have been in evidence particularly in the United States. The prospect that the price recovery will prompt a stabilization of production levels along with OPEC tapering off their cuts by 2 mb to 7.7 mb after July could slow any decline in stock levels. These stocks still overhang the market and any setback to the progress on the demand side will likely lead to renewed weakness in values particularly if refinery throughput is slow to increase due to weak margins.

The focus for now remains on outside markets and the recovery in equities, particularly in the US and China. In addition some industrial metals such as copper have strengthened which is underpinning sentiment that the hits to global manufacturing activity might not be as substantial as previously thought.

Although the recovery in many economies from the depression levels of a few months ago has underpinned the energy complex, supply and demand prospects present considerable uncertainty for values. The large stock overhang remains of concern and will be a key consideration for the OPEC+ Price Monitoring Committee Meeting taking place on July 15th. For now it looks like they will opt to raise production by 2 mb. How the increase will be allocated along with discussion over supplies from Libya following the lifting of force majeure this week will be key considerations.

Ideas that OPEC+ and particularly Russia is content with values near current levels might remain a headwind to rallies. Although it is encouraging that an improvement in global manufacturing activity is occurring, maintaining production restraint will be key to drawing down excess inventories. 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, particularly if OPEC production rises after July, suggesting valuations much above 41.00 to 42.40, the panic gap of March 9, 2020 are likely unsustainable.

Natural Gas

Prices managed to recover today after the retrenchement that developed following the storarge report yesterday. The 56 bcf stock build was slightly below late estimates but prices slipped regargless as poor LNG flows and pandemic concerns helped pressure values, with follow through this morning as the August put in a low at 1.737 before rebounding to settle at 1.805. The underlying support came from continued warm temperatures as power burns in the coming two weeks are expected to be at record levels. Of note from the EIA report was the second week of salt withdrawls, not a typical summer event that helps relieve some of the concern regarding the topping out of storage. Production has remained near 87 bcf/d this week, but did incrementally improve which could indicate a slow recovery from the force majeure declared by Columbia Gas earlier this week. The price recovery over the last two weeks has been impressive, but will need to be well fed to continue near term. Weather will also need to maintain its recent warm trend, ideally through the entire summer to offset the growing concerns regarding the resurgence of the coronavirus and lackluster LNG export situation. With power burns expected well above normal through much of July, we expect today's lows to hold up to any selling pressure and see prices continuing upward, with the 2.00 level the next target and the 2.05 area possible on the completion of the head and shoulders bottom off the late June lows.