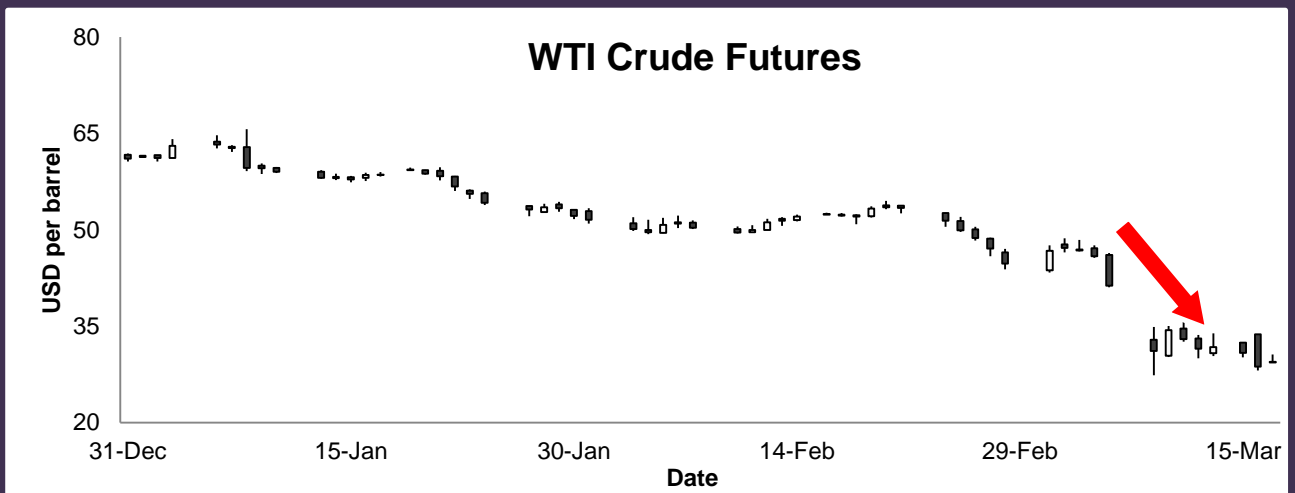
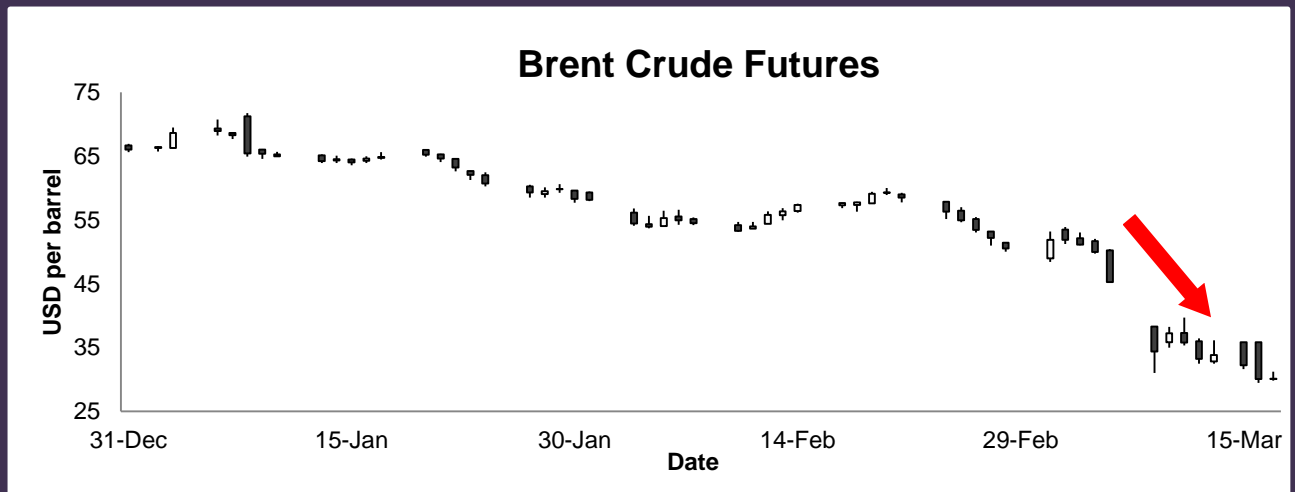


## KF Crude Oil Spotlight : Oil Tanked and It's Spilling Over

Prepared by Aron Liew, CFA and Zainal Aiman

On the first Friday of March in Vienna, a beautiful time where Austrians are waiting for the end of winter and yearn for the start of spring, a very important meeting between OPEC members and Russia was being held behind closed doors. Minutes after the meeting concluded, crude oil prices plunged, sending shockwaves to the market. Traders all around the world, who were scrambling to cope with the impact of COVID-19, suddenly had another issue barreling through their trading ideas.

Crude oil prices plummeted around 10% on the Friday itself and when trading resumed on Monday, prices opened with a wide gap down. Crude oil prices were crushed even more and ended the day badly bruised, down another 24%. Oil and gas related counters and other oil commodities, including crude palm oil, also tanked. Dollar also took a beating and the Malaysian Ringgit also depreciated.



Source : Reuters



## A Closer Look on 9 March Oil Price Crash A New Global Crude Price War?

- 9 March 2020 represent a historic moment in crude oil market when oil prices suffered their biggest daily fall in nearly three decades in the wake of Saudi-Russia oil price war.
- Brent crude futures fell 24.1% to settle at \$34.36 per barrel, while the US West Texas Intermediate (WTI) crude oil dropped 24.6% to end at \$31.13 per barrel.
- This was the first time oil prices experienced their largest daily price decline since 1991 when American forces launched air strikes on Iraqi troops following their invasion of Kuwait

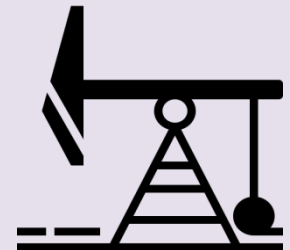
### So, what just happened?



- Since 2016, Saudi Arabia and Russia agreed to form OPEC+ alliance after oil prices plunged to \$30 per barrel.
- Since then, the two leading exporters have orchestrated the production cuts of 2.1 million barrels per day.
- In light of the weaker consumption due to the coronavirus outbreak, Saudi Arabia wished to lead OPEC and its allied producers including Russia to make deeper cuts to oil production to stabilise the oil market .
- However, on 6 March 2020, Russia has refused to join OPEC further on steep supply cut as they believed it will only lead the US shale oil production to keep expanding and hence, strengthening their position in the global crude market.
- On top of that, their energy minister, Alexander Novak signalled a fierce battle on market share when he said countries could produce as much as they please from April 1.

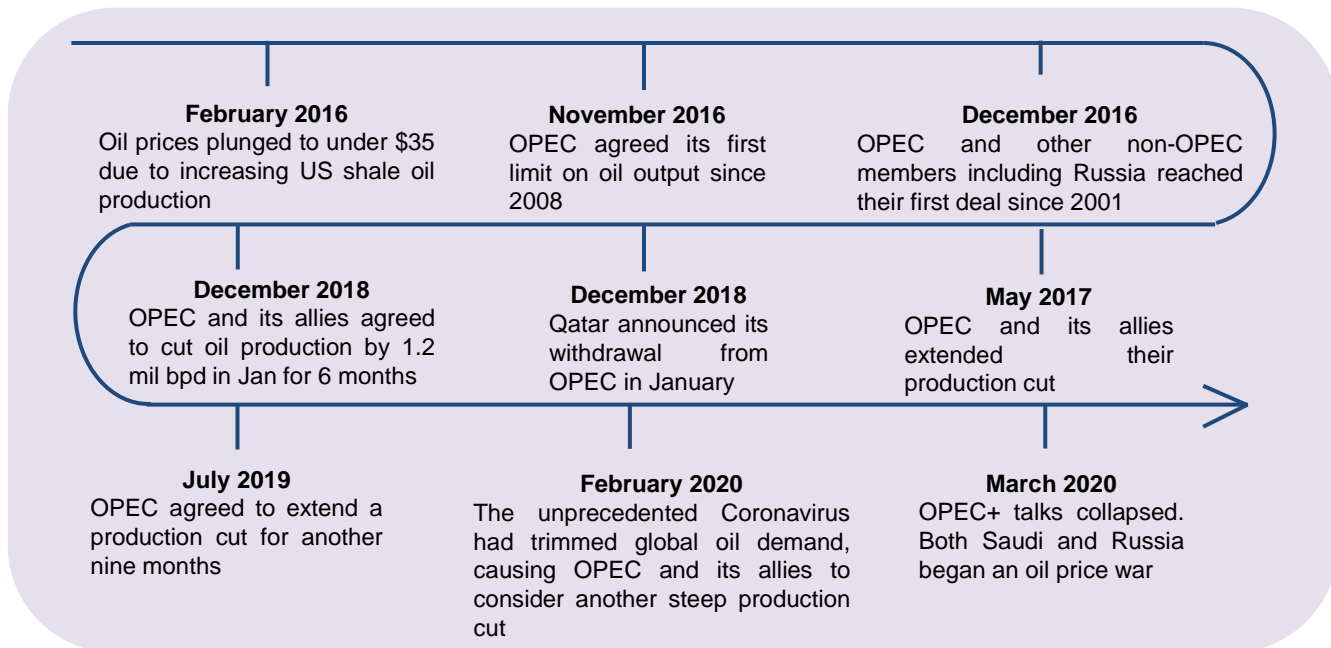
### The beginning of Oil Price War

- In retaliation, Saudi Arabia over the weekend cut its official selling prices for April for all crude grades to all destinations by between \$6 and \$8 per barrel in an attempt to punish Russia.
- It was also reported that the Kingdom is looking to raise its daily crude output by as many as 13 million barrels.



Source : CNN News and CNBC

## The Oil Production Cut Timeline (2016-2020)



Source : OPEC

## How To Navigate the Crude Oil Market Moving Forward?

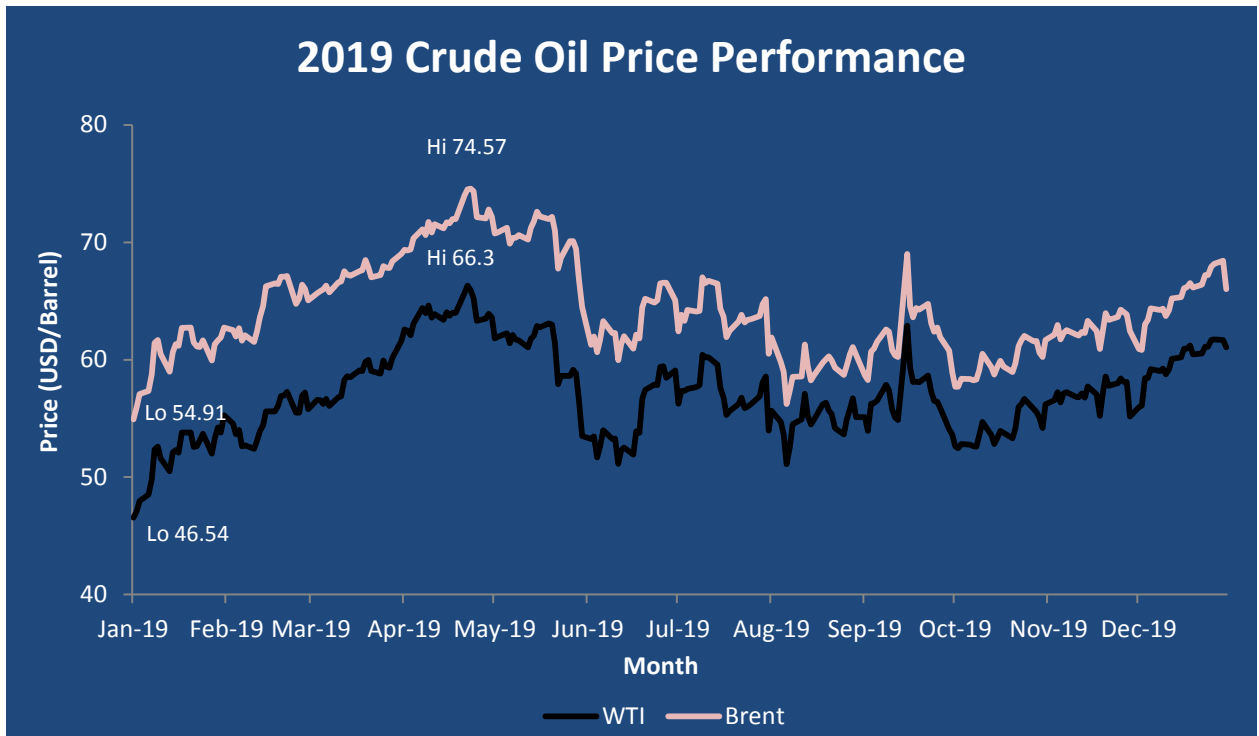


- International Energy Agency (IEA) has already lowered its annual forecast of oil demand by 1 million bpd, the first time demand will have fallen since 2009 due to the coronavirus epidemic and the crude price war.
- So far, three (3) North American oil producers has slashed their capital spending and drilling plans as crude prices tumbled and pressure on businesses intensified.
- KIBB foresee that crude oil prices will be severely affected by the recent developments, hence 2020 average Brent crude oil price is expected to hover around USD40 per barrel.
- However, a market price correction might occur later in H2 2020 as the prolonged low oil price environment could see a reduction in shale production, leading to a slight rebalancing of the market's demand and supply dynamics.
- In addition, with Russia's fiscal breakeven oil prices reported to be circa USD42 per barrel, Russia may return to OPEC's negotiation table.

Source : IEA and Kenanga Investment Bank Berhad

## A Quick Recap Of Crude Oil in 2019

	WTI	Brent
Last Trading Day's Price (USD/Barrel)	61	66
Average 2019 Price (USD/Barrel)	57	64
Performance Change (%)	+20.2	+31.2



### Spread Between Brent and WTI Crude Oil 2019

High : USD11.48 (27/05/2019)

Low : USD3.53 (19/08/2019)

Correlation : 0.95

*Source : Bloomberg*

## What Causes the Crude Oil Market Volatility in 2019?

Oil prices have become volatile in 2019 thanks to the unexpected swings in the factors affecting oil prices

### Positive Factors



OPEC

#### OPEC+ Production Cut Agreement

In light of the swelling US shale oil production, OPEC and its allies which includes Russia, or better known as OPEC+, had made two crude oil supply cut in 2019. The move which happened in January and July, that brought the total production cuts from OPEC+ to 1.7 million bpd, had provide some support to the crude prices.



#### Middle East Geopolitical Tension

The September attack on Saudi Arabia's largest oilfields and the world's biggest crude processing facility at Abqaiq knocked a total of 5.7 million bpd of oil production offline. The situation had spiked nearly 20% in the price of crude oil, but it returned to normal relatively quickly as the damages were repaired.



#### Venezuela Political Crisis

A deep crisis remained in Venezuela in 2019 under the authoritarian rule of Nicholas Maduro despite protest led by opposition leader Juan Guido. The country which once boasted Latin America's richest economy, had now suffered economy collapse due to the corruption, mismanagement and high level of debt under President Maduro. Being the proven largest oil reserves in the world, any crisis in that nation has bullish impact to oil prices due to the expectation of global supply disruptions.

### Negative Factors



#### US-China Trade War

The uncertainty surrounding the trade negotiation, had brought heightened fears over a global economic slowdown, which indirectly impacted the crude oil demand in 2019. As both US and China plays important role in crude oil economy as the largest crude oil exporter and importer respectively, the trade friction caused significant impact to the prices.



#### Increase in US Shale Oil Production

US had continuously charted new records of oil production in 2019 where the new record was 1.2 million bpd, higher than the previous year's record. This had pushed the US to net exporter status for crude oil exports and finished products for the month of October.



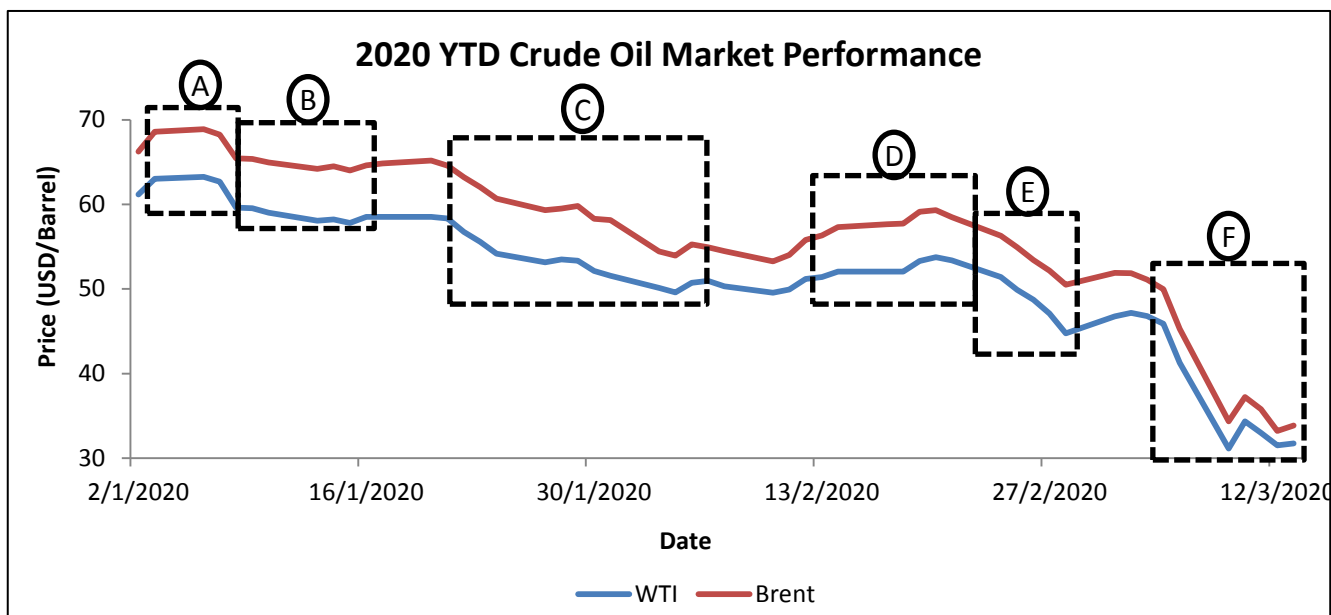
#### Stronger US Dollar

Being a dollar-denominated commodity, the direction of crude is also dependent on the performance of the US dollar. In 2019, the greenback saw a resurgence of strength as the US dollar index pushed to a two-year high despite the trade tension as US economy keep showing a strong sign. Having an inverse relationship to the movement of US dollar, the price of crude oil dropped in light of this situation.

Source : The Edge Market and Reuters



## How's Crude Oil Market Performance So Far in 2020?



Period	Remarks
A (02/01/2020- 06/01/2020)	<b>WTI (+3.42%), Brent (+4.02%)</b> Oil prices jumped after US air strike killed key Iranian and Iraqi military personnel.
B (07/01/2020 – 15/01/2020)	<b>WTI (-7.80%), Brent (-6.25%)</b> Oil prices edged down as fears of conflict between US and Iran eased as both countries stepped back from the crisis, and traders began to eye on the signing ceremony of the phase one US-China trade deal.
C (21/02/2020 – 04/02/2020)	<b>WTI (-14.96%), Brent (-16.46%)</b> Oil prices plunged due to the rapid spread of coronavirus in China which might impact the global fuel demand.
D (10/02/2020 – 20/02/2020)	<b>WTI (+8.49%), Brent (+11.34%)</b> Oil prices stabilise on renewed optimism after OPEC and its allied producers are considering to cut output by up to 2.3 million barrels per day.
E (21/02/2020 – 28/02/2020)	<b>WTI (-16.15%), Brent (-13.64%)</b> Oil prices fell tracking the growing number of new coronavirus cases outside China that deepened fears of the global economic slowdown.
F (06/03/2020 – 13/03/2020)	<b>WTI (-23.13%), Brent (-25.23%)</b> Oil prices plunged to below USD40 bpd for the first time since 1991 due to the collapse of OPEC+ production cut talks.

Source : Bloomberg and Reuters

## How's the Crude Oil Market Will Perform this Year?

### Forecasted Price by Major Organisation (as of March 2020)

Organisation	Forecasted Average Price (USD Per Barrel)	
	Brent Oil	West Texas Intermediate
Energy Information Administration (EIA)	43.30	38.19
Kenanga Investment Bank	40	-

Source : EIA and Kenanga Investment Bank Berhad

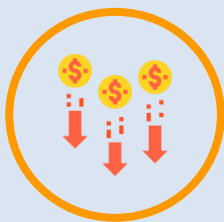


### Positive Indicators



#### **Middle East Geopolitical Unrest**

In January 2020, the killing of Iran top commander elite force escalated the friction between Iran and the West to new heights. Any conflicts in Middle East especially in Iran have greater impact to the crude prices as the region plays an important role in global oil supply. Although the conflict has already de-escalated, many analysts foresee the situation in Middle East to return to chaos at anytime which will eventually drive crude oil prices higher amid the concerns on supply disruption.

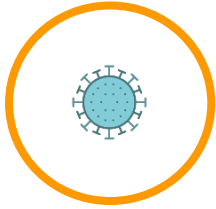


#### **Expectation of Weaker US Dollar**

Many analysts expect the greenback to face some challenges and risk this year amid the growing global uncertainties that brought back the recession fears. A recession concern would force US Federal Reserve to cut rates aggressively and that would weigh on the US dollar. At this point of writing, the Fed had slashed its benchmark interest rate to near zero and promised to boost its bond holdings by at least \$700 billion. Meanwhile the Trump administration is also proposing a fiscal stimulus of up to USD1 trillion.



### Potentially Negative Indicators



#### **Coronavirus Outbreak**

Coronavirus, or better known as COVID19 was first detected in late December 2019 and had quickly spread across the mainland China and around the world. The number of deaths and infected cases have now exceeded those of the SARS outbreak. Worries over potential global economic fallout due to this virus will undoubtedly affect the global crude demand as well.



#### **Potential Global Economic Slowdown**

In their latest Global Economic Prospect and World Economic Outlook report, both World Bank and International Monetary Fund(IMF) had slashed their 2020 global growth forecast to 2.5% and 3.3% respectively, citing the rising geopolitical tensions, intensifying social unrest and slowdown in emerging markets as factors. With the emergence of the coronavirus that is spreading across the world, the possibility of further downgrading of global growth is likely to occur, which may lead to a decline in global energy demand.



#### **The Saudi-Russia Oil Price War**

OPEC and its allies including Russia have been trimming production for most of the past three years in an attempt to offset a surge production from the US shale industry. Unfortunately, their deeper production cut talks amid the coronavirus outbreak collapsed in early March as Russia refused to join the agreement. In retaliation, Saudi Arabia began the oil price war by slashing the crude oil prices to its importers. This situation would severely impacted the global crude oil prices as both nations are major oil producers



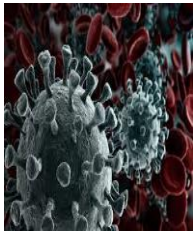
#### **Prospects of Prolonged US-China Trade War**

The long-awaited phase one trade deal signing ceremony between US and China in mid January this year has at least brought some calm to the global financial and stock markets. However, most analysts foresee that the friction between the two world largest economies is not over yet as there are still so many uncertainties ahead with both nations has not removed all the tariffs to each other.



**EXCLUSIVE  
REPORT**

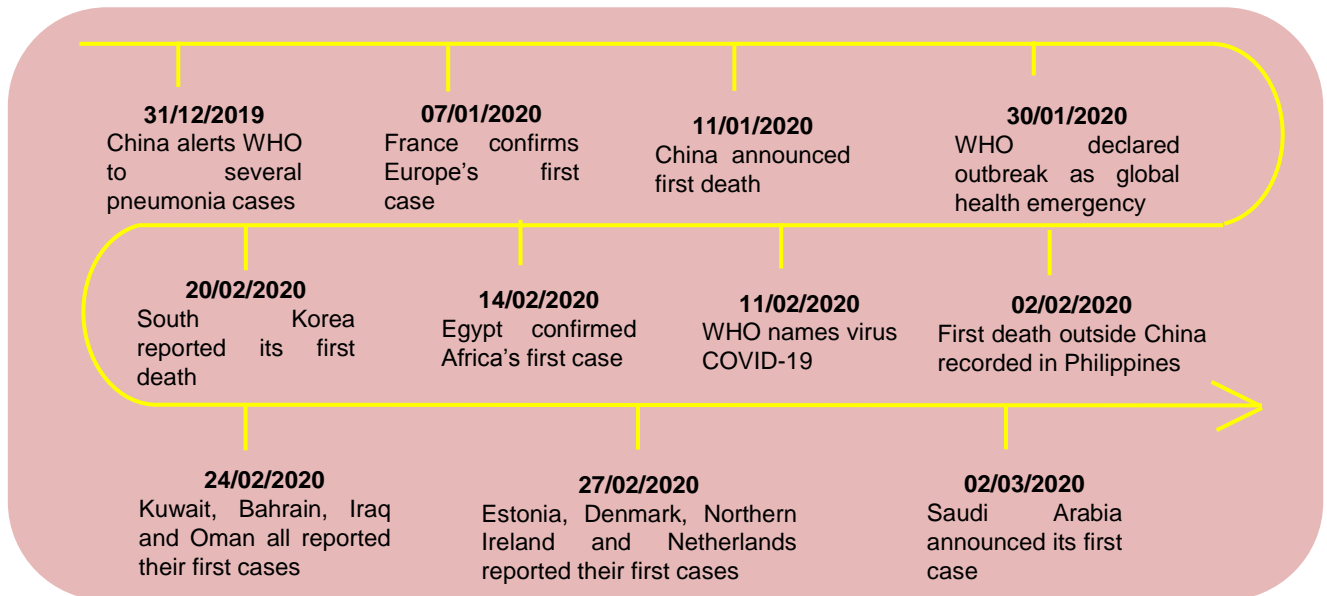
## The Impact of Coronavirus Outbreak (COVID-19) on Crude Oil Price



Coronavirus is a respiratory illness that was first identified during an investigation into an outbreak in Wuhan, China. They are a large family of viruses which also includes Middle East Respiratory Syndrome (MERS) and Severe Acute Respiratory Syndrome (SARS). On February 11, 2020 the World Health Organisation announced an official name for the 2019 coronavirus outbreak as COVID-19.

Source : Centre for Disease Control and Prevention (CDC)

### Short Timeline



Source : CNN News

### COVID-19 Cases Compared to other Major Viruses

Virus	Years Identified	Cases	Deaths	Number of Countries Affected
Ebola	1976	33,577	13,562	9
Nipah	1998	513	398	2
SARS	2002	8,096	774	29
MERS	2012	2,494	858	28
COVID-19*	2019	153,648	5,746	146+

\* As of 15/03/2020

Source : Kenanga Investment Bank Berhad and World Health Organisation

## What are the impacts to crude prices so far?

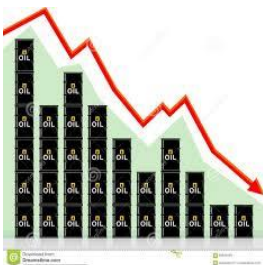
- Oil prices fell dramatically in mid-February, but had been steadily climbing back as the number of new cases of the virus in China slowed.
- In the last week of February, however, reports of the spreading virus knocked prices down. The benchmark for U.S. crude oil fell 16% during the week, settling at \$44.76 a barrel. Brent crude, the international standard, dropped 14% for the week to its lowest levels since July 2017, closing Friday at \$50.52 a barrel.

Source : Bloomberg

## What to expect next?

While the impact to the crude oil prices are alarming, many analysts expect the outbreak should not significantly dampen the global oil demand growth in the long term due to several key factors :

### 1 A Shrink in Global Crude Demand in Near Term



- ❖ According to outlook by International Energy Agency (IEA), the global oil demand is expected to contract by 90,000 bpd to 99.9 million barrels per day in 2020 amid the outbreak.
- ❖ The impact is largely attributed to the potential lower oil demand in China, which is the world's second largest oil consumer, on the back of lower economic activity.

### 2 A Temporary Impact on Oil Prices



- ❖ Despite the pressure of price amid the slam in oil demand, the oil market is expected to move towards balance in the second half of 2020 despite the recent oil price war.
- ❖ This is due to the potential of market correction as both Russia and Saudi Arabia are expected to return to the negotiation table once the crude oil prices breached their breakeven oil prices.

Source : International Energy Agency and Bloomberg

## Why you Should Hedge Now?

- Whether you are a producer or consumer of crude oil, you are **exposed to price volatility** and **uncertainties**.
- **Lack of stability and predictability** in both crude oil and currency movements in recent years has **impacted the profit margin of companies**.
- **Heightened concerns** arisen from the emerging trade barriers, geopolitical uncertainties, supply & demand among others will continue to bring greater uncertainty into the market.
- To manage your price risk exposure and protect your profit, **HEDGE!**

## About CME Group

- ♦ The world's leading derivatives exchange offering the widest range of global benchmark products across all major asset classes in the derivatives marketplace.
- ♦ Comprises four (4) exchanges; Chicago Mercantile Exchange (CME), Chicago Board of Trade (CBOT), New York Mercantile Exchange (NYMEX) and Commodity Exchange Inc. (COMEX).

## Hedging Opportunities on CME Group

Product	WTI Crude Oil Futures	E-Mini Crude Oil
Product Symbol	CL	QM
Contract Multiplier	1,000 Barrels	500 Barrels
Minimum Price Fluctuation	USD 0.01	USD 0.025
Value Per Tick	USD 10	USD 12.50
Settlement	Physical Delivery	Cash Settled
Trading Hours (Malaysian Time)	0700 – 0600 Next Day (Monday through Saturday)	

Source : CME Group

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