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The Worst Is Over for Oil Markets

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Some analysts see the world dodging a recession next year, which provides some upward room for oil prices.

Last week, the IEA warned last week that "the hefty supply cushion" building up in the first half of 2020 will cause OPEC+ problems as the group tries to balance the oil market. Part of the reason for another potential surplus is the steep drop in demand growth this year, forcing oil forecasters to make multiple downward revisions to their projections.

> "With consumption growth of just 830 thousand b/d YoY in 2019, global oil demand has easily expanded at the lowest rate since the global financial crisis 10 years ago," Bank of America **Merrill Lynch** said in a note.

The slowdown was particularly concentrated in industrial sectors, which have been hit hard by the trade war.

> "The manufacturing downturn in 2019 has been so pronounced that we think it could aptly be labeled as the third global industrial recession in the past 10 years, following the activity drops witnessed in 2012 and 2016," the bank said.

Or, put more succinctly, "The world has just lived through an industrial recession," Bank of America concluded, and oil prices really only held up because of massive supply outages in 2019. The industrial slowdown spread around the world.

Take India, for example. The "weak picture for the manufacturing and industrial" sectors of the Indian economy continue, JBC Energy said in a note on Monday, which have hit diesel sales.

> "The 120,000 b/d (7%) y-o-y contraction was greater than even the demonetization-driven downside from January 2017," JBC Energy said. "With bitumen sales also low, it appears activity in Indian manufacturing and construction is waning."

But there are some reasons to think that things could turn around. While a lot still depends on the outcome of the U.S.-China trade war and the "partial deal" that the market still believes is likely, recent streams of data have tamped down fears of a recession.

> "Looking into 2020, we expect an improvement in cyclical demand conditions as manufacturing PMIs seem to have stabilized and in some cases appear to be

turning positive," Bank of America said.

Part of the reason for more optimism is that corporations with global supply chains have held back on purchases over the past year, in large part because of the trade war, and have whittled away at inventory. The strategy seemed to be an attempt to wait out tariffs in the hopes of a negotiated breakthrough. That makes sense at the individual company level, but it hit manufacturers hard as sales and activity dropped. However, companies will now have to restock in 2020, Bank of America says. That could help steady the economy.

Meanwhile, if the U.S. and China can indeed agree to a partial trade deal, that would "further help boost industrial activity and confidence in the global economy," Bank of America said, and "any signs of improvement on the trade front could add upward pressure to cyclical energy and metals prices." The removal of some tariffs could both push down the dollar and raise commodity prices.

Still, a comprehensive breakthrough in the trade war is going to be extremely difficult, and the two sides have been far apart on the big issues. The partial deal, such as it is, would only suspend tariffs in exchange for China buying large sums of agricultural goods.

But even the partial deal has run into trouble. The Trump administration has hyped a $50 billion purchase from China for U.S. agricultural goods, a figure that some say is "not possible." So, it's worth noting that even a very narrow and modest agreement has become a challenging prospect, to say nothing of more structural differences between the two countries.

In short, while the tone has softened and both sides have signaled that negotiations are proceeding to a conclusion, the U.S.-China trade war is far from finished.

In fact, right on cue, doubts began to resurface on Monday. CNBC said that the "mood in Beijing about a trade deal is pessimistic due to U.S. President Donald Trump's reluctance to roll back tariffs." Beijing may instead decide to sit and wait, betting that Trump's standing continues to deteriorate in the face of an impeachment inquiry.

"It looks like this is by no means a done deal," Matthew Miskin, a market strategist at John Hancock Advisors in Boston, told Bloomberg.

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