



## COVID-19 Induced Demand Destruction

### Summary

- The latest monthly oil market report from OPEC lays out a bleak outlook for oil demand growth in 2020, with an average decline of 6.9 million barrels per day (mbpd) expected over the course of the year (Figure 1).
- OPEC and partners (OPEC+) recently agreed on a historic crude oil production moderation. Under the deal, OPEC+ pledged to reduce its overall production by 9.7 mbpd in May and June, 7.7 mbpd in H2 2020, versus October 2018's baseline. As a result, we now expect Saudi crude oil production to average 9.4 mbpd during 2020, down from our previous forecast of 11.4 mbpd.
- Shortly following the OPEC+ deal, oil producing nations within the Group of 20 (G20) announced additional reductions in output totaling up to 3.7 mbpd. However, the lack of detail surrounding these reductions makes it very difficult to assess whether such reductions are guaranteed, raising the risk of persistent sizable daily oil surpluses during Q2.
- As such, commercial oil stocks could rise closer to maximum capacity levels at some point during Q2, with the rate of stock build accelerating if OPEC+ exhibits poor compliance levels. If this unfolds then oil prices will trend even lower, forcing some oil producers to make tough choices around shutting-in wells, and permanently taking their oil off-line. In light of this, we have revised down our Brent oil forecast to \$39 per barrel (pb) for 2020, from \$44 pb previously.
- Lastly, we have updated our economic forecasts for Saudi Arabia to incorporate recent developments in oil markets as well as the domestic response to COVID-19. We now expect overall GDP to contract by 1.7 percent with the non-oil private sector declining by 3.9 percent. On the fiscal front, lower oil and non-oil revenue as well as higher expenditure than budgeted is expected to push the fiscal deficit to SR422 billion (or 15.7 percent of GDP) in 2020.

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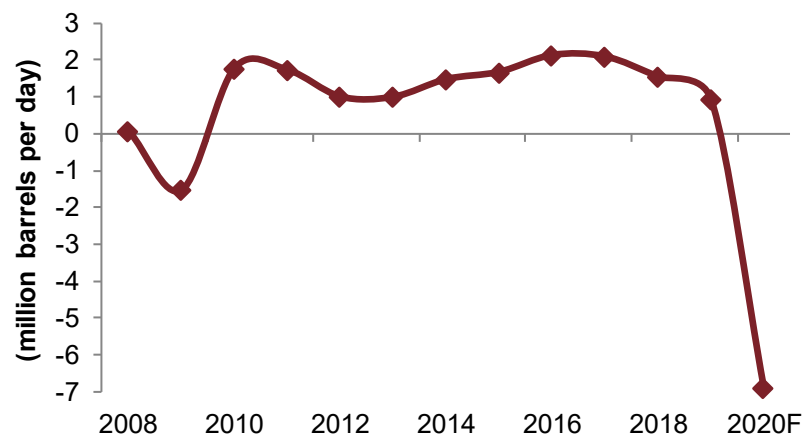
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**Figure 1: Global oil demand expected to contract sharply**





*The latest monthly oil market report from OPEC expects oil demand growth to decline by 6.9 mbpd in 2020.*

*Measures to curb the spread of COVID-19 have inevitably impacted economic activity and energy demand...*

*... with the most obvious impact on transportation fuel demand...*

*...which makes up around 56 percent of total oil demand globally.*

*OPEC+ agreed on a historic crude oil production moderation...*

*...with overall production declining by 9.7 mbpd in May and June, 7.7 mbpd in H2 2020 and 5.8 mbpd from 2021 to Q1 2022.*

**Oil demand in free fall:**

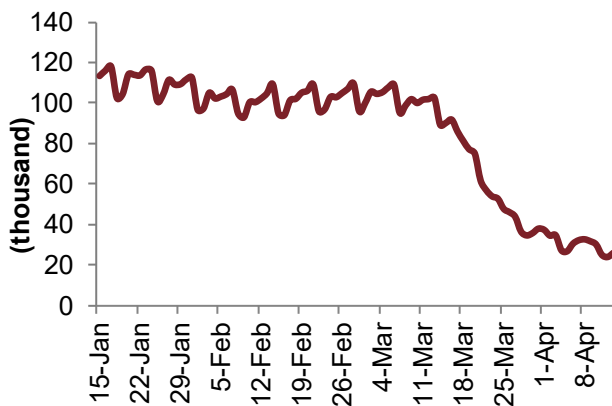
The latest monthly oil market report from OPEC makes for bleak reading with respect to the outlook for oil demand growth in 2020, with an average decline of 6.9 mbpd expected over the course of the year (Figure 1). Considering the measures taken around the world in a bid to slow the transmission of COVID-19 in the last few months, this decline comes as no surprise. What started in China, with strict lockdown measures in some parts of the country, have now been implemented virtually all around the globe in one form or another. Whilst China has lifted these initial measures, most of the rest of world still remains in lockdown. Such measures have inevitably impacted economic activity and energy demand, with the most obvious impact on transportation fuel demand, which makes up around 56 percent of total oil demand globally. Within this, the aviation sector has been hit most drastically, with a large reduction in flights following the outbreak of COVID-19 (Figure 2). The impact has also been felt in non-commercial road transportation (21 percent of total demand), as social isolation and, in many countries, curfews, have effectively halted non-essential travel across most of the major cities around the world (Figure 3). That said, demand for trucking fuel (24 percent of total oil demand) has remained firm. Lastly, with latest global manufacturing purchase managers' index showing factory activity still sitting in deep contractionary levels (industry makes up 12 percent of global oil demand), this is expected to continue eroding demand for fuels, such as industry diesel, going forward.

Overall, despite current forecasts for annual oil demand growth being gloomy, the magnitude of the decline will obviously depend on many factors, including the scale and duration of national shutdowns in different countries, and of course what shape or form the exit strategy from lockdowns takes. As such, there could well be further significant downward revisions in oil demand going forward.

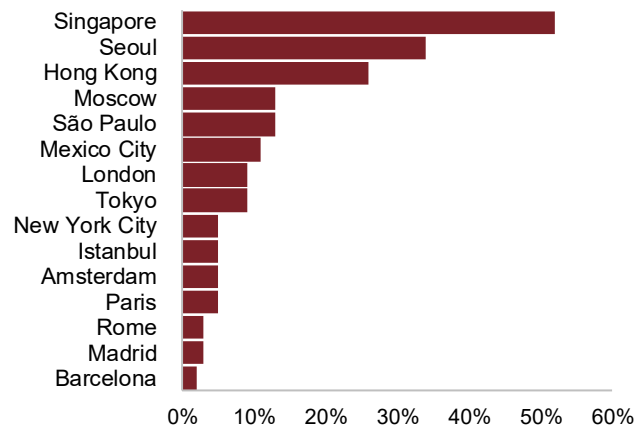
**OPEC+ agrees, eventually:**

OPEC and partners (OPEC+) recently agreed on a historic crude oil production moderation. Under the deal, OPEC+ pledged to reduce its overall production by 9.7 mbpd in May and June, 7.7 mbpd in H2 2020 and 5.8 mbpd from 2021 to Q1 2022. All the of the reductions would take place from October 2018's production levels, apart from Russia and Saudi Arabia's, which both had a baseline of 11 mbpd (Figure 4).

**Figure 2: Number of commercial flights per day**



**Figure 3: Public transport usage**  
(% of city moving in April 2020 versus January 2020)





The agreement faces the same potential problem that the previous agreement encountered...

...namely only a handful of countries likely end up implementing reductions.

Under the current OPEC+ agreement, the Kingdom is expected to hit 8.5 mbpd in May and June, and then 9.1 mbpd in H2 2020...

...as a result, we now expect Saudi crude oil production to average 9.4 mbpd during 2020, down from our previous forecast of 11.4 mbpd.

We do not, however, expect an equivalent reduction in oil exports.

Shortly following the OPEC+ deal, oil producing nations within the Group of 20 (G20) announced additional reductions in output...

...The lack of detail surrounding the proposal makes it very difficult to assess to what extent such reductions are guaranteed.

By all accounts the agreement is historic, but besides the question of whether the reduction will be enough to prevent further stock build (see Oil Price Outlook section below), it also faces the same potential problem that the previous agreement encountered; namely, only a handful of countries likely end up implementing reductions. Thus, when comparing agreed output versus actual output (and discounting Venezuela and Iran's involuntary declines), the Gulf trio of Saudi Arabia, Kuwait and UAE accounted for 89 percent of OPEC's total reduction in 2019. Meanwhile, Russia's production was, on average, 50 thousand barrels per day (tbpd), higher than proposed (Figure 5).

### Box 1. Saudi Crude Oil Production

Saudi crude oil production in the first four months of 2020 is expected to average 10.3 mbpd. Looking ahead, under the current OPEC+ agreement, the Kingdom is expected to hit 8.5 mbpd in May and June, and then 9.1 mbpd in H2 2020. As a result, we now expect Saudi crude oil production to average 9.4 mbpd during 2020, down from our previous forecast of 11.4 mbpd. We do not, however, expect an equivalent reduction in oil exports. This is because measures designed to limit the spread of COVID-19, including strict curfews, and the subsequent decline in overall economic activity (see Economic Update section below), will result in a reduction of energy consumption in the Kingdom. More specifically, we expect Saudi consumption of gasoline and jet fuel (which constituted 30 percent of total liquid consumption in 2019) to be the worst hit. Additionally, we expect a reduction in crude oil burn for electricity generation (which averaged 424 tbpd in 2019), due to the start-up of the Fadhili gas complex ([for more on this please refer to our previous Economic Update](#)), with electricity demand itself likely to decline year-on-year due to preventative measures around COVID-19.

### Non-OPEC+ declines :

Shortly following the OPEC+ deal, oil producing nations within the Group of 20 (G20) announced additional reductions in output. However, unlike the OPEC+ voluntary reductions, the G20 figures were expected to be partly a result of market-driven reductions totaling up to 3.7 mbpd. The lack of detail surrounding the proposal makes it very difficult to assess to what extent such reductions are guaranteed. This is, for example, highlighted by contrasting figures in relation to US output. On the one hand, US officials estimate that output could decline by 2 mbpd by the end of this year, however,

Figure 4: OPEC+ crude oil production for May and June 2020 amounts to a moderation of 9.7 mbpd

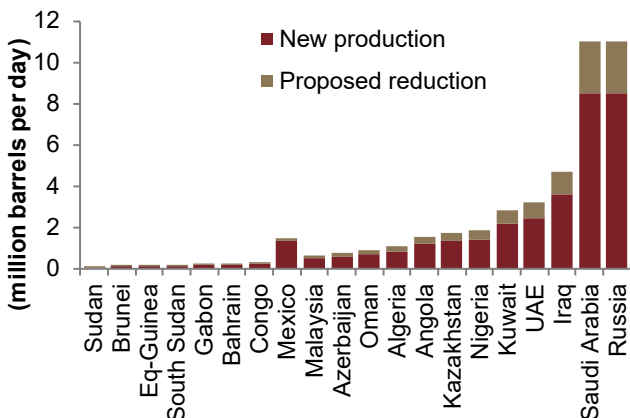
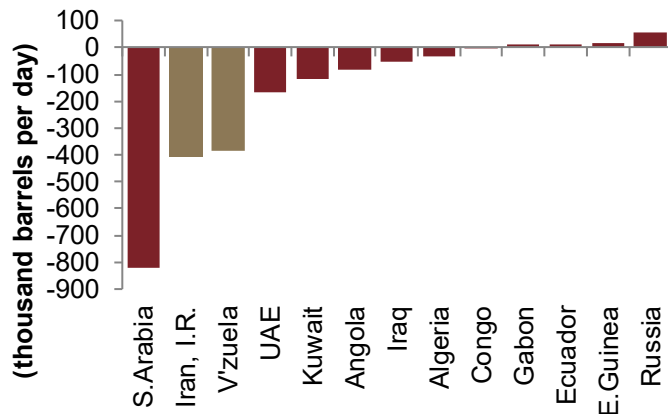


Figure 5: Gulf oil producers accounted for 89 percent of OPEC's output moderation in 2019





*Thus, the ambiguity in the G20 proposal raises the risk of a persistence in sizable daily oil surpluses during Q2, despite the OPEC+ agreement....*

*...which could lead to continued rises in commercial oil stocks.*

*...in turn pressuring oil prices even lower and permanently taking some oil supply off-line.*

*Taking into account all the above developments, we have further reduced our Brent oil forecast to \$39 pb for 2020.*

*We have updated our economic forecast for Saudi Arabia to incorporate recent developments.*

*We now expect overall GDP to contract by 1.7 percent with non-oil private sector declining by 3.9 percent.*

according to latest forecasts by US's Energy Information Administration (EIA), oil production will average 11.8 mbpd in 2020, down 500 tbd from 2019. Thus, the ambiguity in the G20 proposal raises the risk of persistent sizable daily oil surpluses (Figure 6) during Q2, despite the OPEC+ agreement, and adds to downwards pressure on oil prices in the near term.

**Oil price outlook:**

Brent oil prices are currently trading just under \$30 pb, with the year-to-date average at \$42 pb. Current spare global storage capacity (including commercial land and floating, and national Strategic Petroleum Reserves) is estimated at around 1.3 billion barrels (oil in storage stood at around 3 billion at the end of Q1 2020). Looking ahead, the persistence of a sizable daily surplus in oil during Q2 will see commercial oil stocks rising, with the rate of stock build accelerating if OPEC+ exhibits poor compliance levels. If this transpires, oil prices will trend even lower, in turn forcing a larger number of oil producers to make tough choices around shutting-in oil wells, and permanently taking their oil off-line. Whilst a combination of permeant shut-ins and some recovery in demand later in H2 2020 could lend some support to oil prices, any upside would be limited due to the existence of large oil stocks.

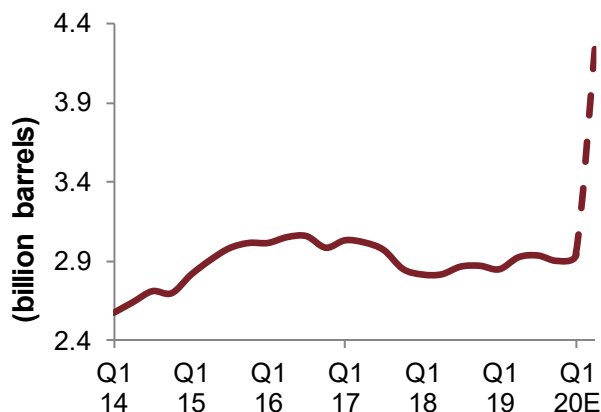
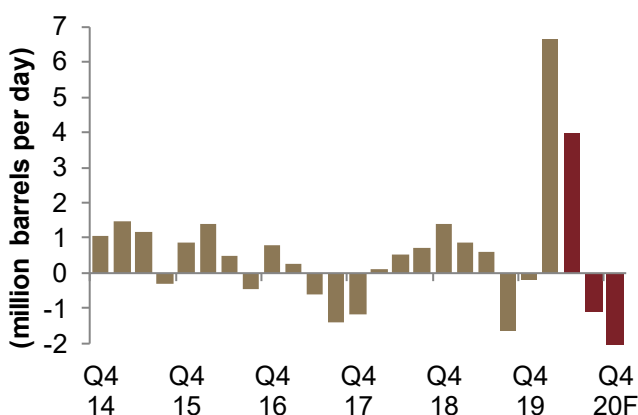
Taking into account all the above developments, we have further reduced our Brent oil forecast to \$39 pb for 2020, versus \$44 pb previously.

**Revised economic forecasts:**

We have updated our economic forecast for Saudi Arabia to incorporate both oil market and domestic developments. Overall, we now expect the Kingdom's GDP to contract by 1.7 percent in 2020, with both oil (-0.4 percent) and non-oil GDP (-2.6 percent) declining during the year. Considering the speed and strictness of measures taken by the Saudi authorities to prevent the transmission of COVID-19, including lockdowns and curfews, coupled with the uncertainty of the duration of such measures, forecasting growth is a particularly perilous task. However, as highlighted in our previous [economic update](#), we are more certain about which sectors will bear the brunt of the downturn during the pandemic lockdown, namely the 'Transport, Storage & Communication', 'Wholesale/Retail Trade & Restaurants/Hotels, and 'Other Manufacturing' sectors (Table 1).

**Figure 6: Daily oil surplus expected to be 4 mbpd during Q2 assuming full OPEC compliance**

**Figure 7: Risk of commercial oil storage rising towards maximum capacity in the near term**





**Table 1: Real GDP shares and growth rates**

% Share of:	2019		2018	2019	2020F
	Total GDP	Non-oil GDP	% year-on-year		
<b>Overall GDP</b>	<b>100</b>		<b>2.4</b>	<b>0.3</b>	<b>-1.7</b>
<i>of which:</i>					
<b>Oil sector</b>	41.8		3.1	-3.6	-0.4
<b>Non-oil sector</b>	58.2	100	2.2	3.3	-2.6
<i>of which:</i>					
Non-oil government sector		30.0	2.9	2.2	0.5
Non-oil private sector		70.0	1.9	3.8	-3.9
<b>Non-oil GDP by kind of activity</b>		<b>100</b>			
Agriculture		4.0	0.3	1.3	0.8
Non-oil mining		0.7	2.4	4.8	-1.0
Non-oil manufacturing		14.6	4.0	-0.9	-2.0
Electricity, gas and water		2.2	1.9	-4.0	-0.8
Construction		7.8	-3.5	4.6	-0.8
Wholesale & retail trade		16.2	1.0	6.3	-5.5
Transport & communication		10.8	2.1	5.6	-7.9
Real estate activities		9.4	2.6	3.4	-0.4
Finance, insurance, & bus.		7.1	3.9	8.0	-0.6
Community & social services		3.7	5.2	6.9	-14.8
Producers of government services		23.9	3.0	1.5	0.5

On the fiscal side, we see government oil revenue totaling SR384 billion...

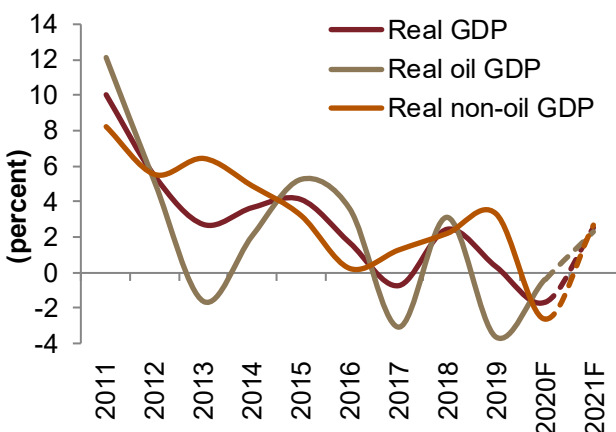
...and expect non-oil revenue to decline by 16 percent over budgeted levels.

On the expenditure side, a roll-out of fiscal measures to support the private sector will push spending to SR1.07 trillion...

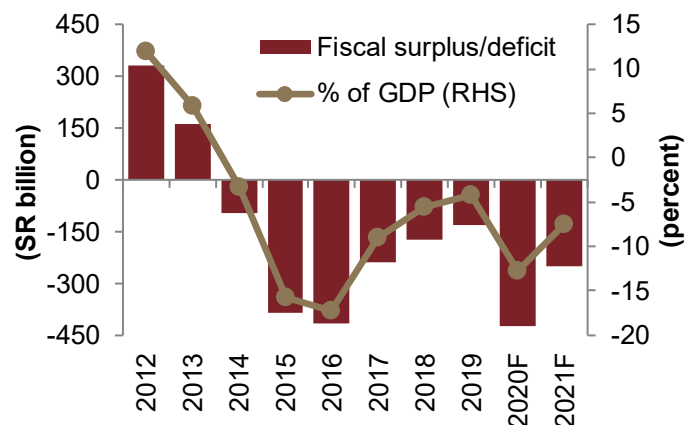
On the fiscal side, with our Brent oil forecast of \$39 pb and crude oil production of 9.4 mbpd, we see government oil revenue totaling SR384 billion, with a sizable 72 percent (SR277 billion) of this coming from Aramco's base dividend. Furthermore, we expect non-oil revenue to decline by 16 percent over budgeted levels, primarily as a result of lower tax revenue, such as VAT, customs tax and institutional taxes. On the expenditure side, despite an announced SR50 billion reduction in spending, a roll-out of fiscal measures to support the private sector (such as payment of dues and 60 percent of salaries for the nationals for up to three months) plus an additional SR47 billion for healthcare, raises government expenditure to SR1.07 trillion.

Taking into account revised revenue and expenditure forecasts, we see the fiscal deficit reaching SR422 billion (15.7 percent of GDP) at the end of the year (Figure 9). Part of this deficit will be financed by debt. More specifically, we expect total of SR176 billion in debt

**Figure 8: Real GDP contracting in 2020**



**Figure 9: Fiscal deficit to hit SR422 billion (15.7 percent of GDP)**





*...pushing the fiscal deficit to SR422 billion (15.7 percent of GDP)...*

*...with a total of SR176 billion in debt issuance during the year.*

*Whilst exports will decline, so too will imports, and we also expect a decline in the invisible balance...*

*...resulting in very slim current account surplus during the year at 0.6 percent of GDP.*

*Significant deflationary pressure is expected in the near term...*

*...but as the economy starts up again there will be a lot of pent up demand, resulting in a jump in inflation.*

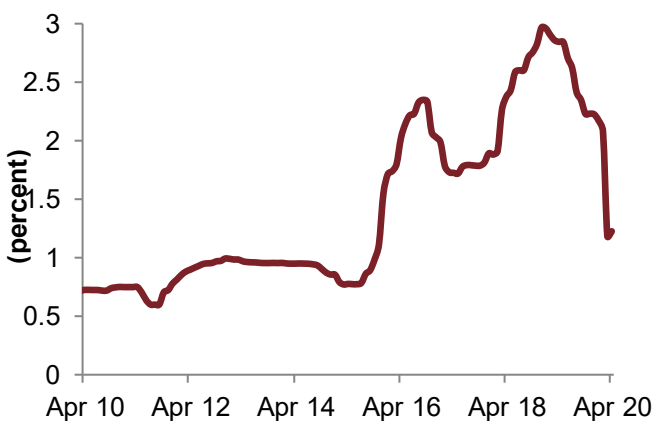
issuance during the year, thereby pushing total debt to SR854 billion (31.7 percent of GDP) by end of 2020. Despite the recent \$7 billion international bond issuance, we see around 60 percent of this year's debt being financed from internal borrowing, especially so since domestic funding costs (SAIBOR) is at multi-year lows (Figure 10), whilst international bond yields have widened. The remainder of the deficit will have to be financed by SAMA deposits.

Considering the size of the fiscal deficit and consequent debt requirement, we would not be surprised if additional reductions in overall expenditure were enacted. However, what we see as more likely is that certain budgeted expenditure is reallocated for i) further measures aimed at providing support to citizens and businesses during the pandemic and ii) kept as 'dry power' and used for fiscal stimulus to ensure a strong economic recovery takes place once the pandemic is over.

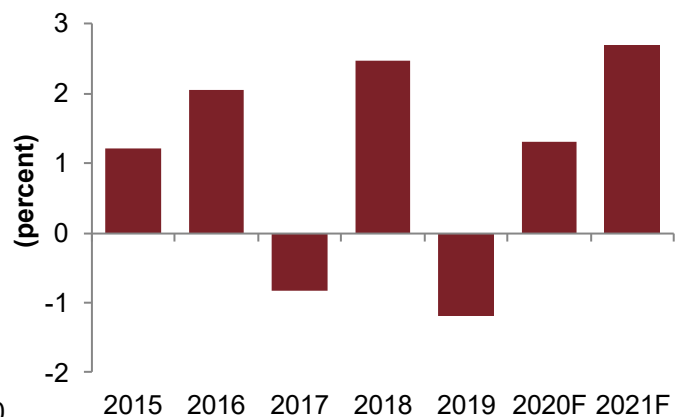
Lower yearly oil production and prices will mean lower oil exports, but we are also factoring sizable declines in non-oil exports as global manufacturing and trade contracts. However, we still see there being a trade surplus as a steep decline in domestic economic activity will also translate into lower imports values. The invisible balance will also be affected, with outflows from the largest segments, transportation services and remittances, likely declining. Overall, we do see a very slim current account surplus during the year at 0.6 percent of GDP.

In the near term we see significant deflationary pressure as economic activity comes virtually to a standstill in many sectors for a few months. But as soon as the economy starts up again there will be a lot of pent up demand, resulting in a jump in inflation. Additionally, there is uncertainty over the readiness of global supply chains to meet demand, since each country will have a differentiated path to recovery from the pandemic. This raises the possibility of supply of goods and services not being able to keep up with the surge in demand as the economy opens up, further adding to inflationary pressures (Figure 11).

**Figure 10: SAIBOR at multi year lows**



**Figure 11: Inflationary pressure expected post-COVID 19**





## Key Data

	2013	2014	2015	2016	2017	2018	2019	2020F	2021F
<b>Nominal GDP</b>									
(SR billion)	2,800	2,836	2,454	2,419	2,582	2,934	3,044	2,697	3,091
(\$ billion)	747	756	654	645	689	782	812	719	824
(% change)	1.5	1.3	-13.5	-1.4	6.8	13.6	3.7	-11.4	14.6
<b>Real GDP (% change)</b>									
Oil	-1.6	2.1	5.3	3.6	-3.1	3.1	-3.6	-0.4	2.3
Non-oil private sector	7.0	5.4	3.4	0.1	1.5	1.9	3.8	-3.9	3.2
Non-oil government	5.1	3.7	2.7	0.6	0.7	2.9	2.2	0.5	1.5
Total	2.7	3.7	4.1	1.7	-0.7	2.4	0.3	-1.7	2.5
<b>Oil indicators (average)</b>									
Brent (\$/b)	110	99	52	43	54	71	66	39	55
Production (million b/d)	9.6	9.7	10.2	10.4	10.0	10.3	9.8	9.4	9.6
<b>Budgetary indicators (SR billion)</b>									
Government revenue	1,156	1,044	616	519	692	906	917	654	740
Government expenditure*	994	1,140	1,001	936	930	1,079	1,048	1,076	990
Budget balance	162	-96	-385	-417	-238	-173	-131	-422	-250
(% GDP)	5.8	-3.4	-15.7	-17.2	-9.2	-5.9	-4.3	-15.7	-8.1
Gross public debt	60	44	142	317	443	560	678	854	948
(% GDP)	2.1	1.6	5.8	13.1	17.1	19.1	22.3	31.7	30.7
<b>Monetary indicators (average)</b>									
Inflation (% change)	3.5	2.2	1.2	2.1	-0.8	2.5	-1.2	1.3	2.7
SAMA base lending rate (% end year)	2.0	2.0	2.0	2.0	2.0	3.0	2.25	0.50	0.75
<b>External trade indicators (\$ billion)</b>									
Oil export revenues	322	285	153	137	171	232	202	141	162
Total export revenues	376	342	204	184	222	294	262	169	208
Imports	153	158	159	128	123	126	132	101	123
Trade balance	223	184	44	56	98	169	129	68	84
Current account balance	135	74	-57	-24	10	71	50	4	15
(% GDP)	18.1	9.8	-8.7	-3.7	1.5	9.0	6.1	0.6	1.9
Official reserve assets	726	732	616	536	496	497	499	470	459
<b>Social and demographic indicators</b>									
Population (million)	29.6	30.3	31.0	31.7	32.7	32.5	32.6	33.0	33.2
Saudi Unemployment (15+, %)	11.7	11.7	11.5	12.5	12.8	12.7	12	12	11.8
GDP per capita (\$)	25,223	24,962	21,095	20,318	21,048	24,065	24,890	21,767	24,802

Note\*: 2016 Government expenditure includes SR105 billion in due payments for previous years

Sources: Jadwa Investment forecasts for 2020 to 2021. Saudi Arabian Monetary Agency for GDP, monetary and external trade indicators. Ministry of Finance for budgetary indicators. General Authority for Statistics and Jadwa Investment estimates for oil, social and demographic indicators.



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