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# THE CORONAVIRUS AND ITS IMPACT ON THE ENERGY SECTOR

## KEY POINTS:

1. **As of March 1, the coronavirus has spread to 61 countries and territories with close to 87,000 cases and 3000 deaths.**
2. **According to the IEA, world demand growth assessments for 2020 have decreased from 1.19 mb/d in January to 0.83 mb/d in February – the lowest annual growth since 2011. OPEC forecasts slightly greater growth closer to 1 mb/d down by 230 kb/d from last month.**
3. **China's inability to absorb incremental supply means that more supply will be on the market thus creating greater volatility and market uncertainty.**
4. **A significant reduction in Chinese demand has a consequential impact on the world economy given the size of China's economy and its integration in the global supply chain.**
5. **Other than oil, the coronavirus may impact other areas of the energy sector including natural gas, renewables, petrochemicals, and battery production.**

## CONTEXT

The coronavirus, which started in Wuhan, the capital city of China's Hubei province, has spread to 61 countries and territories. China first reported the outbreak on December 30, and since then there are approximately 87,000 confirmed cases worldwide with close to 3000 deaths from the virus. Since most of the cases are in China, the Chinese economy has slowed due to factory closures, reduced consumption of consumer goods, and reduced demand for Chinese products. Several jurisdictions across China are also being quarantined to prevent further spread of the virus. These ongoing developments, and the continued spread of the virus beyond China's borders has impacted all sectors of the global economy including the energy sector. A similar situation occurred during the SARS outbreak in 2003, but the number of cases were far lower. OPEC responded by increasing production, but the Iraq war and Venezuelan oil strikes were also factors.

## ANALYSIS

According to the IEA short-term oil market report, world demand growth assessments for 2020 have decreased substantially from 1.19 mb/d in January to 0.83 mb/d in February – the lowest annual growth since 2011. Chinese oil demand growth is expected to grow by just 150 kb/d in 2020, the lowest annual increase since 2008. OPEC's February monthly oil market report, meanwhile, forecasts growth closer to 1 mb/d but that is also down by 230 kb/d from last month. Although part of this decline can be attributed to a correction from January's growth figures (as is usually the case at the start of every year compared to assessments from the prior year), the coronavirus and its associated uncertainty is bringing volatility to global energy markets with Brent oil prices currently below \$55.

Over the years, energy demand has shifted from OECD countries to non-OECD Asia, with most of that demand coming from China. However, the onset of the virus has seen a reduction in air travel, road transportation and manufacturing which has impacted oil demand. This is in addition to a Chinese economy growing at a slower rate than in the past, geopolitical instability in the Middle East, supply disruptions in Venezuela and Libya, and a US-China trade conflict that has seen tariffs on US energy products. A sudden force majeure virus epidemic in an energy market with existing demand-eroding elements has further exacerbated supply-demand fundamentals.

From a supply perspective, China's inability to absorb incremental supply means that more supply will be on the market thus creating greater volatility and market uncertainty. A greater focus will now be placed on the role of OPEC+ to see whether further supply adjustments will be made or if partners will take a "wait and see" approach as the situation develops. If prices continue to fall, US shale production may also slow. Uncertainty related to timelines and how the outbreak will fully manifest itself at its peak becomes the greatest challenge to planning effective actions to maintain energy market stability.

## IMPACTS:

Aside from bringing instability to oil supply-demand fundamentals, the coronavirus could also have knock-on effects in other areas of the energy sector.

1. **Natural gas** – Falling oil prices are also causing natural gas prices to fall given energy demand as a whole is being impacted. Exports of LNG to China are being allocated to new buyers to absorb the additional supply that has come online in the last few years. China's dwindling demand for natural gas could result in a greater natural gas supply glut in the short- to medium-term. Buyers tied to long-term LNG contracts may also try to opt out to take advantage of a slump in spot prices.
2. **Renewables** – China is one of the largest consumers of oil and gas worldwide, but also one of the largest manufacturing economies in the world that includes manufacturing of solar equipment. Extended closure of these companies could impact the global solar supply chain in the short- to medium-term depending on the duration and severity of the outbreak. Wind turbine component production can also be impacted due to production delays.
3. **Petrochemicals** – Although demand for plastics decreases during the Lunar New Year, the coronavirus outbreak may cause a slowdown in Chinese retail activity which will impact demand for packaging. Petrochemical plants have already lowered their operating rates to process feedstock which can decrease in price due to sluggish demand and affect producer margins. Other petrochemical projects slated to come online in 2020 could be delayed as well.
5. **Battery Storage** – Along with solar, China is home to most of the world's lithium-ion battery manufacturing. There are risks that the country's battery storage production capacity could contract by 10 percent or 26 GW which amounts to 7 percent of global production capacity. Constraints on battery production could ramp up demand and reverse cost declines in the short- to medium-term.

## CONCLUSION:

The scenarios outlined above are only possible outcomes given the current extent of one of the most damaging virus outbreaks in recent memory. China's economic influence and the globalised nature of the economy makes energy markets especially vulnerable when Chinese demand is impacted. A longer and protracted duration of the outbreak may give rise to newer challenges that must be overcome through dialogue and collaboration.

As a neutral platform dedicated to global energy dialogue, the International Energy Forum works to enhance dialogue and increase cooperation. Sharing information about how the spread of the coronavirus will impact the energy sector will be of paramount importance as is outlined in the IEF Charter:

...building confidence and trust through improved information-sharing among states.

Section II, Objective 6 - IEF Charter