US-China Trade Dispute Resolution:

38 days. This is how much time the US and China have to strike a deal before their 90-day truce applied on the 1st December expires. Recent developments surrounding this potential deal have been positive and have entertained the idea that 2019 might not be as bad as expected.

Indeed, the 7-9 January vice-ministerial meeting in Beijing ended on a positive note with reports saying that China pledged to increase its purchases of American goods by $1 trillion up to 2024. President Donald Trump has for the last 18-months criticised his country's trade deficit with China, worth $323 billion last year, and China's non-respect of international intellectual property. By increasing imports of US goods to $200 billion in 2019 from $45 billion, and reaching $600 billion of US imports in six years, China hopes to tamper American concerns. If Americans are content with Chinese actions, they are likely to remove tariffs placed over the last months.

As a result of such talks, Donald Trump said on the 19th January that a deal "could very well happen". Chinese Vice-President Liu He is expected by the end of the month in Washington for another two-days of talks with his US counterpart. Altogether, the higher probability of a deal ending the US-China trade dispute has increased oil prices to around $62 for a barrel of Brent crude, up from $50 in late December, that is a 24% increase. Oil futures have risen by 3.3% last week, or their best start since 2001.

Lower Supply:

China is not the only source behind this rally. OPEC is currently applying its 1.2 million bpd production cut announced late last year. Out of this amount, 750,000 bpd have already been cut, mainly thanks to Saudi Arabia accounting for 468,000 bpd. The Kingdom aims to reach 800,000 bpd cuts, whilst Russia and the UAE are expected to contribute for the rest. However, Alexander Novak, the Russian Energy Minister, has admitted that obstacles "technological in nature" were slowing the pace of production cuts in the world's second biggest oil producer.

Other OPEC countries not expected to cut down on production have involuntarily seen lower outputs. Since December, Venezuela has lost 33,000 bpd in production and this decline is likely to further accelerate as the US prepares to implement sanctions on the country as a result of Nicolas Maduro's second presidential inauguration, deemed illegitimate by Washington. In fact, it could well be that the

500,000 bpd of heavy Venezuelan crude imported by US refiners will be banned in the coming weeks.

Libya, another country battered by domestic turmoil has declined its oil production by 172,000 bpd since December. Its biggest oil fields situated in the south and accounting for nearly half of its 950,000 current production are shutdown by tribesmen discontented by government services. The news from the country over the next few weeks will prove to be important for the oil market as General Khalifa Haftar of the Libyan National Army is poised to gain those oil fields and to become the country's biggest oil magnate. It however remains to be seen whether such monopoly will result in a rise of production, hoped to reach 2.1 million by 2021, or a reappraisal of tensions with the UN-backed government of Fayez al-Sarraj.

Targeted by US sanctions, Iran is the other country involuntarily cutting down on its output. Since December, it has lost 159,000 bpd as it only exported 1.1 million bpd of oil and condensates, down from 2.7 million before the sanctions were announced in May 2018. Scheduled 13-14 February in Poland, the Middle East Conference organised by US Secretary of State Mike Pompeo is likely to end with further pressures on Iran's oil sector, and with a potential announcement that oil waivers will be withdrawn by April this year. Indeed, the Trump administration is likely to double down on its sanctions as its current Iran policy has not led to any victory.

In the Americas, oil output is also on the decrease. Mexico and Canada have seen output declines, especially since the latter adopted a mandate to cut production by 300,000 bpd, or 5% of its total production. The US, the world's largest oil producer, are likely to experience output slowdown. With its handing of waivers for Iran sanctions to 8 countries in November 2018 and its higher than expected inventories, Washington was the major force behind low oil prices last year. Yet, such minimal prices have put pressure on shale producers, who are expected to slow down production. On the week to the 11th January, US crude stockpiles were lower by 1.5 million bpd than expected, thus reflecting lower spending and drilling from producers.

Altogether, it is reasonable to say that the oil market is in transition from a state of oversupply to a balanced state. The impact of OPEC oil cuts will take some time before being fully reflected in the oil price but the market already acts like the equity market by pricing in concerns about future supply and demand. For the week ending on the 11th January, commercial crude oil inventory were in fact 3.2 million barrels lower than previously, thus showing the supply decline.

The Big 2019 Question: Demand?

As aforementioned, the perception of lower demand is turning up despite calls from the World Bank that 2019 will see slower economic activity. However, the gradual regain of confidence over higher oil prices and demand faces some important risks in 2019.

Oversupply remains a substantial risk. Russia broke an 11.5 million bpd production record last December. Even if it is set to decrease production and Saudi Arabia pledged to expand cuts if needed, it would be unreasonable to bank on a continued agreement between producers. It is true that they all currently share the priority of increasing prices but their different financial standing might push some to further increase production to break-even.

Indeed, this might well happen to financially distressed US shale producers. The number of drilled but uncompleted wells in America has more than doubled since 2016 and there is a risk that this large backlog could add new supply if some producers decide to accelerate the rate of completion for their wells.

Asia, the world's oil demand engine is also facing difficult times as China's economy shows signs of a slowdown. South China Morning Post reported that retail sale growth only reached 4% last year, which is nearly half of what growth usually looks like in a country with 400 million affluent urban customers. Car sales registered their first year of decline in nearly three decades and new births were at their lowest amount this century. With skyrocketing household debt levels, an ageing population with a smaller labour force, Beijing faces some acute challenges. China is still going to power global growth but at a much smaller pace, this despite the government's plans to boost consumer spending and public expenditure, with $125 billion of new rail projects for 2019.

What is next?

By the end of January, current oil prices will be tested with Liu He's visit to America. If the visit bolsters chances of a US-China deal, oil prices are likely to experience further increases. The Chinese have time and again shown their desire to end the dispute and the end of year sell off has put pressure on Donald Trump to find ways and expand the US' stock market bull cycle a bit longer.

Yet, there are reports saying US negotiators expect China to spend $1 trillion on US goods by 2020, the year by which Donald Trump will probably re-run for elections. It seems that the US would also like to regularly check-up the pace of trade reforms in China, something that might lead this country to ditch trade talks. With no deal in sight, America is likely to impose 25% tariffs on more than $250 billion worth of Chinese goods. This would put much stress on the current oil market rebound and probably draw prices down to at least their December levels.

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