OIL MARKET

OIL PRICE FORECASTS REVISED UP

Author

JEAN-PIERRE DURANTE
jdurante@pictet.com

SUMMARY

- Back in mid-September 2020, when Brent was trading at USD43 per barrel, we forecast that prices would rise by over 30% by end-2021 (see The gradual healing of the oil market is likely to continue). Since then, oil prices have outstripped our forecast, reaching USD69.7 on 11 March (+62% from mid-September) and hovering around USD67 at the beginning of May.
- Global oil demand is likely to increase in H2 as vaccination campaigns lead to further easing of lockdowns in advanced economies, despite a recent increase in daily new covid-19 cases globally (see Vaccination campaign will increasingly support the recovery).
- Global re-opening is reflected in higher forecasts for oil demand (by +230,000 barrels per day on average in 2021, according to the International Energy Agency). By the end of the year, we expect global oil demand to be 3.7 million barrels per day (mbd) higher than it is now. Nonetheless, global oil demand is likely to remain 3mbd below the level of Q3 2019, before the pandemic struck.
- The expected increases in oil demand are perfectly manageable given abundant production capacity. Even after it has increased output by 1.6mbd as planned by July, OPEC+ will still be pumping 5.8mbd less than in April 2020.
- OPEC+ is unlikely to let oil prices go too high because of fears of losing market share to the US. It is more likely to increase supply incrementally, depending on the rise in oil demand.
- Should this be the case, oil prices could fluctuate around their current level. However, the return of the 1.5mbd of missing Iranian production would be a game changer. The Iranian presidential elections in June will be decisive in this regard. Setbacks on the pandemic front or an abrupt increase in geopolitical tensions (currently estimated to be close to zero) could also upset our forecast that oil prices will stay around current levels.
- Taking into account developments in oil supply and demand, we have decided to adjust our year-end target for the barrel of Brent to USD69.

Lockdown measures at the turn of the year have weighed on oil demand

After a rapid rebound in 2020, the rise in oil demand was more fitful in the early months of 2021. Covid-19 cases forced the authorities to introduce new lockdown measures, notably in Europe. As a consequence, global oil demand has been quite volatile, particularly in January and February and global oil demand was flat in Q1 2021 compared to Q4 2020.

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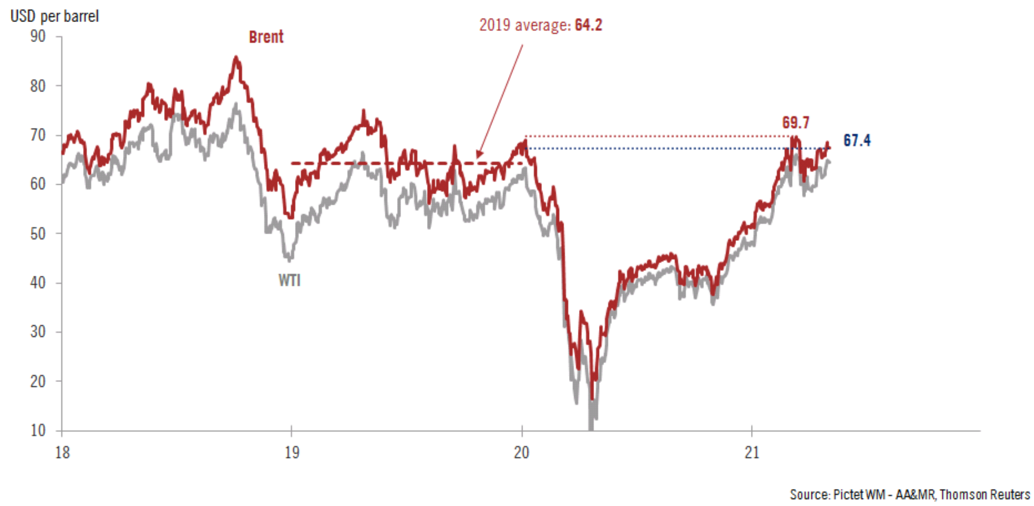
CHART 1: OIL PRICES



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We expect further reopening of advanced economies in the months to come thanks to ongoing vaccination campaigns (see Vaccination campaign will increasingly support the recovery). A partial recovery of air traffic could have a significant impact on oil demand. In normal times, 10mbd were consumed by airline industry. Air traffic is still 25% below pre-pandemic levels, so, 2.5mbd are at stake here.

CHART 2: GLOBAL OIL DEMAND

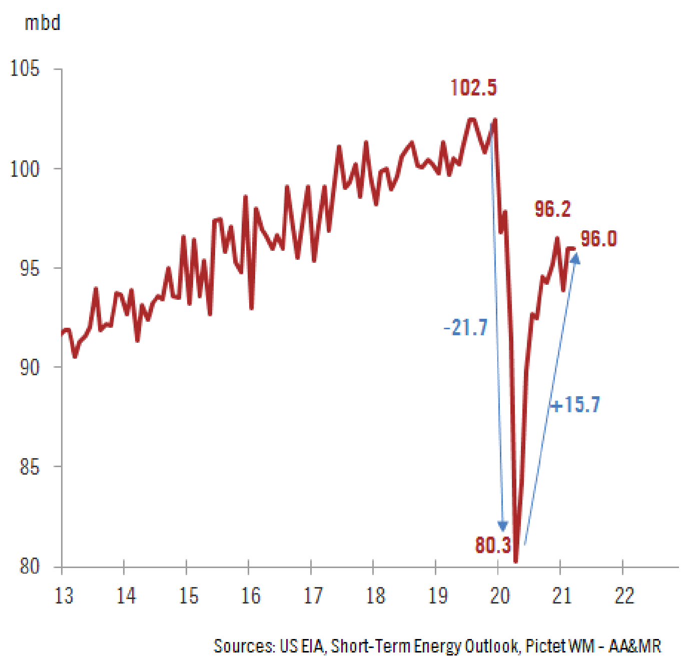
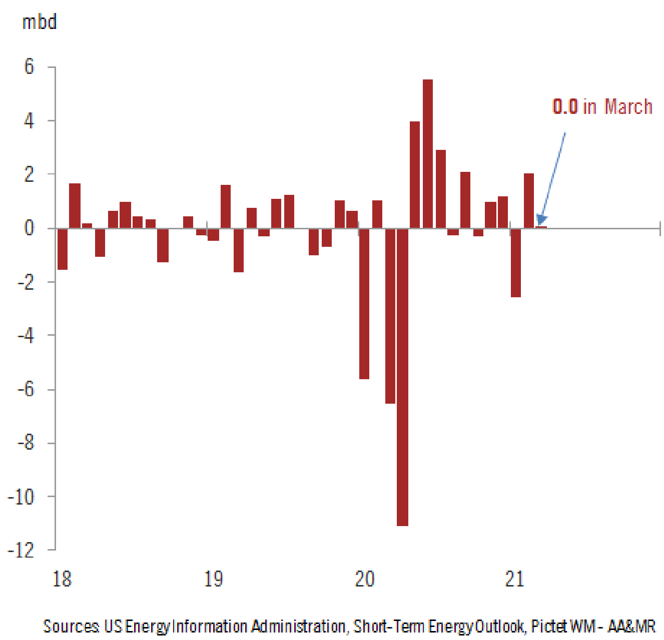


CHART 3: GLOBAL OIL DEMAND (MONTHLY CHANGE)



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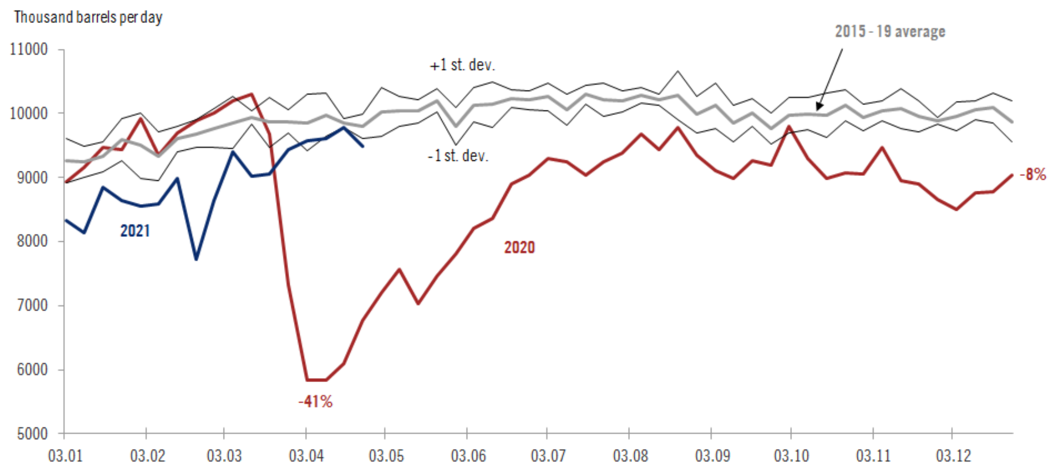
Some other important sources of oil demand are already back close to or above pre-pandemic levels. US gasoline demand is just 3% below its 2015-19 average, for example. Chinese oil demand is close to all-time highs. Further increases in global oil demand, notably in Europe, could see global oil demand rise by 3.7mbd by the end of this year to reach 99mbd. Nonetheless, this would still leave global oil demand 3mbd below where it was in Q3 2019, before the pandemic.

CHART 4: TOTAL DEMAND FOR US MOTOR GASOLINE



Sources: US Department of Energy, PWM AA&MR

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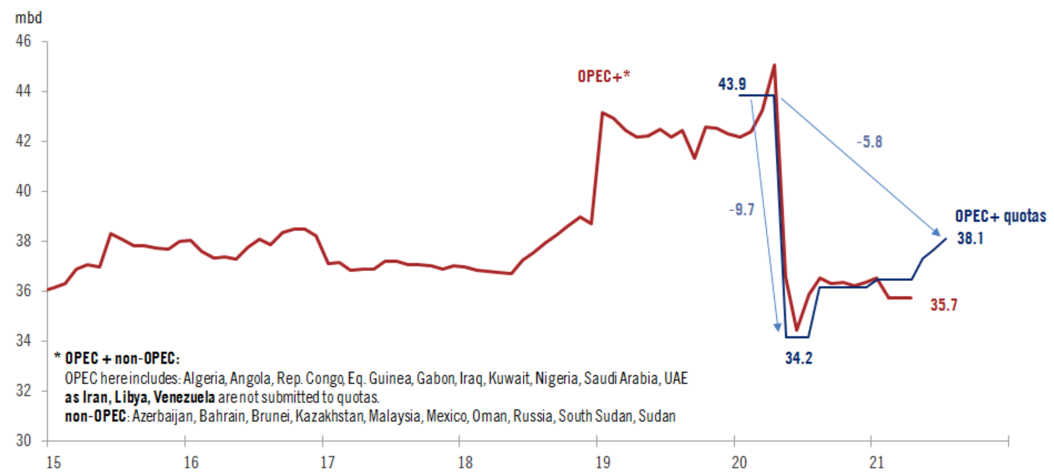
A cautious return to normal supply conditions

On 1 April, OPEC+ decided to increase oil production quotas, starting in May. By July, 1.6mbd will have been added to world oil supply (0.9mbd from the OPEC (less Iran and Libya, which are not subject to quotas) and 0.7mbd from non-OPEC countries that have signed up to quotas, see chart 5 for the list of countries).

CHART 5: OPEC+ OIL SUPPLY



Source: PWM-AA&MR, OPEC, Bloomberg

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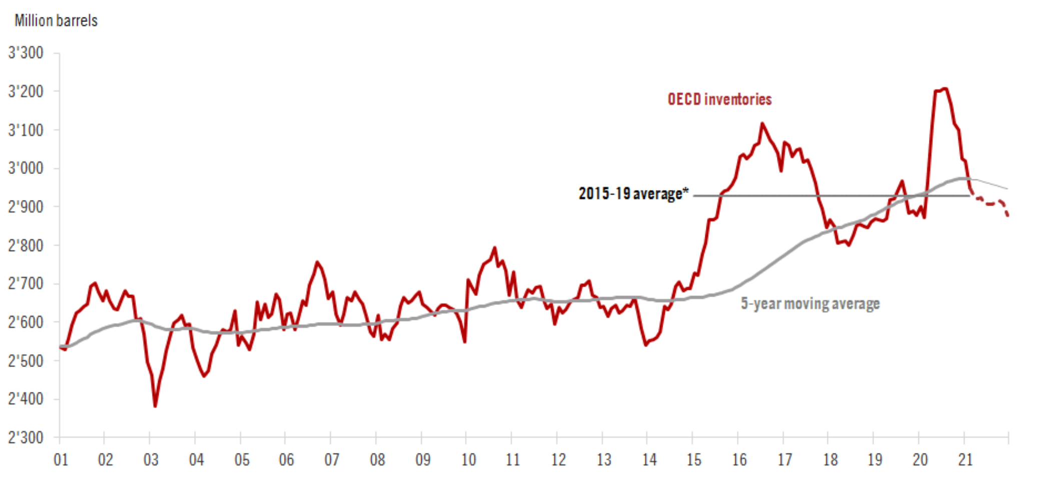
Saudi Arabia has announced that the 1mbd that it cut unilaterally in February will progressively come back on stream (250kbd in May, 350kbd in June, and 400kbd in July). Yet that will still leave Saudi production still 345kbd short of its July quota.

Taking the planned increases in production into account, OPEC+ supply could reach 38mbd in July—but will still be 5.8mbd below pre-pandemic levels. If we consider the excess capacity that prevailed before the pandemic (5.4mbd in March 2020, less 1.5mbd of Iranian capacity that is unlikely to come back next summer), supply capacity could still outstrip demand by close to 10mbd in July. In other words, OPEC+ has the means to respond to the expected increase in oil demand.

Excess inventories have been soaked up

OPEC+ members have been very disciplined since the outbreak of the pandemic at the start of 2020. In contrast to past practice, the vast majority of them have respected agreed-upon production quotas. A few producers that were recalcitrant at the start have since fallen into line. Given that the excess inventories that resulted from the collapse in demand in 2020 have been absorbed by now, OPEC+ is back as the world swing producer, able to open or shut the tap at will to influence the oil price.

CHART 6: OECD CRUDE OIL AND LIQUID FUELS INVENTORIES



* As mentionned by OPEC on 5 January 2021

Source: US Energy Information Administration, Pictet WM-AA&MR

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How to limit supply to achieve higher prices? That is the question

The break-even oil price for Saudi Arabia (for it to be able to fund government spending) is around USD80 per barrel. Riyadh would therefore clearly welcome higher oil prices. Last year, the kingdom took the lead in trying to persuade other OPEC+ members to refrain from supply increases in a bid to support oil prices. By contrast, Moscow has been afraid that leaving oil prices to rise too high will allow the US industry to gain market share. The argument is likely to continue this year. The strength of the economic recovery is another consideration. The pandemic is not over, especially in India. India is quite a closed economy, but it cannot be excluded that a resurgence in the pandemic there spills over into South East Asia and possibly derail the idea of a rapid global recovery.

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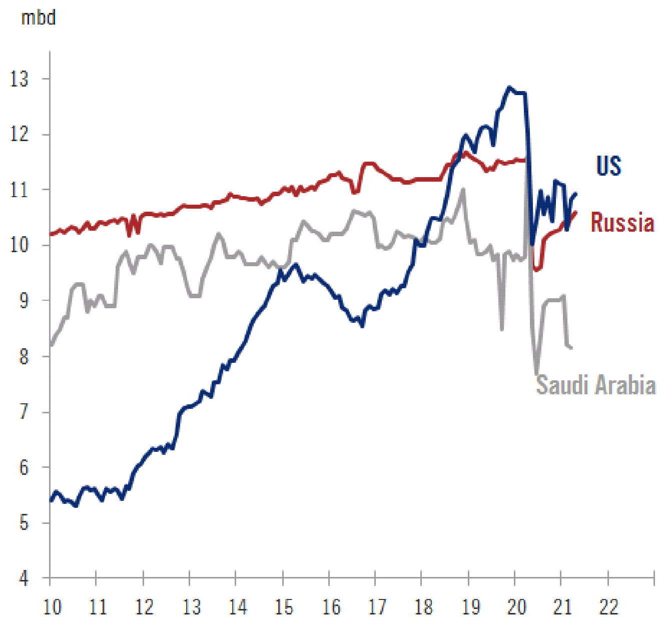
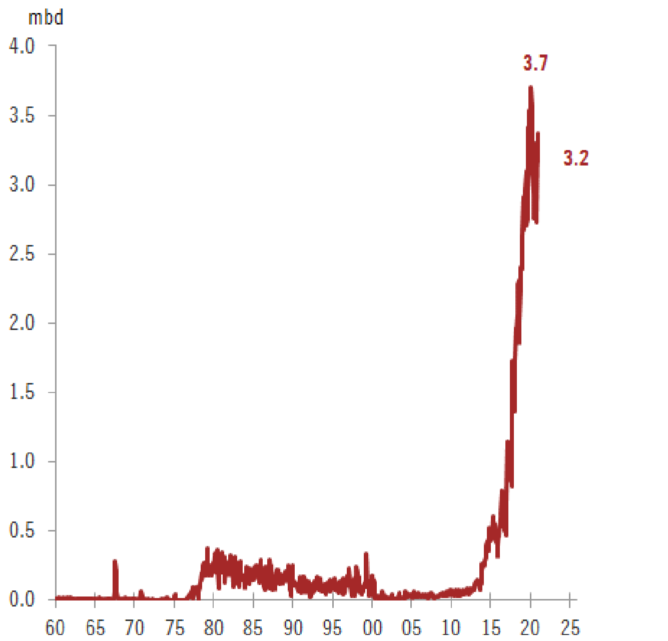
CHART 7: US, RUSSIAN AND SAUDI ARABIAN OIL SUPPLY



Source: PWM-AA&MR, US Energy Information Administration, Thomson Reuters

CHART 8: US CRUDE OIL EXPORTS



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A balanced market

All in all, we expect OPEC+ to smooth supply increases to track changes in oil demand closely while it will try to avoid giving the US oil industry an advantage and at the same risk endangering the on-going economic recovery.

The US shale oil industry has been hit hard by the crisis, forcing a wave of consolidation. The survivors need to coddle investors unimpressed by years of low returns. Nonetheless, rig count is increasing again (+79 year to date after -413 in 2020). So far, this increase in capacity is not translating into higher US production, which is almost flat (it has recovered by 0.9mbd since May 2020 but remains 1.8mbd below pre-pandemic levels). Yet US crude exports remain strong at 3.2mbd, making the US a major player in the oil market.

All things considered, we think oil supply and demand will be largely in balance during the year. As a result, oil prices are likely to fluctuate around current levels.

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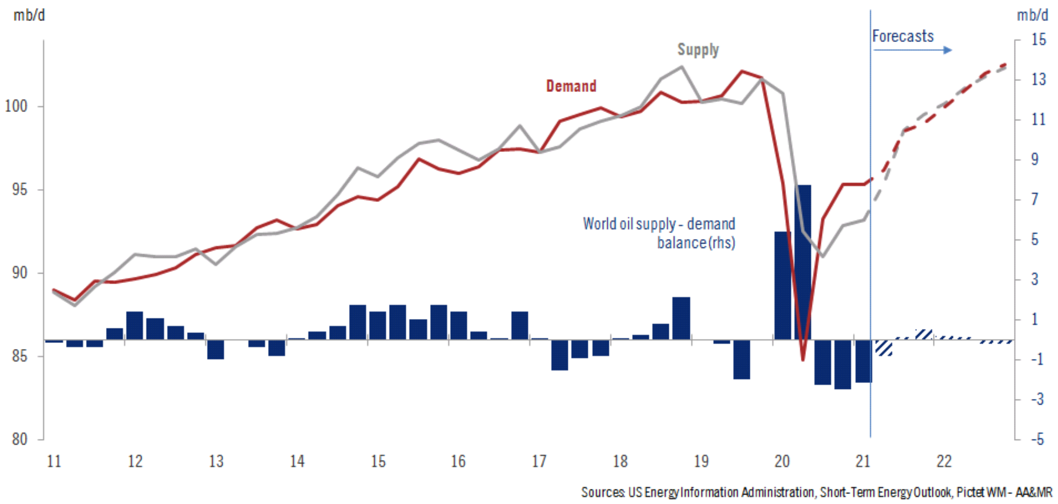
CHART 9: WORLD OIL SUPPLY/DEMAND BALANCE



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The major risks to this scenario are, first, a possible come-back of the 1.5mbd of Iranian oil missing from the market. (Indirect) negotiations between the US and Iran seem to be growing warmer, with Washington probably eager to shore up moderate candidates in the Iranian presidential election in June. The prospect of a restart of the Iranian nuclear agreement sometime in 2022 would be sufficient to weigh on oil prices in H2 2021.

Second, any setbacks on the pandemic front could force OPEC+ to postpone supply increases (or even reduce supply) to support prices.

On the other hand, progress on the covid front and a strong and rapid recovery would boost oil demand and push prices higher. Moreover, a revival of geopolitical risks, currently close to zero, would build some extra risk premium into the oil price. The candidates for geopolitical risk are many, including confrontation between China and the US over Taiwan, the latent Ukraine-Russia conflict and the fierce rivalry between Saudi Arabia and Iran.

Taking into account developments in oil supply and demand, we have decided to adjust our year-end target for the barrel of Brent to USD69 from USD55.

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