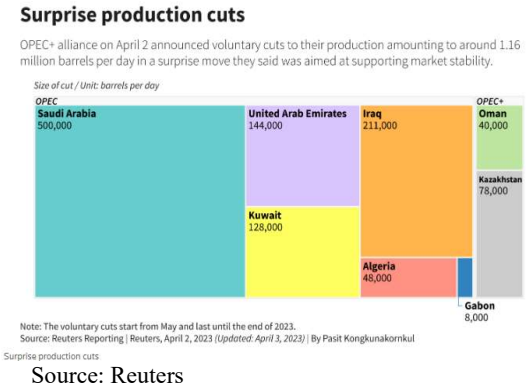
# OIL - OPEC's QUANDARY

## Outlook

### Supply headwinds

In October, the brent crude oil spot price averaged $ 91 per barrel, marking a $3 per barrel decrease compared to September, accompanied by a significant increase in oil price volatility. According to EIA, the Brent crude oil price will increase from an average of $90/b in the fourth quarter of 2023 to an average of $94/b during the first half of 2024. The modest upward oil price pressures in the coming months is due to decline in global oil inventories in the first half of 2024 as risk of supply disruption remain high due to cuts announced by the OPEC members (including Russia) in November 2022 of 3.6 mb/d which will continue till end of 2024 and additional cut of 1.16 mb/d done in April which will end in 2023.

However, any extension of voluntary cut by OPEC+ members in their next meeting can cause additional supply crunch in future which could cause price to rise. Goldman Sachs sees the possibility of deeper group oil output cut when OPEC+ member meet and it expects Saudi Arabia and Russia to announce an extension of their additional voluntary curbs through at least the first quarter of 2024. Along with this it expects that OPEC will ensure Brent in $80- $100 range by leveraging its pricing power.




Source: Reuters

### Stiffening prices

According to an analyst at Standard Chartered, the key question is how much will the other OPEC members and OPEC+ as a whole reduce targets in 2024 when voluntary cuts are unwound? The analyst highlighted that it forecast OPEC crude oil production of 29.3 million barrels per day (on average) for 2024, which is 1.4 million barrels per day higher than October output, "leaving scope for voluntary cuts to be phased out quickly". The analyst continued "However, uncertainty about the correct rebalancing strategy increases when the International Energy Agency (IEA) and Energy Information Administration (EIA) forecasts are also considered," highlighting that the IEA puts the 2024 call on OPEC at 28.4 million barrels per day and the EIA puts it at 27.7 million barrels per day.

United States too is trying to press OPEC members to increase supply by arguing that lower oil prices are necessary to support economic growth and to prevent Russia from generating additional revenue to fund conflict in Ukraine. America has already enabled an increase in oil output by lifting sanction of Venezuela for six months which can yield around 1mb/d. But all of this push by US will only yield 2-3 mb/d which will not offset the cuts done by the OPEC+ members- according to Reuters. Saudi Arabia, Russia and other members have already pledged total oil output cuts of about 5 million barrels per day (bpd), or about 5% of daily global demand, in a series of steps that started in late 2022.

Doug King, chief investment officer at RCMA Asset Management, thinks oil would go higher as the strength in the market was being driven by OPEC+ supply restraint, rather than particularly strong demand. "The move higher is not massively structural, I think it's more contrived," said King. In his view as the crude oil starts approaching the 100$ a barrel mark there will be more "barrels leak" in the market.

## Demand

### Anemic rise

As per OPEC, world oil demand in 2022 grew by 2.5 mb/d with OECD oil demand contributing 1.3 mb/d, while non-OCED countries contributing the remaining, though it remained below pre-pandemics levels. Global oil demand was robust due to host of factors, including healthy economic and manufacturing activity along with recovery in global airline activity which continues to support demand for jet fuel. In November, OPEC marginally revised the oil requirement upward for the remaining part of the year. Oil demand in 2024 is expected to grow by an average of 2.2 mb/d with total world oil demand projected to average 104.3 mb/d largely accounting for steady increase in transportation and industrial fuel demand, supported by a recovery in China's activity as well as other non-OECD regions. China is expected to see the largest growth in the non-OECD, followed by other Asia and India.

Table 4 - 2: World oil demand in 2024*, mb/d

| World oil demand | 2023 | 1Q24 | 2Q24 | 3Q24 | 4Q24 | 2024 | Change 2024/23 Growth | % |
|---|---|---|---|---|---|---|---|---|
| Americas | 25.01 | 24.70 | 25.38 | 25.55 | 25.10 | 25.19 | 0.18 | 0.72 |
| *of which US* | *20.24* | *20.06* | *20.64* | *20.62* | *20.19* | *20.38* | *0.14* | *0.70* |
| Europe | 13.45 | 13.16 | 13.60 | 13.86 | 13.41 | 13.51 | 0.06 | 0.41 |
| Asia Pacific | 7.38 | 7.84 | 6.98 | 7.13 | 7.65 | 7.40 | 0.02 | 0.29 |
| **Total OECD** | **45.84** | **45.70** | **45.96** | **46.54** | **46.16** | **46.09** | **0.26** | **0.56** |
| China | 16.09 | 16.30 | 16.52 | 16.89 | 16.96 | 16.67 | 0.58 | 3.61 |
| India | 5.37 | 5.63 | 5.64 | 5.40 | 5.69 | 5.59 | 0.22 | 4.10 |
| Other Asia | 9.26 | 9.60 | 9.73 | 9.39 | 9.54 | 9.57 | 0.31 | 3.35 |
| Latin America | 6.68 | 6.79 | 6.88 | 6.95 | 6.84 | 6.87 | 0.19 | 2.84 |
| Middle East | 8.64 | 8.91 | 8.76 | 9.41 | 8.98 | 9.02 | 0.38 | 4.40 |
| Africa | 4.50 | 4.70 | 4.42 | 4.48 | 5.01 | 4.65 | 0.15 | 3.33 |
| Russia | 3.79 | 3.89 | 3.70 | 3.89 | 4.08 | 3.89 | 0.10 | 2.65 |
| Other Eurasia | 1.17 | 1.27 | 1.24 | 1.08 | 1.28 | 1.22 | 0.04 | 3.77 |
| Other Europe | 0.79 | 0.81 | 0.78 | 0.77 | 0.84 | 0.80 | 0.01 | 1.75 |
| **Total Non-OECD** | **56.28** | **57.90** | **57.68** | **58.25** | **59.22** | **58.27** | **1.99** | **3.53** |
| **Total World** | **102.11** | **103.60** | **103.64** | **104.79** | **105.38** | **104.36** | **2.25** | **2.20** |
| Previous Estimate | 102.06 | 103.62 | 103.51 | 104.85 | 105.23 | 104.31 | 2.25 | 2.20 |
| Revision | 0.05 | -0.01 | 0.13 | -0.06 | 0.15 | 0.05 | 0.00 | 0.00 |

*Note: * 2024 = Forecast. Totals may not add up due to independent rounding.*
*Source: OPEC.*

### Counterview- price

JP Morgan expects oil demand to rise by 1.6 million barrels per day next year and the increased oil supply to meets this demand is expected to come from outside of OPEC+- like the US. JP Morgan in global oil market note said "Despite sustained economic headwinds, we see demand underpinned by robust EM, resilient US and weak but stable Europe. Demand composition will likely flip, with two-thirds of demand gains set to come from the overall economic expansion, while continued normalization of jet fuel would contribute the rest." Though much of the price action is dependent on whether Saudi Arabia and Russia continue to voluntarily limit their production in 2024 and 2025. Oil prices would fall if those cuts were to be eliminated and more supply was brought into the market. Natasha Kaneva, head of global commodities research at JP Morgan, expects prices for Brent crude oil to remain "largely flat" in 2024, with their forecasts calling for an average price of $83 a barrel in 2024. By 2025, the firm expects to see a 10% drop in Brent prices, falling to an average of $75 a barrel.

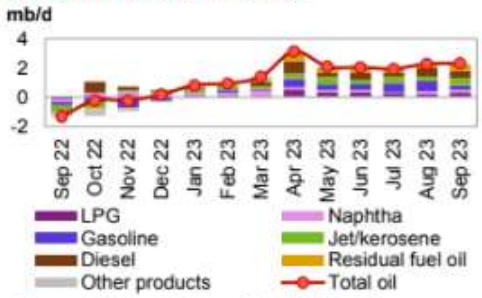
### US barely backsliding

US oil demand increased by 0.62 mb/d year-on-year to 21.17 mb/d in August 2023 supported by strong demand in transportation fuel combined with petrochemical feedstock. According to OPEC, oil demand for US is expected to grow by 51tb/d y-o-y in 4Q23 on the back of heating fuels which will aid demand at the beginning of winter and continued steady growth in the air travel demand will support jet/kerosene demand. Same trend will be seen in 1Q24 as US GDP growth forecasted to stabilize. However, industrial output has been on a prolonged downward trend, and road transportation is expected to soften during the winter season, thus dampening diesel and gasoline demand. Nevertheless, oil demand is projected to increase by about 140 tb/d y-o-y in 1Q24 mostly supported by demand for jet/kerosene and LPG.

### China on the mend

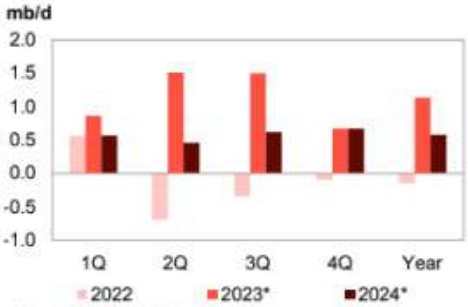
The recent surge in oil demand in China, with September experiencing a substantial y-o-y increase of more than 2.3 mb/d, a trend that mirrors the growth observed in August, though it was due to low baseline because of stringent lockdown place by the government in 2022. Looking forward, oil demand in China 4Q23 is anticipated to grow by 671 tb/d y-o-y, overall, 2023 is expected to record 1.1 mb/d growth. Following the recovery from lockdowns in 2022 oil demand is forecasted to return to normal growth levels supported by rising petrochemical capacity to bolster petrochemical feedstock demand in China and further surge in international air travel and also considering the impact of key cultural events, such as mid-Autumn festivals and National Day golden week holiday, stimulating additional growth in the demand for transportation fuel. The OPEC foresees Chinese demand averaging 16.41 million barrels per day (bpd) in the first half of 2024, up 3.2% on 2023 levels, while the International Energy Agency (IEA) forecasts demand averaging 17.1 million bpd for the full year, to show 3.9% growth.

Graph 4 - 7: China's oil demand by main petroleum product category, y-o-y change




*Sources: Chinese Petroleum Data Monthly, Chinese National Bureau of Statistics, JODI, Non-OECD Energy Statistics, Argus Global Markets, Argus China, and OPEC.*

Graph 4 - 8: China's oil demand, y-o-y change



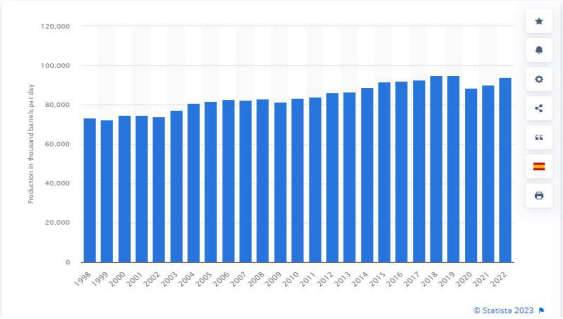

*Note: * 2023 and 2024 = Forecast.*
*Source: OPEC.*

## Supply

### Production resuscitated

The global oil production in 2022 averaged 93.84 mb/d which was better than the previous two years (2020 and 2021) because the demand for oil got affected by pandemic. One might think the average global oil production would have been higher in 2022 when compared to 2018 and 2019 as the price of oil was considerably higher in 2022- in 2022 the average price of WTI (West Texas Intermediate) was $94.53/ barrel whereas in 2018 it was $65.23/barrel and in 2019 it was $56.99/barrel. But 2022 production was not particularly good, during 2018 the rate of production was 94.90 mb/d and in 2019 it was 94.97 mb/d. The global oil production rate in 2022 lagged behind the 2018 rate by 1.06 mb/d and less than the 2019 rate by 1.13 mb/d. Furthermore, it is noteworthy that a substantial 70.7% of the surge in oil production in 2022 emanated from OPEC countries, with remainder attributed to non-OPEC sources.

Oil production worldwide from 1998 to 2022
*(in 1,000 barrels per day)*



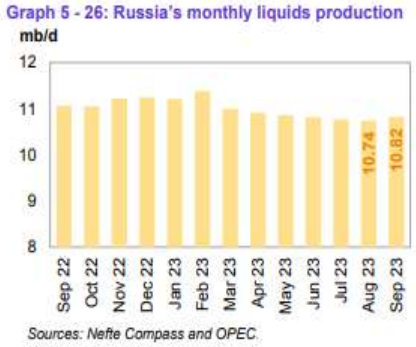

Source: Statista

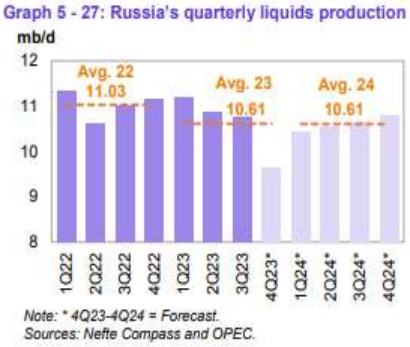
### Tug of war

In the upcoming OPEC meeting JP Morgan sees base case scenario is that existing cuts should be extended. Saudi Arabia has still room for meaningful cut, if needed. Though if the Saudi Arabia is to carry the burden alone, it will need to drop its production level to 8.5 mb/d in 2024 from 9 mb/d in 2023. We may see Saudi to seek "share the load" with other OPEC members to step up and join the task to regulate the market.

In October, Biden administration announced that they lifted sanctions on Venezuela's crude oil exports for six months, contingent on electoral reforms. While the political situation remains in flux, though sanctions relief will only lead to limited increases in oil production. According, to EIA, that Venezuela will increase crude oil production by less than 0.2 million b/d to an average of 0.9 million b/d by the end of 2024. Further increases in Venezuela's crude oil production will take longer and require significant investment after years of deferred maintenance and lack of access to capital.

The crude oil and natural gas (O&G) industry is not new to supply disruptions and price volatility. Over the past years, the industry has seen several peaks and troughs, from above $100/bbl in 2014 to $37/bbl in 2020. But the situation is unique today. According to report by EIA, global liquid fuels production will increase by 1.0 million barrels per day (b/d) in 2024. The ongoing OPEC+ production cuts help will offset production growth from non-OPEC countries, which may help maintain a relatively balanced global oil market next year. While the conflict between Israel and Hamas has not impacted physical oil supply thus far, uncertainties related to the conflict and other global oil supply conditions may exert upward pressure on crude oil prices in the coming months.




## Price Swing

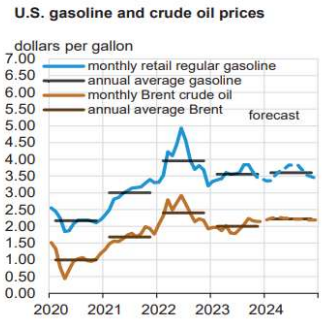
### Volatility barely going away

The crude oil prices have been subjected to sustained volatility over the past couple of months as oil producing cartel OPEC, alongside with Russia, has been keeping a lid on production to ensure prices remain elevated. Despite the announcement of supply cut to continue till the end of the year, crude oil price still continues its downward journey on the back of not so demand from China, which is the largest energy consumer in the world, amid economic slowdown in the country and rising crude inventories in the US- currently standing at 351.27 million barrels in the Strategic Petroleum Reserve (SPR). Significantly, the US is also a major player in the oil market now due to its shale boom. It's a net exporter. This in turn, has allowed US shale producers to ramp up production and grab market share, especially in Europe which is moving away from Russian oil.

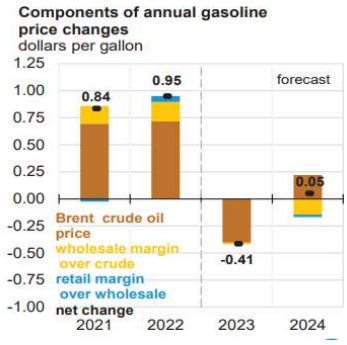
At the beginning of 2023, global financial market was certain about a sharp rebound in Chinese oil demand. This was because of the expected economic recovery after the government dropped its strict covid policies. Well, the Chinese economy has certainly recovered but the pace of the recovery has not met the original expectations. In fact, all throughout the year we have seen reports of growth estimates being revised downwards. This pushed oil prices downward after peaking in September even before the Israel Hamas war. The conflict initially caused a spike in prices, but this effect turned out to be temporary.

## Geopolitics to rule

A survey of 40 economist done by Reuters in October displayed Brent crude would average $84.8 a barrel in 2023 and $86.6 in 2024. Much of the price rise will be due to continued geopolitical tension and strong economic growth. According to John Paisie, president of Stratas Advisors, price of brent crude would likely touch $115 if the Israel-Hamas went out of control. Additionally, fear of Iran playing a significant role in Hamas attack could lead to enforcement of sanction by US which could worsen the problem of already crude market tightness.




Source: EIA

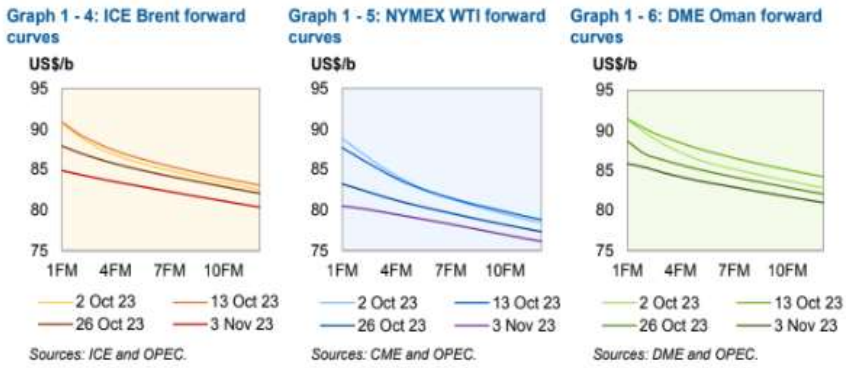



Source: EIA

## Slowing western economies

The winter months, spanning from November to February, traditionally exhibit heightened oil prices due to increase demand for heating in the western world. However, the long-term trend indicates a downward trajectory in crude oil prices. OPEC will eventually start pumping more oil again bringing their spare capacities back online. This one event alone has the potential to crash prices. Then there is still the possibility of a US recession next year. This is not certain but it's possible. If it does happen, then even India won't be spared, aptly captured in the phrase "When the US sneezes, the world catches cold". Many western nations, as well as many emerging markets, are already in a recession or are facing one right now. While India may not be in the recession club, even its economy may take a hit. Rising crude oil prices have the effect of slowing down India's economy.

As far as sharp widening in the oil price differentials between Brent crude oil and WTI crude oil are concerned, effect of current disruptions on European markets has been more volatile compared with markets in the Western Hemisphere. Goldman Sachs Research forecasts Brent spot price at $92 per barrel in 2024 and expects the oil market to tighten at a moderate pace amid solid demand while core OPEC supply remains low.




Source: OPEC

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