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Economic Update

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Oil Markets

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Oil market weakness in March spurs OPEC+ to deepen production cuts

Summary

Oil prices fell in March as contagion fears from the collapse of banks in the US and Europe dominated headlines and heightened risk-off sentiment in financial markets. OPEC+ surprised with a decision to cut output by more than 1 mb/d for the remainder of the year, potentially pushing oil market balances into a deficit before the end of 2Q23 amid accelerating post-Covid oil consumption in China. This saw prices rally back above $80.

- Oil prices trended lower in March as fears of bank failures in the US and Europe raised risk-off sentiment in financial markets during the first half of the month. International benchmark Brent crude fell to $73.0/bbl on 17 March, its lowest level since December 2021, before rallying in the final two weeks of the month to reach $79.8/bbl (-4.9% m/m; -7.1% ytd) as banking fears subsided and as supply disruptions in northern Iraq came into play. (Chart 1). The improved sentiment has carried over into April, with prices surging by more than 8% in opening day trading after OPEC+ surprised markets overnight with its announcement of deeper production cuts. Brent stood at $85/bbl in early April. Local marker Kuwait Export Crude (KEC) dropped 4.4% in March to close at $79.3/bbl (-3.3% ytd) and has since rallied to $87.0/bbl.

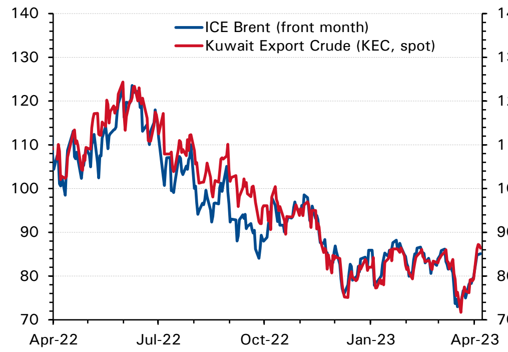
- Oil prices were also helped in late March by Turkey suspending 400 kb/d of oil exports from the semi-autonomous Kurdistan region through its territory following an arbitration ruling by the Paris-based International Chamber of Commerce in favor of Iraq in its dispute with the Kurdistan Regional Government. Overall sentiment has been subdued, however, with speculators increasingly betting on oil prices falling. (Chart 2.) The piling up of significant 'short' positions in oil futures and the market's underwhelming reaction to the Iraqi supply disruption reportedly caused much consternation among OPEC+ oil producers and likely influenced the decision to deepen pre-existing production cuts at this juncture.

- Price pressure in March came despite a more optimistic assessment of oil demand growth by the International Energy Agency (IEA) for the year ahead. Citing expectations of strong consumption in non-OECD countries and especially in China following its reemergence from Covid-19 lockdown, the IEA in its March oil market report raised its oil demand forecasts for 2023 by 100 kb/d to a record annual average level of 102.02 mb/d. It sees demand growing by 2.0 mb/d on average in 2023. (Chart 3.) Though lower than last year's increase of 2.3 mb/d, it is still a solid growth rate. OPEC, meanwhile, kept its overall oil demand estimate for the year unchanged in March (+2.3 mb/d), though did adjust lower its growth estimates for 1Q23 and 2Q23 on weaker demand in the OECD. Both organizations see Chinese consumption as the main driving force for global oil demand growth. Early signs look encouraging, with the authorities hiking the quantity of crude local refiners are allowed to import for the year and refining activity accelerating. (Chart 4.)

- On the supply side, OPEC+'s deeper output cut announcement on 2 April caught the markets off guard as it deviated from previous reassurances that the group would keep production steady. It will see a further reduction of about 1.15 mb/d in OPEC+ supply from May until the end of the year on top of the 500 kb/d that Russia signaled it would reduce from March and which it too said would be extended until end-2023. Among regional oil producers, Saudi will cut by 500 kb/d, Iraq by 211 kb/d, the UAE by 144 kb/d, Kuwait

Chart 1: Oil prices

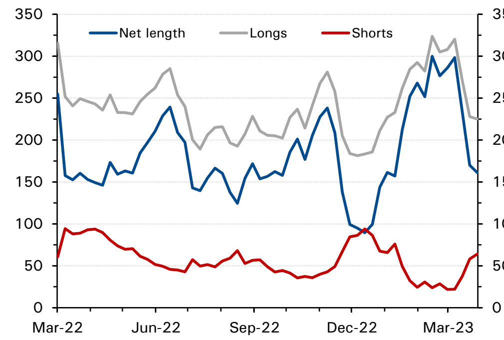
($/bbl)



Source: Refinitiv, KPC

Chart 2: Money manager net length*

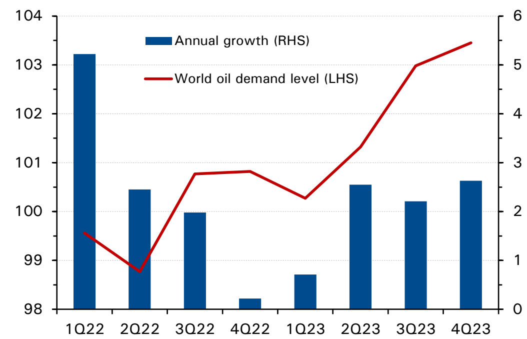
(thousand contracts)



Source: Bloomberg; *as of 28 March

Chart 3: World oil demand

(mb/d)



Source: IEA, mees

by 128 kb/d and Oman by 40 kb/d. Total indicative cuts could therefore top 1.65 mb/d, bringing OPEC+ output down from 38.2 mb/d (excluding Iran, Libya, Venezuela and Mexico) in February, based on OPEC secondary source and S&P Global data, to 36.7 mb/d for most of the year. (Chart 5.) The voluntary and involuntary supply shortfall (members producing below their quota due to capacity erosion, well or pipeline repairs, strife disrupting supply etc.) could exceed 2.4 mb/d.

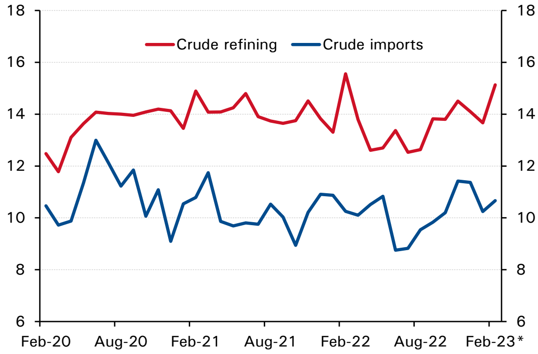
- Kuwait's crude production stood at 2.68 mb/d in February, down a marginal 11 kb/d from the previous month but up 7 kb/d above its OPEC+ quota (95% compliance), according to official sources. Kuwait's Integrated Petroleum Industries Company recently announced the inauguration of the second phase of its 610 kb/d Al-Zour refinery, boosting its output of refined products. Data from Kpler show that exports from the refinery surged 50% m/m in March to 279 kb/d, with further gains likely once the third and final processing unit comes on line by mid-year. (Chart 6.) To capitalize on this recent expansion while adhering to the OPEC+ quota, Kuwait is reducing outbound crude exports, particularly to Asia, in favor of domestic processing. For now, Kuwaiti refined products are mainly sent to Asia, though the gap left by the EU's embargo of Russian crude products leaves the country well-positioned to supply Europe with large volumes of middle distillates such as ultra-low sulfur diesel and kerosene.

- In the US, crude production dropped slightly to 12.2 mb/d in March (+100 kb/d ytd), according to US Energy Information Administration data (EIA). (Chart 7.) Meanwhile, US oil rig counts continued to trend lower, standing at 592 (-4.7% ytd) by end-March. The EIA sees this year's output surpassing 2019 levels as US shale production picks up as elevated oil prices spur increased investment, production and exports. Indeed, US oil producers have taken advantage of the positive Brent-WTI spread (averaging $6.0/bbl in March), which widened in the aftermath of Russia's invasion of Ukraine and subsequent EU sanctions on Russia, to ramp up exports to a record high of 3.6 mb/d in 2022, especially to crude and refined products-short Europe. Elevated oil prices, however, will likely delay the Biden Administration's attempts to refill the much-depleted Strategic Petroleum Reserve.

- The outlook for oil prices this year has improved following the unexpected OPEC+ output cut announcement. The probability that a currently adequately supplied oil market—stock builds were expected through 2Q23—will tighten and slip into a deficit in the second half of the year has risen significantly. Indeed, stocks could begin to draw down from June onwards, assuming full OPEC+ compliance with the deeper cuts, non-OPEC supply growth does not accelerate and that a China-driven oil demand rebound continues apace and offsets any potential further weakness in OECD economic activity.

Chart 4: China crude imports and refinery runs

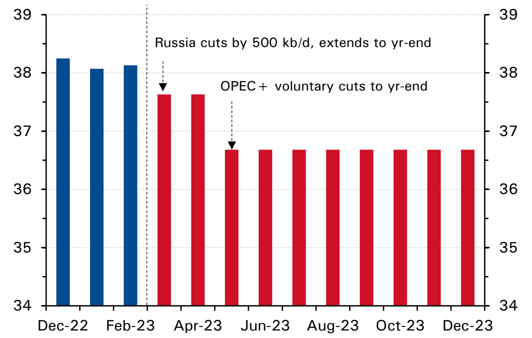
(mb/d)



Source: NBS, GACC; *refining data averaged for Jan-Feb

Chart 5: OPEC+ crude production

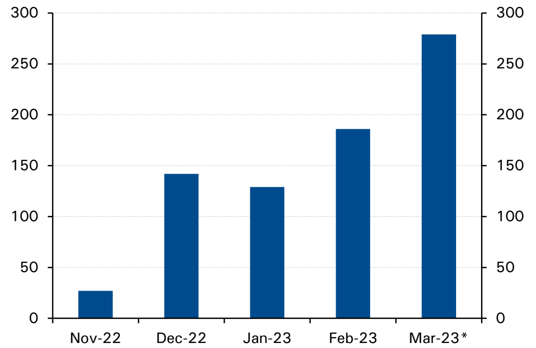
(mb/d)



Source: OPEC, S&P Global; *excludes Iran, Libya, Venezuela & Mexico

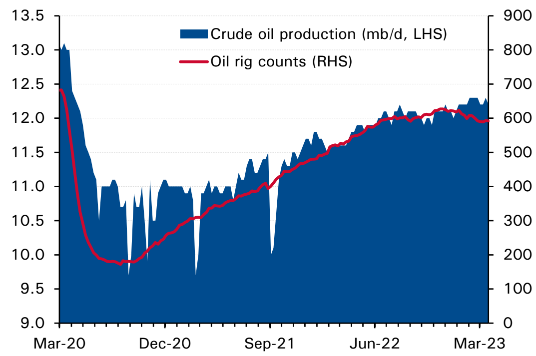
Chart 6: Al-Zour Refinery exports

(kb/d)



Source: Mees, KPLER; *Data to 15 March.

Chart 7: US crude oil production and rig counts



Source: EIA, Baker Hughes

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