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Economic Update

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Oil Markets

Oil surges to seven-year highs above $90 on supply worries and geopolitical risk

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- Oil's surge in 2022 shows little sign of easing, with Brent hurtling past $90/bbl to settle at a fresh seven-year high of $93.3/bbl (+20% ytd) on 4th February. (Chart 1.) Local marker, Kuwait Export Crude, stood a shade under at $92.3/bbl (+16% ytd). Oil's latest gains came amid news that US shale oil producers in the Permian basin had shut-in production due to freezing temperatures. Also adding to the bullishness was an against-consensus, sizeable oil stock draw (-7.7 mb) in the US, driven by heating fuel demand, while US retail gasoline prices have also spiked to 2014 levels ($3.42/gallon). Only upward movements in the US dollar, linked to Fed rate tightening expectations, profit-taking and the prospect of Iranian crude returning have managed to check, albeit temporarily, oil's recent advance.

- The strength of oil demand has surprised amid surging Omicron cases worldwide. While winter fuel switching to oil for power generation has been a factor, it has been the resilience of global economic activity that has stood out. The International Energy Agency (IEA) cited this in its upgrade of oil demand growth estimates for both 2021 and 2022 by 200 kb/d to 5.5 mb/d and 3.3 mb/d, respectively. The IEA now sees oil demand topping pre-pandemic levels this year, at 97.5 mb/d. Moreover, in November, OECD commercial oil stocks fell to their lowest levels in six years at 2.76 billion barrels (-354 mb y/y).

- Amid better than expected oil demand, therefore, market sensitivity to supply-side factors remains acute. Compounding this has been heightened geopolitical risk linked to but not exclusive to Russia-Ukraine tensions. The main thrust of the bullish impulse is that supply shortfalls look structural rather than temporary, a legacy of underinvestment since 2014 and mismanagement, leaving global crude production spare capacity much diminished. Actual or perceived supply outages due to conflict or natural phenomena such as extreme weather could therefore have an outsized impact on oil prices.

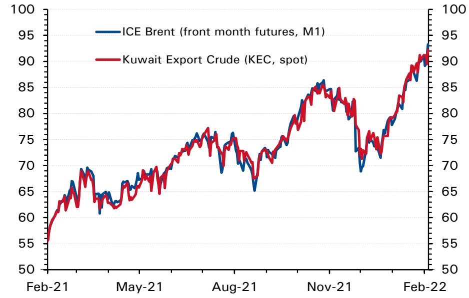
- OPEC+, tasked with restoring the 9.7 mb of pandemic-linked supply cuts, has struggled to raise aggregate output at the scheduled monthly rate of 400 kb/d. December's OPEC+ production of 37.6 mb/d (excluding OPEC-3 and Mexico) was again below target, by an estimated 690 kb/d. (Chart 2.) Preliminary MEES figures for OPEC-10 output in January show only 180 kb/d of the 254 kb/d added, leaving cumulative output 540 kb/d below the ceiling.

- Kuwait, Saudi and the UAE have more or less consistently delivered on their quotas. These three, along with Iraq and Russia, hold the bulk of OPEC+ spare capacity, about 5 mb/d currently. This could diminish to less than 3 mb/d in 2H22, the IEA estimates. This excludes Iran, though, which, once unshackled from US sanctions could supply markets with an additional 1.2-1.5 mb/d of oil.

- The near-term, tight oil market structure is at odds with the consensus outlook for the rest of the 2022, however, which is one of stock builds. (Chart 3.) Oil forecasting agencies see oil supplies outrunning demand on a combination of OPEC+ and US shale-led non-OPEC output increases. (Chart 4.) Brent futures point to a drop of $9 to $84/bbl by December, reflecting the expectation of looser fundamentals down the line. But should demand surprise on the upside and supply falter further then a rise in prices to above $100 in the near term cannot be ruled out.

Chart 1: Crude oil prices

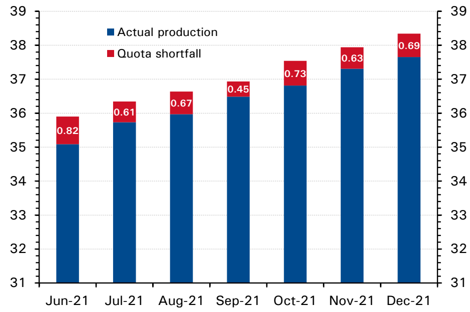
($/bbl)



Source: Refinitiv, KPC

Chart 2: OPEC+ production and shortfall

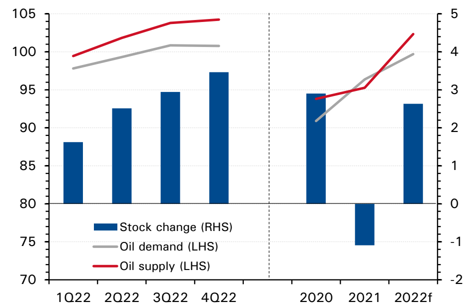
(mb/d)



Source: OPEC, S&P Global Platts

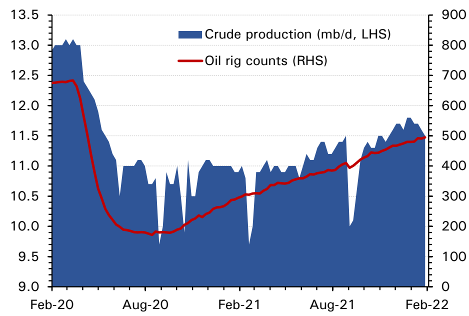
Chart 3: Demand-supply balances

(mb/d)



Source: OPEC, IEA, NBK estimates

Chart 4: US oil production and rig counts



Source: EIA, Baker Hughes

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