Oil tops $70 on improving oil demand outlook and continued supply tightness

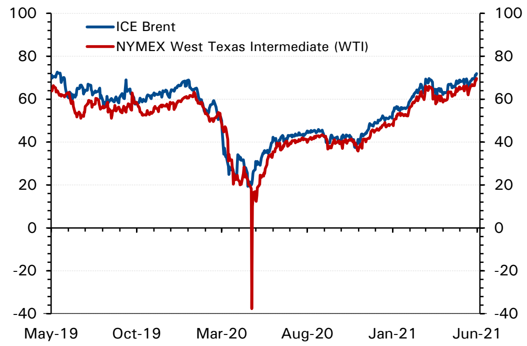
> Omar Al-Nakib
Senior Economist
+965 2259 5360
omarnakib@nbk.com

Summary

Oil prices recently reached levels not seen in more than two years, with Brent topping $70 on 1 June, buoyed by signs that global oil demand growth is accelerating while oil supply remains limited by OPEC policy. Energy watchdogs are upgrading their oil demand growth assessments, and OPEC+ could act in the next month or so to prevent a supply deficit opening up and prices overheating. Recent moves by activists and investors to pressure oil majors to embrace climate-friendly, net-zero carbon practices could have profound implications for the oil industry.

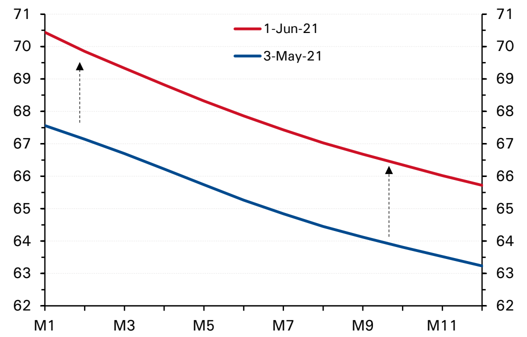
- Oil prices recently set another milestone on their post-pandemic recovery, with Brent futures breaking though the important $70 level on 1 June and then extending that gain to close at a more than two-year high of $71.89/bbl (+38.8% ytd) last Friday. West Texas Intermediate (WTI), the US crude oil benchmark, closed up at $69.62/bbl (+45.0% ytd), a remarkable resurgence from its low of $-37.6/bbl on the 28 of 'Black April' last year amid the most severe cratering of oil demand on record (Charts 1-2.)
- Spurring the recent uptick in prices has been the steady but uneven recovery in global oil demand, with the outlook for major economies improving in tandem with greater vaccine penetration. Industrial activity, consumer spending and employment, which in the US has been supported by a multi-trillion dollar stimulus package, are all up, pointing to an acceleration in economic activity. Inflation has moved higher in response and on the back of constrained global supply chains. This is most visible in the 23% year-to-date and the 61% y/y surge in global commodity prices. (Chart 3.) The OECD just raised its 2021 global economic growth estimate, by 0.2% pts to 5.8%.
- Both the International Energy Agency (IEA) and OPEC are also sounding more bullish lately. The IEA now estimates that oil consumption could return to pre-pandemic levels in a year's time, a significant upgrade from its assessment in March that demand would not likely recover to 2019 levels until 2023. The IEA even went so far as to warn that unless OPEC+ brings on more supply in the coming months the market is at risk of overheating, with prices facing upward pressure as the gap between supply and demand widens. Even the potential return of Iranian barrels would not be able to meet this shortfall.
- While oil demand and supply are currently roughly in balance, a supply deficit of just over 1 mb/d is expected to open up in 3Q21 on current trends, the IEA estimated in its May oil market report. Without a response from OPEC+, this shortfall could then widen to around -2.5 mb/d by 4Q21 and the average for the whole year would be -1.1 mb/d, slightly less than OPEC's deficit estimate of -1.4 mb/d. The IEA has oil demand growing by 5.4 mb/d (avg.) for 2021 as a whole, but is likely to upgrade its growth forecast shortly. (Chart 4.)
- In terms of the supply overhang, according to the OPEC Secretariat, OECD commercial crude and refined products stocks fell 49 mb to 2,987 mb by end-March. (Chart 5.) This put stocks at around 37 mb above the 5-year average and covering 67 days' worth of consumption (vs. 70 days at end-2020).
- OPEC+, for its part, has shown some restraint in keeping supply in check and has benefitted from moving to a monthly cycle of meetings, both in terms of being able to react more quickly to shifting demand and in terms of maintaining group unity. OPEC+ compliance was 114% in April. (Chart 6.)

Chart 1: Benchmark crude oil prices
($/bbl)



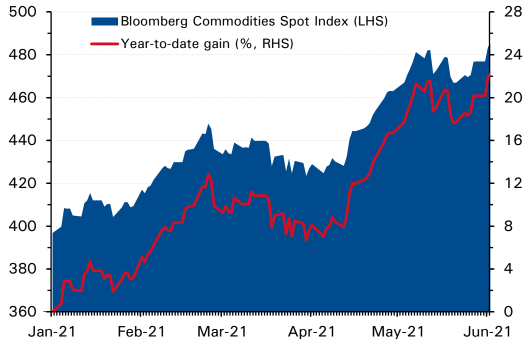
Source: Refinitiv

Chart 2: ICE Brent forward curve
($/bbl)



Source: Refinitiv

Chart 3: Bloomberg Commodities Spot Index

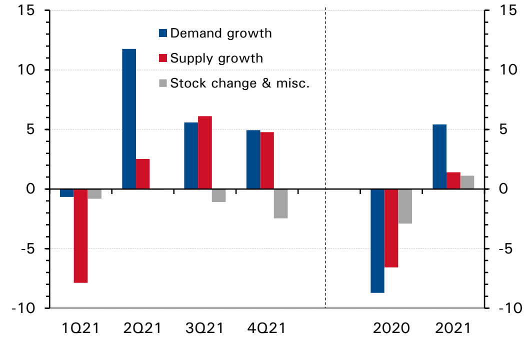


Source: Bloomberg

- At its 1 June meeting, OPEC+ reaffirmed the current production schedule that was agreed in April, which sees output increasing incrementally by 841 kb/d in July following hikes of 600 kb/d May and 700 kb/d in June (these figures include the restoration of Saudi Arabia's additional production cuts). In total, more than 2 mb/d of withheld supply will have been brought back to the market by the end of July—and this excludes any extra output that OPEC members Libya, Venezuela and Iran, which are not subject to quotas, will provide. Of the three, only Iran has the capacity for sizeable increases.
- Iran has been raising output every month since last October, in spite of sanctions, and was up 371 kb/d in 2021 at 2.3 mb/d in April, according to OPEC secondary sources. Were the now-delayed discussions to revive the 2015 nuclear deal to succeed and sanctions lifted then around 750 kb/d of a potential 1.5 mb/d of production (to 3.8 mb/d, though Iran has been talking of expanding capacity to 6 mb/d) could be brought back within 6 months.
- Saudi energy minister Prince Abdulaziz was tight-lipped at the recent OPEC+ meeting about further supply increases beyond July to meet rising demand, preferring to continue with the cautious approach that has worked well so far. However, with oil demand continuing to recover, it seems likely that OPEC+, which is sitting on more than 7 mb/d of withheld supply (vs. pre-pandemic reference levels), will probably have little choice but to open the taps further from August onwards. The next meeting is scheduled for later this month, but the group cannot risk the market overheating and prices moving up too far or members' compliance fraying—it has been a major challenge during the pandemic for OPEC's de facto leader Saudi Arabia to keep the natural inclination of OPEC producers to maximize production in check.
- On 26 May, dubbed 'Black Wednesday' in oil circles, activists and investors successfully held oil companies to account for their climate policies (or lack, thereof). A landmark ruling at The Hague saw oil major Royal Dutch Shell ordered to cut its CO_2 emissions faster than it planned and in line with the 2015 Paris Climate accords after environmental activists won a legal case against the company for 'unlawful endangerment'. Equally significant, ExxonMobil's board will for the first time contain two members that will look to steer the oil major towards more climate-friendly policies. Shareholders at Chevron, meanwhile, approved a measure to enforce stricter emissions targets on the products the company sells.
- These developments came on the heels of a major report by the IEA in which it declared that for the world to reach net zero by 2050 and limit the global temperature rise to 1.5 degrees no new oil and gas investments should be sanctioned. The report caused consternation. Should the assumption inherent in the report of structurally declining oil demand prove to be off, then the call for lower investment would more than likely cause oil prices to rise.
- It is plausible that consumers, investors and eventually governments could start to demand that oil companies base their business models on more climate-friendly practices. Regulation could follow e.g. as with the limits placed on the sulphur content of maritime fuels. While this would mean less oil from IOCs, conversely, it could mean more from OPEC's national oil companies, which could have the opportunity to increase market share.
- In the near-term, oil price risks are therefore tilted to the upside, barring a major reversal in oil demand trends, which should not be discounted in view of continuing pandemic-linked weaknesses in major emerging markets such as India. An autumn relapse caused by new variants could happen. But longer term, however, it is the clean energy transition and the changing pattern of oil demand that will be fundamental to the trajectory of oil prices.

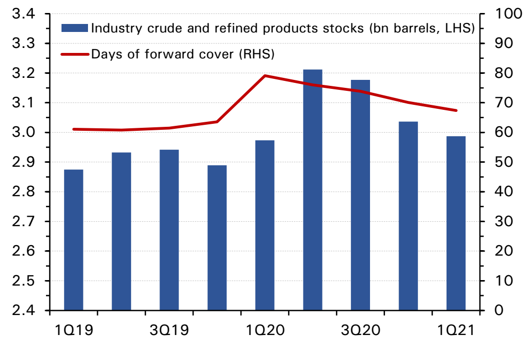
Chart 4: Global oil demand and supply growth

(annual change, mb/d)



Source: IEA, OPEC, NBK estimates

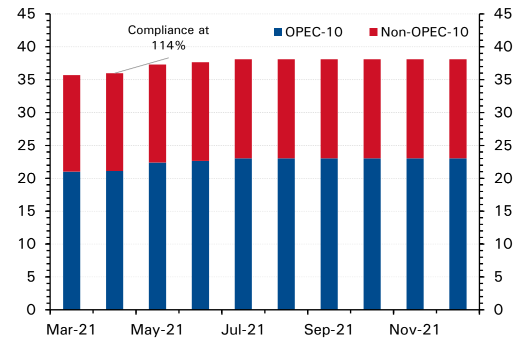
Chart 5: OECD industry stocks



Source: OPEC using data from IEA, EIA, Argus, METI, Euroilstock

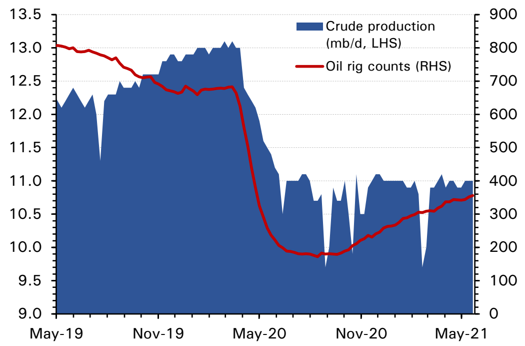
Chart 6: OPEC+ supply

(mb/d)



Source: OPEC, NBK; output assumes 100% quota compliance

Chart 7: US oil production and rig counts



Source: US Energy Information Administration (EIA), Baker Hughes

Head Office

Kuwait
National Bank of Kuwait SAKP
Shuhada Street,
Sharq Area, NBK Tower
P.O. Box 95, Safat 13001
Kuwait City, Kuwait
Tel: +965 2242 2011
Fax: +965 2259 5804
Telex: 22043-22451 NATBANK
www.nbk.com

International Network

Bahrain
National Bank of Kuwait SAKP
Zain Branch
Zain Tower, Building 401, Road 2806
Seef Area 428, P. O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

National Bank of Kuwait SAKP
Bahrain Head Office
GB Corp Tower
Block 346, Road 4626
Building 1411
P.O. Box 5290, Manama
Kingdom of Bahrain
Tel: +973 17 155 555
Fax: +973 17 104 860

United Arab Emirates
National Bank of Kuwait SAKP
Dubai Branch
Latifa Tower, Sheikh Zayed Road
Next to Crown Plaza
P.O.Box 9293, Dubai, U.A.E
Tel: +971 4 3161600
Fax: +971 4 3888588

National Bank of Kuwait SAKP
Abu Dhabi Branch
Sheikh Rashed Bin Saeed
Al Maktoom, (Old Airport Road)
P.O.Box 113567,Abu Dhabi, U.A.E
Tel: +971 2 4199 555
Fax: +971 2 2222 477

Saudi Arabia
National Bank of Kuwait SAKP
Jeddah Branch
Al Khalidiah District,
Al Mukmal Tower, Jeddah
P.O Box: 15385 Jeddah 21444
Kingdom of Saudi Arabia
Tel: +966 2 603 6300
Fax: +966 2 603 6318

Jordan
National Bank of Kuwait SAKP
Amman Branch
Shareef Abdul Hamid Sharaf St
P.O. Box 941297, Shmeisani,
Amman 11194, Jordan
Tel: +962 6 580 0400
Fax: +962 6 580 0441

Lebanon
National Bank of Kuwait
(Lebanon) SAL
BAC Building, Justinien Street, Sanayeh
P.O. Box 11-5727, Riad El-Solh
Beirut 1107 2200, Lebanon
Tel: +961 1 759700
Fax: +961 1 747866

Iraq
Credit Bank of Iraq
Street 9, Building 187
Sadoon Street, District 102
P.O. Box 3420, Baghdad, Iraq
Tel: +964 1 7182198/7191944
+964 1 7188406/7171673
Fax: +964 1 7170156

Egypt
National Bank of Kuwait - Egypt
Plot 155, City Center, First Sector
5th Settlement, New Cairo
Egypt
Tel: +20 2 26149300
Fax: +20 2 26133978

United States of America
National Bank of Kuwait SAKP
New York Branch
299 Park Avenue
New York, NY 10171
USA
Tel: +1 212 303 9800
Fax: +1 212 319 8269

United Kingdom
National Bank of Kuwait
(International) Plc
Head Office
13 George Street
London W1U 3QJ
UK
Tel: +44 20 7224 2277
Fax: +44 20 7224 2101

National Bank of Kuwait
(International) Plc
Portman Square Branch
7 Portman Square
London W1H 6NA, UK
Tel: +44 20 7224 2277
Fax: +44 20 7486 3877

France
National Bank of Kuwait France SA
90 Avenue des Champs-Elysees
75008 Paris
France
Tel: +33 1 5659 8600
Fax: +33 1 5659 8623

Singapore
National Bank of Kuwait SAKP
Singapore Branch
9 Raffles Place # 44-01
Republic Plaza
Singapore 048619
Tel: +65 6222 5348
Fax: +65 6224 5438

China
National Bank of Kuwait SAKP
Shanghai Office
Suite 1003, 10th Floor, Azia Center
1233 Lujiazui Ring Road
Shanghai 200120, China
Tel: +86 21 6888 1092
Fax: +86 21 5047 1011

NBK Capital

Kuwait
NBK Capital
34h Floor, NBK Tower
Shuhada'a street, Sharq Area
PO Box 4950, Safat, 13050
Kuwait
Tel: +965 2224 6900
Fax: +965 2224 6904 / 5

United Arab Emirates
NBK Capital Limited - UAE
Precinct Building 3, Office 404
Dubai International Financial Center
Sheikh Zayed Road
P.O. Box 506506, Dubai
UAE
Tel: +971 4 365 2800
Fax: +971 4 365 2805

Associates

Turkey
Turkish Bank
Valikonagl CAD. 7
Nisantasi, P.O. Box. 34371
Istanbul, Turkey
Tel: +90 212 373 6373
Fax: +90 212 225 0353