Warren Patterson: China's economic recovery could push oil demand to record levels this year

We expect the oil market to tighten as we move through the year, which should drive prices higher. However, there are some key risks on both the supply and demand side, which could challenge this view

Our oil call

The oil market is set to tighten significantly over the second half of 2023. Currently, we are forecasting that the global oil market will be in deficit by almost 2MMbbls/d over the latter part of this year. This deficit suggests that we should see prices moving higher over the remainder of the year. Our current ICE Brent forecast is US$96/bbl over the second half of the year.

Demand growth is an important factor contributing to the large deficit we forecast later in the year. We expect global oil demand to grow by 1.9MMbbls/d this year, which would take overall oil demand to record levels. This growth is predominantly driven by non-OECD countries and specifically China. As for OECD oil demand growth, we expect this will be close to flat year-on-year.

Supply dynamics also play an important role in our tighter outlook for the oil market. OPEC+ supply cuts run through until at least the end of the year, which should continue to take a significant amount of oil supply off the market. Furthermore, there is also the risk that we see further supply cuts coming through from the group, particularly if we see any further price weakness in the short term.

Where could we be wrong?

There are several factors which could prove to be an obstacle to our more constructive outlook for the oil market.

Firstly, when it comes to demand, more than 1MMbbls/d of the 1.9MMbbls/d of demand growth expected this year is set to come from China. The fact that such a large share of demand growth is expected to come from just one country is a risk. And clearly, in recent months there have been concerns over the strength in China's broader recovery. If Chinese oil demand disappoints, this could change the global balance significantly, with the market not as tight as expected. However, up until now, Chinese oil demand indicators have been looking fairly strong, with higher crude oil imports year-on-year and apparent record oil demand in recent months.

Another key downside risk related to demand is how severe a slowdown we'll see in the States. Our US economist expects the US economy to enter recession later this year, and clearly if this turns out to be severe, it would likely lead to some level of demand destruction, which once again would loosen up the oil balance. However, we are already taking a cautious view on US oil demand over the latter part of the year – we are assuming US oil demand will be flat year-on-year.

A final factor where we could be wrong is around OPEC+ supply and how compliant members are with their supply cuts through year-end. The group has made significant cuts since late last year and up until now compliance has been strong among most producers. We are assuming that compliance will remain very high through year-end. However, there is the risk that some producers grow tired of the supply cuts and start increasing output. We also cannot rule out the potential for disagreement between members. For example, there are questions in the market about whether Russia is really cutting by the 500Mbbl/d it had previously announced. Stronger seaborne crude oil exports suggest that we are not seeing these cuts. The risk around this is that it could lead to disagreements between members, which could ultimately lead to the end of the supply cut deal and a price war. This is what we saw between Saudi Arabia and Russia in early 2020.

Author

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com