Energy markets are better supplied

Both the oil and gas market are set to be more comfortable than originally anticipated this year. Strong non-OPEC+ supply growth has shrunk the size of the oil deficit in 2024, while for natural gas, European storage is set to finish the season well above average, suggesting limited upside for prices

Oil, gas and other energy markets seem to be in better shape this year

Oil to edge higher but gains to be modest

The bullish outlook for the oil market has softened in recent months, given stronger-than-expected supply growth from non-OPEC producers in 2023. This was predominantly driven by the US. However, growth was also seen from Brazil, Guyana, and Norway. Stronger non-OPEC supply has meant that OPEC+ has had to take further action to try to keep the market balanced.

Additional voluntary supply cuts announced by a handful of OPEC+ members at the end of 2023 amounted to 2.2m b/d. However, 1.3m b/d was the rollover of existing cuts from Saudi Arabia and Russia, which means that the market sees around 900k b/d of fresh cuts for the first quarter of this year. This action from OPEC+ has ensured that the surplus that was expected in 1Q24 has been erased. However, our balance shows that the market will return to a fairly large surplus in 2Q24 if OPEC+ do not roll over these cuts into the second quarter. We are of the view the group will partially extend current voluntary cuts to ensure the market is more or less balanced in the second quarter and in an attempt to keep prices near US$80/bbl levels, which are around Saudi Arabia's fiscal breakeven.

The issue for OPEC+ is if deeper cuts are needed, as it will be more challenging for members to agree on this. The group is already making significant cuts and recent supply reductions from the group have come in the form of voluntary cuts from a handful of members rather than group-wide cuts, suggesting that members are finding it increasingly more difficult to agree on any reductions. This is also evident with Angola's recent departure from OPEC; it wasn't happy about its production target for 2024, even though the country is unlikely to produce much above its proposed target level.

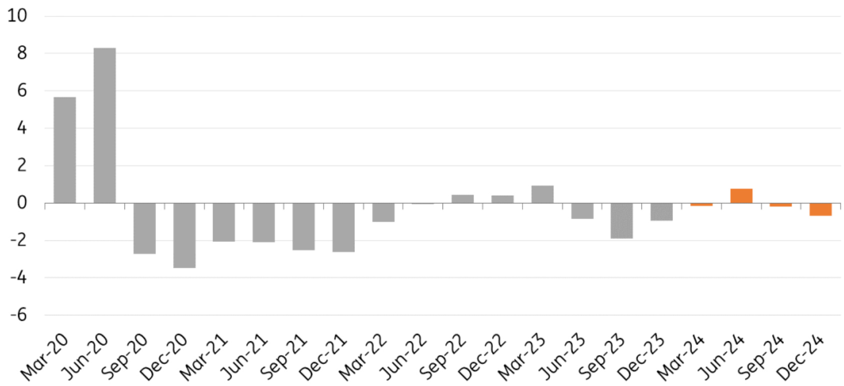
OPEC+ policy will be important for price direction through 2024 and a large part of OPEC+ policy will depend on how demand plays out throughout the year.

For 2024, we expect oil demand to grow in the region of 1m b/d, which would be roughly half of the demand growth achieved in 2023. A slower growth rate should not be surprising, given that the post-Covid demand recovery is now largely behind us. In addition, global GDP growth is set to slow this year, given the scale of monetary tightening we have seen from central banks worldwide. In Europe and the Americas, we expect oil demand to fall year-on-year, while growth will be predominantly driven by Asia and specifically China, which is expected to make up around 70% of global demand growth.

We expect ICE Brent to average US$82/bbl over the course of 2024, with most of the upside likely to be seen over the second half of the year, a period where our balance shows the market to be in deficit. Although, to be fair, the deficit over this period has shrunk in recent months.

Recent developments in the Middle East remain an upside risk to our view on the market. Attacks in the Red Sea have seen a growing number of crude oil and refined product tankers deciding to avoid the region and take a longer route around Southern Africa. Longer voyage times could lead to some tightness in physical markets, but it is important to point out that the rerouting of tankers is not having an impact on oil production. However, the bigger upside risk for the oil market is if tensions in the Middle East spread, which starts to have an impact on oil production or cuts off oil flows that cannot be rerouted. This would be the case if we were to see any disruption around the Strait of Hormuz, which sees in the region of 20m/d of oil moving through it.

Oil market to return to surplus in Q2 without an extension in OPEC+ cuts (m b/d)



Source: ING Research, IEA, EIA, OPEC

European natural gas storage to remain comfortable

The European natural gas market has had a relatively comfortable 2023/24 heating season so far, which puts the market in a good position for the rest of the year. European storage remains well above the 5-year average despite the region having gone through several cold spells this winter.

Our balance sheet shows that Europe should exit this heating season with storage around 52% full compared to a 5-year average of 41% (assuming no demand spikes or supply shocks). This will once again make the job of refilling storage through the summer months a lot more manageable. This suggests that any upside in prices is likely limited. We also expect Europe to go into the 2024/25 heating season with storage well above the European Commission's target of 90% by 1 November. We believe storage will be around 96% full by the end of October.

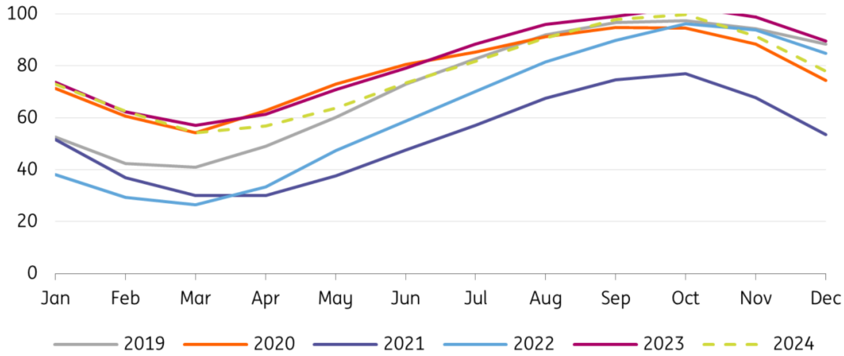
However, much will depend on how gas demand evolves through the year. In 2023, the lack of demand response to weaker prices surprised many in the market. Gas demand has remained well below the 5-year average and, in fact, for large parts of 2023, it was also down YoY.

In 2023, European natural gas demand was down around 18% from the 2017-21 average and also 8% below 2022 levels. For 2024, we are assuming demand will remain around 15% below the 2017-21 average through until the end of March. From April onwards, we assume a recovery in gas demand, which will see demand around 10% below the 2017-21 average, which suggests demand should grow in the region of 7% YoY. Less volatility and weaker gas prices should see some industrial consumers becoming increasingly more comfortable. However, obviously, if demand continues to disappoint, it will leave the market even more comfortable, and the EU will likely hit full storage once again before the start of the 2024/25 heating season.

A key driver behind weak gas demand is the power sector. Not only has electricity generation been weaker, but spark spreads were negative for much of 2023, which weighed on power generation from gas. Stronger renewables generation and the return of French nuclear capacity have meant power generation from fossil fuels was unprofitable for large parts of last year. Looking at forward spark spreads for the remainder of 2024, they are in negative territory and that suggests that demand from the power sector could remain weak.

Industrial demand is also still weak. Although, we are starting to see some signs of recovery in this area. Since August 2023, monthly industrial gas demand in Germany has grown YoY, with the exception of September. EU chemicals output could also be showing some signs of recovery, with output in November growing by around 1% YoY. Although, production over the first eleven months of 2023 was still down 8.7% YoY. The uncertainty for the market is how much of this lost demand will make a comeback or whether we have seen permanent demand destruction in the industrial sector, either due to substitution, energy efficiency gains or the permanent shutting of production capacity in Europe.

EU natural gas storage to remain comfortable through 2024 (% full)



Source: GIE, ENTSOG, Eurostat, ING Research

EUA demand pressures

The pressure seen on EU allowances (EUAs) towards the end of last year has only continued into 2024, with the market briefly breaking below EUR60/t in January and trading to its lowest levels since March 2022. While the longer-term outlook for EUAs remains constructive as allowances in the market are reduced, short to medium-term dynamics are more bearish. The EU has seen reduced industrial activity, which means lower emissions and the need for installations to surrender fewer allowances. Emissions over the first half of this year totalled 1.76b tonnes CO2eq, down 4.2% YoY.

If we look at the power sector, in addition to overall power generation having fallen last year, we have also seen changes in the power mix. Renewables output has been strong, and in France, nuclear power output has also recovered, therefore reducing the number of allowances needed. EU electricity generation has been in YoY decline from March 2022 through to September 2023. Generation from coal and natural gas has been under pressure throughout the year, and this is not expected to change anytime soon. Both forward spark and dark spreads are in negative territory through 2024, suggesting that power generation from natural gas and coal will remain under pressure, which means demand for EUAs is likely to remain subdued from the sector this year.

Supply dynamics have and will continue to play a role in pressuring EUAs. This is partly due to REPowerEU, which aims to end the EU's reliance on Russian fossil fuels by diversifying energy sources, energy savings, and accelerating the roll-out of renewables. Part of the REPowerEU plan is set to be funded by the Recovery and Resilience Facility (RRF) through the sale of ETS allowances. The Commission's aim is to raise EUR20 billion from allowance sales. 40% of these funds are set to be met by bringing forward the auction of allowances scheduled to be auctioned between 2027-2030. These will now be brought forward to before 31 August 2026. Meanwhile, the remaining 60% will be met by sales of allowances from the Innovation Fund. Regulation from the Commission suggests this will be reached by the auctioning of around 267m allowances, although obviously, this will depend on where prices are trading.

While the outlook for 2024 is less supportive than originally anticipated, the longer-term picture remains bullish. Ambitious targets under Fit for 55 mean a more aggressive reduction factor will be used for allowances moving forward. A reduction factor of 4.3% per year will be used between

2024 and 2027 and 4.4% between 2028 and 2030. This compares to a previous linear reduction factor of 2.2%. In doing so, the Commission hopes to see emissions under the ETS fall 62% from 2005 levels by 2030 compared to a 43% reduction target previously. This is also slightly more aggressive than the proposed 61% reduction.

ING forecasts

	1Q24	2Q24	3Q24	4Q24	FY24
ICE Brent (US$/bbl)	82	80	82	84	**82**
TTF (EUR/MWh)	29	25	25	35	**29**

Source: ING Research

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