

Geopolitics dominate commodity markets

Geopolitics have rattled energy markets over the last month. And for oil, it's a theme which is likely to continue to dictate prices – at least in the short term



There's no shortage of supply risks in the oil market at the moment, but for now, we're sticking to our base case

Supply risks hang over the oil market

The oil market witnessed increased volatility over October, which shouldn't come as a surprise given the growing geopolitical risk in the Middle East over the last month. However, this increased volatility and strength in the market largely reflect supply risks rather than actual changes to supply and demand fundamentals. Up until now, the conflict between Israel and Hamas has not had an impact on oil supply from the region. Israel is a very marginal oil producer, so any disruptions to this output will not have an impact on the market.

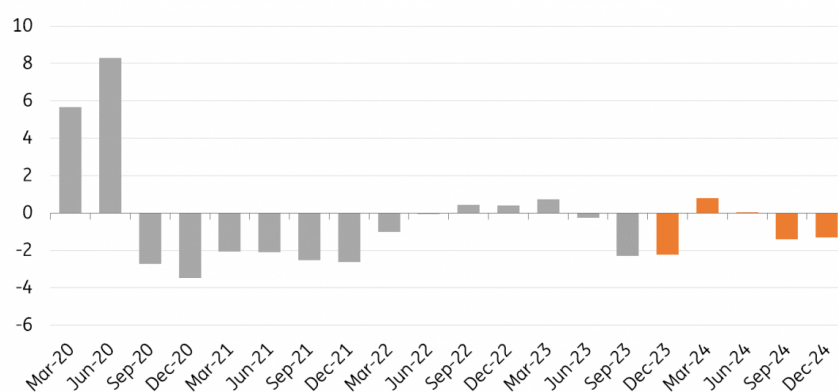
However, the clear risk for the market is if an escalation leads to supply disruptions from some key producers in the region. The most obvious supply risk in the current environment is Iran. While US sanctions against Iran remain in place, they have not been enforced strongly this year. As a result, we have seen Iranian oil supply growing from around 2.5m b/d at the start of the year to more

than 3m b/d currently. Given concerns over higher energy prices, the US has decided not to strictly enforce these sanctions. However, if suggestions that Iran played a role in Hamas' attacks on Israel prove to be true – and if we continue to see attacks on US bases in the Middle East by Iranian-backed groups – the US could start enforcing sanctions more strictly once again. This could potentially remove anywhere in the region of 500k b/d to 1m b/d of Iranian supply.

Venezuela could partially offset potential supply losses from Iran. The US government recently reached a deal with the Venezuelan government whereby the US would ease sanctions in return for fairer elections in Venezuela in 2024. Expectations are that this could see an additional 200k b/d of supply over the course of 2024. However, there are risks to this. Since the deal, the Supreme Court in Venezuela has already suspended the results of the opposition's primaries. Clearly, the risk is that the US will reimpose sanctions if the Venezuelan government does not stick to its side of the deal.

While there are plenty of supply risks in the oil market at the moment, our base case remains unchanged. We assume Iranian oil supply will average 3m b/d over 2024. The oil market should be in surplus in the first quarter of 2024, which should see a pullback in prices early next year. However, the market is then set to tighten for the remainder of 2024, particularly over the second half, which suggests further upside to prices. We currently forecast ICE Brent to average \$90/bbl in 2024 and \$95/bbl in the second half of 2024. However, the potential loss of Iranian barrels would leave the market in a deeper deficit and bring \$100/bbl oil back into play.

Oil market returns to surplus in 1Q24 before tightening for the remainder of the year (m b/d)



Source: ING Research, IEA, EIA, OPEC

European gas storage full

Geopolitics have also provided support to the European gas market in October with TTF breaking above EUR50/MWh. A leak found along the Balticconnector pipeline, which runs between Finland and Estonia was initially treated as a deliberate act of sabotage. While the pipeline is not significant in terms of wider European gas supply, the incident raised concerns over the vulnerability of European gas infrastructure as the region heads into the 2023-24 winter. More recently, however, it's less clear whether or not the damage was intentional.

Developments in the Middle East will also be providing support to the European gas market. While Israel is a very small oil producer, it does produce meaningful amounts of natural gas and exports

some of this volume to Egypt. Following the Israel-Hamas conflict, Israeli gas flows to Egypt have stopped with Israel ordering the shutdown of one of its gas fields. Reduced pipeline flows to Egypt reduce its ability to export LNG to Europe through the winter. Although to be fair the volumes are relatively small – Egypt made up around 4% of total European LNG imports in 2022.

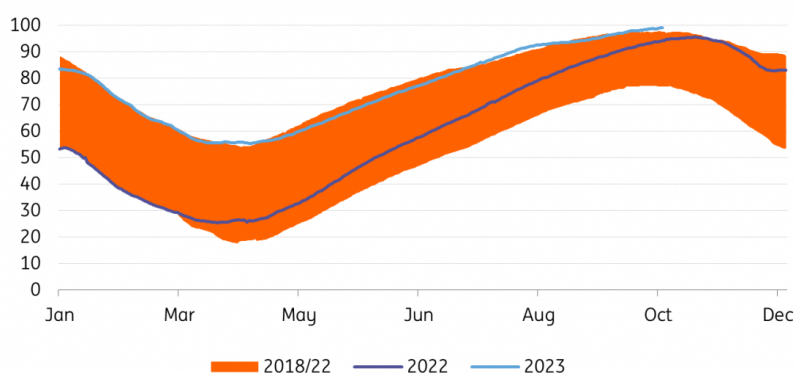
Despite some of the risks facing the European gas market, fundamentals in the short term remain bearish. European storage is now more than 99% full, which is record levels ahead of the start of the heating season.

The broader strength in the gas market means that for power generation it makes more sense to burn coal through the winter. Given that the region will want to ensure adequate gas storage at the end of the 2023-24 heating season (to make the injection season in 2024 more manageable), gas prices could remain relatively strong through the winter to ensure this trend continues.

In addition, European gas storage should start drawing over the coming weeks as the heating season gets underway. This should provide further support to the market. The risk to this view is if there is a late start to the heating season (as seen last year) when storage only started declining from mid-November.

However, assuming a normal winter, no significant supply disruptions and industrial demand remaining largely under pressure (at around 15% below the 5-year average), European gas storage should end the 2023-24 heating season with storage a little more than 40% full. While this is below the 56% seen at the end of the last heating season, it is still above the 5-year average of 34% full.

European gas storage at record levels (% full)



Source: GIE, ING Research

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