Commodities: Milder winter offers some comfort to energy markets

A mild European winter has seen gas prices continue to collapse in January and Europe is likely to get through this winter in a comfortable state. However, there are still clear upside risks. Oil prices have been more rangebound, but we see prices moving higher later in the year as the market tightens

A mild winter has allowed Europe to build up its gas storage levels

Drastic change in the natural gas outlook

A late start to the 2022/23 heating season saw Europe building gas storage almost until mid-November. At a little more than 95% full, storage was essentially maxed out. This was far above the target of 80% by 1 November 2022 set by the European Commission. While there have been some cold spells in the current heating season, it has been largely mild, which has meant storage levels have held up well. In fact, there have been days this winter when storage has seen net increases. Storage at the moment is around 72% full, well above the five-year average of around 53% for this time of year.

Assuming Europe does not experience a prolonged cold spell in the current heating season, the region should exit the 2022/23 winter with storage above 50% full. This is significantly higher than the 26% seen at the end of the last heating season and above the five-year average of 34%.

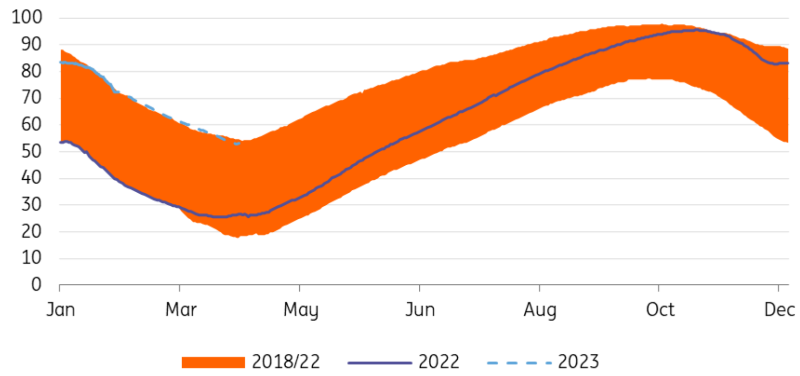
Ending this winter with very comfortable inventories makes the job of refilling storage over the injection season and hitting EU inventory targets of 90% by 1 November 2023 easier. Between 1 April and the end of October last year, the EU added in the region of 67 billion cubic metres (bcm) to storage. If we were to see similar storage levels at the start of the next heating season, the EU would only need to add around 43bcm of gas this year.

A more comfortable European balance suggests that prices do not need to trade as high as initially expected, although prices will still remain historically high in order to ensure adequate demand destruction and liquefied natural gas (LNG) supply. We expect TTF to average EUR70/MWh over 2023 with prices peaking over the fourth quarter of 2023 to average EUR80/MWh.

The assumption to these forecasts is that we do not see a further decline in remaining Russian pipeline flows to Europe, and that Europe sees a marginal increase in LNG imports in 2023 (this would mean not seeing a return to 2021 LNG import volumes for China) and that we see demand destruction in the region of 10% from April 2023 onwards. These factors should ensure that the EU hits its target of having storage at least 90% full by 1 November 2023.

Clearly, an upside risk to our view is if we see Russian flows fall further and/or stronger-than-expected Chinese LNG imports in 2023.

EU storage to exit this winter comfortably (% full)



Source: GIE, ENTSOG, Eurostat, ING Research

Oil market set to tighten

Oil prices have been trading in a largely rangebound manner so far this year, although there is still plenty of uncertainty over the demand outlook (which will really depend on how strong a recovery we see from China this year) and Russian oil supply.

Global oil demand is expected to grow in the region of 1.7MMbbls/d this year, which would take global oil demand above pre-Covid levels and to a record 101.3MMbbls/d. Around 50% of global demand growth is expected to come from China this year, following the reversal of its zero-Covid policy.

As for Russian supply, the EU ban on Russian seaborne crude oil imports came into force in December and whilst there was an initial drop in Russian seaborne export volumes, we have seen a recovery. On 5 February, the ban will include Russian refined products, which could prove more disruptive for oil markets, given the challenge of rerouting refined products that would have gone to the EU to other destinations. We expect that the Russian oil supply will fall in the region of 1.3MMbbls/d year-on-year in 2023 due to the EU ban on Russian crude and refined products. Clearly, the risk to this view is if Russia manages to find new homes for its refined products, much like it has done with increased crude oil flows to India and China.

The oil market is comfortably supplied over the first quarter of the year with Russian supply holding up better than expected, whilst a milder winter will also mean reduced fuel demand for heating purposes. This leaves the oil market in surplus over the first quarter, which suggests that the upside for prices is limited in the short term. However, in the medium to long term, the market is expected to tighten which should see prices moving higher from the second quarter onwards. We expect ICE Brent to average US$100/bbl over 2023, with the bulk of strength coming in the second half of the year, when we see prices averaging US$108/bbl.

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