

Sticky Russian oil output requires a crude rethink

Russian crude oil output has held up better than expected which has meant that the oil market is not as tight as originally thought. In addition, weaker demand means the oil balance is looking more comfortable for the remainder of the year. We have revised our forecasts lower



The likes of China and India have been able to absorb larger volumes of Russian oil as European demand has fallen

Oil price forecast revisions

Stubborn Russian oil output and weaker than expected demand growth mean the oil market is likely to remain in surplus for the remainder of this year and into early next year, which should limit the upside in oil prices. Time spreads also point towards a looser market, with the backwardation in the prompt spreads narrowing significantly in recent weeks.

As a result, we have revised lower our oil price forecast for the remainder of this year. Although, given that inventories are at historically low levels, we still believe that prices will remain elevated, whilst limited OPEC spare capacity and uncertainty over how Russian flows will evolve once the EU ban comes into full force should also limit downside in the medium term.

We have lowered our 3Q22 and 4Q22 Brent forecasts from US\$118/bbl and US\$125/bbl to

US\$100/bbl and US\$97/bbl respectively. Our full year 2023 Brent forecast has been revised down from US\$99/bbl to US\$97/bbl.

ING oil price forecasts

New	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	FY22	FY23
ICE Brent (US\$/bbl)	98	112	100	97	94	92	98	102	102	97
NYMEX WTI (US\$/bbl)	95	109	95	94	91	89	95	99	98	94
Previous	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	FY22	FY23
ICE Brent (US\$/bbl)	98	112	118	125	107	95	97	98	113	99
NYMEX WTI (US\$/bbl)	95	109	115	122	104	92	94	95	110	96

Source: ING Research

Stubborn Russian output

Since Russia's invasion of Ukraine, it has become more difficult to get transparency on Russian oil output with the government no longer publishing monthly data. However, the IEA estimates that Russian oil production was around 310Mbbbls/d below pre-war levels in July. The decline in output has been much more modest than many in the market were expecting, despite sanctions. IEA numbers suggest that Russian oil exports came in at 7.4MMbbbls/d in July, which is only slightly below the 7.5MMbbbls/d exported over 2021.

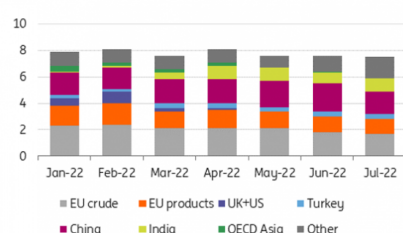
The likes of China and India have been able to absorb larger volumes of Russian oil as European demand has fallen. China imported a record 1.99MMbbbls/d of Russian crude oil in May, whilst in June Russian oil made up 20% of total Chinese oil imports, making it China's largest supplier. These stronger Russian flows to China come despite overall weaker domestic oil demand due to Covid-related lockdowns. Whether China has the appetite to increase Russian oil purchases even further will depend on how quickly we see a recovery in domestic demand.

However, whilst Russian output has held up well until now, we would expect production to start coming under more meaningful pressure once the EU ban on Russian seaborne crude oil and refined products is fully implemented in February 2023. For now, we are assuming that Russian output declines by a little more than 2MMbbbls/d once the ban comes into full force.

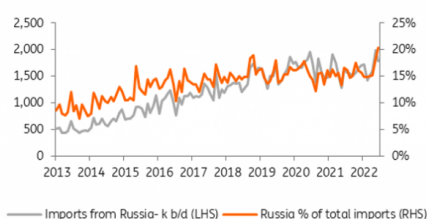
In addition, if for any reason India and China are unable to sustain the volumes of Russian oil they have imported, there is the risk that Russian oil output will eventually fall more aggressively, which would lead to a tighter market. Similarly, the US has been pushing for a price cap on Russian oil, and if enforced (which will be difficult), there is always the risk that Russia reduces its output in response.

Russian oil flows are holding up well for now

Russian oil exports (MMbbbls/d)



Russian crude oil flows to China



Source: IEA, NBS, ING Research

Weaker demand offers a helping hand

The higher price environment that we have seen for much of the year has done its job in terms of ensuring demand destruction to try to balance the oil market. Demand growth forecasts have been downgraded consistently as we have moved through the year. And EIA data provides clear evidence of demand destruction. US implied gasoline demand has underperformed since early June. Generally, we would expect demand to trend higher over the summer driving season, but higher prices have led to US gasoline demand trending quite some distance below the 5-year average (and this average includes 2020 data – a period of weaker demand due to Covid). EIA data shows that from early June through to early August, implied gasoline demand (4-week rolling average) in the US has lagged the 5-year average by almost 450Mbbls/d.

In addition, Chinese demand has clearly disappointed this year, which has led to significant revisions in global demand estimates. There had been expectations that demand would come back strong following the easing of lockdown measures in Beijing and Shanghai in the second quarter. However, demand continues to suffer due to further Covid outbreaks and China's insistence on following its Zero-Covid policy. Cumulative Chinese oil imports are down 4% over the first seven months of the year, whilst apparent domestic demand over the same period is down almost 11% YoY.

In 2022, global oil demand is expected to grow by a little over 2MMbbls/d, whilst a similar growth number is expected for 2023. This would mean that in 2023, global oil demand will exceed pre-Covid levels. However, growth next year will depend largely on a recovery in China, and also on how severe any potential recession in the US and Europe is.

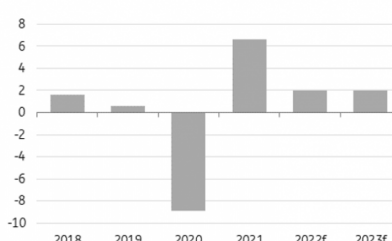
An upside risk for oil demand comes from the gas market. European natural gas and Asian spot liquefied natural gas (LNG) prices are trading at elevated levels. In fact, the Dutch gas, TTF, is trading at an oil equivalent in excess of US\$400/bbl, whilst spot Asian LNG is trading at an equivalent of close to US\$330/bbl. Therefore, where there is capacity, we will likely be seeing gas-to-oil switching from the power sector. This will include the Middle East, Asia, and even Europe, where there have been reports of increased oil-fired power generation.

Higher oil prices have weighed on demand

US implied gasoline demand (Mbbls/d)



Global oil demand growth (MMbbls/d)



Source: EIA, IEA, ING Research

Note: US implied gasoline demand numbers are 4-week rolling average

OPEC has limited room to pump more

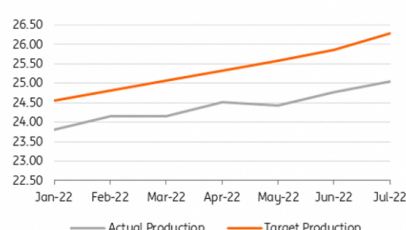
OPEC+ has been reluctant to deviate away from its planned monthly production increases, although the group finally agreed on larger supply increases for July and August, whilst also allowing for a 100Mbbls/d supply increase over September. And with hindsight, it seems as though

OPEC+ made the right decision not to give in to pressure to increase output more aggressively, given the market is expected to be in a more comfortable state for the rest of the year.

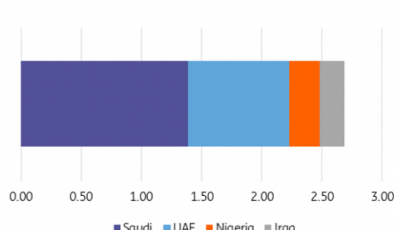
However, regardless of the state of the market, OPEC members have very limited capacity to increase output significantly more. The group has failed for almost the last 12 months to hit its production target, with a number of producers having faced disruptions or simply not having the capacity to increase output further. Spare capacity within the OPEC-10 (excludes Iran, Libya and Venezuela) stands at around 2.7MMbbls/d and is in the hands of a few. Saudi Arabia and the UAE hold more than 80% of this spare capacity. Shrinking spare capacity leaves the market more vulnerable to supply disruptions

OPEC struggles to hit output targets

OPEC-10 output vs target (MMbbls/d)



OPEC-10 spare capacity (MMbbls/d)



Source: OPEC, IEA, ING Research

SPR releases coming to an end

The SPR releases that we have seen from the US this year have helped the oil market. With 1MMbbls/d of crude being released, it has limited the drawdown in commercial crude oil inventories in the US. Had we not seen these SPR releases, commercial inventories would have been significantly tighter. However, the releases are set to continue only until the end of October. Therefore, there is the potential that from November we start to see some sizeable drawdowns in US commercial inventories. And given that US inventories are more visible to the market, this could provide some support to prices.

US draws down strategic petroleum reserves

US Strategic Petroleum Reserves (MMbbls)



No. of days of net crude oil import cover in US SPR



Source: EIA, ING Research

Iran a key downside risk to the market

Iranian nuclear talks have been on and off for the last 18 months. However, the potential for a deal is looking more promising. The EU has provided its proposal for a nuclear deal with the US and Iran, and up until now there has not been a rejection by either party – although the Iranians have said

that the US will need to show some 'flexibility'. If we were to see a deal and the eventual lifting of sanctions, there is the potential for a significant increase in supply from Iran. Over time Iran would be able to increase production by around 1.3MMbbls/d, which would help ease the tightness that is expected over the second half of 2023. While in the short term, it will be able to boost exports from crude held in storage, and so could put some pressure on prices in the short term. Despite the more positive tone around a deal, we are still assuming in our balance sheet that we do not see an increase in Iranian supply.

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