Oil market set to tighten amid growing supply risks

Brent has traded to its highest levels since November last year on the back of OPEC+ extending supply cuts, while supply risks have provided further support. We have revised higher our price forecasts

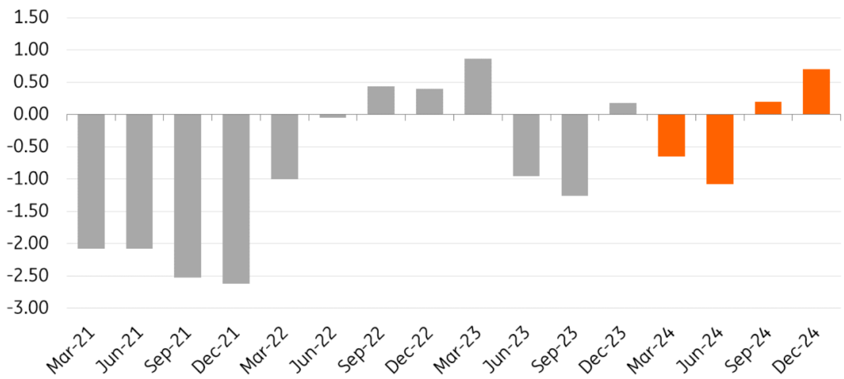
Oil market to tighten

The oil market appears to have finally broken out of the fairly narrow range we have seen it trading in since the beginning of the year. Brent has spent much of the year trading within a $75-85/bbl range. However, recently the market managed to break above US$85/bbl. The rollover of voluntary supply cuts from OPEC+ into the second quarter of 2024, Ukrainian attacks on Russian refining capacity more recently, and lingering disruptions to oil flows through the Red Sea have provided a boost to the market.

The roll over of supply cuts from OPEC+ means that the oil market will shift from a surplus environment in the second quarter of the year to a deficit environment. Expectations of a tightening in the market are reflected in the forward curve, with timespreads having moved deeper into backwardation.

While a rollover of some of the OPEC+ voluntary cuts was expected, the fact that the full 2.2m b/d of cuts was rolled over into the second quarter of 2024 leaves the oil market in a deeper-than-expected deficit over this period. Our balance shows a deficit of a little over 1m b/d in the second quarter. As a result, we have revised higher our short-term price forecast, while also adjusting the profile later in the year with prices likely to peak in the third rather than in the final quarter of the year as previously expected.

Oil market moves into deeper deficit in 2Q24 (m b/d)



Source: ING Research, IEA, EIA, OPEC

We have revised up our Brent forecast from US$80/bbl to US$87/bbl for the second quarter of this year, while our third quarter forecast has been increased from US$82/bbl to US$88/bbl. As a result, for 2024 we expect Brent to average US$86/bbl, up from US$82/bbl previously.

However, the outlook for the second half of the year will once again largely depend on what OPEC+ decide with its additional voluntary cuts. In our balance, we are assuming no extension beyond the second quarter. However, we are certainly not ruling out at least a partial rollover into the latter half of the year. A rollover in cuts would ensure that the market remains in fairly deep deficit for the remainder of 2024 and would also likely require a further revision to our price forecasts for later in the year.

ING oil price forecast

	1Q24	2Q24	3Q24	4Q24	FY24
ICE Brent (US$/bbl)	82	87	88	85	**86**

Source: ING Research

Fed easing should increase speculative interest

Speculators have increased their net long in Brent significantly since late last year, as it has risen from around 100k lots to a little over 230k lots currently. However, positioning is still fairly modest when compared to pre-2022 levels. This is despite a number of risks hanging over the market, whether it is tension in the Middle East or the possibility of further disruptions to Russian energy infrastructure. These risks come at a time when Saudi Arabia also seems adamant in supporting oil prices. It's possible that the large amount of spare capacity that OPEC sits on leaves speculators feeling that significant upside in prices is fairly limited.

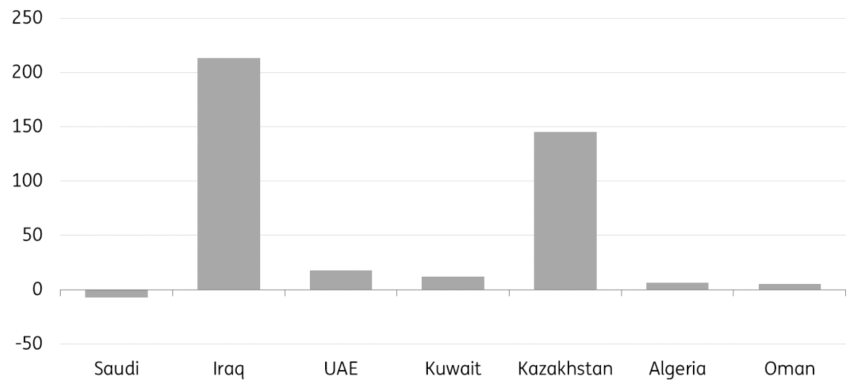
However, with the expectation that the US Federal Reserve will start to ease its monetary policy later in the year, this could see speculative interest picking up, providing some further tailwinds for the oil market. Obviously, this would be the case for most risk assets once the Fed enters its easing cycle.

OPEC+ voluntary cuts and compliance

The bulk of OPEC+ members who announced additional voluntary cuts for the first quarter of this year have mostly followed through with these supply reductions. However, there are two producers who have produced above their target levels so far this year. Iraq has a production target of 4m b/d, yet output averaged a little more than 4.2m b/d in the first two months of 2024. Similarly for Kazakhstan, production over January and February was close to 150k b/d above its target of 1.47m b/d. Both countries have said they would compensate for the overproduction, with Iraq set to cut export supply while Kazakhstan said it would pump less in the months ahead.

We will have to wait and see if these members do compensate for their overproduction. The higher prices we are seeing now may make these producers more willing to stomach their full supply cuts. Although, given the scale of cuts we are seeing from OPEC+, it is becoming more difficult for members to justify deeper cuts. OPEC is sitting on a significant amount of spare capacity, which highlights the level of cuts we are seeing from the group. Spare OPEC production capacity stands at a little more than 5.3m b/d, 3.1m b/d of which sits in Saudi Arabia.

Over/under production of OPEC+ additional voluntary supply cuts- Jan-Feb 2024 (k b/d)



Source: OPEC, IEA, ING Research

Russian refinery disruptions

There has been an increasing number of attacks by Ukraine on Russian energy infrastructure in recent weeks, specifically refinery infrastructure. According to reports, at least nine refineries in Russia have been attacked this year, and the impact from these drone strikes is estimated to be in the region of 600k b/d. Oil prices have been supported by these disruptions. However, it is more supportive for refined products than crude oil. Russia is a key exporter of middle distillates, fuel oil and naphtha.

In fact, the attacks could see crude supply to the global market increase, as lower refinery run rates in the domestic market sees oil producers diverting a larger amount of crude oil to the export market. One would expect this could weigh on the Urals differential, but up until now, we have not seen significant pressure on these values. If domestic producers also struggle to export larger volumes, they will likely be forced to reduce oil output.

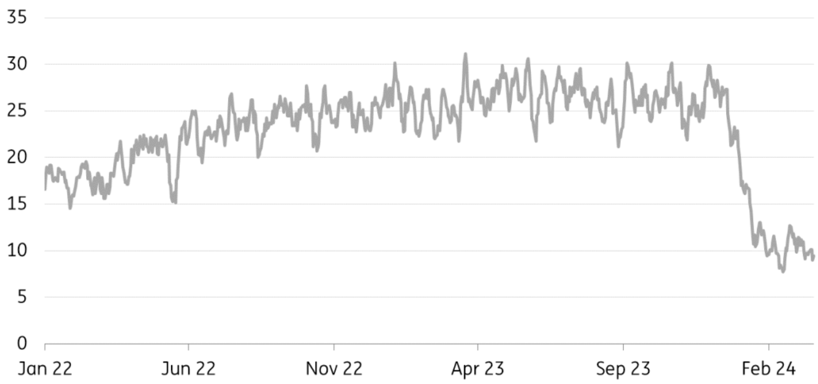
Oil flows through Red Sea still under pressure

Oil flows through the Red Sea are still affected by the risk of Houthi attacks. Daily average transit calls at the Bab el-Mandeb Strait remain significantly below usual levels, with tankers diverting and taking the longer route around the Cape of Good Hope. According to IMF PortWatch, daily transit calls at this choke point average a little less than 10 so far in March, down almost 63% YoY.

The disruptions have had more of an impact on refined product markets, with the longer journey times leading to some tightness in regional markets – specifically the European middle distillate market. Asian middle distillates (particularly Indian) which would usually move westwards towards Europe may remain within the region, suggesting a looser Asian middle distillate market relative to Europe.

However, with time, trade flows appear to be adjusting to the Red Sea disruptions. And with the Northern hemisphere winter now largely behind us, tightness in the European middle distillate market is likely to be less of a concern.

7-day moving average of daily tanker transit calls- Bab el-Mandeb Strait



Source: IMF PortWatch, ING Research

Author

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