

Twitchy gas and rangebound oil

Price action in energy markets over the past month has been interesting. European natural gas has seen increased volatility, suggesting that the market is still nervous about supply risks, whilst the oil market is stuck in a range despite deeper Saudi supply cuts



Drilling activity in the US has slowed this year

Natural gas disruptions leave the market nervous

The European gas market has witnessed plenty of volatility over the last month. TTF rallied from less than €23/MWh in early June to a peak of almost €50/MWh in mid-June, only to fall back to the €30-35/MWh range. The catalyst for this move has been disruptions to Norwegian gas flows due to outages, which led to a significant short-covering rally in the market. Firstly, this shows that market participants are still nervous about potential supply disruptions in the market, and secondly, there was a large segment of the market which was caught short and needed to cover.

The fall in Norwegian pipeline flows since mid-May has been significant because of outages. In April, flows out of Norway averaged almost 313mcm/d (9.38 bcm over the month), whilst in June these fell to almost 232mcm/d (6.96 bcm over the month). While most of this gas infrastructure maintenance was planned, some of it has run longer than planned. However, despite the fall in supply from Norway, storage in the EU is still at very comfortable levels and continues to trend higher. EU storage finished June being 77% full, well above the five-year average of 62% as well as

the 58% seen at the same stage last year.

The lack of demand response to the broader weakness in gas prices has meant that storage continues to fill up at a good pace. In fact, our numbers suggest that the EU only needs to see around 10% demand destruction relative to the five-year average. However, in May it appears as though the EU saw demand around 18% below average. The lack of demand response does raise an important question: how much of the demand destruction since the war is permanent? It will take a while to get a clearer answer on this. In addition, whilst the market has been well within the coal-to-gas switching range, we have not seen a strong demand response for gas from the power sector. This is very likely due to the fact that while it makes more sense to burn gas than coal, spark spreads are still in negative territory.

We still expect that the EU will hit full storage before the start of the next heating season – as early as September and possibly even a bit earlier if demand continues to remain as weak as it is. This suggests that we should see renewed pressure on European natural gas prices as we move through the third quarter. Prices will need to trade lower to ensure that liquefied natural gas (LNG) cargoes are redirected elsewhere. Longer term, if we assume a normal 2023/24 winter, storage drawdowns will be stronger through the heating season relative to last year, and we should exit the 2023/24 winter with storage closer to the five-year average. These stronger draws should provide some upside to prices over the winter months.

There are upside risks to our view for weaker prices in the short term. This includes prolonged Norwegian outages, lower LNG send-outs – something we have started to see more of recently – and finally, the ever-present risk of disruption to remaining Russian pipeline flows to the EU.

Tighter oil market over the second half of 2023

Fundamentals are not dictating oil prices at the moment. Instead, macro uncertainty and concerns over the China recovery are proving an obstacle to oil prices moving higher. In addition, expectations for a more hawkish US Fed will certainly not be helping risk appetite.

Speculators have reduced their positioning in the market considerably in recent months. ICE Brent has seen the managed money net long fall from a year-to-date high of around 300k lots in February to around 160k lots in the last reporting week. This has predominantly been driven by longs liquidating, although there has also been a fair number of fresh shorts entering the market.

We still expect global oil demand to grow by around 1.9MMbbls/d in 2023, and while this may appear aggressive in the current environment, it is more modest than some other forecasts – for example, the International Energy Agency forecasts demand to grow by 2.4MMbbls/d this year. Whilst we believe that our demand estimates are relatively modest, there are still clear risks to this view. The bulk of demand growth this year (more than 50%) is expected to be driven by China. So far this year, indicators for Chinese oil demand have been positive, as the economy has reopened. However, the concern is whether China will be able to keep this momentum going through the year. The risk is that the growth we have seen in domestic travel starts to wane as the effects of 'revenge' spending ease.

Supply-side dynamics continue to provide a floor to the market. OPEC+ continues to cut and we have seen Saudi Arabia announce further voluntary supply cuts through the summer. Recently-announced cuts from Saudi Arabia, Russia and Algeria amount to a reduction of a little over 1.5MMbbls/d in supply over August 2023. Although, there are doubts over whether the 500Mbbls/d

of cuts recently announced by Russia will be followed. It doesn't appear as though Russia has stuck to a previous cut of 500Mbbls/d when you consider that Russian seaborne crude oil exports have been strong for most of the year.

Drilling activity in the US has also slowed this year with the number of active oil rigs in the US falling from a year-to-date peak of 623 in mid-January to 545 recently, which is the lowest level since April 2022. While supply growth is still expected from the US, and output is set to hit record levels, the growth will be much more modest than in previous years. For 2023, US oil output is expected to grow in the region of 600-700Mbbls/d, while for 2024 growth is expected to be less than 200Mbbls/d. Higher costs, a tight labour market and an uncertain outlook all contribute to this more tepid growth. While the broader theme we have seen from US producers in recent years is to also be more disciplined when it comes to capital spending.

We have revised lower our oil forecasts for the latter part of the year. A more hawkish Federal Reserve, limited speculative appetite (given the uncertain outlook), robust Russian supply and rising Iranian supply all suggest that the market will not trade as high as initially expected. We still forecast that the market will be in deficit over the second half of the year and so still expect the market to trade higher from current levels. We forecast ICE Brent to average US\$89/bbl over 2H23.

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