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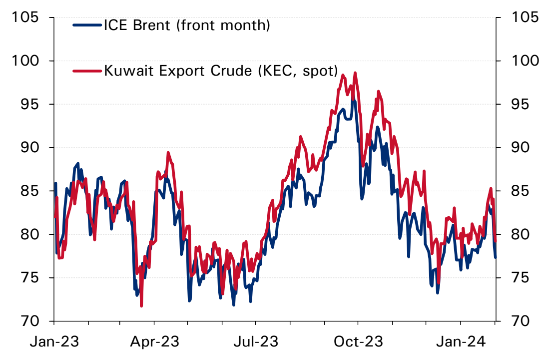
Economic Brief | 6 February 2024

Oil prices gain in January on higher risk premia, global growth upgrade

Oil prices rallied in January, with Brent posting gains of 6% amid heightened geopolitical risk related to Gaza conflict-spillover and on slightly improved global economic prospects. Oil demand growth expectations for 2024 remain subject to considerable variation among oil reporting agencies, however. Nevertheless, with OPEC+ supply cuts going into effect in Q1 2024, the group has a good chance of achieving its aim of a balanced market and minimal inventory gains.

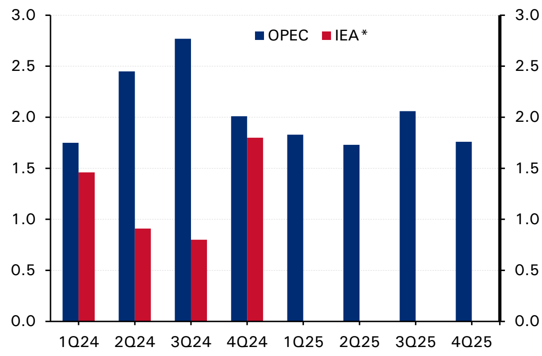
- Brent futures rallied in January, posting their first monthly increase since September with a rise of 6% m/m to $81.7/bbl. (Chart 1.) Price gains reflected a combination of heightened geopolitical risk in the Middle East, inventory drawdowns in the US and better-than-expected global economic activity. Houthi attacks on passing vessels in the Red Sea forced shipping companies to transit around the much lengthier—and costlier—Cape of Good Hope in South Africa. Meanwhile, US commercial crude oil inventories dropped to a multi-month low in December, further adding to the bullish impulse. Prices were also buoyed with the release of data showing that the US economy grew at a much faster rate than expected in Q4 23 and after Chinese authorities unveiled stimulus measures to support the economy. Local marker Kuwait Export Crude (KEC) closed the month at $84.1/bbl, up 5.7% ytd.
- In terms of oil demand expectations for the year ahead, the outlook looks slightly more positive following the upgrade to global GDP growth by the IMF in January: growth was revised up from October's forecast by 0.2% pts to 3.1%. The International Energy Agency (IEA), which takes its economic cues from the IMF, may follow suit with another upgrade to its oil demand projections for 2024, having just last month revised them up by 180 kb/d to 1.24 mb/d from 2.25 mb/d in 2023. (Chart 2.) The organization has raised its 2024 forecast by a cumulative 380 kb/d in total since June last year and was behind the curve in its 2023 oil demand growth estimates, underestimating the resilience of gasoline consumption especially. OPEC, meanwhile, has been consistent since the outset in its projection of oil demand growth of around 2.25 mb/d for 2024. The oil exporters' group has been firm in its view of above-trend demand and has extended the bullish narrative into 2025 with its projection of growth of 1.85 mb/d to 106.2 mb/d. Consumption growth in non-OECD countries will account for 94% of this rise.
- On the supply side, OPEC+ has determined that further supply restraint will be necessary in 2024. The group will roll over and deepen last year's voluntary production cuts through Q1—and potentially longer—to balance the market and prevent a large buildup of oil inventories. The volume of cuts pledged at November's OPEC+ meeting was around 2.2 mb/d, though in practice only about 500 kb/d will be fresh cuts including 135 kb/d from Kuwait, 223 kb/d from Iraq and 82 kb/d from Kazakhstan. Russia signed up to an additional 200 kb/d of export reductions (refined

Chart 1: Oil prices
($/bbl)



Source: Refinitiv, KPC

Chart 2: Oil demand growth projections
(mb/d)



Source: IEA, OPEC. *IEA 2025 forecasts to be released in April.

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products). Saudi's 1 mb/d voluntary production cut rollover remains the largest item in the 'cut' announcement.

- OPEC+ output (quota-bound members only and excluding Angola) is therefore scheduled to fall to 34.3 mb/d in Q1. (Chart 3.) Supply in December rose to 34.7 mb/d (+49 kb/d), according to combined OPEC secondary source and S&P Global data, with the largest gains coming from Nigeria (+99 kb/d) and Kazakhstan (+30 kb/d), offsetting slight declines in most members. Outside of quota-bound members, Iran's output declined modestly from November's post-2018 sanctions high of 3.2 mb/d to 3.1 mb/d. Iranian production soared in 2023: with gains of almost 600 kb/d, it was one of the largest contributors to global supplies. Meanwhile, Venezuela, which has benefitted from a reprieve in US sanctions, has been gradually pumping more oil. Output in December reached 786 kb/d (+7 kb/d m/m), its highest level since February 2019.

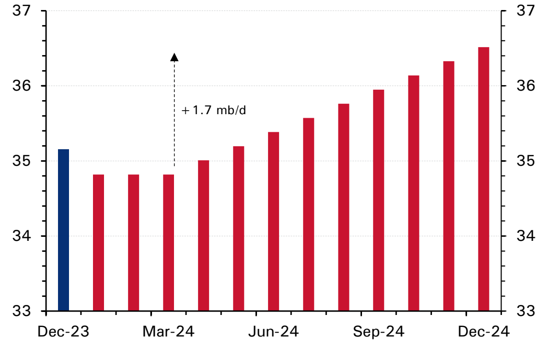
- Non-OPEC supply, meanwhile, increased by 2.3 mb/d in 2023, the IEA estimated. This was mainly on the back of output gains in the US, Canada, Brazil and Guyana. In the US, oil production expanded at the fastest rate since 2019, by more than 1.0 mb/d to 12.9 mb/d, according to US Energy Information Administration (EIA) data. Weekly EIA data showed that output, at 13.0 mb/d, was hovering near its record high of 13.3 mb/d. (Chart 4.) Remarkably, such gains have taken place while oil drilling has been in decline (-19.5% in 2023), though by the end of January the drop in the number of active oil rigs appeared to stabilize at the 500 level, according to Baker Hughes. Looking ahead, the EIA thinks such oil production gains are unlikely to be sustained, with growth dropping to less than 300 kb/d on average over the next two years.

- As far as the outlook for 2024 is concerned, notwithstanding the forecasting uncertainties by research houses over the pace of global economic and demand growth amid a myriad of factors including the prospects for monetary policy easing in the US and the Europe, we think that overall activity will be fairly solid. Oil demand growth will slow from last year's 2.2 mb/d but remain slightly above trend at 1.4 mb/d given ongoing consumption gains in emerging markets. Non-OPEC supply growth should also moderate, with Iran and the US not expected to bring on supply at 2023's breakneck pace.

- OPEC+ supply management will, therefore, once again be key to the oil price outlook, geopolitical risk apart. Provided that supply cuts remain in place beyond Q1, we think OPEC could succeed in keeping market balances tight, with bias towards a stock decline. Of course, OPEC+ compliance issues and market share considerations are bound to come into play and could result in supply cuts being unwound from Q2 onwards: OPEC+ will not want to cede market share to rivals by suppressing supply indefinitely. Nevertheless, we think that Brent will find support at the $80/bbl level for the year.

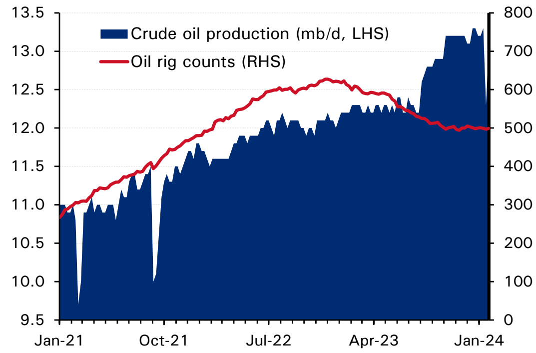
Chart 3: OPEC+ supply 2024

(mb/d)



Source: OPEC; *quota members only, excludes Angola

Chart 4: US crude production and rig counts



Source: EIA, Baker Hughes

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