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Prices on defensive as softer oil demand, oversupply concerns resurface

Oil prices are on the defensive, ranging at two-month lows, as concerns intensify over the health of the global economy amid rising trade tariff protectionism and markets refocus on the prospect of a developing supply glut after OPEC+ fast-tracked the unwinding of its supply cuts. The IEA has maintained its assessment of below trend, sub-1 mb/d global oil demand growth, tapering off into negative territory beyond 2029. Oil price risks for 2026 are tilted to the downside while these dynamics remain in play.

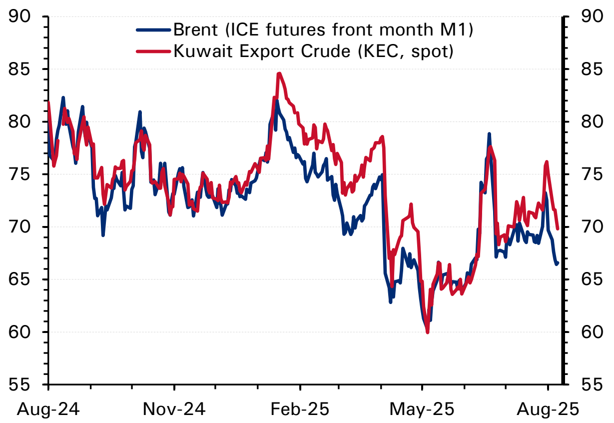
Markets: Prices in retreat amid resurgent supply glut and weak global economic growth worries

Oil's run of three consecutive monthly gains extending back to May appears to be faltering, with markets turning more bearish moving into August amid worries over global economic growth undermined by US trade tariffs, less than stellar US economic readings and the near completion of OPEC+'s supply cut unwinding plan a year ahead of schedule. Brent is trading near its lowest level in two months at around $66/bbl (-10.8% ytd), with market participants positioning for a larger-than-expected supply glut after OPEC+ signaled the return of all 2.2 mb/d of supply cuts by September and on the prospect that the upcoming meeting between President Trump and Russian President Vladimir Putin results in a negotiated ceasefire in the Russia-Ukraine conflict, a lifting of Russian sanctions and more freely-flowing Russian crude. (Chart 1.)

The shift towards an increasingly bearish view is reflected in money manager positioning, with 'net length' – the difference between the number of 'long' (betting on prices rising) and 'short' (positions staked on prices falling) contracts – declining in two of the last three weeks. In the week ending 5 August, Brent net length fell by 20,375 contracts to 240,977 on an increase in the volume of 'short' contracts and a much larger decrease in the number of 'long' contracts. (Chart 2.)

Chart 1: Oil prices

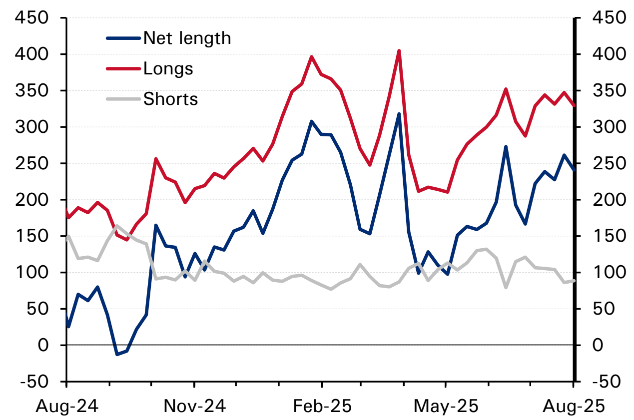
($/bbl)



Source: Haver, KPC

Chart 2: Money manager net length

(thousand futures and options contracts)



Source: LSEG Workspace, ICE

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These movements in speculator positioning signal more near-term pressure on prices, usually reflecting the view that supplies are ample in the context of demand. Brent's forward curve structure, though remaining in 'backwardation' (near-term prices higher than longer-term prices), has flattened at the front end in response.

Oil demand: Below-trend growth to remain over forecast period

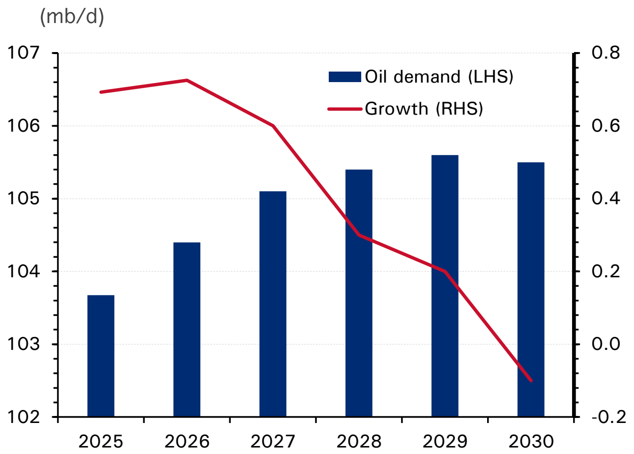
The International Energy Agency (IEA) expects annual global oil demand growth to remain below last year's increase of 1 mb/d for both 2025 and 2026 at around 0.7 mb/d, according to the agency's most recent forecast in July. (Chart 3.) This is the weakest increase in oil consumption since 2009 outside of the Covid-19 pandemic, and a reflection of the ongoing penetration of renewables in the transportation fuel mix as well as headwinds linked to the imposition of global trade tariffs. That said, the IEA could revise up its demand projection when it publishes its August edition of the monthly oil market shortly to take into account the IMF's upgrade to global economic growth (by 0.2% pts to 3.0% for 2025 and by 0.1% pts to 3.1% for 2026). The IMF cited lower-than-expected effective US tariffs, stronger pre-tariff purchases and better-than-expected economic activity in China in the first half of the year in its explainer. The IEA has already acknowledged that Chinese strategic oil stockpiling, which tends to accelerate during periods of lower oil prices, has been an important factor supporting oil demand and preventing the global oil market balance from tipping more severely into oversupply. According to the IEA's longer-term outlook, oil demand growth will begin to slow noticeably after 2026 before turning negative after 'peak' oil demand is reached in 2029 (105.6 mb/d) as substitution away from oil in the transport and power sectors accelerates.

Supply: OPEC-8 to unwind all 2024 supply cuts a year ahead of schedule; non-OPEC growth slowing

OPEC+ signaled its intention over the summer months to accelerate even further the pace of its market resupply and complete the unwinding of the full 2.2 mb/d of voluntary cuts (+300 kb/d baseline increase for the UAE) by the end of September, one year ahead of schedule. At their July and August meetings, the group agreed to raise the aggregate monthly gain in production for the eight members participating in the voluntary cuts to 548 kb/d m/m for both August and September from 411 kb/d in May, June and July. August and September's rate is quadruple the original monthly gain of 137 kb/d from April.

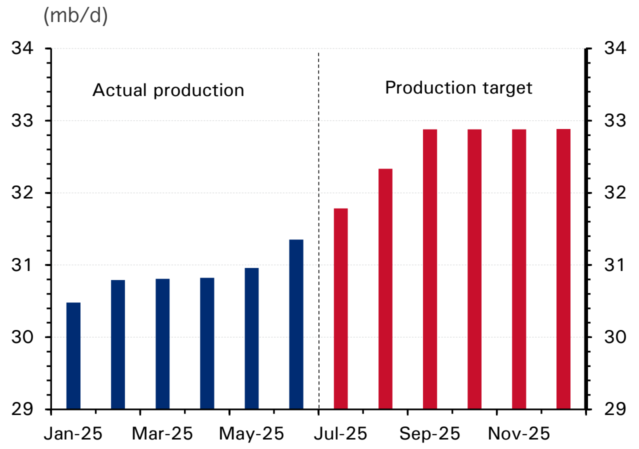
Both the move and its effect on the market have largely run counter to expectations, with OPEC+ deftly orchestrating the unwinding of such a large volume of withheld supply without a commensurate decline in prices. The group has (so far) managed to avoid a more negative price response for several reasons: (i) delivered-to-market volumes have significantly fallen short of pledged volumes due to production capacity

Chart 3: IEA world oil demand growth



Source: IEA

Chart 4: OPEC-8 production*



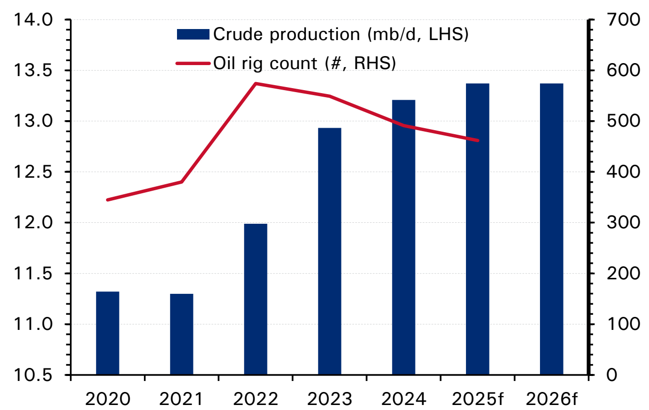
Source: OPEC; *excludes compensatory cuts being more limited than thought among the non-GCC oil producers especially. OPEC-8 production as assessed by OPEC secondary sources reached 31.3 mb/d in June, a rise of only 542 kb/d cumulative from April rather than 958 kb/d as per the schedule (see Chart 4); (ii) the implementation of offsetting, compensatory production cuts by serial overproducers; and (iii) global oil demand turning out less soft than was projected, supported by Chinese stockpiling.

For non-OPEC supply, the IEA expects volumes to grow by 1.4 mb/d this year from 0.9 mb/d last year and by 0.94 mb/d in 2026. This year, additions to US shale production will once again constitute the bulk of expected gains, along with Brazil and Canada. Growth will trend sharply lower in 2026, however, due to pullbacks in US drilling activity, especially amid lower oil prices. The US Energy Information Administration's (EIA) July Short-Term Energy Outlook goes further by forecasting actual declines in US production through 2026, from a high of 13.4 mb/d in Q2 2025 to less than 13.3 mb/d by the end of 2026, though in annual average terms, growth is flat. (Chart 5.) BP's CEO recently echoed the trailing off narrative for non-OPEC supply more broadly, predicting that it will be "relatively flat for 12-18 months" after peaking in early 2026.

Market balance and price outlook: prospect of oil surplus amid softer demand to keep pressure on prices

The slowdown in non-OPEC supply growth will help mitigate the developing surplus but not erase it, given the acceleration in OPEC-8 supply growth since May and the uncertain prospects for global oil consumption amid higher trade tariffs and perhaps a slowing US economy. Fundamentals, as assessed by the IEA, showed supply outstripping demand by more than 1.1 mb/d in Q1 2025, rising to 1.74 mb/d in implied stock builds in Q2. Observed OECD commercial oil inventories were up by almost 74 mb in May, according to the IEA, and by 35 mb to 2,771 mb, according to OPEC. (Chart 6.) These figures likely mask the true state of global inventories, however, which are increasing more quickly on the back of Chinese commercial and especially strategic stockpiling. The implications for oil prices are bearish. Looking ahead, it will likely be more difficult for OPEC+ to defend prices at current levels if the group decides to proceed with unwinding the pre-2024 tranche of supply cuts estimated at 1.6 mb/d from October onwards. Also, a resolution to the Ukraine-Russia conflict that leads to the removal of sanctions on Russian oil would likely compound the supply overhang. Having said that, the negative price response could prove to be overdone, if, as is looking likely, more limited OPEC+ spare production capacity precludes the full unwinding of these supply cuts. This and potential upcoming upgrades to global oil demand growth for next year informs our assessment that oil prices could range higher than the current consensus in the oil market, which is heading towards the low $60s for 2026 (down from an estimated $68/bbl for this year). The year-to-date average for Brent is approximately $70.5/bbl, in line with our forecast from last November.

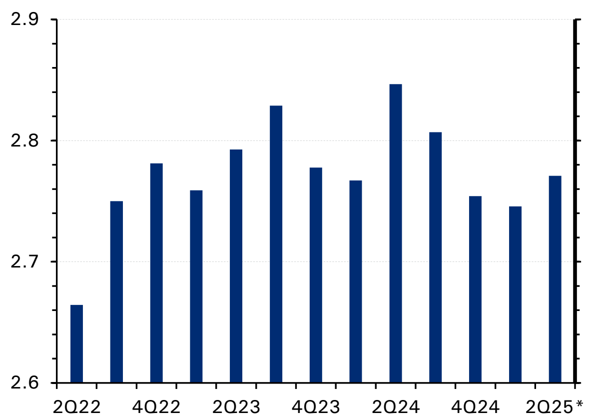
Chart 5: US crude production and rig counts



Source: EIA, Baker Hughes

Chart 6: OECD commercial oil inventories

(billion barrels)



Source: OPEC, Haver

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