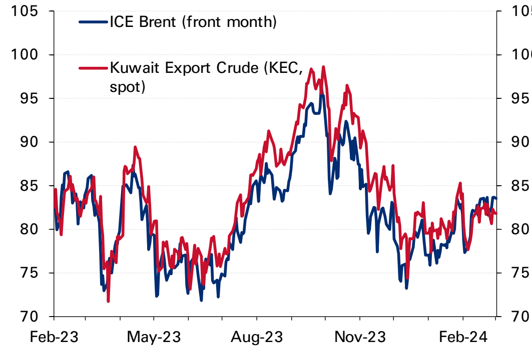
Economic Brief | 12 March 2024

Oil prices post second month of gains in February

Oil futures rose in February, reaching the highest levels since last November on relatively positive economic developments and continued geopolitical risk linked to the conflict in Gaza/Red Sea. Global oil demand growth forecasts were largely unchanged in February, though with OPEC+ recently announcing an extension to its voluntary supply cuts into Q2, market balances will almost certainly tighten in the months ahead, which should support oil prices.

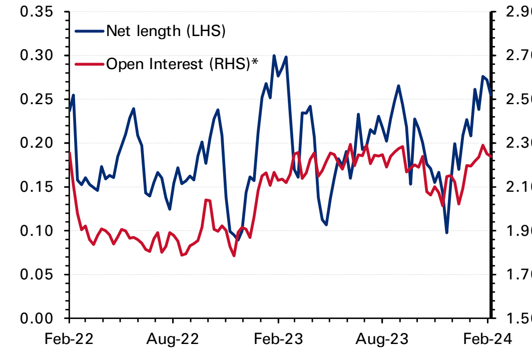
- Brent futures rallied for a second consecutive month in February, rising by more than 2% to $83.6/bbl (+8.5% ytd) on the back of positive macroeconomic signals and continuing geopolitical tensions surrounding events in Gaza and the Red Sea. (Chart 1.) Stimulus measures undertaken by the Chinese government and expectations of an extension of OPEC+' supply cuts into Q2, which were announced on 3 March, also factored in oil's move to its highest level since November. Brent's backwardated price structure, where prices for prompt delivery are higher than prices for delivery in the future, widened to more than $2.4/bbl (M1-M3) by February's close, a four-month high, signaling increasing supply tightness. Local marker Kuwait Export Crude (KEC), meanwhile, closed the month at $81.8/bbl (-2.7% m/m; +2.9% ytd).
- In the futures markets, bullish speculator positioning increased substantially in February, with net length (the difference between the number of bullish "long" and bearish "short" contracts) reaching the highest in nearly a year at 276k contracts, before pulling back towards the end of the month. (Chart 2.) The ratio of longs to shorts was back up over 5 in mid-February, the most since last October. Furthermore, as a sign of renewed appetite for oil trades, Brent open interest (the total number of outstanding derivative contracts) rose in February to its highest level since last July.
- Oil demand growth forecasts for 2024 remained relatively unchanged in February, though all the reporting agencies noted the likelihood of a softer pace of expansion this year compared to last. The International Energy Agency (IEA) reduced its projection by 20 kb/d to 1.2 mb/d, still a huge 1 mb/d below OPEC's estimate of 2.2 mb/d, which is by far the most bullish among forecasters. (Chart 3.) Non-OECD economies including China, India and Brazil are expected to drive the increase this year, accounting for 78% of total oil demand gains in 2024. OECD members, on the other hand, will likely post much slower growth amid a lackluster economic environment. For 2025, OPEC sees oil demand rising by a still strong 1.85 mb/d to 106.2 mb/d.
- On the supply side, combined data from OPEC secondary sources and S&P Global show aggregate OPEC+ production (quota-bound members) falling 234 kb/d m/m to 34.4 mb/d in January. (Chart 4.) Among OPEC members, the steepest declines came from Kuwait (-109 kb/d) and Iraq

Chart 1: Oil prices
($/bbl)



Source: Refinitiv, KPC

Chart 2: Brent money manager net length
(million futures and options contracts)



Source: Bloomberg. *Futures contracts only

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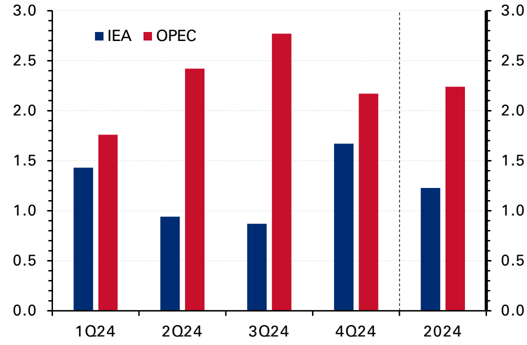
(-98 kb/d) as both countries began implementing their voluntary cuts. Increased production in the UAE (+31 kb/d), in accordance with its new higher baseline, and in Saudi Arabia (+25 kb/d), slightly offset the losses. Of the 8 OPEC+ members taking part in the latest round of supply cuts, which on paper total 2.1 mb/d but which in practice will see only about 500 kb/d of fresh production cuts (the remainder is a combination of Saudi's 1 mb/d output cut rollover from mid-2023, Russia's 300 kb/d export cut rollover from 2023 and an additional Russian 200 kb/d refined product exports cut, while the UAE's 163 kb/d cut is offset by a 200 kb/d increase to its baseline) only Saudi Arabia was in perfect compliance in January, with Kazakhstan yet to move at all with its 82 kb/d cut. Meanwhile, quota-exempt Libya saw its output fall 135 kb/d to 1.0 mb/d in February following protests at Al-Sharara field earlier in the month and Iran recorded its first monthly production decline in a year (-5 kb/d to 3.16 mb/d). As was widely expected, OPEC+ announced on 3 March that these producers will extend their cuts through Q2, with Russia also signing up, but with a mix of production and export cuts totaling 471 kb/d rather than an outright 500 kb/d export cut as was the case in Q1. Russia intends to gradually deepen its production cut from 350 kb/d in April to 471 kb/d in June while simultaneously reducing its export cuts from the initial 121 kb/d in April. (Chart 5.)

- Outside of the OPEC+ group, the IEA reckons that output gains from the US, Canada, Brazil and Guyana will drive aggregate non-OPEC supply growth of 1.5 mb/d in 2024, which, while down on 2023's breakneck pace of 2.5 mb/d, will, nonetheless, outpace expected demand growth this year, leading to a surplus of supply over demand and potentially around 0.2 mb/d of oil inventory gains on average. The US Energy Information Administration (EIA) and OPEC do not share that view, with the former pegging non-OPEC supply growth in 2024 at around half the IEA's rate and OPEC at around 1.3 mb/d. We think non-OPEC supply growth could come in lower at about 1.1 mb/d, which, with OPEC+'s supply cut extension into Q2, could almost certainly leave the market short of barrels and facing an inventory drawdown in Q1-Q3 and for the year as a whole (-0.4 mb/d). Were OPEC+ to extend their voluntary cuts beyond Q2 then the oil market balance/stock change would tip further into a supply deficit/drawdown.
- In the US, crude oil production returned in February to the record 13.3 mb/d level following January's winter storms when 1 mb/d of output was shut in. It is partly as a result of this and partly on expectations of lower drilling during the rest of the year that the EIA has reduced its crude oil output growth projections this year from 290 kb/d to just 170 kb/d, a sizeable drop from 2023's growth of 1.0 mb/d. The EIA expects output to generally flatline around 13.1 mb/d on average for 2024. For 2025, however, the agency expects production to rise to 13.5 mb/d (+400 kb/d) despite no significant change in the expectations of oil prices over the period. Meanwhile, active oil rigs increased to 506 (+1.2% ytd) by February's close, the highest level since September.
- OPEC's policy path will likely be the focal point for markets this year. Having announced an extension to their Q1 supply cuts, the producer bloc will be watching carefully how oil demand fares through the months ahead and the trajectory of non-OPEC supply. Of comfort to OPEC+ will be that prices appear to have firmed with a price floor established at around the $80/bbl level. We think that level will be a reasonable base case for 2024, though with a stronger upside risk developing than before.

Chart 3: Oil demand growth projections

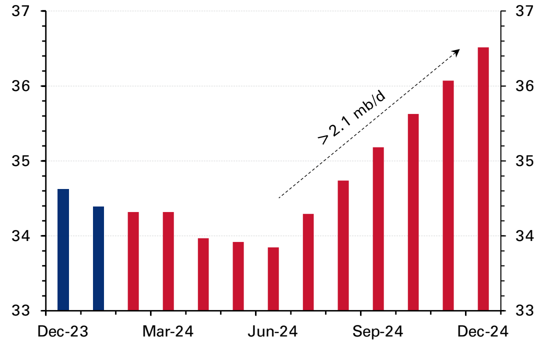
(mb/d)



Source: IEA, OPEC

Chart 4: OPEC+ supply in 2024

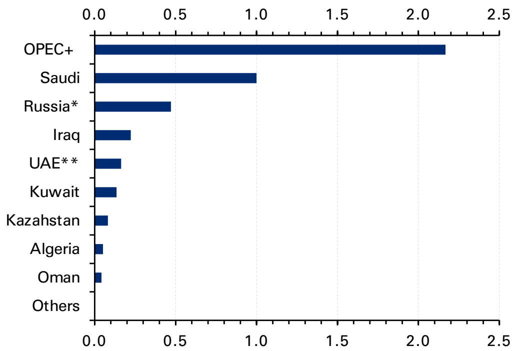
(mb/d, quota-bound members only)



Source: OPEC; note: assumes full compliance among members

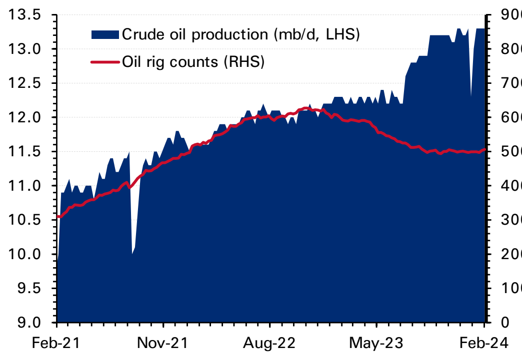
Chart 5: OPEC+ output cuts through Q2 2024

(mb/d)



Source: OPEC; *Russia cut by June; **before baseline increase

Chart 6: US crude production and rig counts



Source: EIA, Baker Hughes

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