Energy Intelligence

Energy Intelligence Premium Weekly

Thursday, August 25, 2022

Oil Markets: Products Will Keep Balances Tight

Global product markets will become increasingly tight and highly vulnerable to disruption, despite sufficient crude supply, our analysis shows. Fuel switching, tempered inflation and refining constraints will keep prices elevated into next year, barring a deeper-than-expected recession.

- **Softer crude prices disguise future product shortfalls and supply uncertainties.** Oil markets are split: Crude balances are slack, but product balances — especially diesel — remain razor thin and will tighten this winter, elevating concerns of future supply shortfalls. Looming EU bans on Russian crude and product imports and shipments add significant supply uncertainty and potential for disruption. Prospects of a deeper economic slowdown and full return of Iranian crude exports have partially countered these bullish signals and constrained liquidity in paper markets, stoking volatility. But overall, prices continue to be elevated vs. pre-Ukraine levels in anticipation of increased market tightness.

- **Demand growth will be robust into 2023.** Our updated balances point to a significant uplift in oil demand this winter and continued growth in 2023, despite macroeconomic headwinds. We see demand exceeding supply by 1.1 million b/d in Q4. Product balances will steadily worsen into 2023, even if wider oil markets appear balanced (see chart). Record natural gas prices are expected to drive historically high fuel switching to diesel and fuel oil in Europe and Asia, potentially 1 million b/d at its peak and extending beyond winter. We see front-loaded central bank efforts to curb inflation staving off more dire economic forecasts, supporting demand, including aviation. We have upgraded our forecast for 2023 oil demand growth to 1.9 million b/d (to 101.5 million b/d) vs. 1.2 million b/d previously.

- **Russia and Iran could upset crude's more balanced outlook.** Resilient Russian crude exports have helped ease near-term concerns of a crude shortage, deflating prices from post-Ukraine invasion highs and narrowing crude's backwardation. But Russia's future supplies remain a huge unknown, and Opec-plus spare capacity is thinning. Russia will have to divert 1.7 million b/d of crude still shipped to the EU when the Dec. 5 embargo takes effect — an arduous task if proposed EU restrictions on shipping and insurance materially limit available tankers. Our forecast assumes Russian crude output slips by 1.85 million b/d by end-2023, half from falling domestic refinery runs — but we will be monitoring this closely, given Russia's better-than-expected performance so far. On the other side, we estimate an Iran nuclear deal could boost Iranian exports to 1.25 million b/d by early 2023 and 2 million b/d by midyear, from 600,000-900,000 b/d, helping counter Russian losses. Any slowdown in Chinese strategic stock purchases could ease pressures on crude, but will be partially countered by the end of US SPR releases.

- **Product supplies look perilously tight.** Global refining constraints are exerting strong pressure on markets, regardless of crude flows. Some 1 million b/d of Russian product exports to Europe will need to be rehomed when a Feb. 5 EU ban takes effect to avoid a global deficit, our balances indicate. Capacity additions of ~3 million b/d this year and next will not fully offset 4 million b/d of capacity lost in the Covid-19 pandemic, and some additions (Dangote in Nigeria, Dos Bocas in Mexico) could slip to 2024. China's 800,000 b/d of additions would have limited global impact if Beijing maintains product export restrictions. Record natural gas prices could further pressure supplies if European refineries cut runs on poor economics. US product exports are already at historic highs.

- **These pressures will keep oil prices elevated into next year.** If inflation forces are kept at bay, we see oil markets struggling more to meet consumer fuel demand next year than to source crude. Our Q4'22 Brent price outlook remains below consensus, at $93/bbl, but jumps above consensus to $103 for full-year 2023, with product prices running higher. We see little margin for error in the products market, particularly given depleted inventories. Significant volatility will persist as unprecedented disruptions to oil flows from a major producer (Russia) are digested in a potentially lumpy manner. Periodic price spikes will threaten demand destruction, particularly industrial demand in Europe. On the flip side, macroeconomic headwinds present tangible downside risk. Saudi Arabia has hinted at new coordinated Opec-plus crude supply cuts if these threaten lower prices, with $90 a potential line in the sand.

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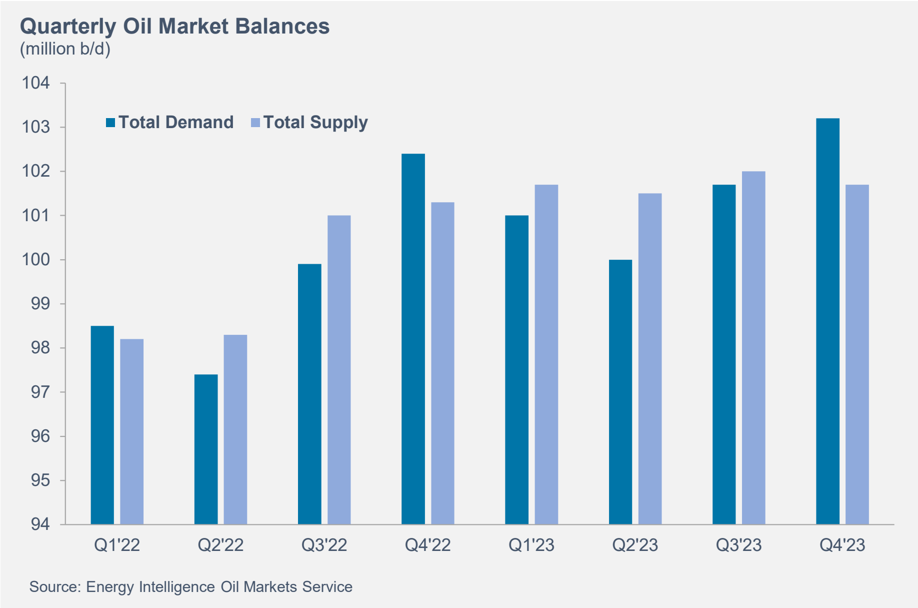

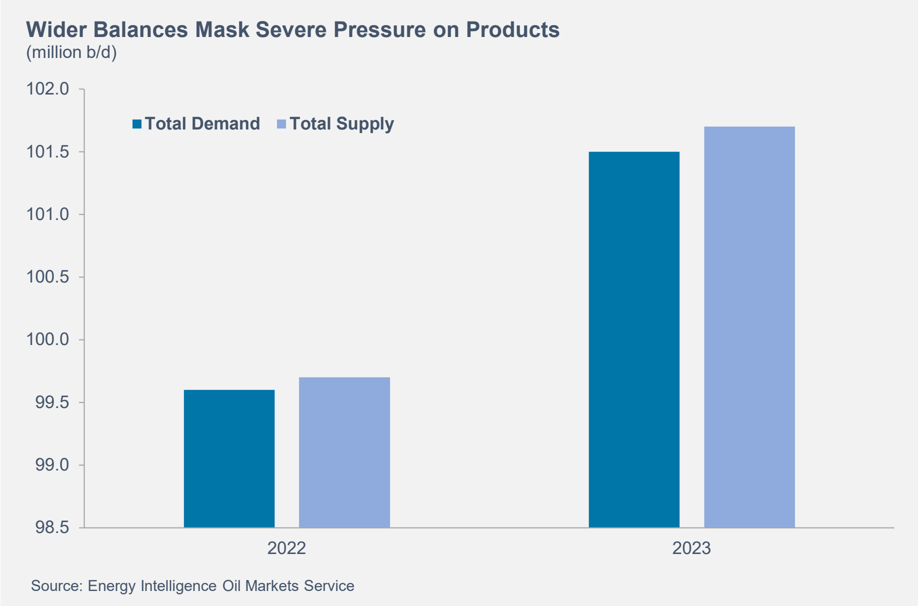

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