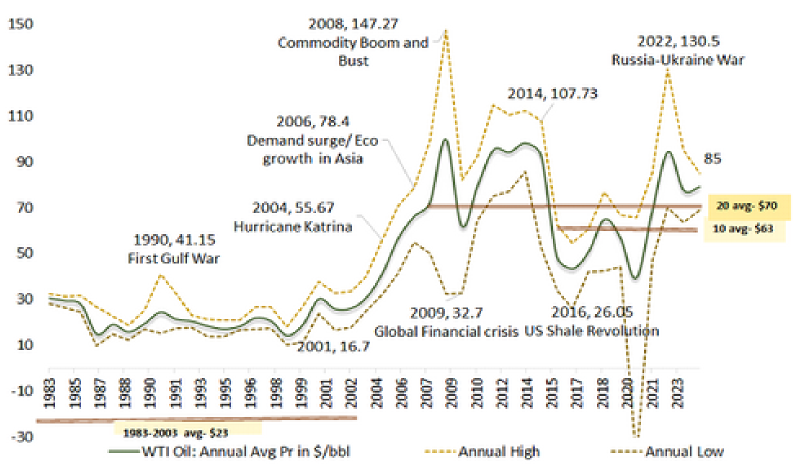
Crude Oil: Riding on the waves of Supply, OPEC+ cuts, China, and Geopolitics

Crude Oil in the current context is influenced by a complex interplay of factors including fluctuating supply from non-OPEC producers, strategic production cuts by OPEC+, economic headwinds from China, and ongoing geopolitical tensions. The balance between these forces is what making the Crude Oil market highly dynamic and closely watched by governments, industries, and investors.

- Crude Oil's historical price footprints: A journey through time

Oil has historically been a trigger for geopolitical events that affect supply and demand fundamentals, leading to price volatility. Besides geopolitics, weather and other uncertain events also have a significant impact on Crude Oil and petroleum products. While supply shocks from such events are usually temporary and markets stabilize over time, the oil market also undergoes structural changes driven by economic booms or technological advancements. These broader developments can cause a more significant and permanent shift in average oil prices.

WTI Oil Price Swings since 1983 till date visa-vis factors affecting Prices



However, post-2003 saw a remarkable surge in oil prices, with WTI climbing from $28 to $134 per barrel due to structural demand shifts associated with an unexpected expansion of the global economy and strong additional demand for oil from emerging Asia. Because oil producers were unable to satisfy this additional demand, the price of oil increased.

A more significant movement in crude oil price history occurred in 2008, against the backdrop of the global financial crisis following the collapse of the US home loans market. Volatility led to oil spiking to $145 a barrel, and months later it collapsed to under $40 a barrel as demand for the commodity dropped off.

There have been a number of smaller demand and supply shocks in the oil market between 2010 and early 2019. However, the notable development of that decade was the unexpected growth of US shale oil production, not only in the US but also increased oil production in other countries including Canada and Russia. The next big oil price movement came during the COVID-19 pandemic starting in March 2020 when global lockdowns stopped travel and slowed demand for fuel. As a result, oil prices plummeted to abnormally low levels.

In 2022, as the world rebounded from the pandemic and demand for fuel returned with travel and industrial output, crude oil prices skyrocketed, leading to the oil market hitting near-record levels. Demand in the oil market was further exacerbated by Russia's invasion of Ukraine in February. Russia is a key global supplier of oil, and when sanctions were imposed against the country for its actions, other nations, including those in the European Union, had to scramble to find replacements from other parts of the world.

Now, let's look at the current context.

- Year 2024 so far in Crude Oil:

A comparatively stable year

Year 2024 featured a comparatively stable year for Crude Oil with prices largely hovering between $70 and $85 per bbl level. After ending 2023 below $70, prices rebounded and surged toward $85 by the end of the 2Q 2024. The ongoing geopolitical tensions, accompanied by OPEC+ cuts and resilient US economy outweighed China demand concerns and higher Non-OPEC supplies.

Despite elevated interest rates, US economy is resilient. But at the same time, being the election year the nation won't be happy if oil prices rise sharply as it will stoke inflation. Non OPEC countries including US, Brazil, Canada continues to pump oil and Non-OPEC output is seen growing. Considering higher Non- OPEC production and faltering Chinese economy, OPEC remains in forefront and the key members maintains the voluntary output cuts.

WTI Oil Price trend since Q4 2023 vis-a-vis factors affecting Prices

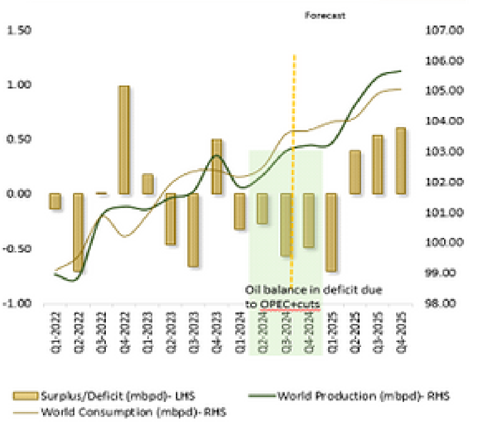
Going forward, let's see how these factors might pan out over the remaining part of 2024.

- How long will OPEC continue with its output cuts?

A well supplied market and slowdown fears may force OPEC+ to extend cuts till year -end

Crude Oil: Quarterly Surplus/ Deficit

Oil to remain in deficit as OPEC+ cuts in place for 3Q 2024



Source: Bloomberg, AR Research

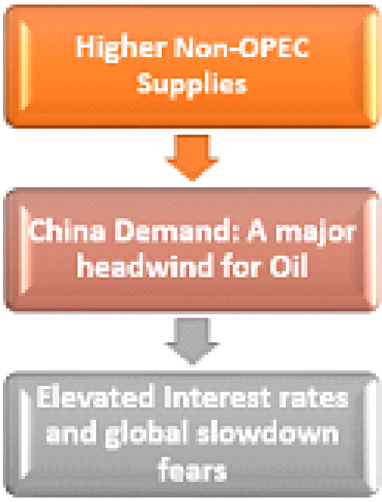
Since late 2022, OPEC and its allies have made production cuts to balance increasing output from the US and other non-OPEC nations and to address demand concerns in major economies. Currently, OPEC+ is cutting production by 5.8 million barrels per day (mbpd), or 5.7% of global demand which includes 3.6 mbpd from OPEC+ members until December 2024 and an additional 2.2 mbpd voluntary cuts. In its June 01 meeting it extended the entire cuts for 3Q 2024 but said the 2.2 mbpd output cuts will be restored gradually from October2024 onwards, depending on the then situation.

However, a well-supplied oil market and tepid demand outlook may force OPEC+ to extend all output cuts to year-end despite several members' eagerness to increase production. The group's strategy of supporting prices has effectively subsidized external supply growth (especially in the US), leaving little room for OPEC+ to taper its curbs. Thus oil balance sheet would remain in slight deficit with OPEC+ cuts remaining in place, keeping the broader picture a bit positive for oil.

- US WTI Oil faces potential plunge below $70

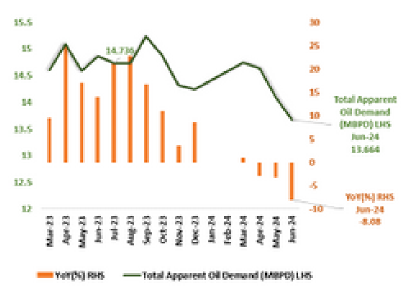
Higher Non-OPEC supplies, China demand woes and unwinding of cuts

Key Downside Catalysts



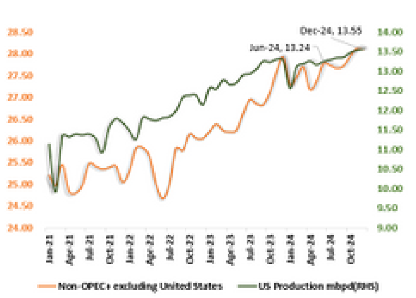
As long as the entire OPEC+ cuts remain in place, we don't see possibility of oil prices sliding below $70 per bbl level. However, the same cannot be completely ruled out. If the cartel starts unwinding the cuts starting October, prices faces a potential plunge below $70 as well. Oil markets could face a 100,000 bpd surplus in 4Q if Saudi Arabia and other major producers scale back voluntary cuts after 3Q. If US shale oil producers keep ramping up output, or if China's economic weakness causes demand to drop faster than expected, oil's supply-demand dynamics could shift, and prices may fall back below $70 a barrel by year-end. America's oil boom is helping drive global supply growth in 2024. While China's economy is faltering denting demand for Crude. The nation's apparent oil demand as well as imports are declining and holds potential threat on demand.

China's Oil demand growth slows
China's Apparent Oil Demand (tn) and YoY change(%)



Source: Bloomberg, AR Research

Non OPEC Supplies Rising consistently
Monthly Oil Production of Non OPEC Countries



Source: Bloomberg, AR Research

- **Fed rate cuts and oil prices**

Jobs data pointing to more rate than one rate cut in 2024

The recent US jobs data has shown Non-farm payrolls declining and unemployment rate rising signalling slowdown fears. This has boosted more than one rate cut expectation in the US in 2024. Oil prices usually drop during economic downturns due to a surplus supply in crude markets and dented demand. Even if central banks cut rates to boost growth, it may take time for consumption and energy demand to recover. Investors often seek safer investments during these times. Historically, recessions have led to a 30% drop in WTI prices during rate-cut cycles in 1984-86, 1989-92, 2000-03, 2007-09, and 2019-20 (Source: Bloomberg). WTI prices typically began to rise 180 days after interest rates bottomed out in those periods.

- **WTI Oil: Potential to Surpass $85?**

Supply Threat from Geopolitics and Hurricane

The Israel-Hamas war has so far had a limited global economic impact, but it remains a volatile situation with a risk of escalation. If the conflict widens to involve direct military action between Israel and Iran, oil prices could soar tremendously due to potential attacks on regional oil facilities and the closure of the Strait of Hormuz. This could lead to supply disruption. On the other hand, a lasting cease-fire in Gaza could ease trade flows in the Red Sea, but it would likely have little effect on oil prices, global growth, and inflation.

Another event that poses a supply threat to oil markets is the ongoing hurricane season. This year, the US is likely to see a strong hurricane season, which risks disrupting US oil output. Hurricane Beryl, the earliest in years to occur in July, could push oil prices higher due to supply disruptions. However, the hurricane's impact on the energy industry will depend on its path.

- US elections and oil price

Harris, Trump's Energy plans could both hit oil price

US Election is another important trigger this year which the oil markets will be closely watching. This is because of the fact that the Oil's long-term supply-and-demand dynamics could be significantly impacted by the 2024 US presidential elections, despite differing visions from Republican nominee Donald Trump and Democratic front runner Kamala Harris on climate and energy independence.

Harris may focus on climate change, aiming for net-zero carbon dioxide (CO_2) emissions by 2045 and proposing up to $10 trillion in spending to promote clean energy and rebuild infrastructure. Trump, on the other hand, prioritizes America's energy independence through lower costs and making the U.S. a net energy exporter. Oil could face greater price risks due to Harris' clean energy policies potentially reducing demand, and Trump's America First Energy Plan possibly causing a supply glut.

- **Concluding remarks**

No one truly has a crystal ball – tomorrow, circumstances could shift in the exact opposite direction. Change and volatility appear to be the only constants in the oil market. However, history has certainly taught us there is a direct correlation between geopolitical events and the markets – and with no near end in sight to the Israel- Hamas or Ukraine-Russia conflict, Crude Oil supply threat might bring in temporary bounce in Oil from time to time. Nonetheless, global slowdown fears, China woes and unwinding of OPEC+ cuts are seen exerting downward pressure on the Oil prices. Therefore, volatility is expected to be a key feature in the short to medium term for the global oil markets.

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