PICTET WEALTH MANAGEMENT

2023 Global Macro Outlook

Oil prices to increase after temporary weakness

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FLASH NOTE

SUMMARY

- Global oil consumption has declined by 2.4 million barrels per day (mbd) year to date (ytd) as economic activity has weakened. With western economies likely to enter recession and a possibly chaotic exit from zero-covid policy (ZCP) weighing on Chinese economic activity, **global oil demand is likely to remain subdued in H1 2023**.
- By contrast, at 101.6mbd, **supply is close to the all-time high** (102.2mbd) reached in late 2018 and may not climb much higher. US shale oil production looks set to lose steam in 2023, non-OPEC+ countries are already producing above pre-pandemic levels, and Russian production is likely to remain capped by sanctions.
- With most OPEC members unable to fulfil their production quotas, spare capacity is concentrated in Saudi Arabia, UAE and Iraq. Indeed, **Riyadh is back in the driving seat when it comes to future oil supply**. OPEC+ is very likely to match a weakening of global demand with further cuts, thus **putting a floor under oil prices**.
- The oil market looks set to remain broadly balanced in the short term, but rising demand in the wake of full reopening in China combined with low supply elasticity may boost prices in H2 2023. **We expect Brent oil to reach USD115 per barrel at end-2023**.
- The **downside risks** to this scenario for oil prices, from the most to the least likely, are: a deeper global recession than expected, weak Chinese economic growth caused by a chaotic end to ZCP, further sustained expansion of US shale oil production, a settlement in the war in Ukraine, a decision by OPEC+ not to reduce supply, and regime change in Iran.

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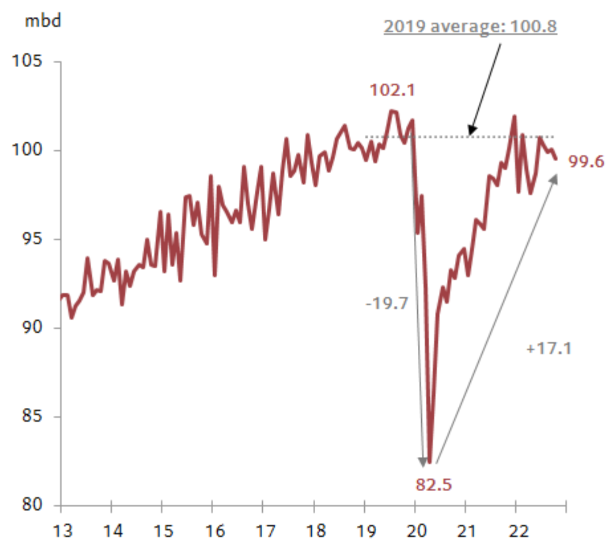
GLOBAL ECONOMIC SLOWDOWN IS WEIGHING ON OIL DEMAND...

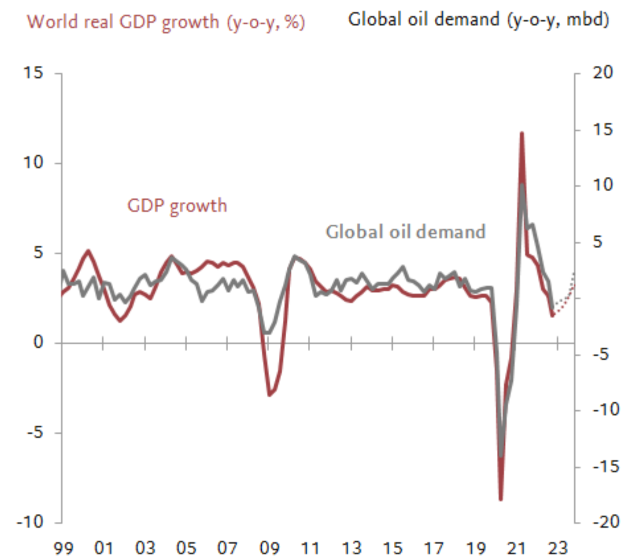
Global oil demand continues to closely track changes in world GDP. Economic slowdown in western economies and ZCP in China have weighed on oil and liquid fuel consumption, which has declined by 2.4 million barrels per day (mbd) globally year to date (ytd). Consumption has been particularly weak in advanced economies (-1.5mbd ytd), but it has declined also in emerging economies (-0.9mbd ytd), particularly in China where it contracted by 0.8mbd in October (and by -1.3mbd ytd). The risk of a precipitous reopening in China could weight further on economic activity there while we expect Western economies to enter recession during H1 2023. Our 2023 forecasts are consistent with subdued demand for oil in H1, followed by a rebound in H2 as western economies recover and Chinese re-opening runs smoother after a period of transition. We expect global oil demand to increase by 2.4mbd in 2023 to 102mbd, slightly below 2019's all-time highs.

World crude oil and liquid fuel demand



Sources: US Energy Information Administration, Refinitiv, Pictet WM CIO & MR

World real GDP growth and global oil demand



Sources: IMF, US Energy Information Administration, Refinitiv, Pictet WM CIO & MR

As of 2 December 2022

... WHILE OIL SUPPLY IS CLOSE TO THE ALL-TIME HIGH

By contrast, global oil supply has increased by 3.4mbd ytd to 101.6mbd, close to the all-time high (102.2mbd) reached in late 2018. Supply is expected to have declined by 1.2mbd in November due to the recent OPEC+ decision to cut production quotas, bringing global oil supply back to its 2019 level.

At the same time, we expect US shale oil production to lose steam in 2023. The expansion of shale production this year (+0.7mbd ytd) has been facilitated by the accumulated stock of drilled but uncompleted wells (DUCs), but this stock has been largely depleted by now. New investment will be required to expand production further. However, labour and input costs have increased significantly. Drill-pipe prices have risen 4.2 times since 2020. The recent stabilisation in the number of

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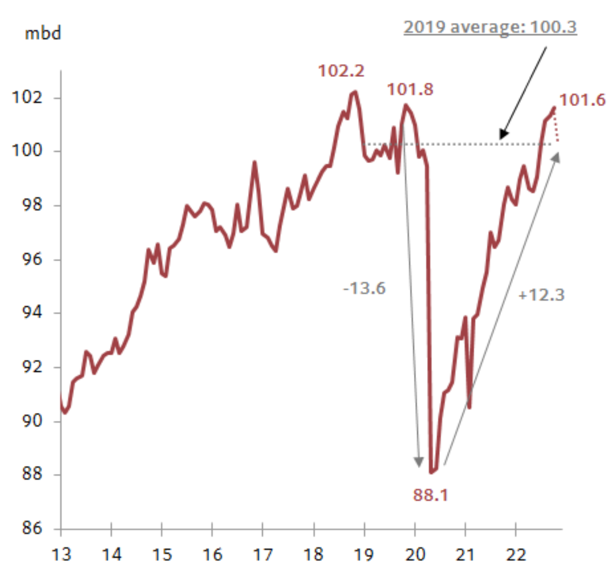
rigs, at around 620, would seem to indicate that companies remain committed to investment discipline. As a result, we expect US shale oil to expand at a slower pace in 2023 (below +0.5mbd) than in 2022.

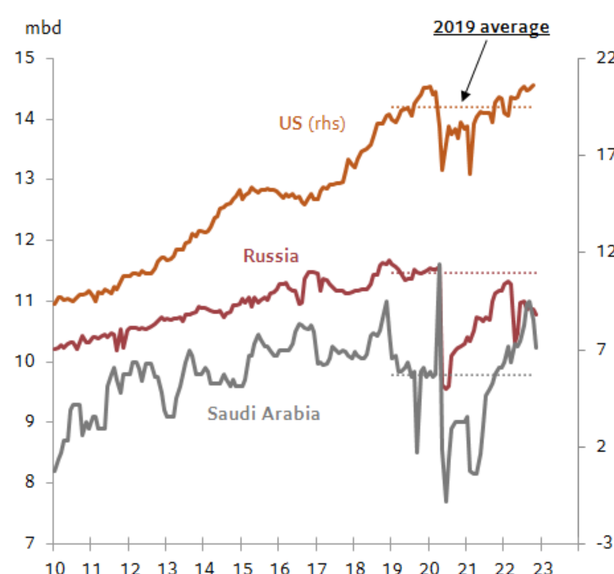
Since non-OPEC+ countries, particularly Canada, Brazil and Norway, are already producing above pre-pandemic levels, their potential to increase oil supply further appears limited.

Russian production is likely to remain capped by sanctions. The EU and UK embargos on Russian seaborne crude oil imports take effect on 5 December and are expected to weigh further on already falling Russian supplies. The capacity of 'dark fleets' combined with Russian, Indian and Chinese tankers will be insufficient to transport Russia's current volume of oil exports if there is a full-scale embargo on carrying Russian oil. As a result, Russian supply is likely to decline a further 0.7mbd, to about 10mbd (compared with 11.3mbd in March 2022).

World crude oil and liquid fuels supply



Big 3 suppliers



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RIYADH IS BACK IN THE DRIVING SEAT

Most OPEC+ members are unable to fulfil their production quotas, including important suppliers like Nigeria, Angola, Mexico, Azerbaijan and Malaysia. In fact, the gap between the quotas and actual productions is 2.5mbd in overall OPEC+. Underinvestment, social upheaval or a number of other factors explain these gaps but whatever the reasons, this situation is unlikely to change for the better in the near term. Spare capacity is concentrated in a few big suppliers—namely Saudi Arabia, UAE and Iraq. Riyadh, especially, is back in the driving seat, providing impetus for schemes to keep a lid on oil supplies. OPEC+ is very likely to match any weakening of global demand with further cuts, thus putting a floor under oil prices. Any move below USD80 per barrel for Brent oil therefore appears unlikely or should prove to be temporary.

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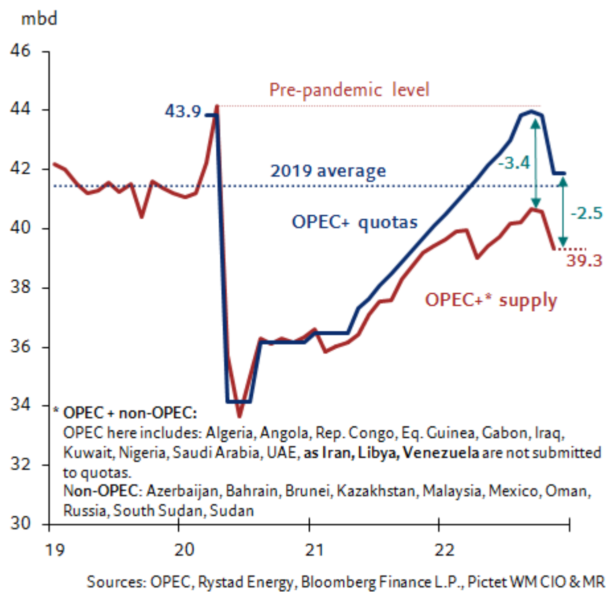
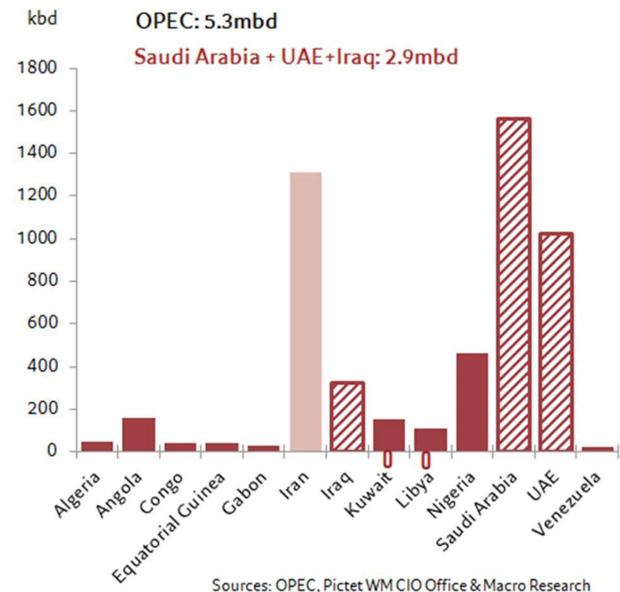
OPEC+: Production and quotas



OPEC: Spare capacity



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WORLD ECONOMIC RECOVERY IN H2 2023 SHOULD BOOST DEMAND AND PRICES

All in all, we expect the oil market to be pretty much in balance in H1. By contrast, increased demand resulting from economic recovery in western economies and China, combined with low supply elasticity, is likely to boost prices, with **Brent reaching USD115 per barrel at end 2023**.

The **downside risks** to our central scenario for oil prices, are plentiful. From the most to the less likely, these are: a deeper global recession than expected, the maintenance of ZCP in China, further sustained expansion of US shale oil production, a settlement in the war in Ukraine, a decision by OPEC+ not to reduce supply, and regime change in Iran.

There are also plenty of **upside risks** to our central scenario. These include: snags in Europe's efforts to replenish gas storage; an earlier and/or stronger-than-expected Chinese economic rebound; an avoidance of recession in western economies; significant US dollar weakening; attacks or sabotage on a major production facility or a major technical problem; and a significantly greater-than-expected reduction in Russian supply.

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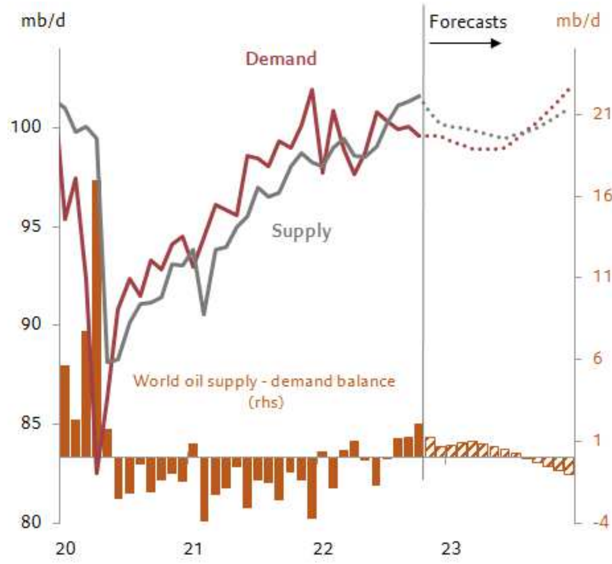
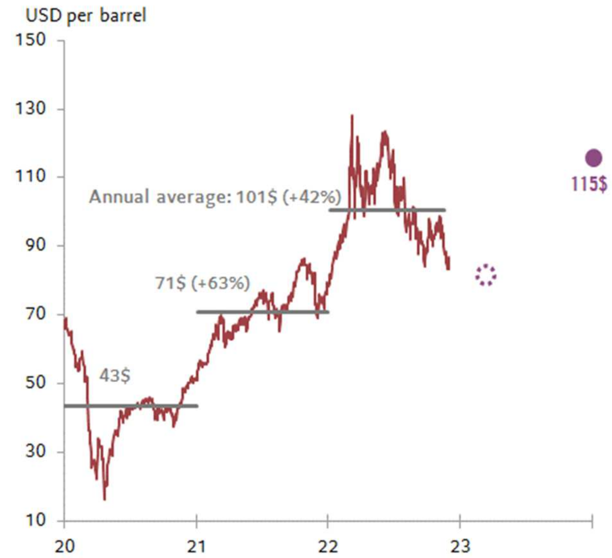
Global oil demand – supply balance



Sources: US Energy Information Administration, Refinitiv, Pictet WM CIO Office & MR

Brent price forecast



Sources: Refinitiv, Pictet WM CIO Office & Macro Research

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