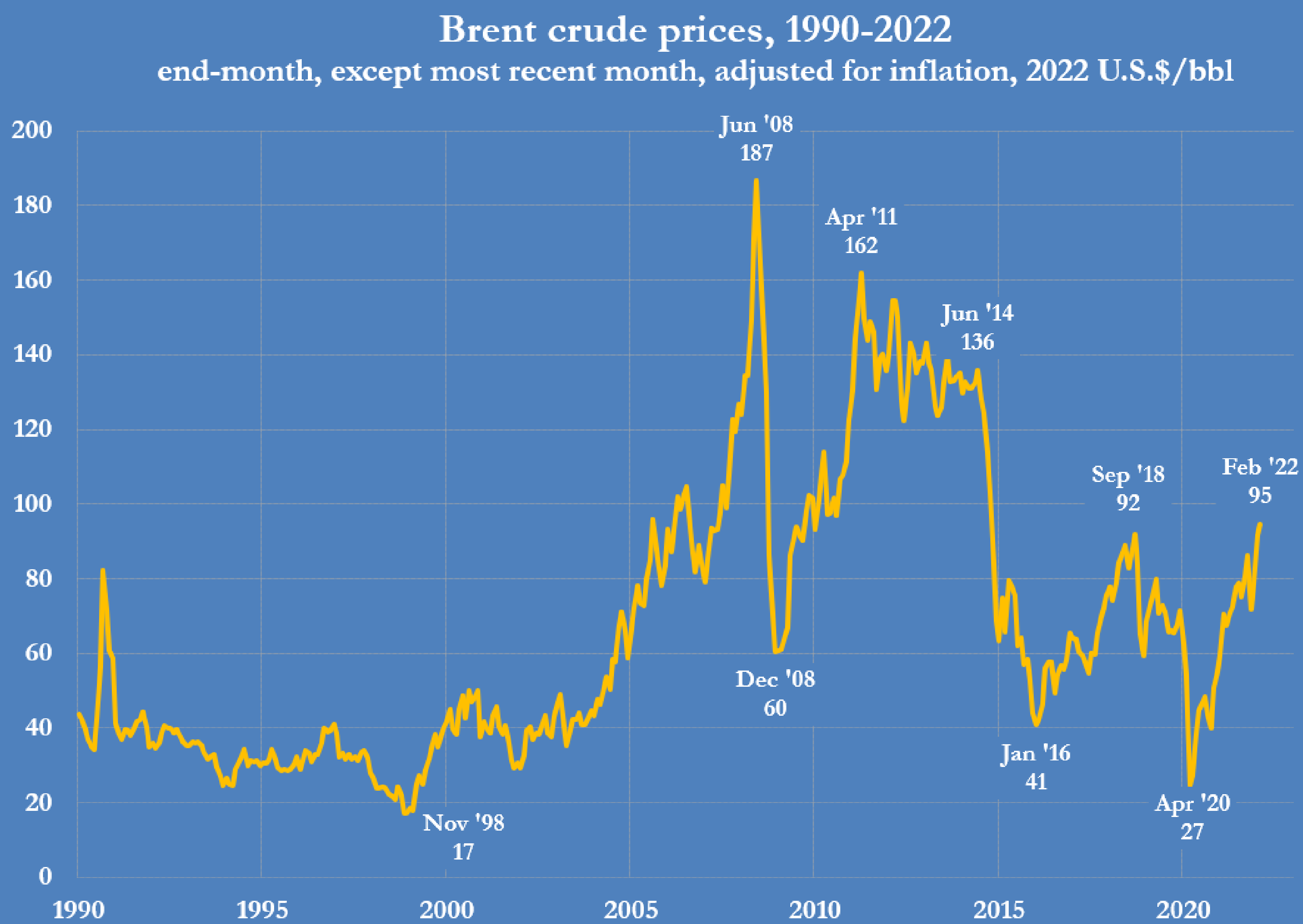
Oil price outlook for 2022/23

Baltic Exchange tanker forum

JOHN KEMP
REUTERS
21 Feb 2022

Oil prices have rebounded strongly after the coronavirus recession

In real terms, prices are highest since 2014



Source: ICE Futures Europe, U.S. Bureau of Labor Statistics

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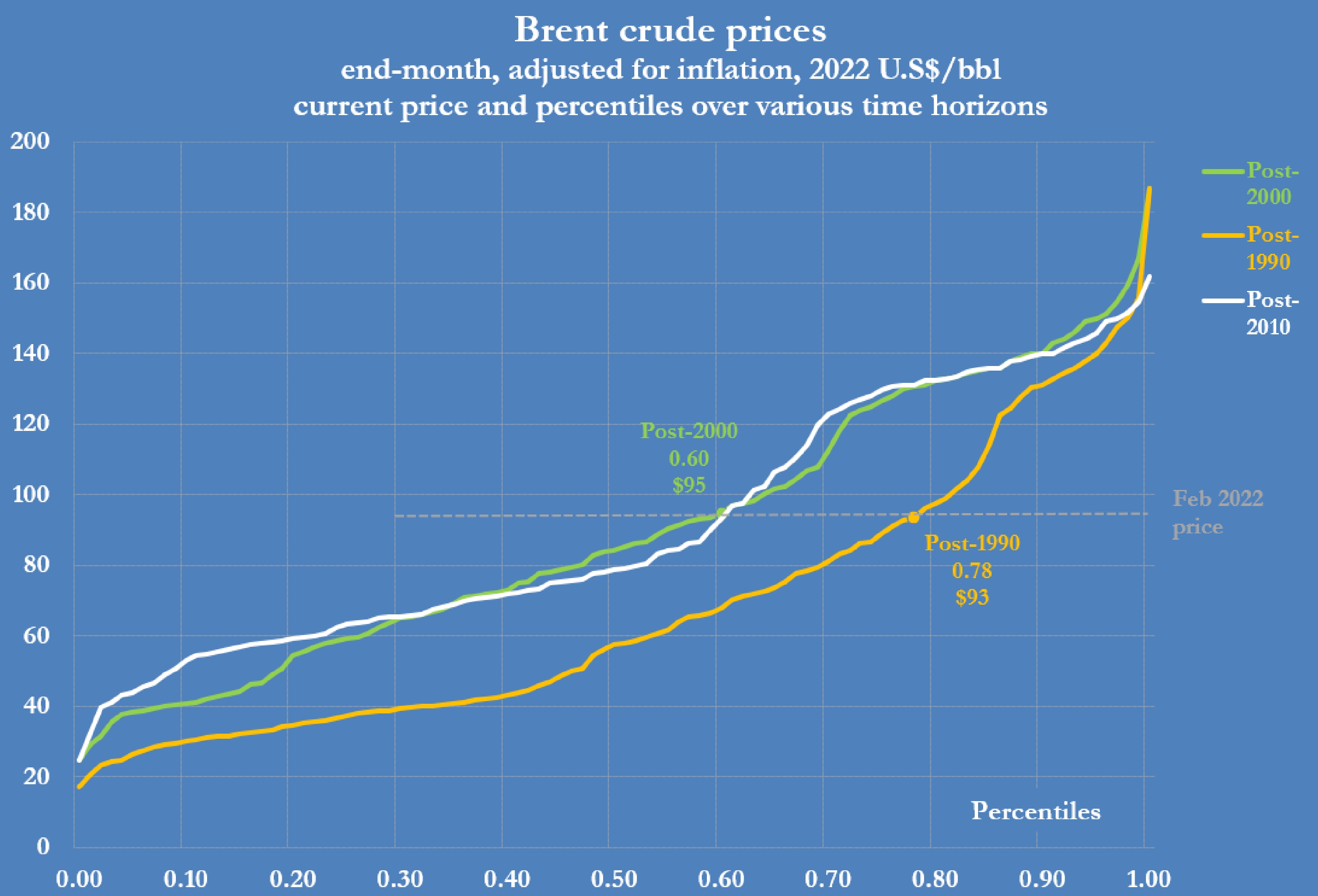
Real oil prices are fairly high but not extremely so in historic terms

Price in 60th to 80th percentile depending on time horizon used for evaluation



Source: ICE Futures Europe, U.S. Bureau of Labor Statistics

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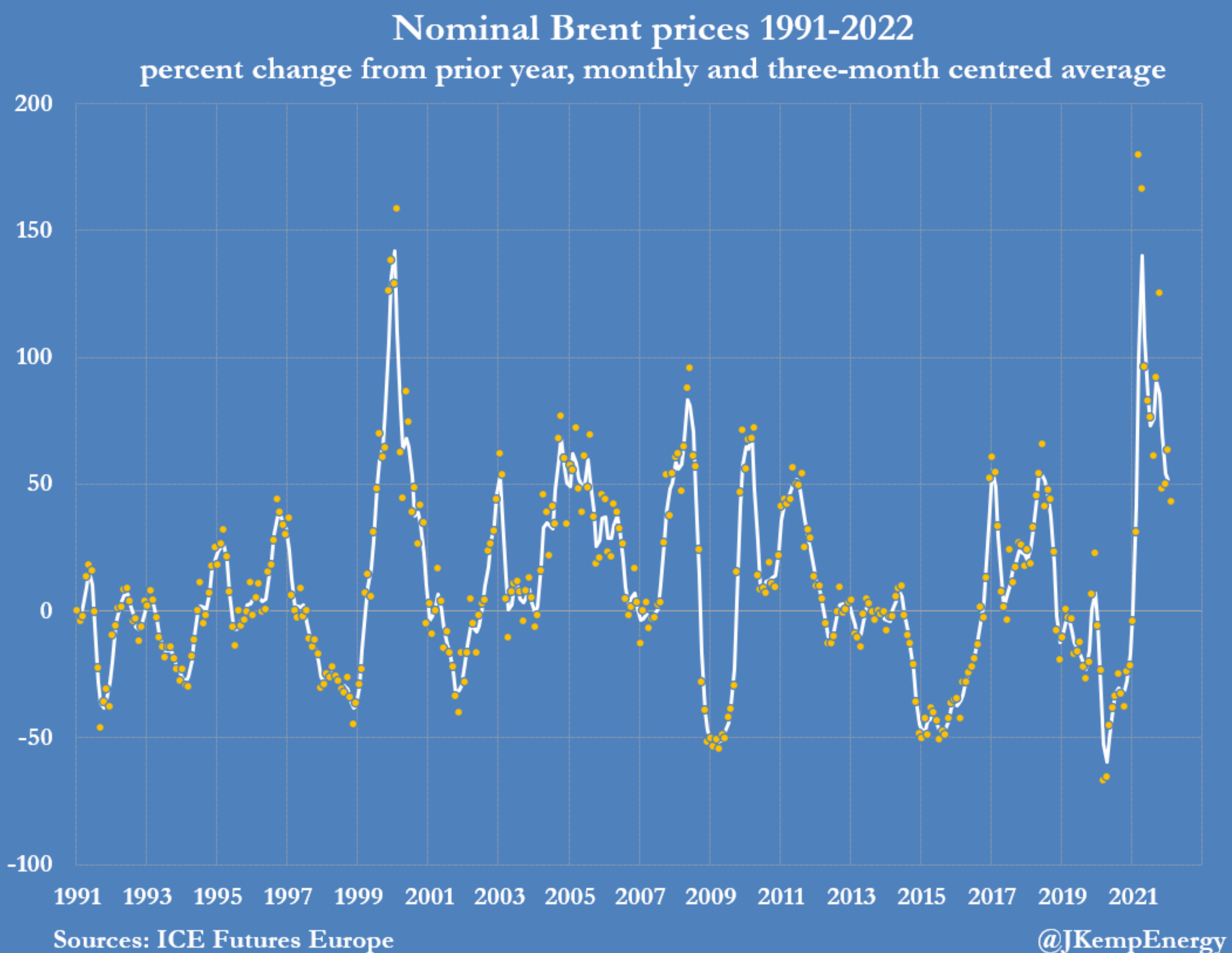
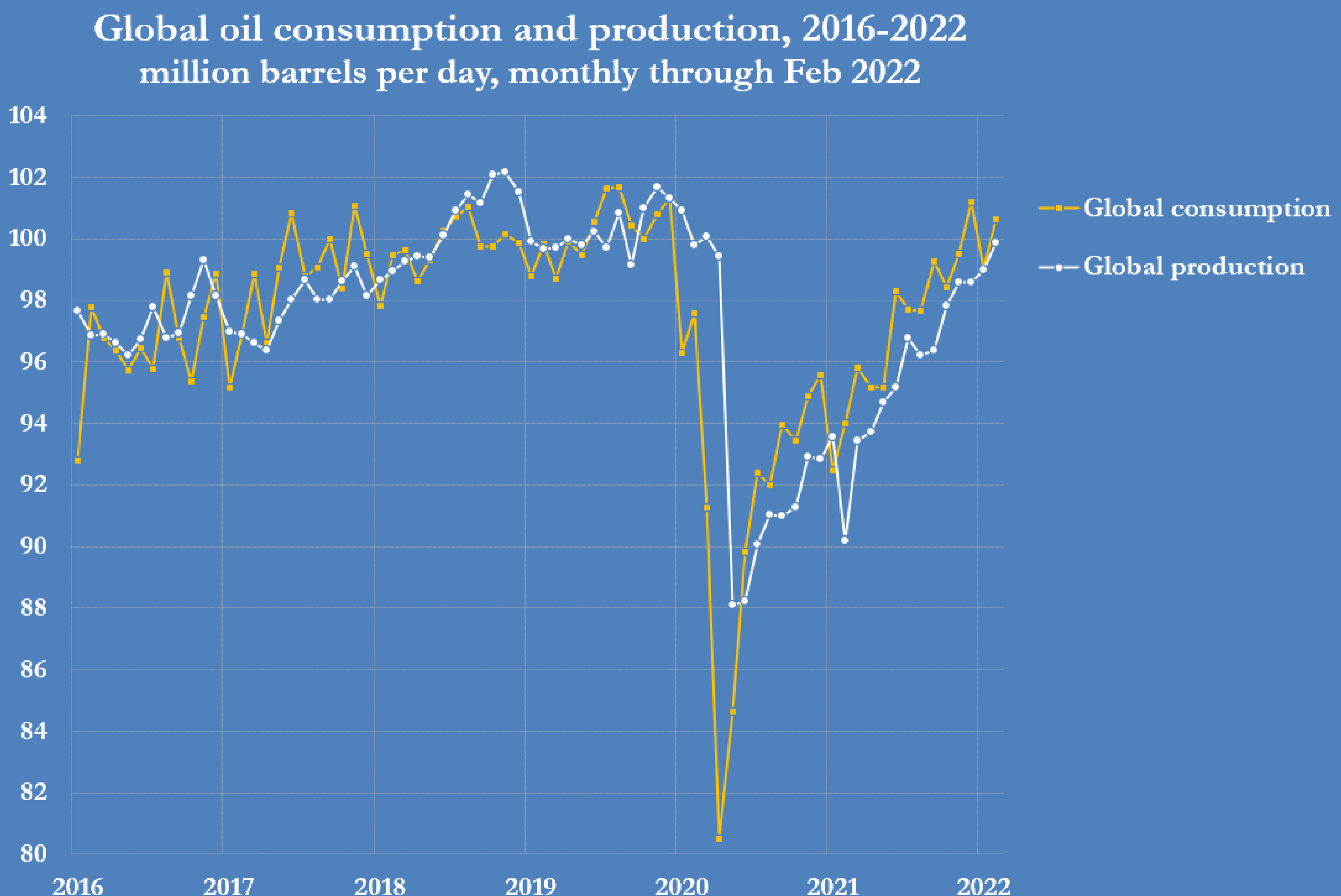
Oil prices exhibit strongly cyclical behaviour

Extreme slump in coronavirus recession followed by equally strong rebound



Consumption fell earlier/faster and has recovered more rapidly

Production changes lagged behind in both the slump and rebound



Source: U.S. Energy Information Administration

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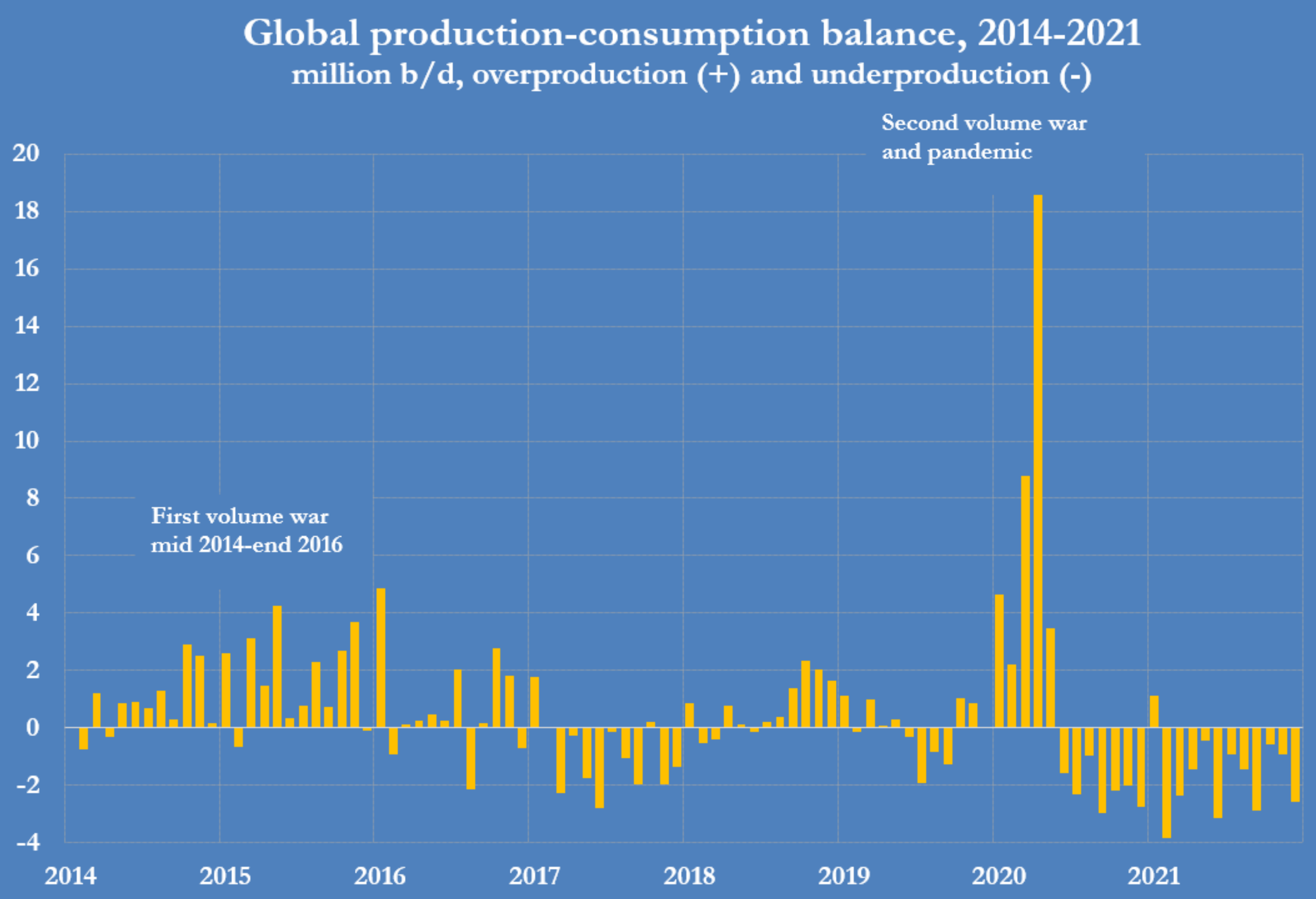
Massive production surplus during first coronavirus wave/lockdowns

Followed by production deficit every month except one since June 2020



Source: U.S. Energy Information Administration

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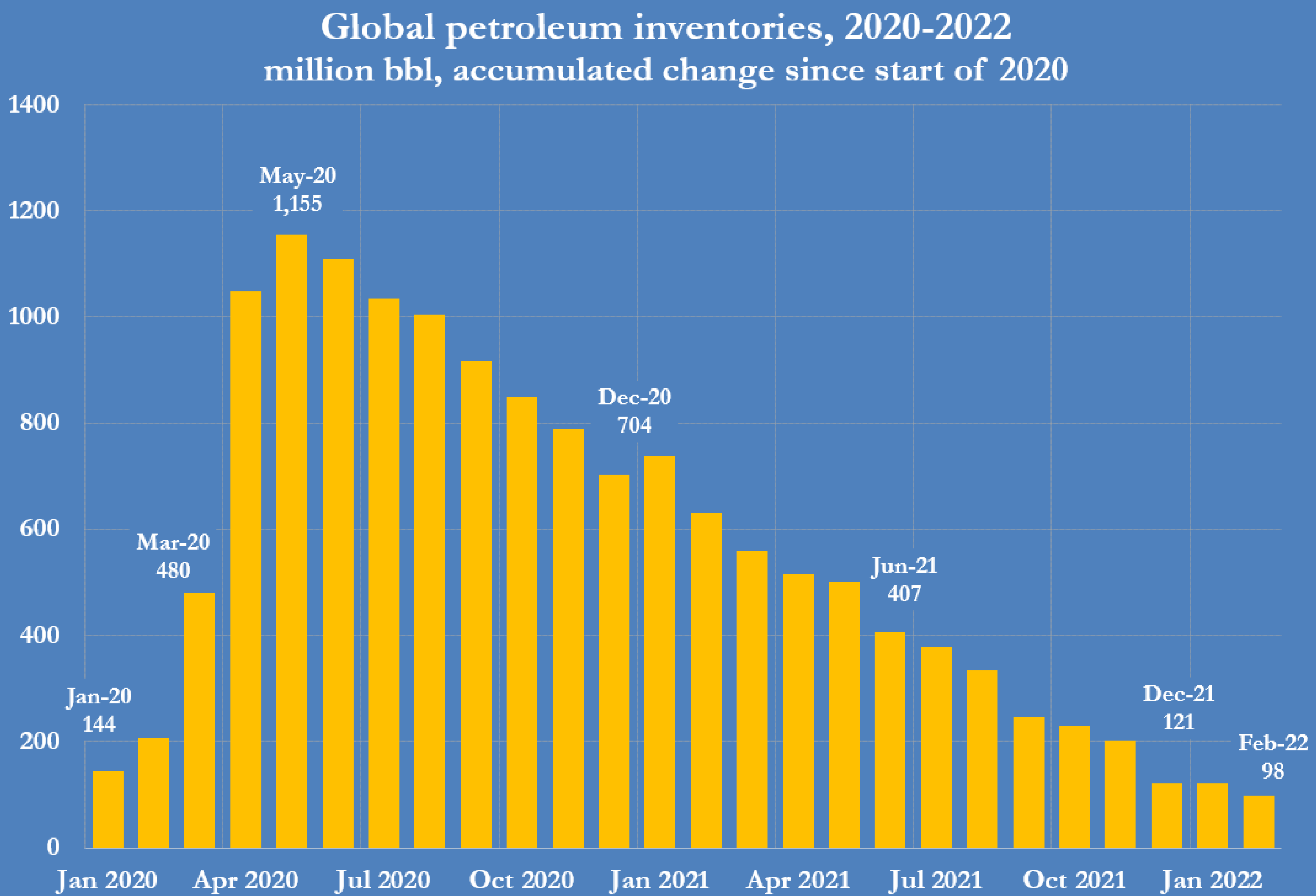
Global inventory accumulation of +1.2 billion bbl in Jan-May 2020

Followed by inventory depletion of -1.1 billion bbl since June 2020



Source: U.S. Energy Information Administration

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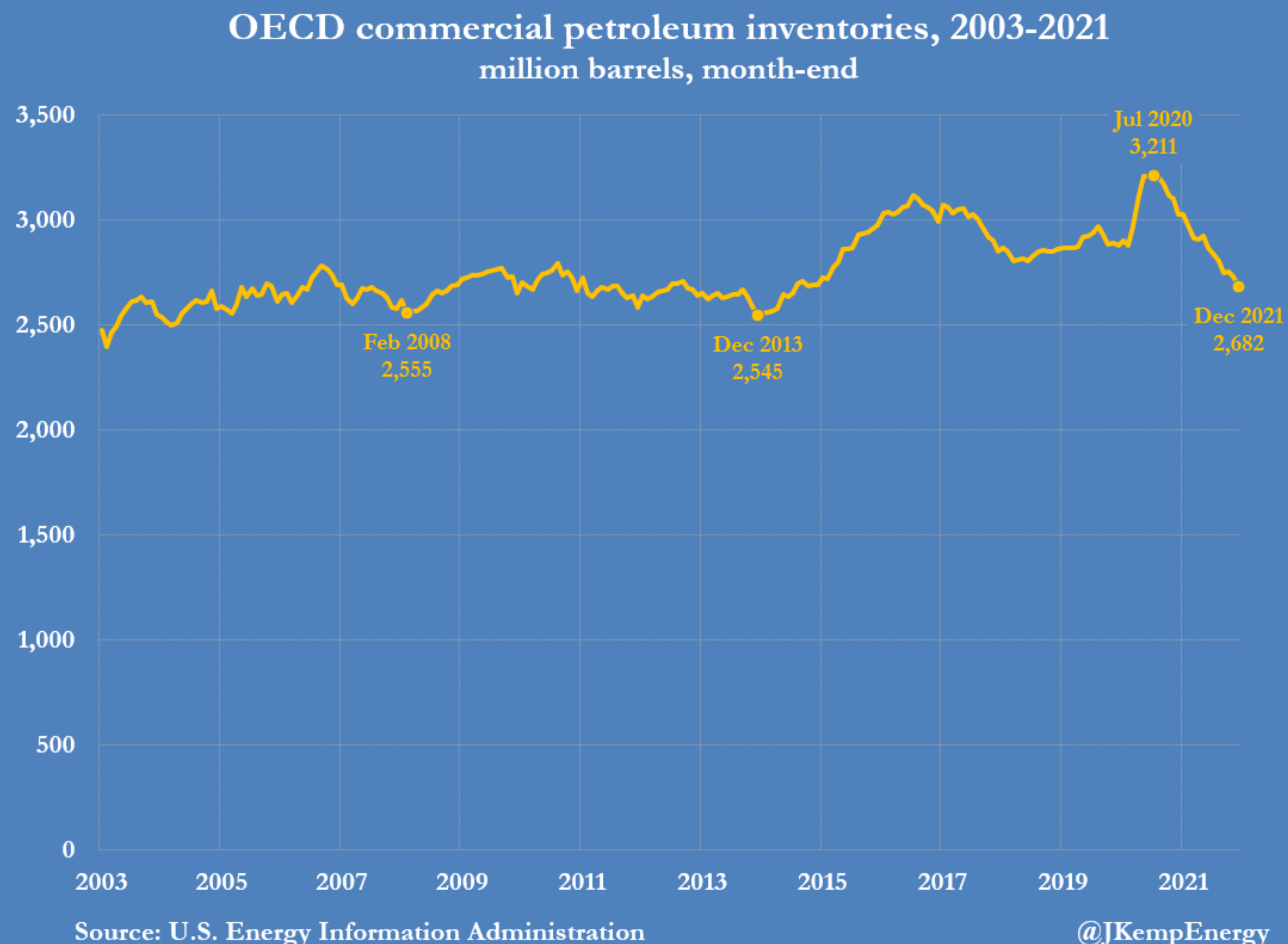
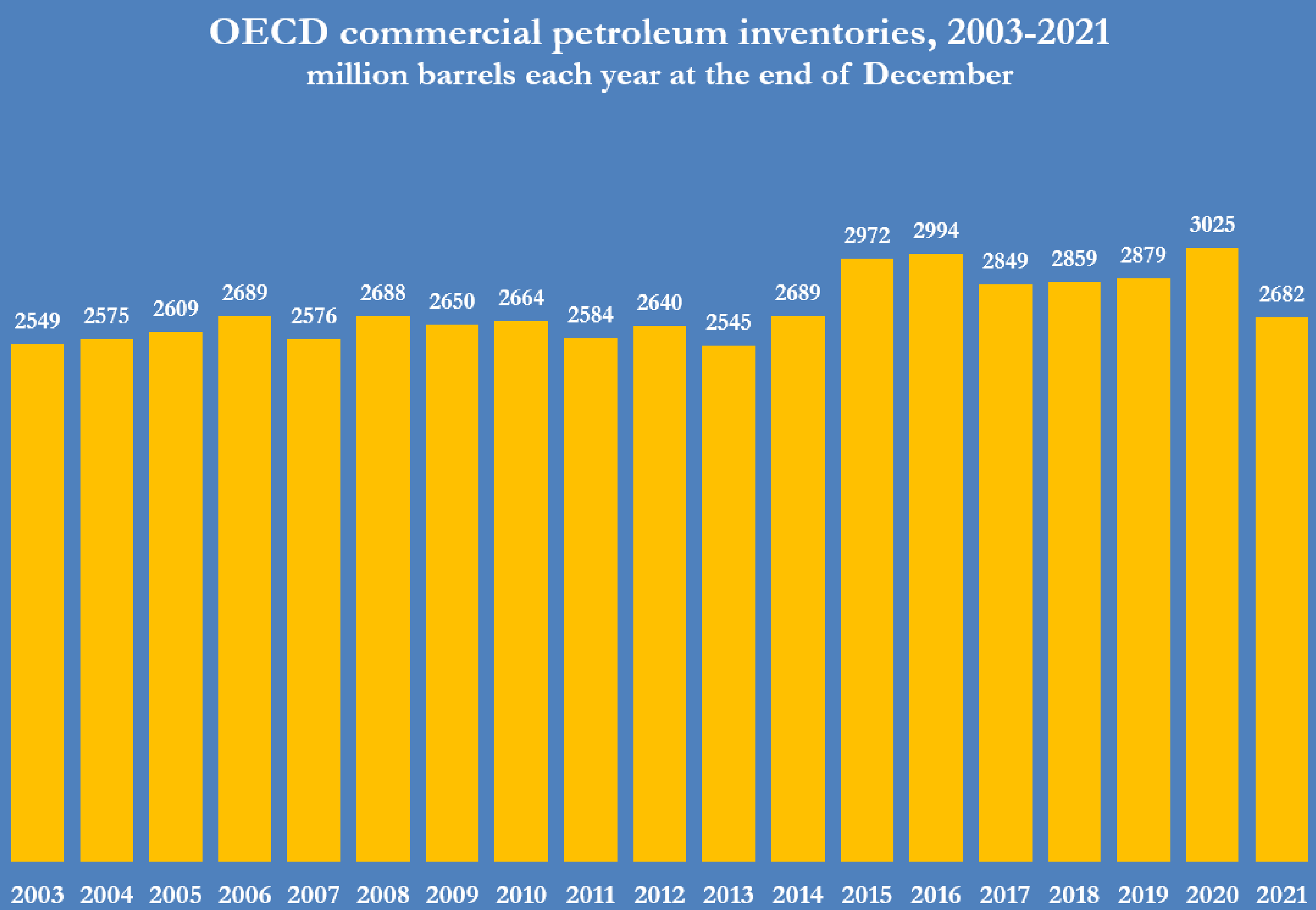
OECD inventory depletion is largest and fastest for decades

Market has been persistently under-supplied since June-July 2020



OECD inventories ended 2021 at lowest for time of year since 2013

Inventory drawdown at this rate is unsustainable



Source: U.S. Energy Information Administration

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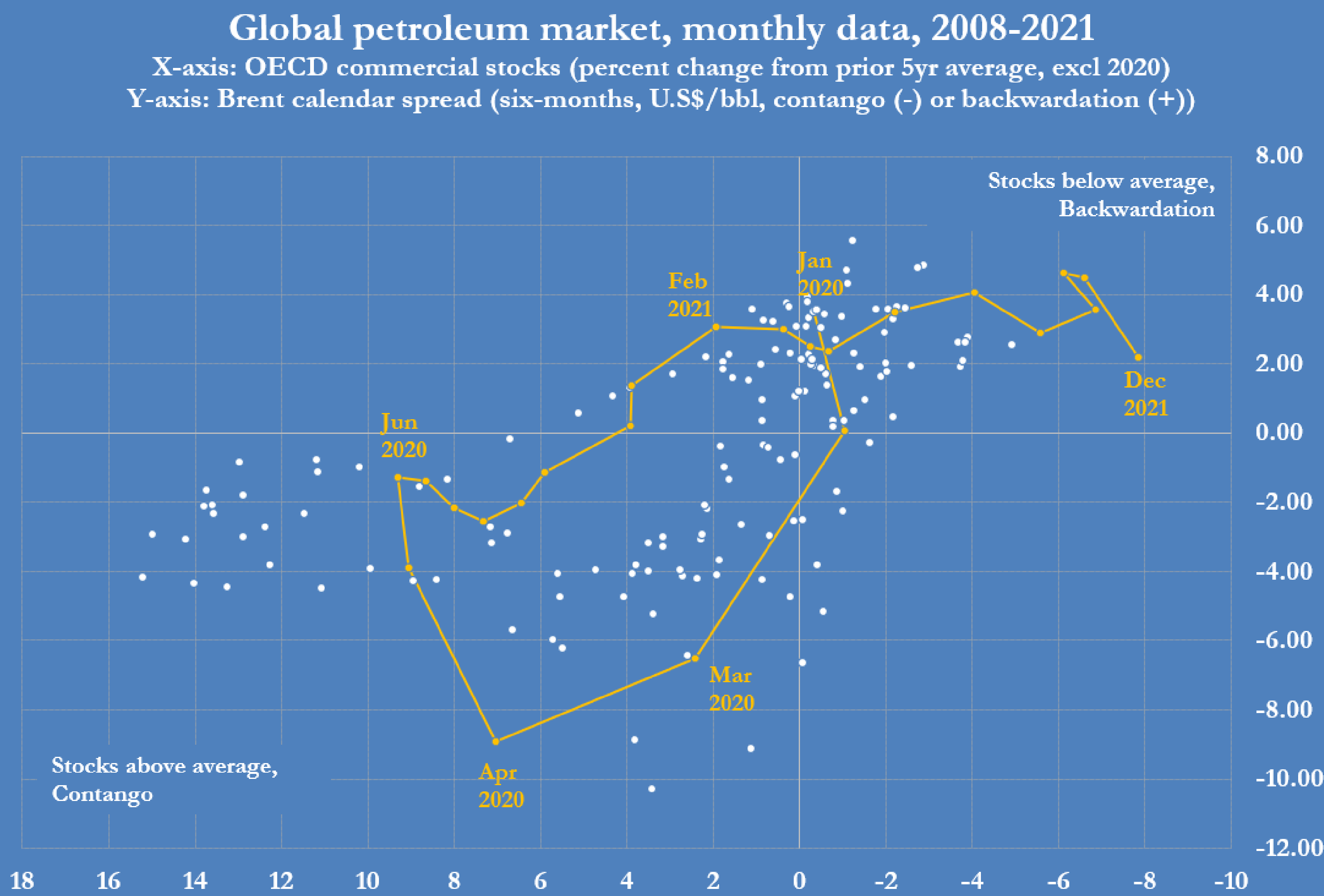
OECD inventories are -8% below pre-pandemic five-year average

Low and falling inventories have pushed futures curve into steep backwardation



Sources: U.S Energy Information Administration (Short-Term Energy Outlook), ICE Futures Europe
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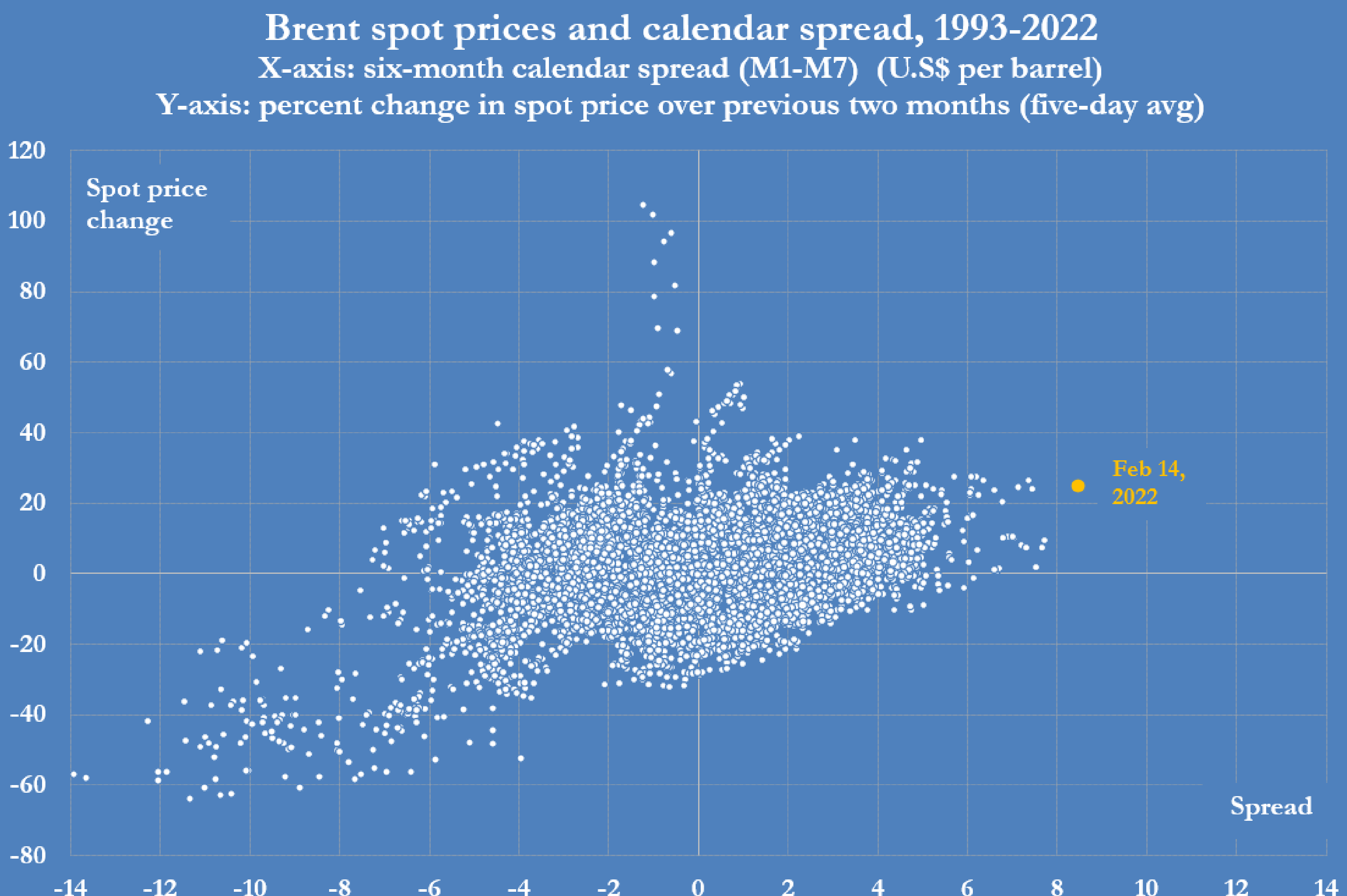
Oil inventories are tightest for decades

Spot prices escalating rapidly with futures in steep backwardation



Source: ICE Futures Europe

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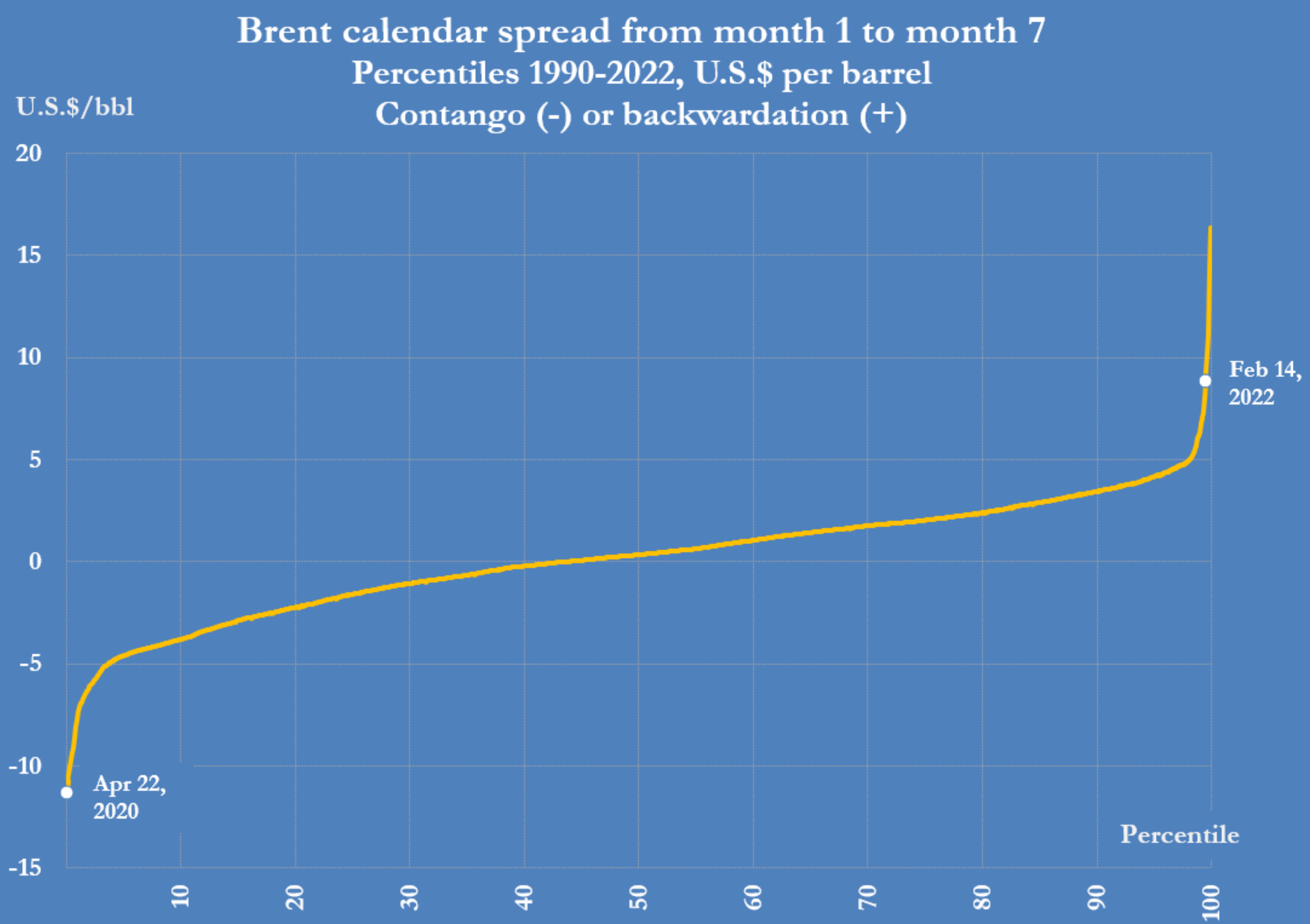
Backwardation correlates with fears about insufficient inventories

Brent's six-month backwardation in 99th percentile for all trading days since 1990



Source: ICE Futures Europe

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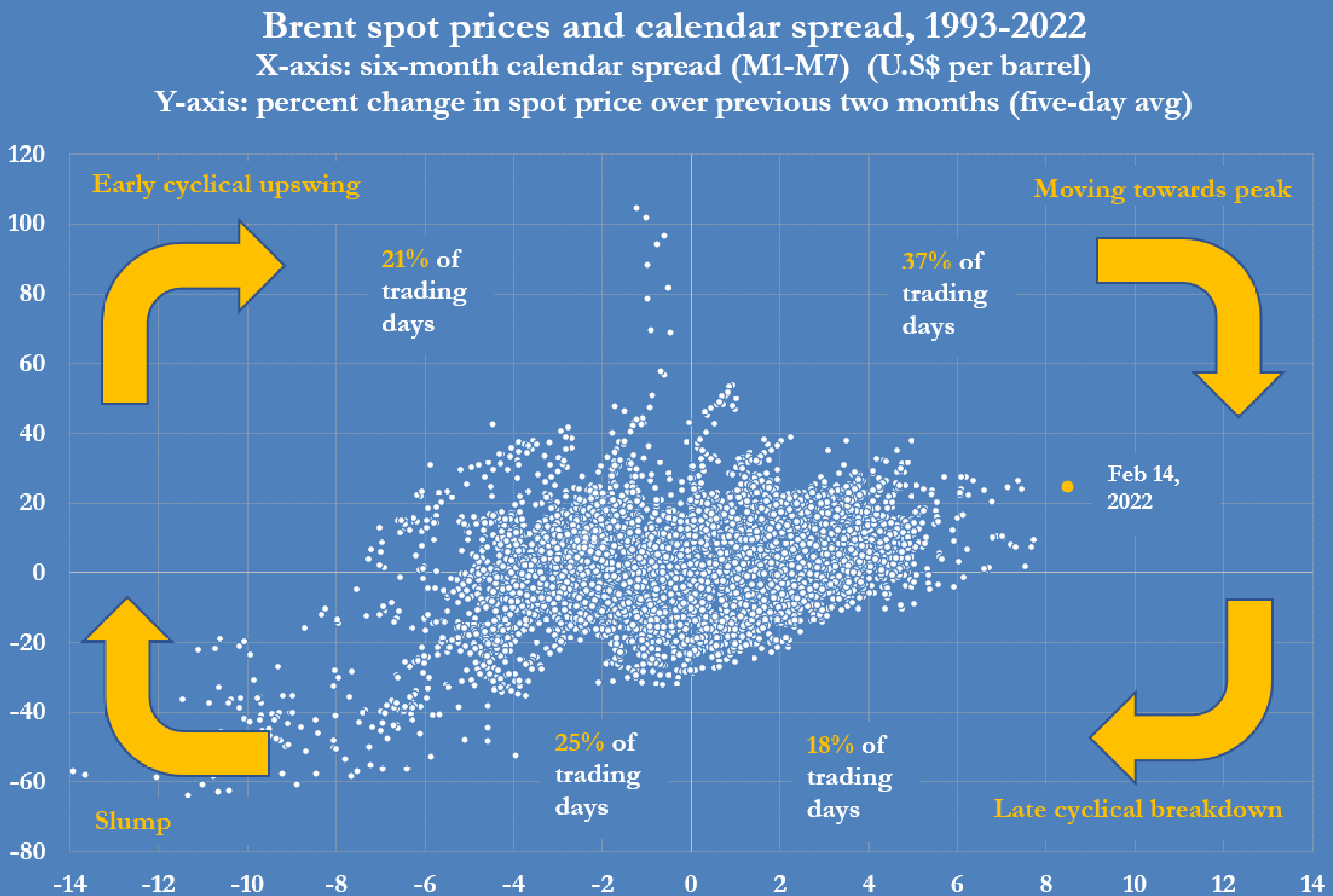
Oil market moving rapidly towards some sort of cyclical peak

But short-term, medium-term or long-term peak?



Source: ICE Futures Europe

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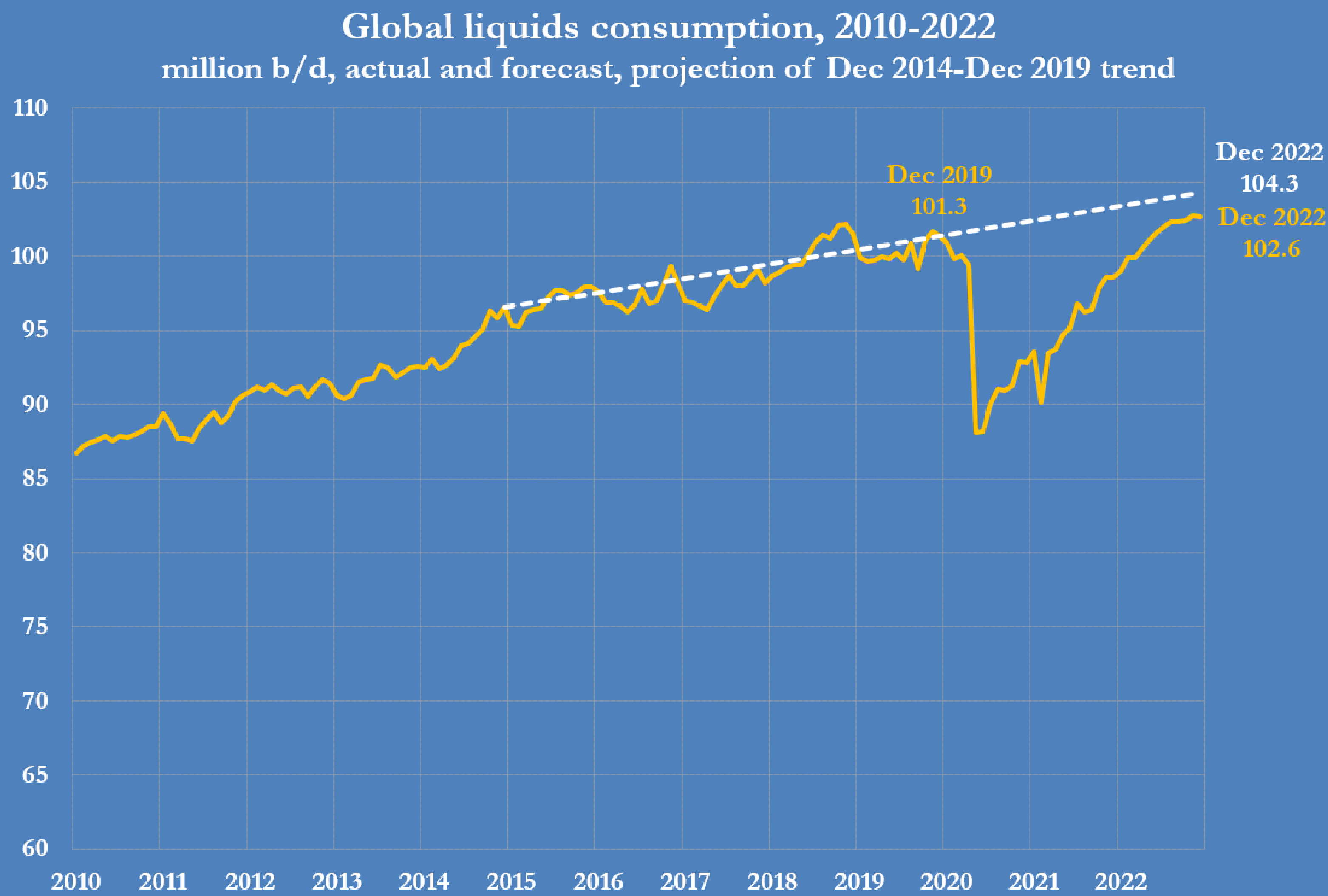
Global oil consumption is still below pre-pandemic trend

But global oil production is even further below trend



Source: U.S. Energy Information Administration ("Short-Term Energy Outlook", Feb 2022)
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Current rate of inventory depletion is unsustainable

If something cannot continue forever, it will stop — Stein's Law

Either production must grow faster and/or consumption must grow slower

Faster production growth scenarios

- **OPEC+**
- **U.S. shale producers**
- **Non-OPEC non-shale**
- **Iran and Venezuela sanctions eased**

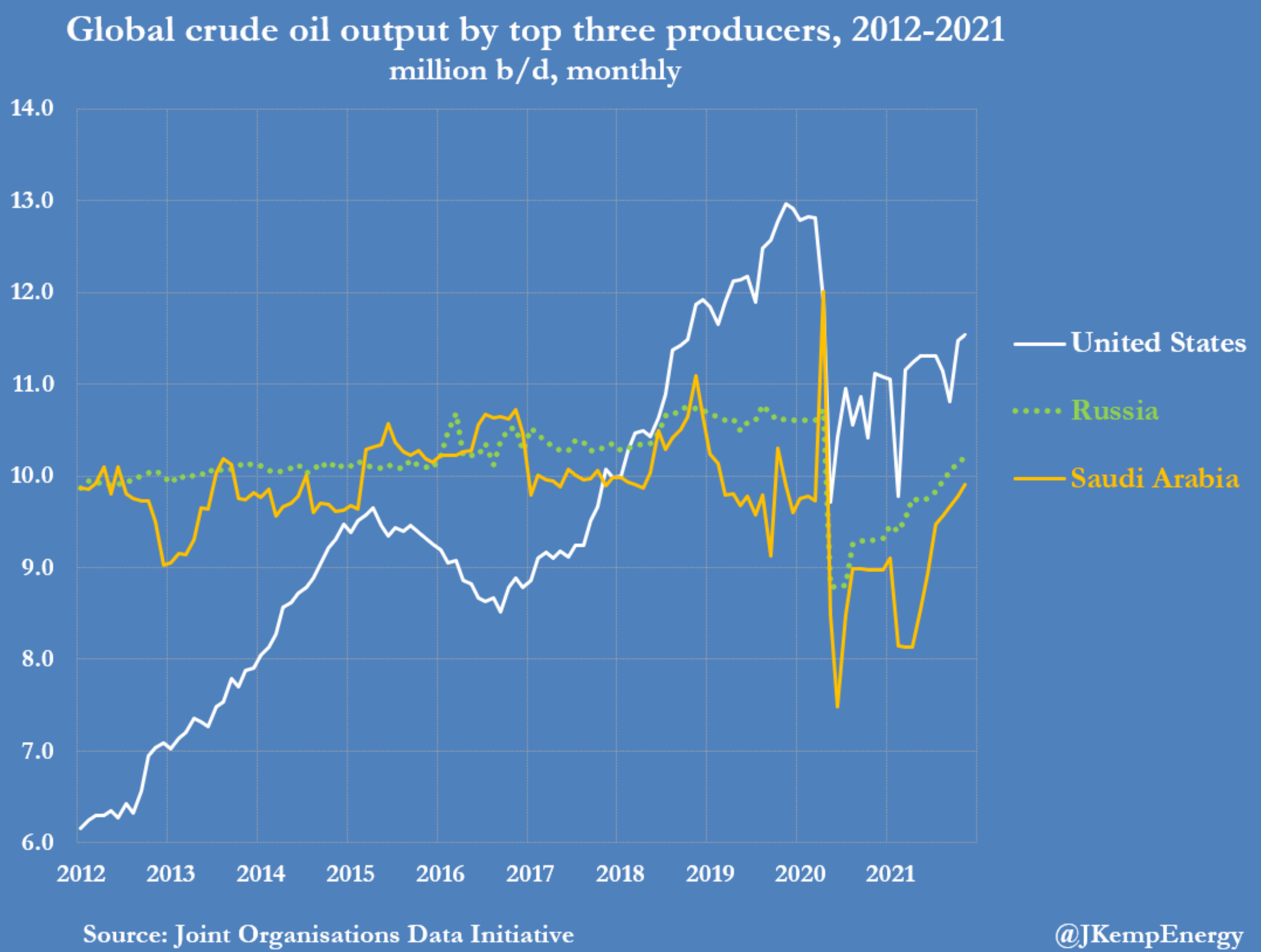
Slower consumption growth scenarios

- **High prices restrain demand?**
- **Spontaneous business cycle downturn?**
- **Federal Reserve forces cyclical slowdown?**
- **China experiences cyclical downturn?**

Some or all these scenarios must occur in 2022/23

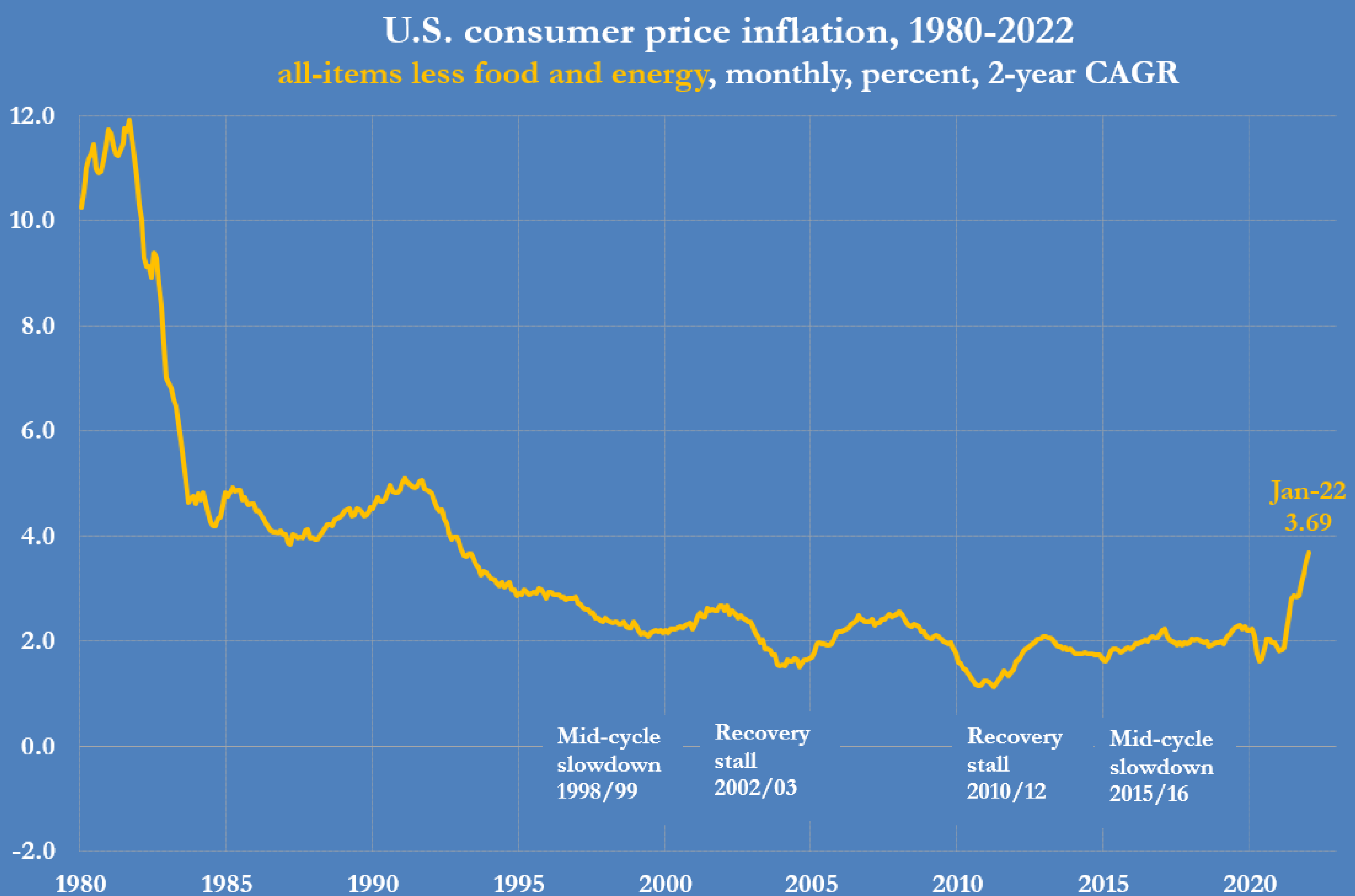
Faster production growth would have to come from U.S. shale or Saudi

Easing sanctions on Iran and/or Venezuela could also help



U.S. core inflation running at fastest rate since 1993

Federal Reserve shifts from supporting recovery/jobs to controlling inflation



Source: U.S. Bureau of Labor Statistics

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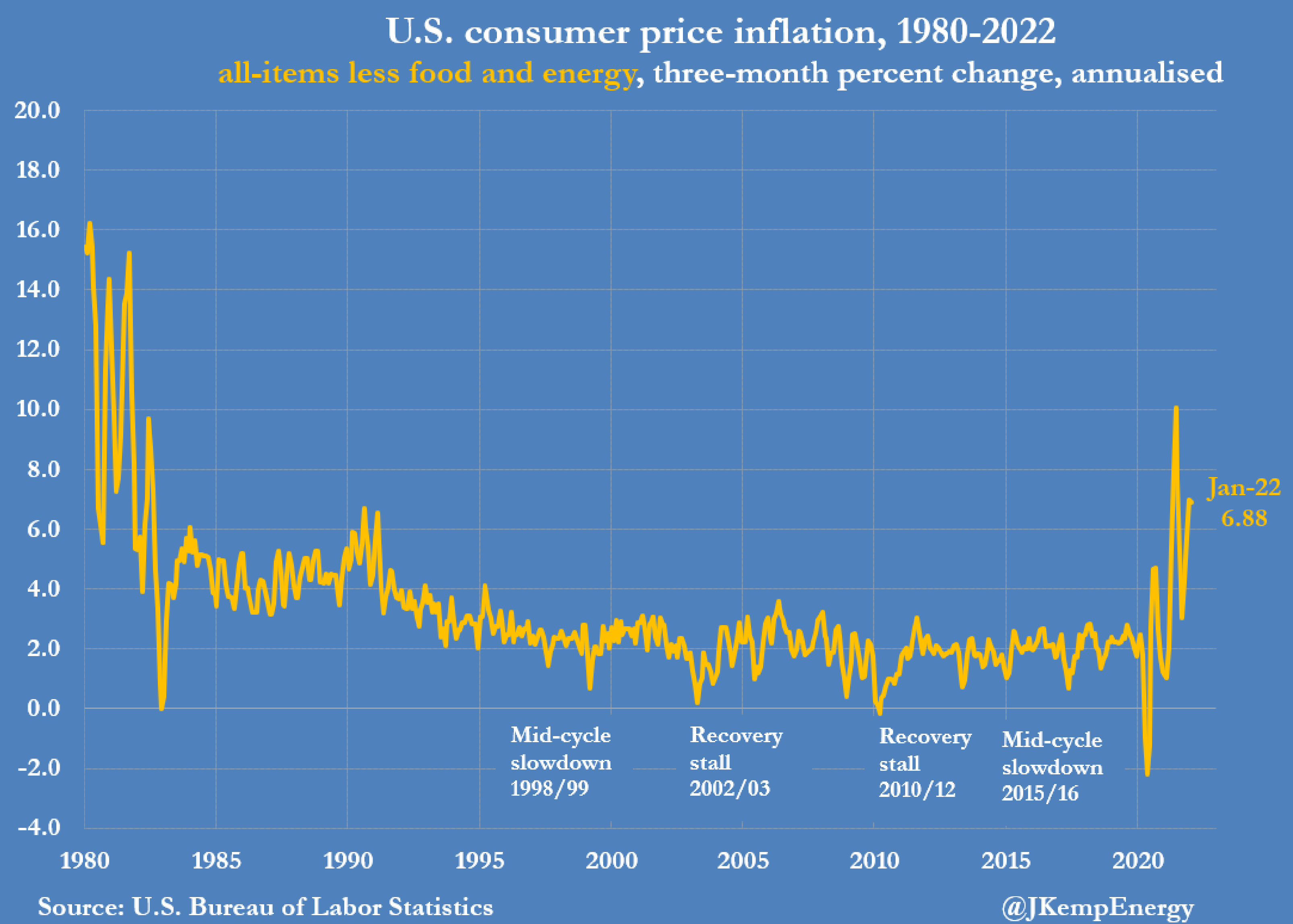
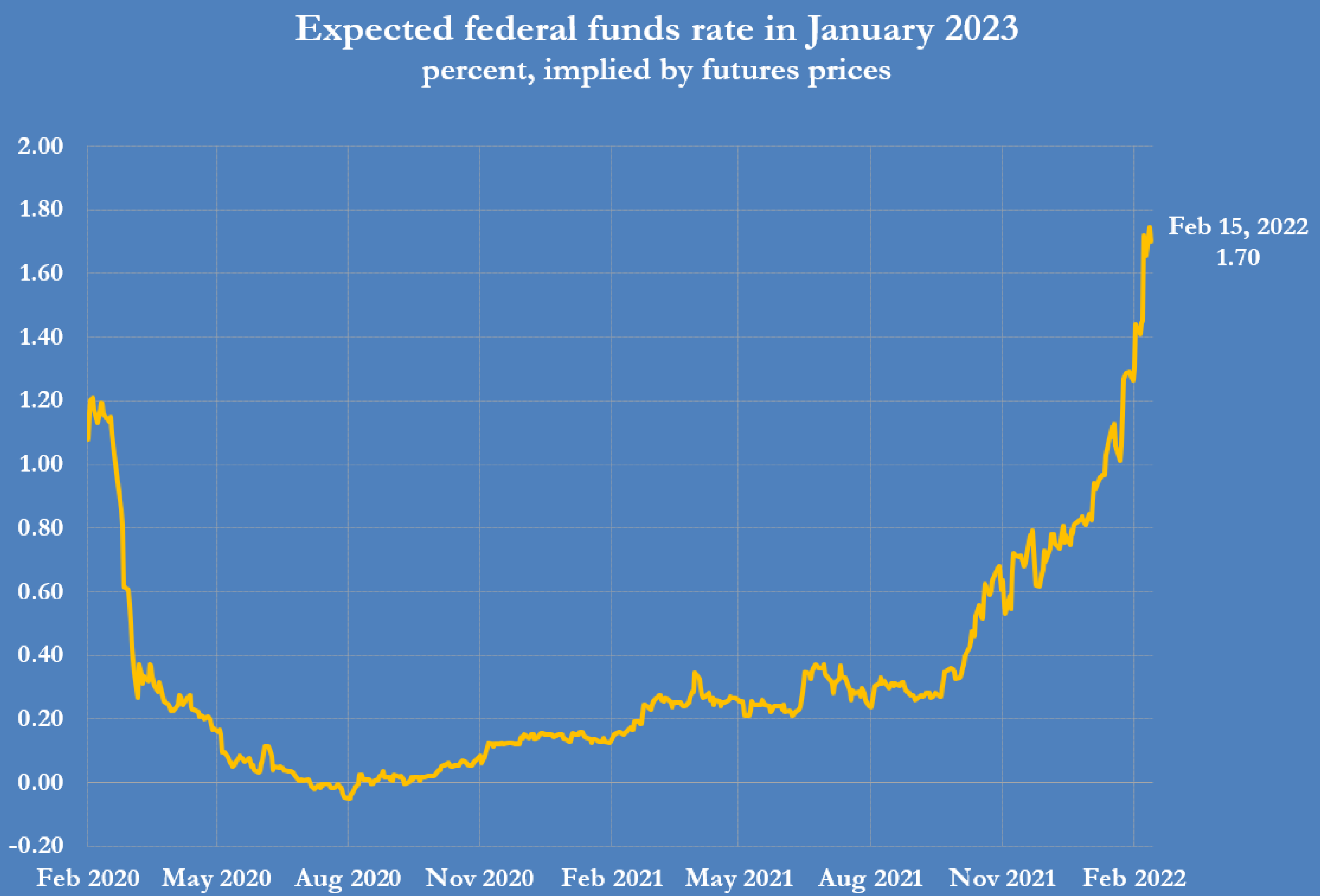
Inflation is accelerating – transient threatens to become permanent

Upward pressure on prices likely to intensify as business cycle matures



Fed expected to raise interest rates by 1.5 percent points this year

Six-quarter point increases (or equivalent) before the end of 2022



Source: CME Group

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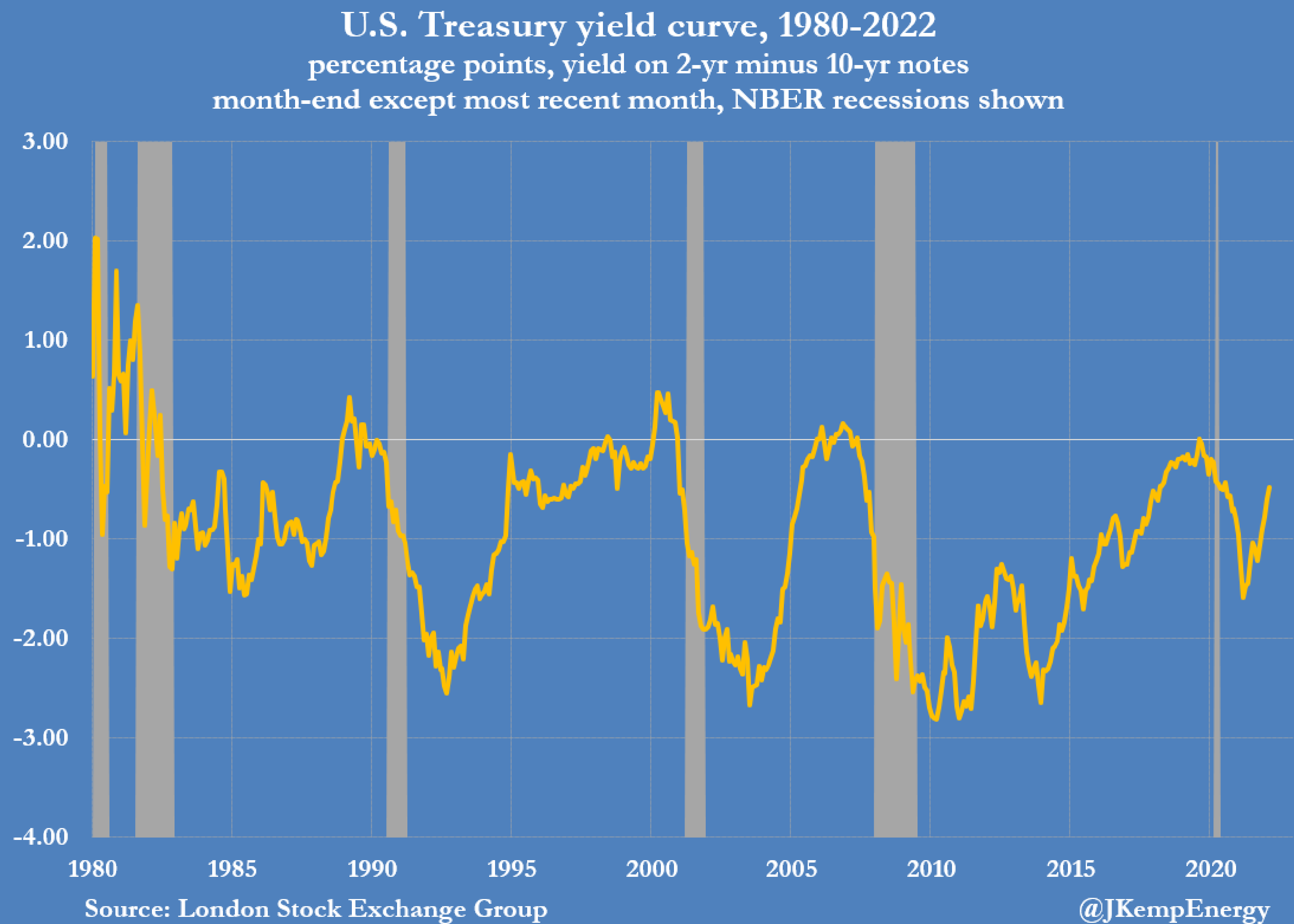
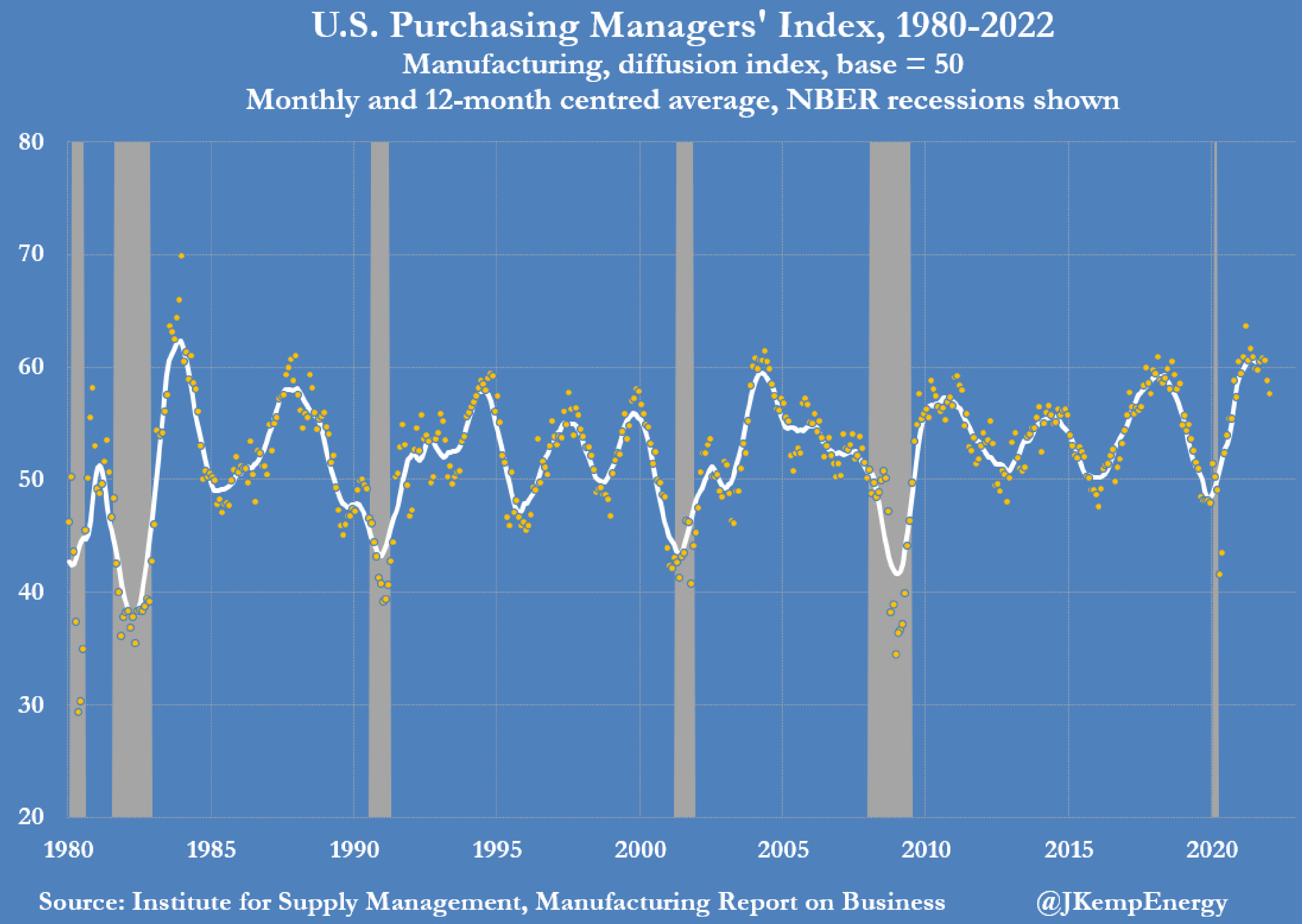
U.S. Treasury yield curve flattening – cyclical slowdown ahead

End-of-cycle recession or mid-cycle slowdown?



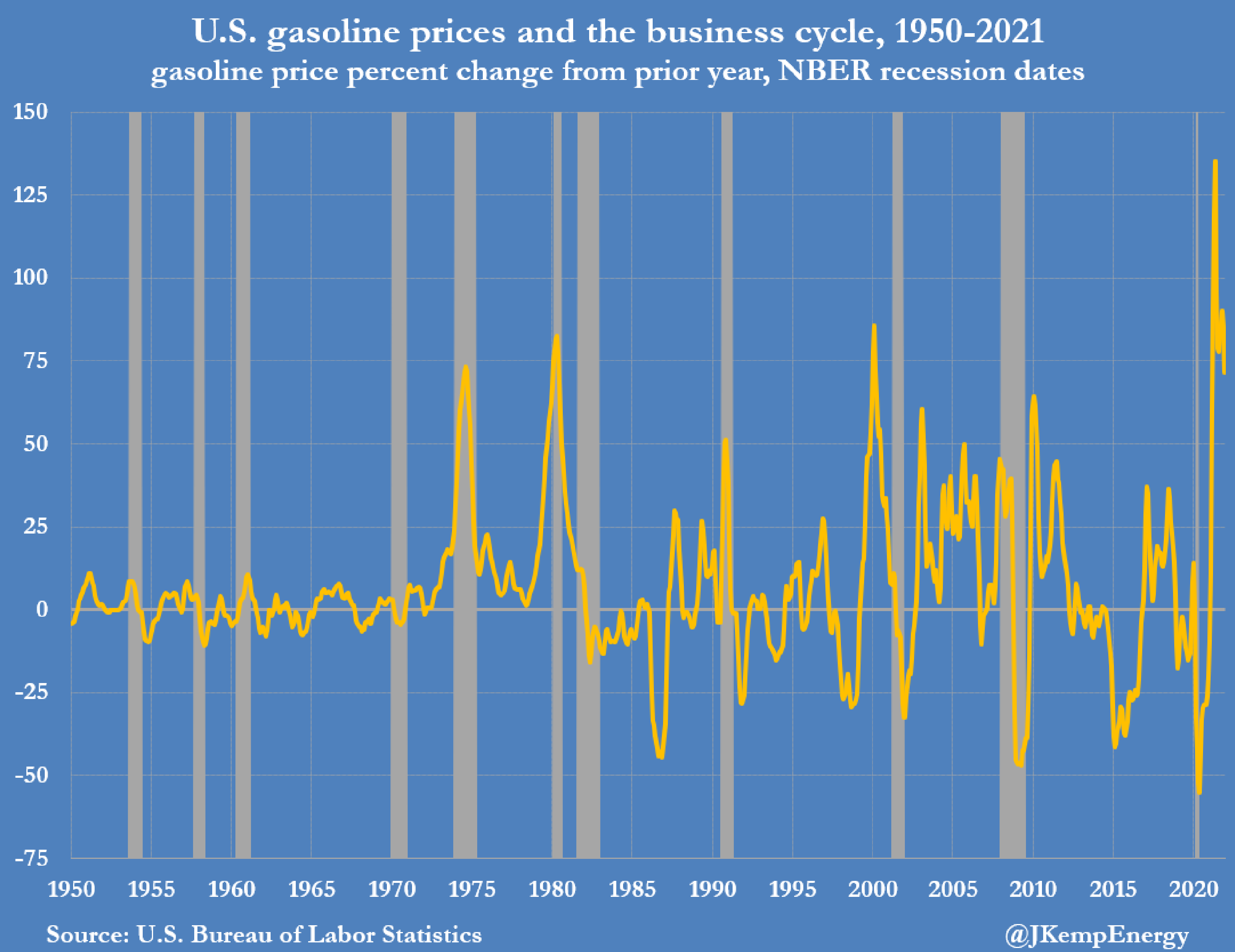
Manufacturing and freight growth is decelerating

Slower growth ahead after frenzied re-opening following coronavirus recession



Oil prices are strongly pro-cyclical

Recession or mid-cycle slowdown normally required to bring prices down

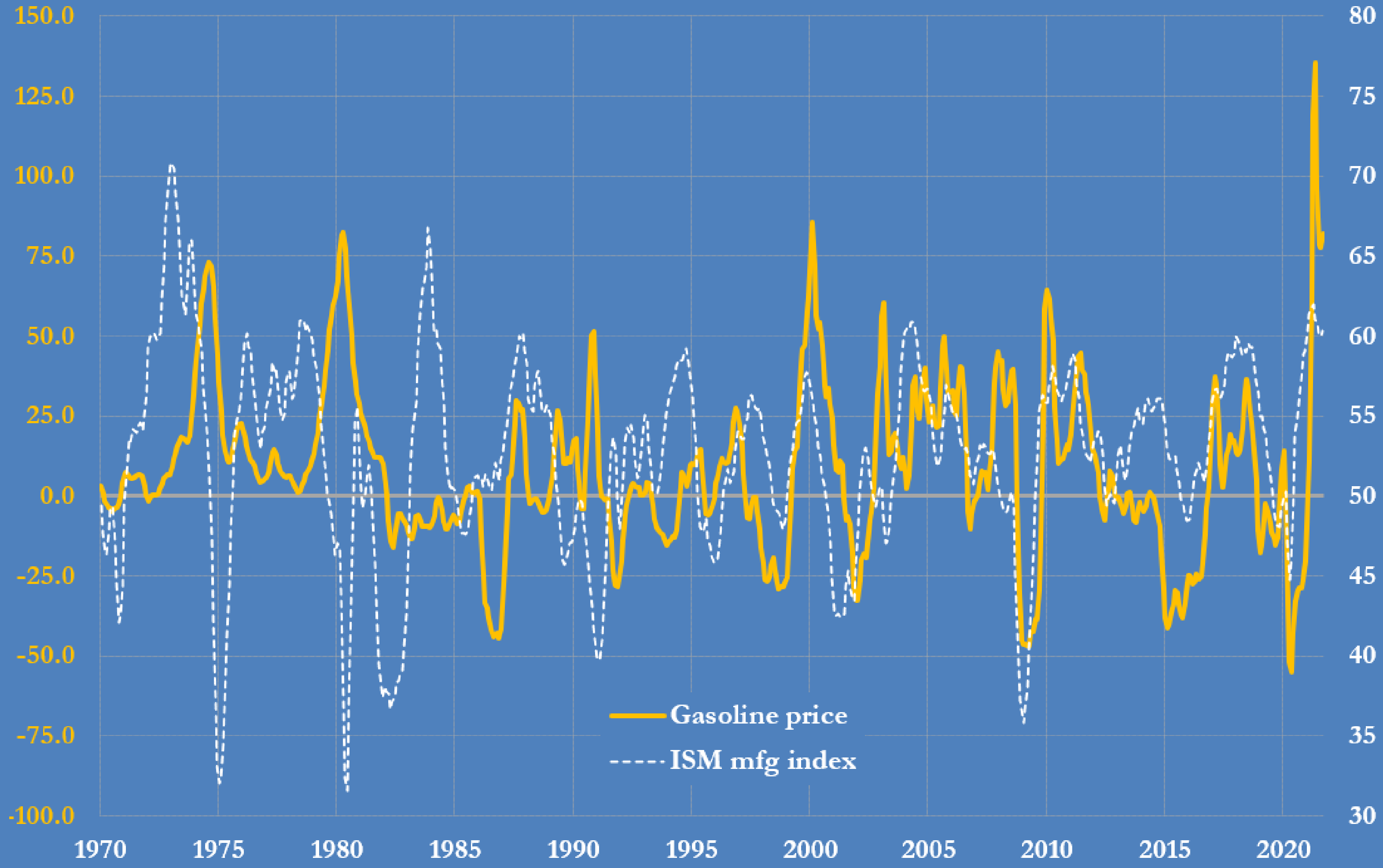


Oil prices track business cycle

Prices are likely to continue rising until U.S. business cycle slows

U.S. gasoline prices and the business cycle, 1970-2021

gasoline price percent change from prior year, ISM manufacturing index



Source: U.S. Bureau of Labor Statistics

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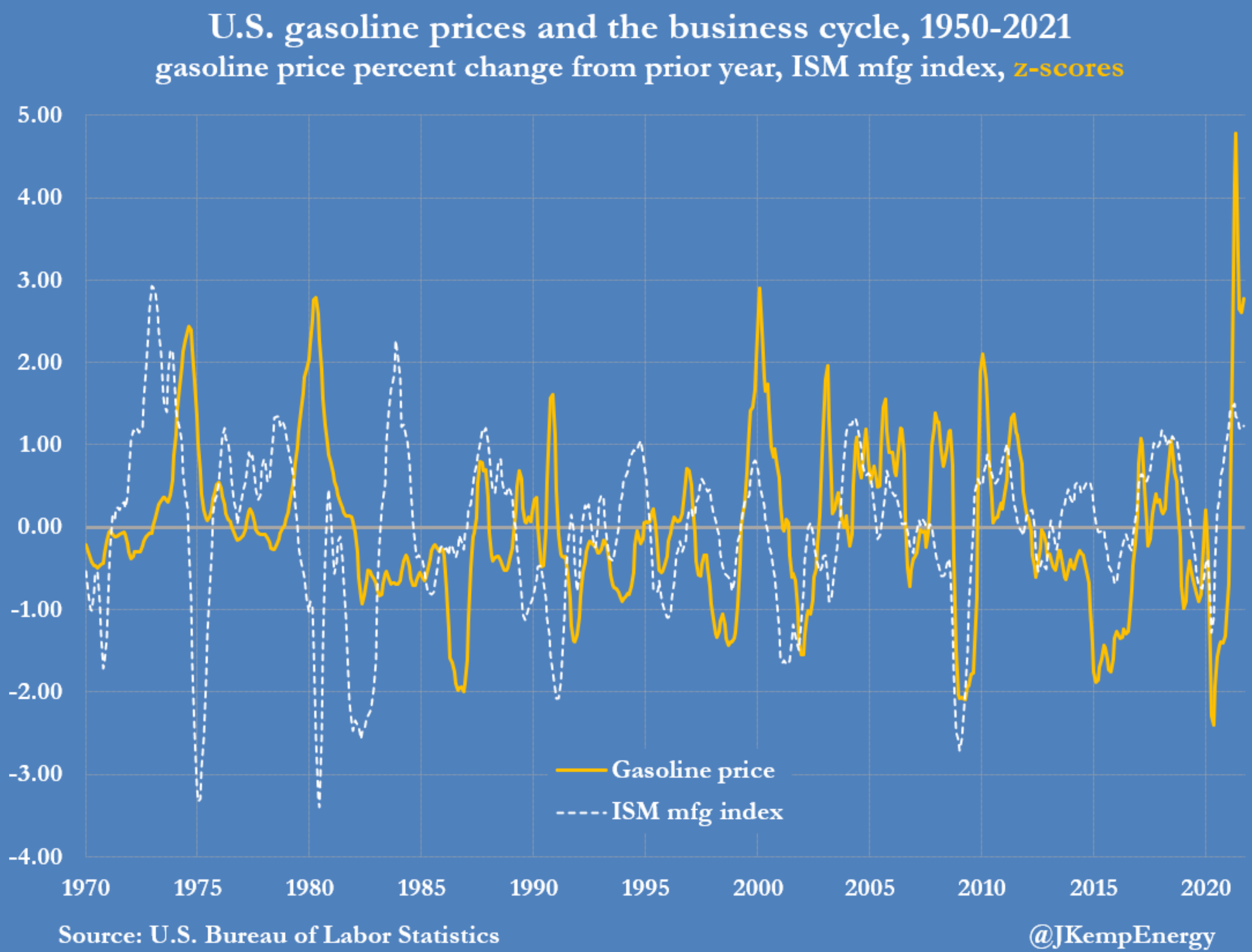
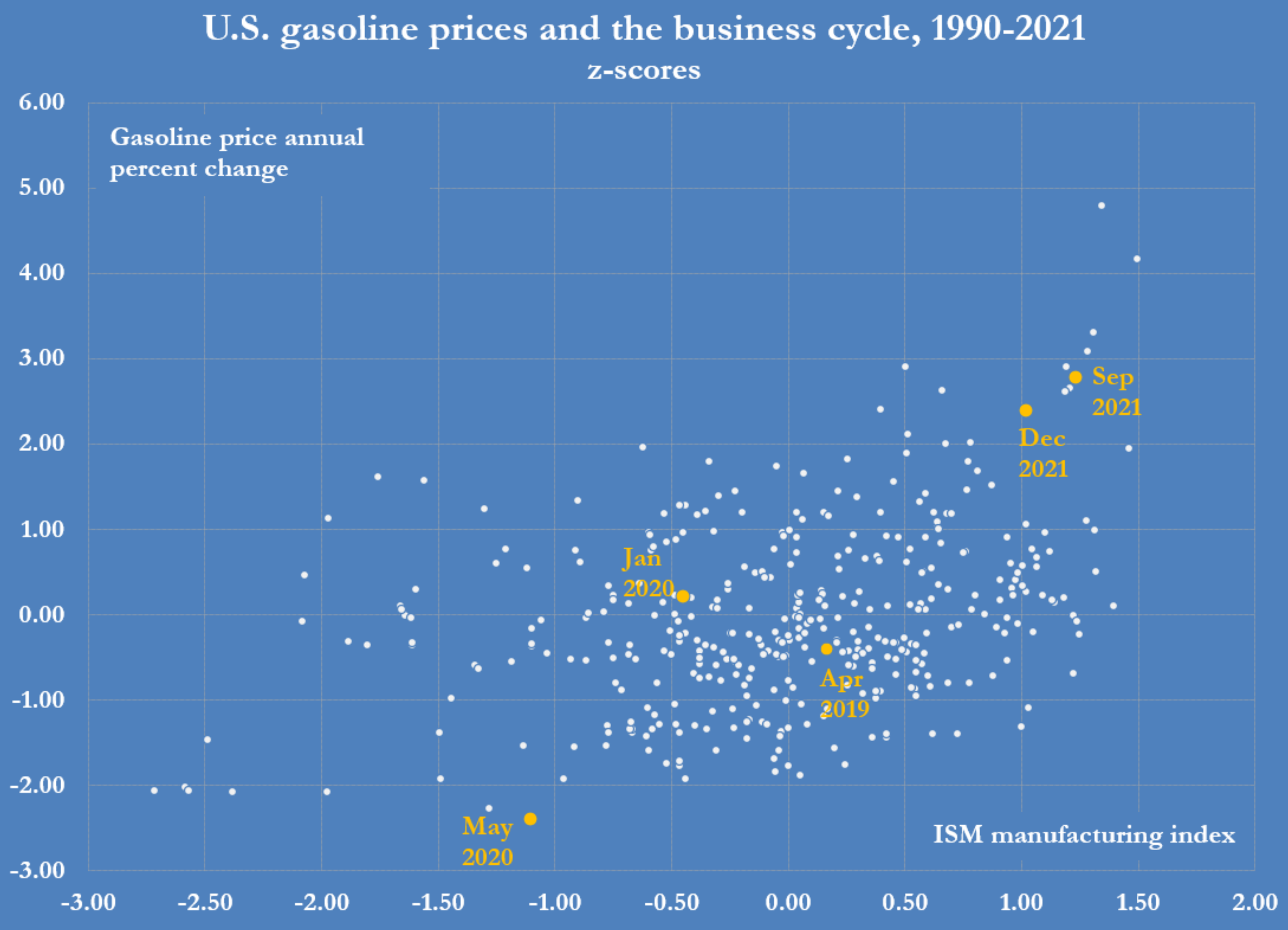
Oil prices likely to continue rising and add to inflation

Can Fed engineer a soft landing (mid-cycle slowdown) and avoid hard landing (end-of-cycle recession)?



Soft-landing implies moderate growth and stable oil prices

ISM manufacturing index in low 50s, oil and gasoline prices roughly flat on year



Source: U.S. Bureau of Labor Statistics, Institute for Supply Management

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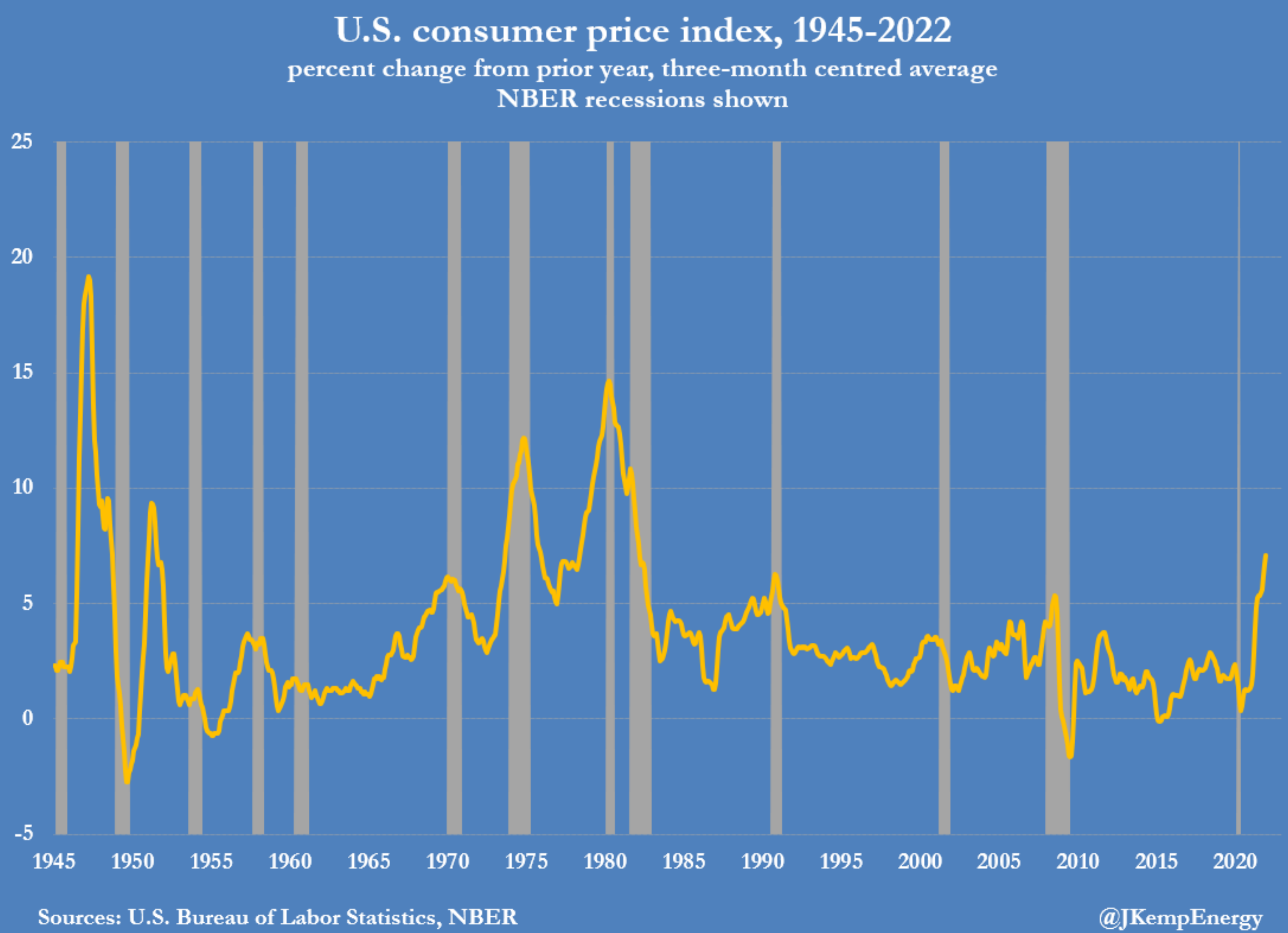
Soft-landings are hard to achieve – will this time be different?

On last five occasions when inflation peaked above +5.0% per year, a recession ensued when Fed tried to bring price increases under control



Thank you for listening

If you would like a copy of the slides please email me and I will send the chartbook: john.kemp@thomsonreuters.com

If you would like to receive a daily digest of best in energy news + my own research notes, you can add your email to the circulation list using this link: https://eepurl.com/dxTcl1

All data was current as of February 16 – and in most cases the most recent month was either Jan 2022 or Dec 2021