Oil & Gas

Energy Research Strategy

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Demand expectations dominate oil market

In late April and early May, oil prices unexpectedly fell sharply after the market assessed the risk of further escalation of the tensions in the Middel East as low. Now the oil price has stabilised around USD 83 per barrel of Brent oil. This Market Update takes a detailed look at how expectations about global oil demand and macroeconomic figures impact the oil market. As markets react to deviations between actual figures and market expectations, sentiment plays a major role in this. Demand trends and expectations are important in the OPEC+ decision on production cuts, which is expected on 1 June.

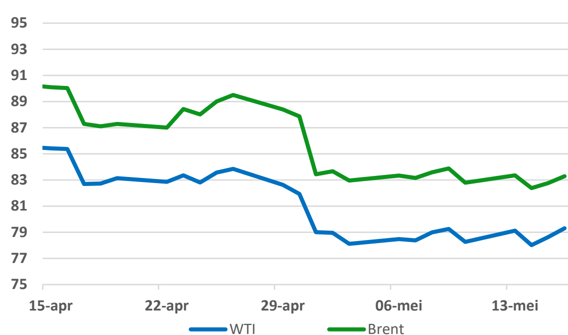
The monthly TTF gas price contract is hovering around EUR 30/MWh. Norwegian gas supplies to Europe are again significantly higher than in recent weeks, although scheduled maintenance is due to take place again this week. Norway supplies about 30% of European gas demand, the risks of which are highlighted in this Market Update. In addition, having the US as the largest LNG supplier also brings risks. Finally, there are some points in the new negotiation agreement that could eventually affect the gas market.

Oil price stabilises after rapid fall

In late April and early May, oil prices fell hard. Currently, the price has stabilised and the market is moving sideways, where a barrel of Brent oil now costs around USD 83, about USD 5 more than for WTI, the US benchmark.

Oil price stable around USD 83/barrel

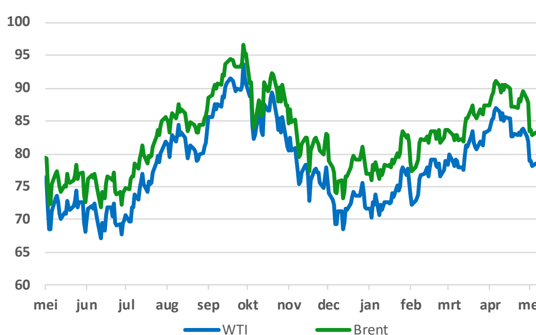
USD/bbl



Source: LSEG Eikon

Annual progress

USD/bbl



Source: LSEG Eikon

First, the rapid price drop earlier this month. This came rather unexpectedly, after oil prices had been trading around USD 90/barrel for much of April, and for a while even seemed to shoot through to USD 100/barrel. This was mainly due to rising tensions in the Middle East, including direct attacks by Iran on Israel and vice versa. The same region was also largely responsible for the rapid fall in prices that followed. The risk of further escalation between Iran and Israel was rated low by the market after the direct confrontation. Added to this were reports that a potential ceasefire was in the air between Israel and Hamas. Together with disappointing macroeconomic figures - which we will elaborate on later in this Market Update - this led to a downward correction in oil prices in late April.

Global oil demand: the market expects a decline that is not there

Our Market Updates often address factors such as geopolitical events, production decisions by oil-producing countries (OPEC+, the US), or other shocks to global supply in the oil market. The developments described above on the situation in the Middle East have a major impact on the oil

market and are thus a good example. In addition, demand-side developments are also an important factor. Here a distinction is made between what the actual impact is and what expectations about demand developments do to the price.

To get an idea of demand in the short term, the market looks at the (expectation regarding) consumption of petroleum products. For instance, low demand for diesel is seen by market participants as a factor this year. Although this is mainly due to the mild winter and the increasing market share of biodiesel, rather than economic decline, figures showing a drop in diesel consumption have a significant impact. This in turn was offset by growth in petrol and paraffin consumption in 2024, fuelled by a record amount of internal combustion engine road and air miles.

Besides consumption and production figures of oil products, macroeconomic data also has an impact on the oil market. Figures from major oil consumers - such as net importers China, the US and the EU - can create movements in the oil market. Especially if these figures deviate significantly from the average. These are figures that show economic growth, or, for example, employment rates, industrial production, and consumer confidence. The idea here is that if these figures show a more positive picture of the economy, this will lead to more oil consumption. Expectations that this consumption will pick up may already result in higher prices.

So, while macroeconomic data can indeed be indicative of changes in oil supply and demand, much of its impact on the market is sentiment-driven. Positive figures - for example, if they are above analysts' expectations - give investors and market participants confidence that oil demand will start or continue to grow in the medium term. The opposite is also true, where disappointing figures can give the idea that oil demand may well weaken. The actual figures are compared with market expectations (and not necessarily always with the previous period's figures), and that is the measure of a disappointment or a positive surprise.

The dip in oil prices - which we often see after announcements of disappointing US or Chinese growth - is thus mainly sentiment-driven. Indeed, in the physical market, we see a robustly growing global oil consumption, growing to a record amount of over 103 million barrels per day by 2024. The exact growth is in all likelihood between the IEA's forecast growth (1.1 million barrels per day (mv/d), adjusted in most recent Oil Market Report) and that of OPEC+ (2.2 mv/d). The bulk of major banks and commodity traders are also assuming growth of around 1.4/1.5 mv/d. Physical growth could certainly lead to a trend of higher oil prices (long term) as a result of this sustained rising demand. Nevertheless, market sentiments will determine price movements in the short term.

OPEC+ policy in line with demand trends

This makes the OPEC+ meeting in June all the more interesting. Although the market sees pressure on demand and thus the price, in reality there is little evidence of this yet. At the same time, OPEC's forecasts in their monthly Oil Market Report are also definitely on the high side. Whereas the long-term average (since 1991) stands at 1.1 mv/d of growth, OPEC assumes 2.2 mv/d for the year 2024. Notable in the latest Oil Market Report was the shift in focus from OPEC to OPEC+. Where normally only OPEC's crude oil demand is forecast, now it was about oil demand from so-called Declaration of Cooperation (DoC) countries, the official name for OPEC+. This is a sign that the focus is increasingly shifting from OPEC (12 countries, 27% market share) to OPEC+ (22 countries, 41% market share).

Recently came an announcement by Saudi Arabia's state-owned oil company, Saudi Aramco, which raised oil prices for delivery in June. This is a good indication of how Saudi Arabia, the unofficial leader of OPEC+, interprets the current status of the global oil market. As described earlier, oil demand is still rising, especially in Asia. As the non-OPEC+ producing countries are fairly at their maximum capacity, much of the market power lies with OPEC+, especially Russia and thus Saudi Arabia. The ability to meet the high demand for oil - and thus balance supply and demand - lies largely with Saudi Arabia. Raising prices is one method of achieving this while earning more from oil exports. At the same time, this is an important signal with regard to 'managing expectations' for the outcome of

the OPEC+ meeting. A price hike towards Asia now, suggests little willingness to increase production in the short term.

Indeed, the other option to balance supply and demand is to lift or reduce production cuts totalling 4.2 million barrels per day (mv/d). OPEC+ will meet again on 1 June to discuss this. We assume the production cuts will be extended and no production capacity will be added. Overall, OPEC and OPEC+ seem comfortable with the current price level.

Monetary policy and the oil market

The previous Oil & Gas Market Update already discussed the impact of monetary policy on the oil market. Here, it was reasoned how a rate cut is more obvious in Europe, especially due to the sluggish economic growth on this continent. For this reason, publications of macroeconomic data are keenly watched by the market.

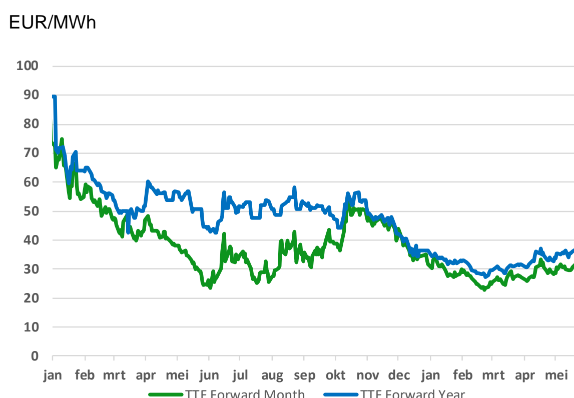
Thus, the US labour market figures for April (published on Friday 3 May) were disappointing, including job growth, the unemployment rate, and hourly wage trends. The US labour market has long been overheated, driving inflation and thus keeping interest rates high. Now that things seem to be cooling down a bit, this may contribute to the Fed's decision to cut interest rates. In the Fed's latest interest rate decision a week earlier, Jeremy Powell, the Fed chairman, stressed that the inflation target (2%) could be eased a bit if the labour market deteriorates. This will prevent the economy from slumping. These statements explain the high level of speculation in the market.

All in all, the recent figures have again brought forward expectations for a US rate cut somewhat. The market is factoring in September and even July. In Europe, on the other hand, Q1 figures show higher-than-expected wage growth. This increases the chances of the dreaded wage-price spiral, where higher wages are passed on to prices, keeping inflation high. This does not necessarily sit in the way of a rate cut in June, but it does reduce the likelihood of a rapid rate cut, for instance in the months following. It could give EUR/USD additional support in the coming months.

Slight upward price pressure on relatively calm gas market

The monthly contract (June delivery) is currently trading at around EUR 32/MWh. Although Norwegian maintenance ahead is causing some upward price pressure, market fundamentals generally point to calmness in the gas market.

Gas prices slightly above EUR 30/MWh again



Source: LSEG Eikon

For instance, gas stocks in Europe (67%) and the Netherlands (61%) are fuller than the long-term average. As a result, LNG imports are declining in May, which so far is 22% lower than at the same

time in April. Although the gas price in Europe is rising slightly, there is still a premium between the Asian benchmark (Japan Korea Marker, JKM) and the TTF (around USD1/MMbtu). This is mainly due to high demand in Asia as a result of El Niño, which brings high temperatures and thus high use of air conditioning.

Europe again heavily dependent on one supplier

From Norway, landings are currently at around 325 mcm/day. This is a lot higher than in recent weeks. However, maintenance is again scheduled from this week, which will depress exports. The Troll gas field is expected to deliver 46 mcm/day less, and the Kollsnes production site 66 mcm/day. Given the large share of Norwegian gas in European energy supply, it is not surprising that Norwegian exports largely determine the price of gas on the continent. History shows how risky it is to depend on one supplier to such an extent.

Norwegian gas exports to Europe rebound, dip expected again

Source: Gassco

Since the outbreak of the war in Ukraine - over two years ago now - Norway's importance as a gas exporter skyrocketed. It currently supplies 30% of Europe's gas demand. Before February 2022, the situation was similar, but it was Gazprom that was responsible for 35% of Europe's gas demand.

While Norway is by no means subject to the same risks as Russia, being overly dependent on one supplier remains dangerous. This is evident from the impact that maintenance at Norwegian gas fields and facilities has on the price of gas in Europe. Planned maintenance - which is accurately tracked by the state-owned company Gassco - is already causing upward price pressure, while in theory the market is already taking this into account. Large, unplanned maintenance can already cause a price spike altogether. This has been visible before, for instance last summer. The TTF gas price rose 20% after it was announced that major maintenance in Norway was taking longer than planned.

What Norway is to pipeline gas, the US is to LNG. In total, almost 50% of imported LNG in Europe comes from the US. This amounts to about 20% of total gas consumption. Although Russia and Qatar are also major LNG suppliers, LNG from these countries only accounts for 6% and 5.3% of total European imports, respectively. This makes Europe highly dependent on the US in terms of security of supply.

While the US is also obviously a more reliable trading partner than Russia, there are still significant risks lurking. Similar to the risks of pipeline gas from Norway, maintenance on US LNG facilities can limit supplies to Europe. This was evident just this year, when the second-largest LNG export terminal in the US (Freeport) was subject to unexpected maintenance. The export terminal is not expected to operate at full capacity again until this month.

In the case of the US, the risks are not limited to unplanned maintenance. In November 2024, the US presidential election will take place. Although it is exciting, there is a chance that Donald Trump will reenter the White House. Restrictions in the export of America's mineral resources to protect its own industry would fit the list of protectionist measures Trump implemented in his first term. But even if Biden is re-elected, the risks for Europe are not over. The protectionist measures from Trump's first term have largely been continued and in some cases expanded by the current president and Democratic candidate for the upcoming elections. Adding to this, Biden has already put a halt to the licensing of new LNG export facilities. This not from an economic, but from an environmental perspective.

Negotiation agreement: more North Sea gas production, long-term contracts, and Groningen permanently closed

The risks around energy dependency are also recognised in the negotiation agreement, published late last week after months of negotiations between the parties PVV, VVD, BBB, and NSC. Becoming less dependent on 'unreliable countries' is therefore one of the spearheads of the new coalition.

Security of supply for natural gas needs to be improved by more own production of natural gas in the North Sea. Although this was also called for by the current outgoing cabinet after the outbreak of the energy crisis, North Sea production has not been scaled up any faster since then. Not only North Sea natural gas production, but also long-term contracts should ensure security of supply. Whereas so far it is only companies that conclude long-term contracts in the Netherlands, the Dutch state has so far not been actively involved in this, unlike, for instance, Germany. In addition, the negotiation agreement states that the Groningen field will remain permanently closed. All in all, the agreement brings little news and no specific measures affecting the gas market.

Besides security of supply, affordability of energy is also an important pillar in the agreement. For instance, the energy tax on gas will go down for small-scale users and the planned increase for large-scale consumers will not go ahead. This was about an increase in the third, fourth, and fifth tranches. For small users, the tax in the first and second tranche will go down by EUR 0.0282 per cubic metre.

The agreement states that becoming less dependent on third countries is also possible by boosting the Netherland’s own renewable energy production. More specifically, however, there is talk of curtailing subsidies for renewable energy through the SDE++ scheme. Also, wind energy will preferably no longer be generated on land and there will be more reliance on nuclear energy (4 additional power plants instead of 2). Solving grid congestion will also be a priority, without naming many details. Finally, the balancing subsidy scheme will still be abolished by 2027, where it was previously stranded in the Senate.

Finally, another important factor for Dutch industry is that the new coalition intends to be more in step with policies from the EU. The current outgoing cabinet tended to be ahead in a number of cases. The negotiation agreement states that the new cabinet will stay in line with the rest of Europe in terms of abolishing so-called fossil subsidies. In addition, the increase in the national CO_2 tax - recently proposed by the outgoing cabinet - will also not go ahead. The tailor-made agreements will be maintained by the new coalition, with possibly even extensions to new technologies or regional industrial companies.

In short

Norwegian Energy Ministry issues licences for oil and gas exploration and production on 37 additional lots - Every year, the ministry issues these licences, called 'Awards in Predefined Areas' (APA), for areas on the Norwegian continental shelf. The additional plots are scattered in the Barents Sea (34) and the Norwegian Sea (3). The ministry indicates that further exploration is badly needed to keep production levels high. This is important, the ministry says, to preserve jobs, boost the Norwegian economy, and contribute to Europe's energy security. Applications can be made until September and the ministry aims to have production licences issued by early 2025. This thoroughness and reliability of the process (APA system), along with the reasoning behind this policy, are at odds with how fossil energy production is viewed in other parts of Europe.

US government announces to replenish emergency reserves totalling 3.3 million barrels of crude - US emergency reserves were at their lowest level in four decades. This was mainly because the government deployed a lot of crude oil from emergency reserves to mitigate the effects of the energy crisis following Russia's invasion of Ukraine. The US government buys the oil on a platform where market participants can bid, using a price ceiling of USD 79.99/barrel. This is about USD 1/barrel above the monthly contract of WTI, the US benchmark.

IEA lowers oil demand growth forecast to 1.1 million btn/day - The previous Oil Market Report still estimated expected growth at 1.2 million btn/day. The main reasons for this lowered growth forecast are slowing economic growth, especially due to a decline in industrial production, and mild weather in Europe.

Qatar energy minister: despite possible supply surplus in coming years, economic growth makes LNG necessary even after 2030 - Currently, the LNG market is very tight, but supply surplus is expected from 2026 onwards due to multiple LNG facilities becoming operational, in the US, Africa, and Qatar, among others. Qatar currently produces 77 million tonnes per year and wants to get to 126 million tonnes by 2027 and 142 million per year from 2030.

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