Oil & Gas

Energy
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Strategy

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Series of meetings sets oil market in motion

The Brent oil price is back to square one after the OPEC+ meeting on 2 June caused a dip. The unwinding of voluntary production cuts was announced, with the disclaimer that implementation will only take place if market conditions allow. The OPEC+ market share and market balance will be a priority in this regard, possibly at the expense of price. Balancing supply and demand in the oil market - OPEC+'s official goal - will become increasingly difficult in the future, at least if the IEA models are to be believed. In our view, however, the energy agency's static supply and demand projections are unlikely to come true.

In addition, this Market Update also analyses the ECB and Fed policy meetings. Where the ECB decided to cut interest rates, deposit rates in the US remain unchanged. There is a trade-off here, as different interest rates lead to a stronger dollar, which in turn could lead to more inflation in Europe via energy prices.

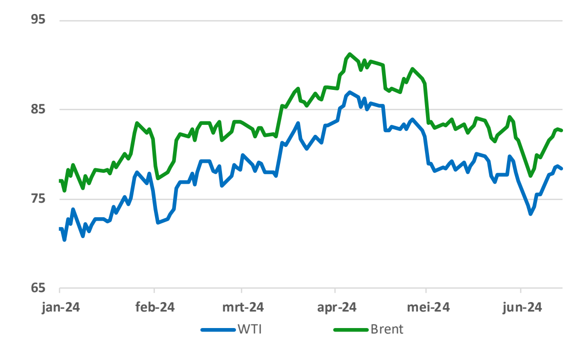
In the gas market, increased competition for LNG and plant maintenance gives upward price pressure. At the same time, upward price pressure is lagging, mainly due to high gas stocks. The filling rate does slow down, a logical consequence of globally high LNG demand and relative calmness in the market.

Oil price back to square one after 'OPEC+ dip'

After trading in a narrow price range of USD 81-84/barrel from the beginning of May, the price of Brent North Sea oil dropped significantly after the OPEC+ meeting on 2 June, to around USD 77/barrel. The reason: OPEC+ indicated it was going to phase out production cuts. In the days that followed, the price climbed back to the pre-OPEC+ meeting price level. The rebound in the price was mainly due to Saudi Arabia and Russia's disclaimer: easing production cuts will only happen if market conditions allow.

Oil price back to USD 82/barrel

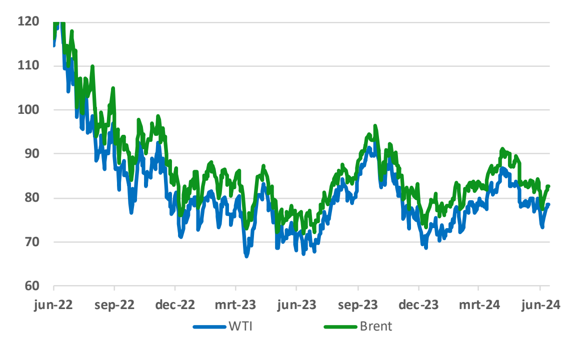
USD/bbl



Source: LSEG Eikon

Oil benchmarks last 2 years

USD/bbl



Source: LSEG Eikon

OPEC+ protects market share with tapering of production cuts

After the OPEC+ meeting on 2 June, the monthly Brent oil contract with July delivery dropped to well below USD 80/barrel. Although at first glance the meeting did not seem to have any surprising outcomes, announcements were made that explain the depressing effect on oil prices.

The production cuts - extended by the oil cartel on 2 June - are an accumulation of an overall OPEC+ production cut, along with voluntary production cuts. These voluntary contributions, particularly from

Saudi Arabia and Russia, will be slowly reversed from October 2024. This will return a total of two million barrels of oil per day to the market between October and September 2025. The OPEC+ wide production cut will, however, be extended until the end of 2025. Another important outcome is the adjustment of the United Arab Emirates' (UAE) production target, which will be allowed to pump an additional 300,000 barrels per day next year.

The market's aftertaste at outcomes of the meeting quickly became apparent. The day after the conference, the price dropped below USD 80/barrel. Besides OPEC+'s additional production in 2025, oil production in non-OPEC+ countries is also still rising steadily. Together with disappointing oil consumption in China in particular, the market is preparing for an oversupply situation. With this, the USD 100/barrel seems out of sight, which according to the IMF is roughly the oil price Saudi Arabia needs to make ends meet for its government budget.

However, it is important to realise that the price (of USD 100/barrel) has never been the official target. OPEC+ claims that policy has always been focused on balancing supply and demand. Apparently, they expect more demand, which therefore also allows the supply of oil to go up. Added to this, if OPEC+ does not do this, other oil-producing countries will jump into this gap. This would reduce OPEC+'s market share, while maintaining it is also an important (unnamed) objective, especially for Saudi Arabia. Increasing its own production would preserve its market share. The possible drop in price that comes with this will be taken at face value.

Static IEA models: oil supply surplus in 2030

The International Energy Agency (IEA) expects a supply surplus of eight million barrels per day by 2030. Demand will then be 105.4 million barrels per day, according to the IEA, while supply is expected to be 113.8 million barrels per day (mv/d). This is stated in the IEA's *Oil 2024*, the report on medium-term oil demand. Whereas the monthly Oil Market Report focuses on the shorter term, in this report the IEA focuses on the period to 2030.

In the IEA projection to 2030, supply exceeds demand for a number of reasons. First, the growth of oil demand is slowing down, partly due to lower oil consumption in Western countries and a flattening of growth in China and India. The growth of renewable and energy-saving technologies is largely behind this. Meanwhile, oil supply will continue to grow, of which - according to the IEA - 76% of the growth will come from non-OPEC+ countries, especially in the Atlantic basin (Brazil, Guyana, the US, Canada). In addition, 45% of the growth will come from the supply of so-called *Natural Gas Liquids* (NGLs), especially in Saudi Arabia and the US. These are liquids extracted as by-products from gas production and can be used as substitutes for petroleum. With this, the IEA seems to think that, unlike oil production, gas extraction will take off even more.

The IEA hereby reports that these supply and demand developments in the oil market may affect the OPEC+ decision to phase out voluntary production cuts during 2024 and 2025. The agency also indicates that low prices, due to excess supply, will be the first to impact shale oil production in the US. This method, with its high production costs, short lead times, and purely commercial drivers, is often the most sensitive to price fluctuations.

IEA models do not take into account strategic considerations

The IEA's demand and supply projections, in our view, do not include or incorrectly include a number of factors. For instance, supply growth is not static but dynamic, with OPEC+ in the lead. If supply does indeed become well above demand, as described in the IEA report, OPEC+ - and Saudi Arabia in particular - will actively pursue policies to negate this effect based on these market conditions. As indicated above, balancing supply and demand is OPEC+'s main official goal but protecting market share is also important.

It would not be the first time that Saudi policymakers therefore decide to open the oil tap, flooding the market with oil. Lower oil prices and, by extension, bankruptcies among US oil producers could then quickly result. Unlike oil production in the wealthy oil state, oil production in the US will only happen if it makes commercial sense. Saudi policy thus has a major impact not only on OPEC+ oil production, but also on that part of non-OPEC that reacts quickly to price changes. This kind of strategic consideration is not taken into account by the IEA model.

In addition, demand is also dynamic. If demand were to fall as far below supply as stated by the IEA, the price will come under pressure. This will make oil more attractive compared to alternatives, such as biofuels. This will cause the demand for oil, and therefore ultimately the price, to rise again. Added to this, modelling the speed at which renewable and energy-saving technologies will develop is very difficult and uncertain. Where electrification has been (unexpectedly) rapid in recent years, progress could stall in coming years due to, for instance, grid congestion, shortages of materials and/or workers, or political unwillingness. As a result, the emergence of electric vehicles, for example, could lag behind expectations, keeping demand for fossil fuels high for longer. Also, the production of green hydrogen, described by many as a *silver bullet* of the energy transition, does not want to take off on a large scale for the time being. Finally, the expectation from OPEC, but also for instance from the Energy Information Administration (EIA), is that oil demand, at around 112 mv/d, will grow significantly further than the IEA suggests.

Dollar stronger after different ECB and Fed policies

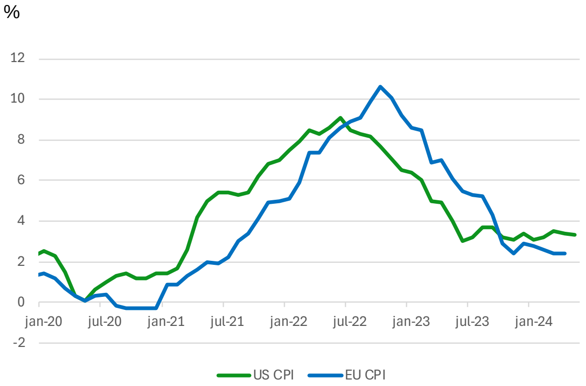
Besides OPEC+, the meetings of two more bodies were decisive in the oil market. The ECB announced at its press conference on 6 June, as previously expected, that it would cut interest rates by 0.25%. This now puts the deposit rate - the rate at which commercial banks deposit money with the central bank, which thus trickles down to businesses and individuals - at 3.75%. According to ECB president Lagarde, the central bank's models repeatedly showed that inflation will reach between 1.9% and 2% by the fourth quarter of 2025, the central bank's target. Based on these forecasts, the ECB seems to be getting a grip on inflation and high interest rates can slowly come down a bit.

Despite this, published inflation figures actually showed an increase in inflation. Recent data on the labour market, which is still very tight, resulting in higher wages, also did not show a uniformly positive picture. For this reason, Lagarde also informed her listeners that future interest rate decisions will be made repeatedly on the basis of the latest inflation figures and macroeconomic data, so the recent rate cut is not a starting signal for a further reduction. Nevertheless, currently, the market expectation is that more interest rate cuts will follow in 2024. The market sees a 60% chance of another 0.25% interest rate cut in September. According to the market, there is a 40% chance of a third interest rate cut later this year.

The other body is the US Federal Reserve (FED). The FED decided on Wednesday 12 June to leave interest rates unchanged (5.25% to 5.50%), despite US inflation data showing slight improvements. These stood at 3.3% (annualised) for May. While this is a little lower than expected, it is still well above the 2% target. Jerome Powell, the FED president, indicated that only one cut could be expected this year, perhaps none at all. However, US government bond yields made no reversal and continued to fall, leading to the conclusion that the market still sees the chance of two rate cuts as realistic. Besides the better-than-expected consumer price index published earlier that day, it also showed that a significant portion of the FED’s individual policymakers do expect two interest rate cuts. This will undoubtedly have contributed to market sentiment.

Given the inflation figures, it is not surprising that the FED is less likely to cut interest rates than the ECB. Still, it may well have an impact on ECB policy. For instance, higher US interest rates can make the US dollar stronger against the euro, making imports into Europe more expensive and thus fuelling inflation. Oil is a prime example of this. The product is mainly traded in US dollars, making a stronger dollar relatively more expensive for non-US importers.

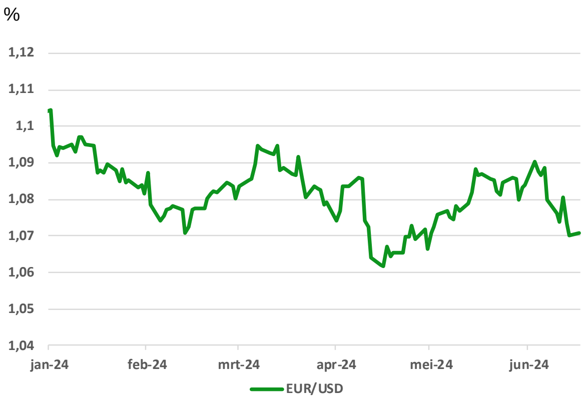
EU inflation rises, US inflation falls slightly



Source: LSEG Eikon

The impact of the Euro/Dollar exchange rate has also increasingly applied to natural gas, in the form of LNG, in recent years. This is now a global product, much of whose European imports also come from the US and must be settled in dollars. Interest rate policy in the US also affects inflation expectations in Europe. Partly for this reason, the ECB will also keep an oblique eye on the FED when it comes to future interest rate decisions.

Dollar stronger after ECB and Fed meeting



Source: LSEG Eikon

Record hurricane season expected in the United States

Hurricane season has started again in the United States, which takes place annually from June to November. The season mainly affects the south- and east coast of the US. Records are expected to be set this year with a forecast of 25 named storms and 12 hurricanes. Of these 12 hurricanes, 6 are expected to be at least category 3. The higher number of hurricanes is due to a transition from El Niño to La Niña. More storms and hurricanes may also make landfall.

The hurricane season affects the US oil market especially in the Gulf of Mexico. In this area, many refineries and oil platforms are located, the oil that is not produced in the US is brought in, and a lot of US oil is exported from here. Since the hurricane season with flooding, among other things, can cause a lot of damage, refineries, for example, are often shut down at the threat of a hurricane. Production platforms offshore are also shut down to prevent major damage to the platforms and the environment.

In 2020, for example, hurricanes Marco and Laura caused the closure of more than 80% of oil production, and almost 60% of gas production in the Gulf of Mexico.

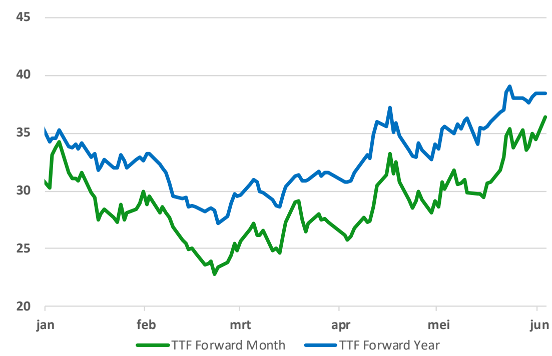
Right now, a possible first hurricane of this season is forming in the Gulf of Mexico. If this storm develops into a hurricane off the coast of Mexico, it could become the first of the year with a name: Alberto. This hurricane could potentially move towards Texas, according to weather models, posing the first serious threat to the energy sector, among others.

Maintenance and heatwave support gas price, EU market fundamentals provide counter pressure

The TTF gas benchmark is in an upward trend channel. Currently, the active monthly contract is trading around EUR 35/MWh, while the annual contract for delivery in 2025 is at EUR 37/MWh. In particular, it is the high demand for LNG - due to the heatwave in large parts of Asia - that is providing support to the price in Europe. Despite this, there is still plenty of supply and gas stocks are high, bringing market fundamentals to calm the gas market.

Maintenance supports gas price

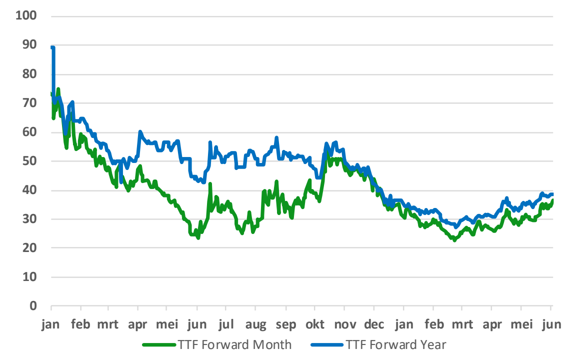
EUR/MWh



Source: LSEG Eikon

Gas contracts last 1.5 years

EUR/MWh



Source: LSEG Eikon

In terms of unplanned maintenance - often a factor that can provide a short-term price boost - the last few weeks have been another hit. Production from Norway's Visund gas field is currently reduced by 15.4 mcm/day due to unplanned maintenance. Norwegian TSO Gassco expects this to continue until 23 June. This is longer than initially reported, causing additional upward pressure on the gas price. Despite the maintenance at the Visund gas field, Norwegian exports to Europe are hovering around 330 mcm/day. This is the highest level since late April, when a period of maintenance on several Norwegian gas fields and facilities began. The last (scheduled) maintenance of this period lasted until early June. No significant production cuts are planned until the end of August.

Besides Norway, unexpected outages also took place in Australia, the world's largest LNG exporter. Here, the Wheatstone LNG processing facility (capacity of 12.1 bcm/year) has been under maintenance since Monday 10 June, depressing Australian export capacity. The end date for the maintenance is not yet known. Although no LNG is going from Australia to Europe, it is still fuelling concerns about security of supply in the global natural gas market.

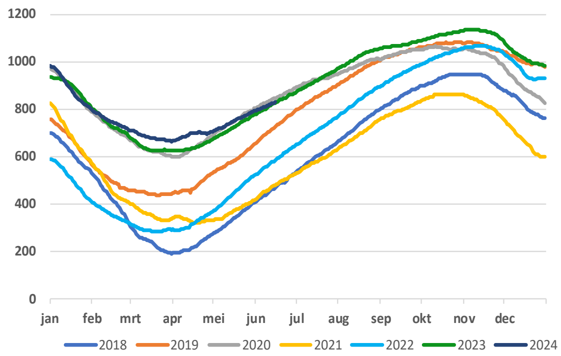
Filling rate of European gas stocks decreases

Gas stocks after the winter of 2023/2024 were exceptionally full. For Europe, on 1 April, the official start of the filling season, stocks were at a record high, as shown in the chart below. In the Netherlands, gas stocks were also well filled, only slightly less than in the record year 2023.

That the filling rate is coming down a bit may be a consequence of high gas stocks. Although the filling season started at a record high in Europe, refilling has now weakened to the extent that stocks are below 2020 and 2023 levels. There is still several months to fill stocks. And right now, due to increased competition in the global LNG market, filling stocks at (too) high prices is less financially attractive. Nevertheless, it is expected that the deadline set by the EU - namely full gas stocks by 1 November - can be amply met.

Gas stocks Europe

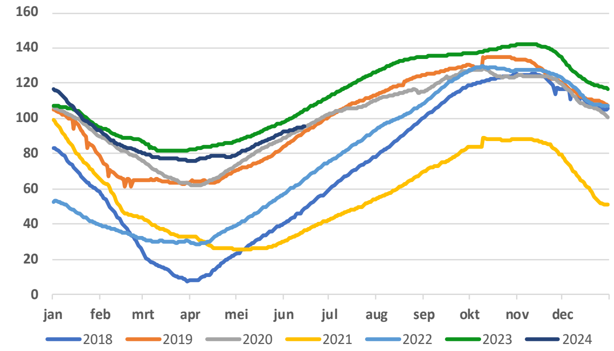
1,000 TWh



Source: GIE

Gas stocks Netherlands

1,000 TWh



Source: GIE

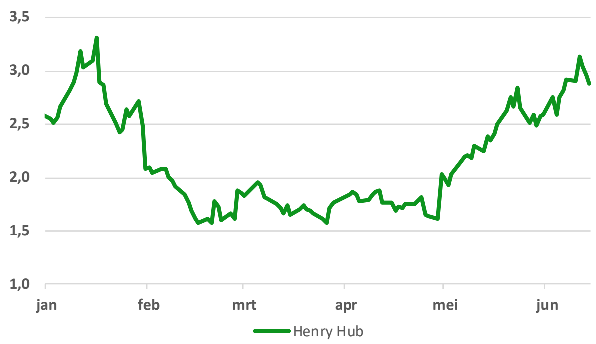
US gas price on the rise, but nowhere near Europe

The US gas benchmark (Henry Hub) is on the rise. Whereas in March and April the price was still hovering around USD 1.5/mmBtu, it is now close to USD 3/mmBtu. This is partly due to the low price in the aforementioned months. Whereas gas in the US is much extracted as a by-product - and thus production is not affected by the price - there is also direct gas production. This was cut back considerably in the spring, so now the price is slowly creeping back up. In addition, exports have also risen. For instance, the Freeport LNG terminal is fully operational again, which promotes exports to Europe and thus increases competition.

USD 3/mmBtu is roughly equivalent to just under EUR 10/MWh. This still puts Henry Hub's price nowhere near the TTF market price that forms the basis for the gas price paid by European businesses and households.

Henry Hub is on the rise

USD/mmBtu



Source: LSEG Eikon

In short

G7 countries stress importance of LNG and call for further investment in the sector - Within the G7, European countries, as well as Japan, are largely dependent on imports of liquefied natural gas. On the other hand, the US is a major exporter, especially to Europe. In their final declaration, the countries reiterated their commitment to meeting the Paris targets. At the same time, gas is seen as a transition fuel, taking into account security of supply and affordability in addition to sustainability.

Saudi Arabia again floats part of state oil company Aramco - In total, the government is selling about 1.55 billion shares (0.7% of the total), raising about USD 11.2 billion. Current plans to reform the economy are costing a lot of money, which has led to the government increasingly running a budget deficit in recent years. According to IMF research, Brent oil prices need to be at least USD 100/barrel to close the Saudi budget deficit. Part of Saudi Aramco went public earlier in 2019. The bulk of the company is still state-owned; 82% directly and another 16% is owned by the government-run Public Investment Fund. Foreign investors now hold a total stake of 0.73% of the share capital.

Outgoing State Secretary Vijlbrief decides to resume oil extraction at Schoonebeek - Oil extraction had been on hold since 2021 due to chemicals in the wastewater. Wastewater treatment is now safe, and it has also been decided that part of the proceeds will benefit the surrounding area. The wastewater will now be stored in an empty gas field near Schoonebeek, where it was first transported to an empty gas field in Twente. The Schoonbeek region will receive EUR 1/barrel. If the oil price is above EUR 80/barrel, it will be EUR 1.50/barrel.

Highest prices since war began for oil from Russia - A boycott on oil has been imposed by Europe since the Russian invasion of February 2022, with a price ceiling of USD 60. This price ceiling is applied by the EU, G7, and Australia. Since India is not covered by it, a significant amount of Russian oil has been sold to India at a discount in recent times. This discount was at 30-40% early last year and has now dropped to USD 3/barrel, to USD 3.50/barrel against Dubai crude (local benchmark priced slightly cheaper than Brent).

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