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MACROCOSM

Oil Weirdly in Balance

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Middle East black swans notwithstanding, the oil market is pretty squared away.

Despite the ongoing conflict in the Middle East, *oil prices have fallen from above the top of our $70 to $85 forecasted trading range* for the Brent benchmark (see "(see "Oil 2024: Black Swans, But More Demand Growth" January 22, 2024). We called the top perfectly when we said, on a Sunday night over a very frightening weekend (see "Our Hot Take on Iran's Attack on Israel" April 14, 2024), that the direct conflict between Israel and Iran would not escalate after a pair of tit-for-tat bombings. This does not mean that conflicts in the Middle East and Ukraine can't heat up again and assign a higher war premium to crude oil prices in the future.

But we will focus on less *non-linear fundamentals this time, which point to crude oil prices right where we originally forecasted them* – as a cautious Saudi Arabia puts pressure on OPEC+ members that produced above their quotas this year, before allowing production quotas to significantly increase next year (please see the chart below).

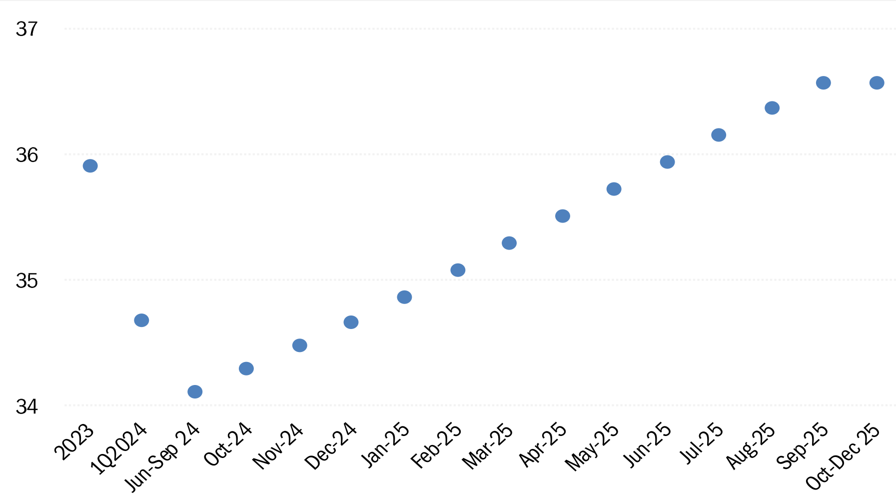
Note that year-end 2024 production for OPEC+ will be higher than the present quarter, but only back to the level of Q1-2024. The net increase in OPEC+ production will occur in 2025. But even that won't take it much

Update to strategic view

OIL: Altogether, production growth in the Americas will be about 1 million barrels per day this year. Members of the original OPEC cartel that are not participating in the current OPEC+ group will add about a half-million barrels. This leaves OPEC+, which is currently over-producing by about a half-million barrels, with limited production growth options – while demand likely expands by 2 million barrels. With the Saudi-led group having postponed most of its quota increases to 2025 instead of 2024 to give it time to rein in over-producers, we think oil stays in our originally forecasted range of $70 to $85.

[Strategy dashboard]

OPEC+ current production and future quota targets (millions barrels per day)



Source: OPEC. TrendMacro calculations

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above where it was in 2023. Saudi is keeping a keen eye on four OPEC members in particular – Iran, Nigeria, Libya, and Venezuela – who have increased production by nearly a half-million barrels per day in first quarter 2024 compared to yearly averages in 2023.

From our point of view the June OPEC+ meeting delivered what we thought it would: a gameplan to slowly relax production cuts while seeking to keep oil prices elevated (again, see "Oil 2024: Black Swans, But More Demand Growth"). Our view at the beginning of the year was that OPEC+ would allow more production from its participating members sometime after the second quarter of 2024 when demand picks up to achieve a year-over-year growth volume of 2 million barrels per day.

The June OPEC+ meeting unveiled a 2024-2025 production timetable for countries participating in additional voluntary cuts last year to increase production toward levels agreed to in the June 2023 OPEC+ meeting. And as always, Saudi stipulated in the joint communique that "this monthly increase can be paused or reversed subject to market conditions." While the OPEC+ voluntary cuts will dissipate mostly in 2025, the mandatory 2022 production cut (albeit with several changes to baseline and levels) will still be in force to year-end 2025. For example, the key 300,000 quota adjustment to the United Arab Emirates actually takes place next year – not in 2024. According to the OPEC+ production timetable, the 2024 UAE crude oil production will be close to its 2023 level.

And while Russia also appears to get an increased quota of 121,000 barrels per day in the same document, it is the biggest overproducer by 437,000 barrels, according to OPEC's May Monthly Oil Monitor Report. The MOMR footnotes say Russia "is working with secondary sources to update its production figures" because the country is currently observing other metrics (exports, rather than production itself) that also demonstrate overproduction (again, see "Oil 2024: Black Swans, But More Demand Growth").

With Q1-2024 production volumes now in the record book, we know OPEC+ is overproducing by 482,000 barrels per day (after chronic under-producer Angola left the cartel last year). Russia, along with over-producers Iraq and Kazakhstan, will resubmit production plans to follow new OPEC+ quotas. Iraq needs to reduce volumes by 226,000 barrels, which should keep the Ceylan pipeline shuttered as it has been since March 2023. And Kazakhstan will need to reduce volumes by 145,000 barrels by September 2024.

We think any risk of collapsing oil prices is not in the cards for this year. Yet that danger could manifest itself if members of the expanded OPEC+ cartel see original OPEC members – Saudi Arabia, the UAE and Kuwait – increase production quotas by more than a million and a half barrels per day in 2025 while they are left only divvying up an additional production quota of less than a half million barrels (please see the chart on the next page). While Saudi has been able to hold this group together for six years with extraordinary voluntary reductions in their overall crude oil production, the large 2025 production increase for the original OPEC heavyweights

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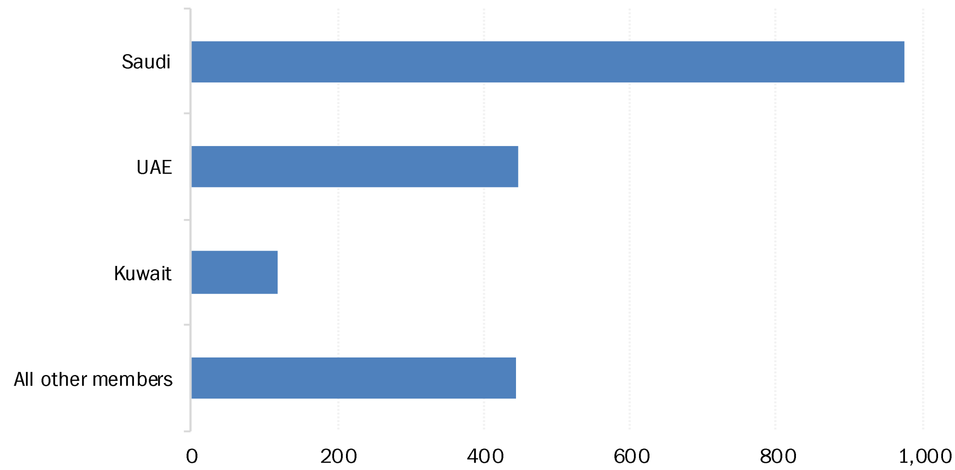
[About us]

Q4-2025 target production versus Q1-2024 actual (thousands of barrels per day)



Source: OPEC. TrendMacro calculations

might give the nine non-OPEC members of the OPEC+ group reason to rethink the deal – let's call it the seven-year itch.

There is also concern that countries not part of the OPEC+ agreement will increase crude oil production in 2024 to levels that cannot be accommodated without a collapse in pricing. We still do not think that will happen. In January 2024 we thought Canada, the US, Brazil and Guyana could increase production by about 1 million barrels per day to fill half the volume needed to satisfy incremental crude oil demand this year (again, see "Oil 2024: Black Swans, But More Demand Growth").

- Our 2024 US crude oil production outlook has not changed a bit: an increase of 300,000 barrels per day. Year-to-date, drilled but uncompleted wells have declined by only 40 in the oil-prone shale plays. Rigs are flat and frack crews are down about 7%, averaging about 250 so far this year. The US Energy Information Administration lowered its US production forecast to less than 300,000 barrels in the most recent Short-Term Energy Outlook from 400,000 in March. The EIA also lowered its 2025 crude oil production forecast from a growth rate of 800,000 barrels to about a half-million.
- The Biden administration has finally started to refill the Strategic Petroleum Reserve, with the most recent solicitation set for November 2024. His administration has only bought 38.7 million barrels to refill the SPR out of about 300 million released since Joseph R. Biden, Jr. took office.
- Canada's Trans Mountain Pipeline experienced another delay, but it is finally full of oil and tankers are lining up in Burnaby, British Columbia to send volumes abroad. Yet the most recent six-week delay in incremental take-away export capacity should reduce year-over-year crude oil production growth to about 300,000 barrels per day instead of our initial estimate of 400,000 barrels. The EIA is less sanguine. It sees 2024 production increasing by only 133,000 barrels and then 150,000 next year.

- New Brazilian president Luiz Ignacio de Silva is awaiting legislation to tax oil production by 1% and increase local content requirements. This will probably not affect our forecast for 2024, in which we see crude oil production increasing by about 200,000 barrels per day, because many floating production, storage, and production-offloading vessels can tap oil reserves in the pre-salt fields going forward. Unfortunately, Petrobras's chances of increasing crude oil production could be severely curtailed in 2025 and beyond due to that legislation. The EIA agrees with our assessment, forecasting about 200,000 barrels of crude oil growth in 2024 and about 60,000 next year.
- Finally, Guyana is the shining star of Latin America. Crude oil production growth will be about 200,000, barrels per day, higher than the 100,000-plus we envisioned earlier this year. ExxonMobil claims that it is increasing production by about 245,000 barrels in 2024 with the rapid development of two fields – which is slightly greater than the EIA estimate. XOM claims that crude oil production could increase to 1.2 million barrels by 2027 – which would make Guyana's annual crude oil production greater than half of the current OPEC members.

Bottom line

Altogether, production growth in the Americas will be about 1 million barrels per day this year. Members of the original OPEC cartel that are not participating in the current OPEC+ group will add about a half-million barrels. This leaves OPEC+, which is currently over-producing by about a half-million barrels, with limited production growth options – while demand likely expands by 2 million barrels. With the Saudi-led group having postponed most of its quota increases to 2025 instead of 2024 to give it time to rein in over-producers, we think oil stays in our originally forecasted range of $70 to $85.