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MACROCOSM

Oil 2024: Black Swans, But More Demand Growth

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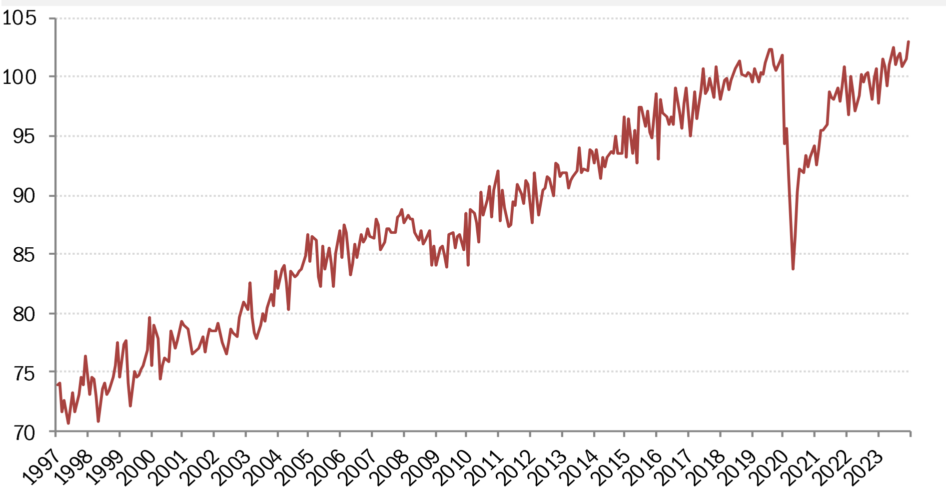
Michael Warren and **Donald Luskin**

OPEC+ will navigate growing demand, and the possibility that peace breaks out in Israel.

Before we turn to 2024, we'll review our oil calls for 2023.

- Standing against persistent recession fears and overblown imaginings about the impact of electric vehicles, *our global demand-growth prediction of 2.5 million barrels per day was just about perfect* (see "Surprises of 2023 Volume 2: Oil Demand, With or Without EVs" January 11, 2023). According to the US Energy Information Administration, it was 2.25 million, ending the year at an all time high of 103 million (please see the chart below, and "Data Insights: Oil" January 16, 2024). A year ago, the International Energy Agency was predicting demand growth of just 1.7 million barrels per day, and the US EIA *just 1 million!*

World crude oil demand (barrels per day, millions)



Source: US EIA, TrendMacro calculations

- Our expectation that *$70 would be a price-floor for the year was perfect for the Brent benchmark* ($70.12 in March) and somewhat too optimistic for WTI ($63.64 in May). Our call for *$100 Brent was a little too optimistic* ($97.69 in September) – but that short-lived price spike was only after we'd lowered our upside target to $85 (see "Russia's Oil Miracle" June 12, 2023). Overall, prices were

Update to strategic view

OIL: Our 2023 forecast for global demand growth was almost perfect, and our forecast for the price range was good but not great. For 2024 we forecast 2 million barrels per day in global demand growth, down somewhat from 2023 because the world has by now significantly put the Covid lockdowns behind it, but well above consensus. We forecast production growth in the US at 300,000 barrels, now that drilled and uncompleted wells are significantly reduced. There is an indeterminate risk premium in crude prices against the possibility of expanded disruption of Middle East shipping. But this is only a black swan risk, and we don't think the worst case will materialize. If our demand forecast is right, OPEC+ would seemingly have the scope to pare back its production cuts, while seeking a price in the high $80's. But if the Israel/Hamas conflict winds down and its associated risk premium bleeds away, the cuts would be more likely to stay. Either way, our price forecast for 2024 is a range from $70 to $85 for the Brent benchmark.

[Strategy dashboard]

weaker than we'd expected. We think it's due to a dynamic we're very proud to have identified early on, days after Russia had invaded Ukraine and Brent crude had spiked to $140 – that *Russia would become a pariah seller in global markets, and would have to sharply discount its exports, lowering the price structure for everyone else* (see "The Bear/Bull Case in the Russian Oil Ban" March 16, 2022). We think this has been the dominant dynamic in global pricing ever since, and we probably underestimated its magnitude and durability.

Now let's look to 2024.

- *The dominant concern for oil markets at the start of the year has been seaborne supply transport disruptions out of the Middle East* (we'll discuss this elephant in the room in detail later in this report).
- That concern has been offsetting the perception of a crude oil oversupply scenario caused by – *almost unbelievably at this point!* – *ongoing expectations for imminent recession in the global economy that will dampen demand growth*.
- Both the International Energy Agency and US Energy Information Agency expect 2024 global crude oil demand to grow at a much slower pace than 2023, at 1.2 and 1.4 million barrels per day respectively, similar to their failed forecasts for 2023. OPEC sees crude oil demand growth at 2.2 million barrels per day in 2024. The cartel was the only one to get it right last year – along with us (again, see "Surprises of 2023 Volume 2: Oil Demand, With or Without EVs") – at 2.5 million barrels per day.
- *We think 2024 global crude oil demand growth will be 2 million barrels per day* – more than the international agencies predict, but less than OPEC. Just as last year, we think *recession fears and the threat of oil demand substitution from electric vehicles are overblown*. That said, and while our growth forecast is higher than the consensus, it is lower than our forecast for last year. *We can no longer count on demand growth coming from recovery from the Covid lockdowns* in which mobility was restricted. That's over, and if anything, in many parts of the world *the stay-at-home revolution implies somewhat less personal mobility* than before, although now on a voluntary and productivity-enhancing basis.

Before we discuss the transport turmoil in the Middle East, let's look at the oversupply concerns that continue to get significant coverage in the international press. Most of the discussion involves non-OPEC supply growth in the Americas. Last year four countries from the Americas contributed incremental supply growth of 1.3 million barrels per day; this year we expect the Americas to contribute about 1 million barrels per day:

- Last year the US contributed the most to global crude oil supply growth (see "A Bottom in Oil Prices, but Not in US Production" April 5, 2023, and again, "Data Insights: Oil"). US crude oil production grew by 1 million barrels per day despite the fact that rig count fell from 779 at the start of the year to 622 at year-end. This is yet another step in the productivity boom in fracking we forecasted all

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the way back at the beginning (see, among others, "I Have Seen the Future, and It Fracks" February 24, 2015).

- Frack crews didn't experience such a large pullback, only falling by 10 to 240 from 250. Frack crews kept busy last year and reduced the inventory of drilled uncompleted wells in the oil-prone shale regions by 884. Since the pandemic, US operators have reduced the oil-prone DUC count by more than two-thirds from 6,802 to 2,172. *We think the reduced DUC inventory will limit US crude oil production in 2024 – contributing only 300,000 barrels per day in incremental supply*. Going forward, operators need to drill more wells to expand production significantly and that costs more, so it's harder to do.
- Last year Canadian crude oil production was basically flat due to the forest fires that impacted Alberta (based on the latest data, through October). *This year Canadian production should increase by about 400,000 barrels per day from 4.4 to 4.8 million – contributing the most to incremental global supply* as long as the Trans Mountain pipeline doesn't experience any more delays (see "Russia's Oil Miracle" June 12, 2023). The 890,000 barrels per day pipeline should allow a tripling of Canadian crude flows to the Pacific coast for Asian markets starting in the second quarter of 2024.
- We expect Brazil to add 200,000 barrels per day, similar to 2023. The National Petroleum Agency projects about that growth rate through 2025. This forecast might change, with Brazil having joined OPEC+ as a participating member starting in January 2024, in a surprise move.
- It's hard to get a handle on Guyana crude oil production. Based on secondary sources, we expect Guyana to produce 550,000 barrels per day in 2024, up from 389,000 in 2023. In 2022, Guyanese crude oil production averaged about 276,000 barrels per day. So incremental growth should be similar to last year at slightly more than 100,000 barrels per day.

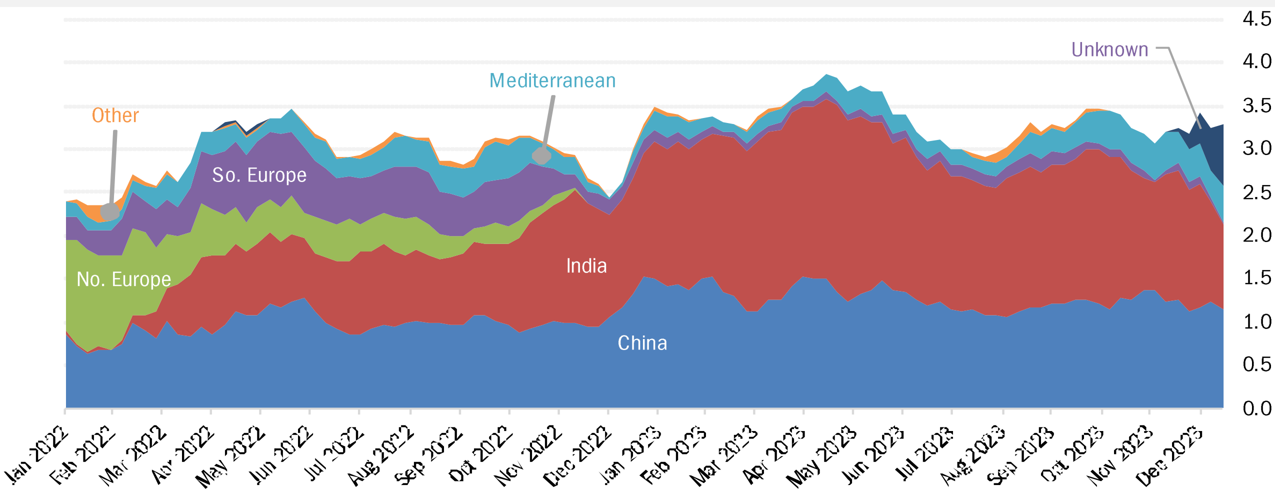
Given 2024 global crude oil demand growth of about 2 million barrels per day and the Americas adding about 1 million in incremental supply, a million barrels of supply will need to come from elsewhere.

- Of the three OPEC members not participating in the prevailing production cut agreement, only Iran could significantly increase production. In January 2016 when President Barack H. Obama lifted sanctions on Iran, we estimated that maximum production could rise to 3.8 million barrels per day (see "Iran: The New New World Oil Order, Volume I" July 20, 2015).
- President Joseph R. Biden, Jr. has been following Obama's playbook since taking office in 2021, even without a new nuclear deal, by failing to enforce secondary sanctions. This has allowed Iranian production to increase by 1.1 million barrels per day so far during the Biden presidency – from 2.12 million to 3.16 million.
- We don't think his policies toward Iran will change in this election year, especially as his administration may wish to appease Iran as a means of attempting to dial down tensions in the Israel/Hamas

conflict. So *Iran's production would increase by an additional 300,000 barrels per day* – the same as last year.

- *Saudi Arabia will act, unilaterally if need be, to keep crude oil prices in the high $80s*. The IMF projects that the kingdom needs to produce about 10.5 million barrels per day at $86 per barrel to cover budgetary outlays. Current production is at 9 million, with Brent at about $80 per barrel. Saudi voluntarily reduced production below its agreed-upon OPEC+ quota several times last year to try to close the gap.
- Russian production is extremely difficult to confirm given that its agreed quotas as a member of OPEC+ are measured in terms of transit – seaborne exports of crude oil and refined products (please see the chart below). Not only did Russia change its compliance metric for OPEC+, it also changed its baseline month the exports are measured against. Russia's 500,000 barrels per day voluntary cut will be calculated from average crude oil and refined products exports in the months of May and June 2023. These months were cherry-picked because they experienced higher volumes of crude oil exports averaging 3.69 million barrels per day. Since December 4, 2022 when the G7 and EU sanctions kicked in (see "Europe: Winter of Energy Discontent" December 5, 2022), Russian crude oil exports have averaged 3.27 million barrels per day. So *Russia's OPEC+ quota is calculated from an artificially high base, making an effective cut of only 100,000 barrels per day instead of a half million*.

Russian seaborne crude oil exports (barrels per day, millions)



Source: Bloomberg, TrendMacro calculations

- Moreover, *while OPEC advertised its November decision as a 2.2 million barrels per day overall production cut, the reality of the horse-trading among different members is actually a slight increase in production*. Specifically, the United Arab Emirates will increase production this year, while chronic under-producer Angola left OPEC altogether.

Given our demand outlook, calling for growth of 2 million barrels per day, there is scope for OPEC+ to loosen its quotas later this year without downward impact on prices. *But we think the cartel would like prices somewhat higher than they are now. So all else equal we think oil will trade in a range between $70 and $85 in 2024.*

Now let's look at transport risk arising from the Israel/Hamas conflict.

- On the face of it, you could make a markets-based inference that the conflict doesn't matter to oil markets. After all, Brent was $84.58 before the Hamas terror attack on October 7, and as of this writing it's substantially lower at $78.56.
- That doesn't necessarily prove there is no risk premium built in with respect to an increasing number of attacks on shipping by Iran's proxies.
- It's not hard to argue that given the phony production cuts at OPEC+, and the Saudi price cut to their benchmark crude oil in February – when refinery maintenance season usually starts – *global oil markets would probably be trading even weaker if these attacks on shipping were not going on*.
- The violence has escalated in shipping lanes in the Red Sea, impacting the movement of all cargoes – not just oil – through the key Bab el-Mandeb Strait, a strategic choke point for Saudi and UAE oil and refined product shipments to Europe that travel through the Suez Canal (see "Oil and the Obama Doctrine" April 10, 2015).
- On January 11, the Iranian Navy seized an oil cargo vessel off the coast of Oman after exiting the Strait of Hormuz (the most important strategic choke point for oil transport). The vessel had been previously intercepted by the US Navy in 2021 and its oil was eventually confiscated by US authorities in Houston. As such, its seizure now is as much political theater as anything else.
- As the cadence of ship seizures in the Middle East has risen, the cost of insurance and reinsurance is rising too, raising the all-in cost of oil transport – which has to eventually show up in price.
- All that said, disruption in shipping at a scale that would cause a traumatic and discontinuous change in global oil pricing *remains a black swan risk – not a dominant risk, but not zero, and very hard to price, and also hard to ignore*.
- We haven't put this in a written report, but since the Hamas terror attacks in October, we've been telling clients in calls that we don't see the current conflict evolving into a global oil crisis as did the Israel crisis 50 years ago. Then the oil producing states were unified against the West, and willing to join together in a boycott that changed the petro-strategic landscape forever. But since that change, those states have been able to afford to sort themselves into warring camps of Shia and Sunni, battling each other for regional dominance than battling the West together. *So a full-on attack on shipping by Iran, the leader of the Shia faction, would be not an attack on the West, but an attack on its regional rivals who lead the Sunni world, notably Saudi and the UAE.*

- In mid-January, Iran launched missile attacks at a purported Israeli spy hub in Iraq and a Sunni militant group in Pakistan after the bombing of events commemorating the death of Qasem Soleimani, who was killed by a US missile strike in 2020. So it's not like Iran isn't willing to play rough with its regional rivals. But we think the game theory of this situation argues against broader or truly significant attacks. Iran can probably rely on a flaccid Western response to its aggressions, because under current leadership the West is not comfortable exerting military strength because, among other reasons, it fears drawing in other super-powers. But Iran cannot be so sure that an attack on Saudi assets would not draw a devastating response. So while you can't rule out black swan events, our central expectation is that this will likely not rise above the level of more political theater.
- Assuming that the Israel/Hamas crisis gets resolved somehow this year, we would expect whatever risk premium must be in present prices to gradually bleed away. Based on demand growth, OPEC+ will have room to reduce their production cuts and still aim at price targets somewhat higher than today's prices. But if peace breaks out in the Middle East, the black swan risk premium is gone – and OPEC+ will have to carefully manage its quotas to maintain price (possibly even making some moves to give them sharper teeth). Either way, the cartel's goal is a price somewhere near the top of our expected range, that is, about $85.

Bottom line

Our 2023 forecast for global demand growth was almost perfect, and our forecast for the price range was good but not great. For 2024 we forecast 2 million barrels per day in global demand growth, down somewhat from 2023 because the world has by now significantly put the Covid lockdowns behind it, but well above consensus. We forecast production growth in the US at 300,000 barrels, now that drilled and uncompleted wells are significantly reduced. There is an indeterminate risk premium in crude prices against the possibility of expanded disruption of Middle East shipping. But this is only a black swan risk, and we don't think the worst case will materialize. If our demand forecast is right, OPEC+ would seemingly have the scope to pare back its production cuts, while seeking a price in the high $80's. But if the Israel/Hamas conflict winds down and its associated risk premium bleeds away, the cuts would be more likely to stay. Either way, our price forecast for 2024 is a range from $70 to $85 for the Brent benchmark.