



## Oil to \$100?

### Summary

- Brent oil prices averaged \$74 per barrel (pb) during Q3 2021, up 7 percent quarter-on-quarter, and 71 percent over the same period last year. Brent oil's rally has continued into Q4, with the benchmark rising a further 10 percent over September levels. Whilst some supply issues in the US Gulf have contributed to the uplift in prices over the last couple of months, the rally has mainly been a result of rising oil demand.
- More specifically, the continued roll-out of vaccines across the world eased restrictions in mobility and helped lift transportation fuel (jet fuel and gasoline) closer towards pre-pandemic levels. At the same time, huge rises in the price of natural gas has prompted buyers to look for alternatives, with crude oil being one substitute for gas in electricity generation.
- Looking ahead, there is a strong possibility that oil prices could trend higher in the near term if gas-to-liquid substitution accelerates during the winter months. This combined with any unplanned outages in oil output (from Libya, for example) could well push oil prices towards \$100 pb.
- That said, such an elevated level of prices would likely move OPEC+ to raise oil output beyond current stated levels in order to stabilize oil markets, and would also likely trigger a moderate rise in shale oil output in the near-term.
- In addition, with OPEC actually forecasting a quarterly decline in global oil demand (by 2 percent) in Q1 2022 (prior to hitting all-time highs by Q4 2022), this further diminishes the possibility of oil prices being sustained at \$100 pb (if they hit this level) beyond the near term.
- As such, whilst we acknowledge that there is an upside risk to our full year 2021 Brent oil forecast of \$67 pb, we have kept our full year 2022 Brent oil forecast unchanged at 65 pb, for now.

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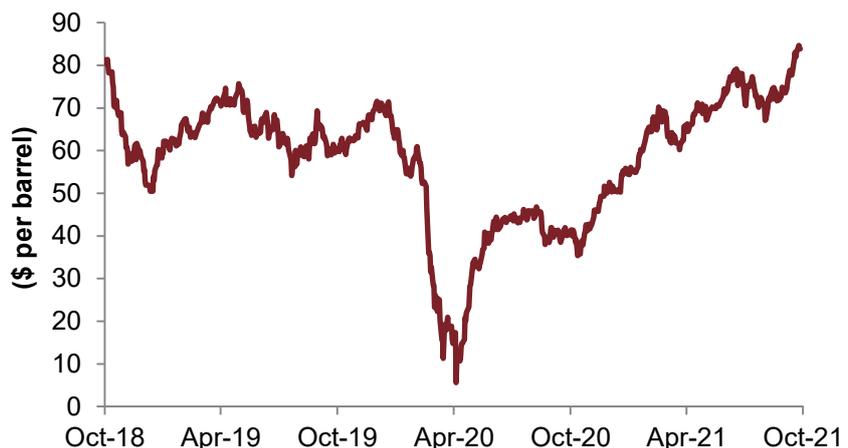
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**Figure 1: Brent oil prices have risen sharply to three year highs**





The rally in oil prices has mainly been a result of demand.

More specifically, according to OPEC, oil demand rose by 3 percent quarter-on-quarter in Q3...

...as the continued roll-out of vaccines across the world eased restrictions in mobility and helped lift transportation fuel demand.

At the same time, huge rises in the price of natural gas has prompted buyers to look for alternatives...

...with crude oil being one substitute for gas in electricity generation.

Looking ahead, further gas market developments could continue to spillover into higher oil demand...

**Recent rally in oil prices driven mainly by demand:**

Brent oil prices averaged \$74 per barrel (pb) during Q3 2021, up 7 percent quarter-on-quarter, and 71 percent over the same period last year. Brent oil's rally has continued into Q4, with the benchmark rising a further 10 percent over September levels. Whilst some supply issues in the US Gulf (*please refer to our latest [chartbook](#) for more detail*) have contributed to uplift in prices over the last couple of months, the rally has mainly been a result of demand. More specifically, according to OPEC, oil demand rose by 3 percent quarter-on-quarter in Q3, to 98.3 million barrels per day (mbpd), as the continued roll-out of vaccines across the world eased restrictions in mobility and helped lift transportation fuel (jet fuel and gasoline) closer towards pre-pandemic levels (Figure 2, Box 1).

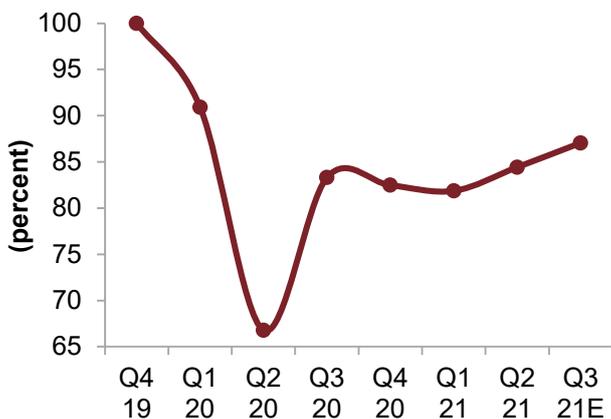
**Box 1: Demand spillover**

The improvement in oil markets since the start of the year has also been mirrored in the natural gas markets, with combination of a strong recovery in demand, extreme weather events and unplanned supply outages leading to a tighter market for natural gas. As a result, Henry Hub natural gas spot prices have climbed 270 percent year-to-date (Figure 3). In fact, some regional gas prices have jumped much more aggressively as the winter season approaches and demand for heating rises. More specifically, Dutch Title Transfer Facility (TTF) spot prices, a European benchmark for natural gas, rose to \$200 of barrel of oil equivalent (boe) in early October, with Asia seeing prices of liquefied natural gas (LNG) also surging. Such huge rises have prompted global gas buyers to look for alternatives, with crude oil being one substitute for gas in electricity generation, especially in Asia, whilst demand for coal (which is more polluting) has also been rising.

**Could oil prices rise further in the near term:**

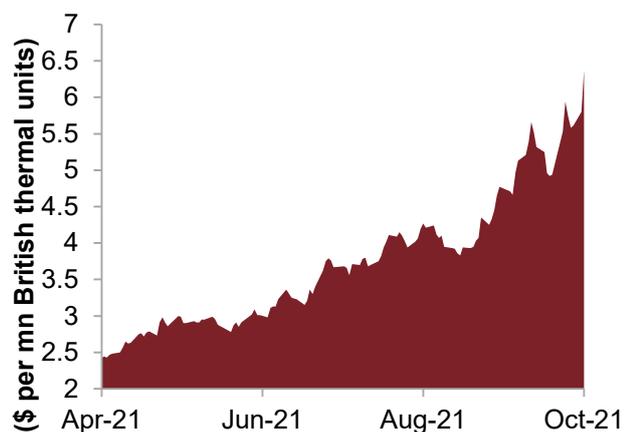
Based on latest OPEC data, Q4 2021 oil demand is expected to rise by 2 percent or 1.5 mbpd quarter-on-quarter, a majority of which would be covered by OPEC+'s stated 400 thousand barrels per day (tbpd) monthly rise. That said, further gas market developments could continue to spillover into higher oil demand. According to the International Energy Agency's (IEA) Gas Market Report, forward curves suggest Dutch TTF prices are averaging \$24 per million British thermal unit (mmBtu) (equivalent to \$139 per boe) during Q4, with currently high gas prices expected to continue into Q1 2022. In

**Figure 2: Transportation fuel is the only segment sizably below pre-pandemic levels\***



\*data from 20 largest consuming countries

**Figure 3: Gas prices up sharply, encouraging substitution of gas to liquids in some instances**





*...with the IEA noting that gas storage levels in key demand centers are much lower than usual.*

*Meanwhile, after a period of disruptive conflict, Libya has been being able to stabilize oil production during 2021...*

*...although the danger is that the fragile political situation could deteriorate as the country heads into elections towards the end of this year.*

*European gas prices have eased slightly in the last few days as Russia stated it helped stabilize gas markets.*

*OPEC+ still has a decent level of spare oil capacity that can be used in a short space of time.*

addition, the IEA notes that gas storage levels in key demand centers are much lower than usual, with European storage levels at 16 percent below the five year average, US 7 percent below, and Japan 17 percent below, all of which adds to the possibility of further gas-to-liquid substitution. It is worth noting that some estimates suggest that the recent climb in gas prices added around 500 tbd of oil demand for use in power generation.

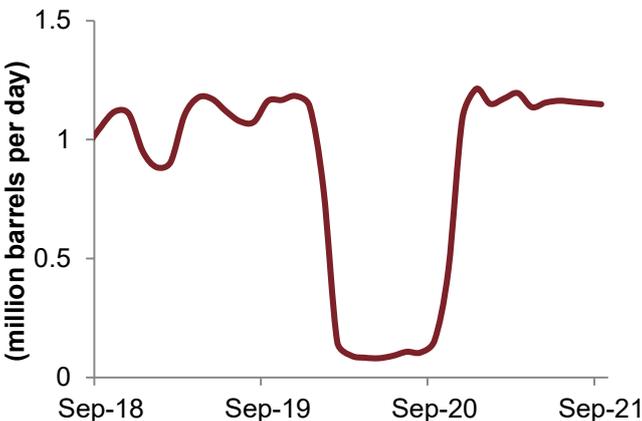
Meanwhile, after a period of disruptive conflict, Libya has been being able to stabilize oil production during 2021, at around 1.2 mbpd in the year-to-September, seven times higher than the same period last year (Figure 4). That said, some friction (between the Libyan Oil Ministry and the National Oil Company) has developed recently, and whilst output has remained steady, the danger is that the fragile political situation could deteriorate as the country heads into elections towards the end of this year. More specifically, the risk is that armed groups or protesters could shut down oil facilities, as they have done on and off over the past decade, to press political or economic demands. Any sizable and prolonged disruption in the months ahead would obviously add to tighter oil markets.

**Risks are not all skewed to the upside:**

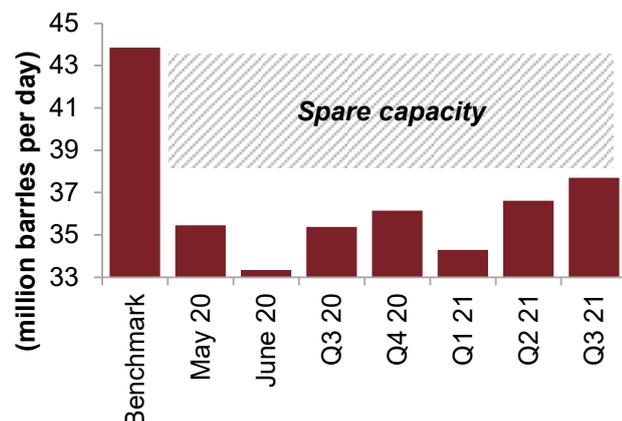
Whilst the abovementioned factors do raise the risk of higher oil prices in the near term, this is, by no means, guaranteed. Indeed, a number of developments could, at the very least, slow the upward momentum in oil prices. Firstly, European gas prices have eased slightly in the last few days as Russia (which supplies circa 50 percent of the region's gas) stated it would withdraw gas from storage in order to help stabilize the market, with the IEA estimating that Russia could raise gas exports by roughly 15 percent. At the same time, the European Commission (EC) is in the process of announcing a number of measures to address the energy crisis. One proposal is reportedly set to include a joint voluntary scheme for gas purchases in order to build up strategic reserves.

Despite risks around Libyan oil supplies, we note that OPEC+ still has a decent level of spare oil capacity that can be used in a short space of time. OPEC+ output averaged 37.7 mbpd during Q3 (with compliance at 117 percent above agreed levels), meaning circa 6 mbpd of spare capacity (excluding Iran) is sitting with the 20 countries. As such, if OPEC+ were to take the view that extra oil is needed, the alliance could decide to raise by more than the currently agreed 400 tbd when it next meets in early November.

**Figure 4: Libyan oil output has been consistent during 2021, so far**



**Figure 5: OPEC+ could raise oil output if deemed necessary in next month's meeting**





*Oil demand is set to hit all time record highs by the end of 2022.*

*Depending on the outcome of talks between Iran and a number of countries in order to restore the 2015 nuclear deal...*

*...Iranian oil supply could rise by around 1 mbpd towards the end of next year.*

*Despite recently elevated oil prices, the EIA has not made any major upward revisions to US oil output.*

*That said, there has been a notable increase in the number of private operators' drill rigs ...*

*... which has, in turn, helped push oil output in the largest shale oil formation -the Permian- close to pre-pandemic levels.*

**Will 2022 see higher oil prices?:**

Beyond the very near term, a continued recovery in the global economy, in-line with higher vaccination rates, should, according to OPEC data, push oil demand to all time record highs by the end of 2022, to 102.9 mbpd, circa 4.6 mbpd higher than Q3 2021 demand of 98.3 mbpd. As it stands, therefore, OPEC+ has enough spare capacity (at circa 6 mbpd) to meet expected demand levels, barring any unforeseen developments (Box 2).

**Box 2: Iranian oil still a risk**

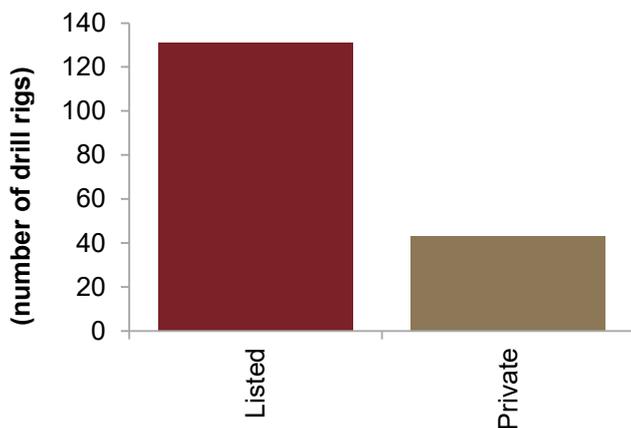
Very little progress has been made between Iran and a number of countries towards resuming multilateral negotiations in order to restore the 2015 nuclear deal. The uncertainty over negotiations adds another layer of risk to oil supply going forward. Despite this, in the year-to-September 2021, Iranian crude oil output rose by 20 percent year-on-year, to 2.4 mbpd (although it is difficult to assess changes in oil exports as Iran has not been submitting this data to Joint Organizations Data Initiative since August 2018).

Looking ahead, if some sort of break-through in negotiations between Iran and the other countries were to take place, Iranian oil supply could rise by around 1 mbpd towards the end of next year. Conversely, if negotiations were to hit a wall, oil output could actually decline back to 2020's average of 2 mbpd.

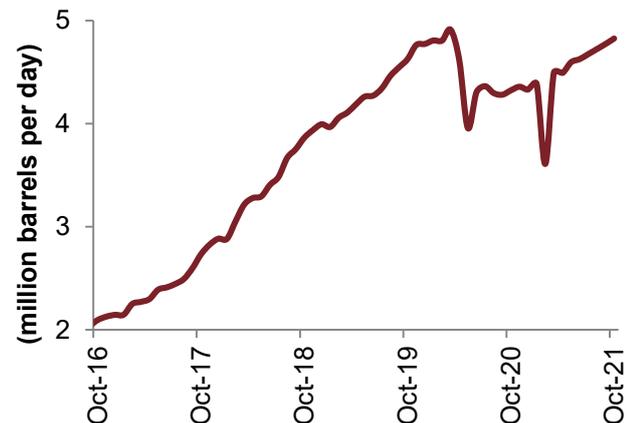
Meanwhile, despite recently elevated oil prices, the US Energy Information Administration (EIA) has not made any major upward revisions to US oil output. EIA data shows that US oil output is virtually unchanged at 11 mbpd since the turn of the year, and only 2 percent higher year-on-year in Q3 2021. Moreover, the EIA still expects US oil output to be 7 percent lower at the end of 2022, when compared to peak 2019 output.

As we noted in our previous [oil update](#), it now seems to be the case that US listed oil operators are more keen on using any windfall from higher oil prices to pay down debt and/or pass these gains onto investors via dividends. That said, there has been a notable increase in the number of private operators' drill rigs (Figure 6), which has, in turn, helped push oil output in the largest shale oil formation -the Permian- close to pre-pandemic levels (Figure 7). The Permian is a particularly attractive place to raise oil production because of its low breakeven costs (ranging between WTI oil price of \$46-53 pb according to a recent Dallas Fed Energy Survey) and has generally

**Figure 6: One quarter of total US onshore drill rigs are privately operated**



**Figure 7: Oil output in US's Permian basin close to pre-pandemic levels of 4.9 mbpd**





*As such, the longer that oil prices remain elevated, the higher the likelihood of a larger quantities of US shale oil hitting the market.*

*Whilst we acknowledge that there is an upside risk to our full year 2021 Brent oil forecast of \$67 pb..*

*...we have kept our full year 2022 Brent oil forecast unchanged at 65 pb, for now.*

higher rates of oil production per rig. As such, the longer that oil prices remain elevated, the higher the likelihood of larger quantities of US shale oil hitting the market. In fact, it is worth noting that back in January 2020 (prior to spread of Covid-19, and when WTI oil was trading at around \$60 pb), the EIA forecasted that Permian oil production would rise by 800 tbpd during the year, which just serves to highlight the potential upside of oil output from this region.

#### **Oil price outlook:**

Overall, Brent oil is currently trading at around \$85 pb, and there is a strong possibility that it could trend higher in near term if gas-to-liquid substitution accelerates during the winter months. This combined with any unplanned outages in oil output (from Libya, for example) could well push oil prices towards \$100 pb. That said, such an elevated level of prices would likely move OPEC+ to raise oil output beyond current stated levels in order to stabilize oil markets and would also trigger a moderate rise in shale oil output in the near-term. In addition, with OPEC actually forecasting a quarterly decline in global oil demand (by 2 percent) in Q1 2022 (prior to hitting all-time highs by Q4 2022), this further diminishes the possibility of oil prices being sustained at \$100 pb (if they hit this level) beyond the near term.

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