جدوى للإستثمار
Jadwa Investment

April 2022

Quarterly Oil Market Update

Elevated oil prices here to stay

Summary

- Although OPEC data showed global oil demand grew by a healthy 5.3 percent year-on-year in Q1 2022, the agency recently revised down full year 2022 oil demand growth by 12 percent (Figure 1). It is also worth highlighting that OPEC's current outlook on oil demand is based not only on the assumption that armed conflict in Ukraine does not escalate, but that it eases in the second half of the year.

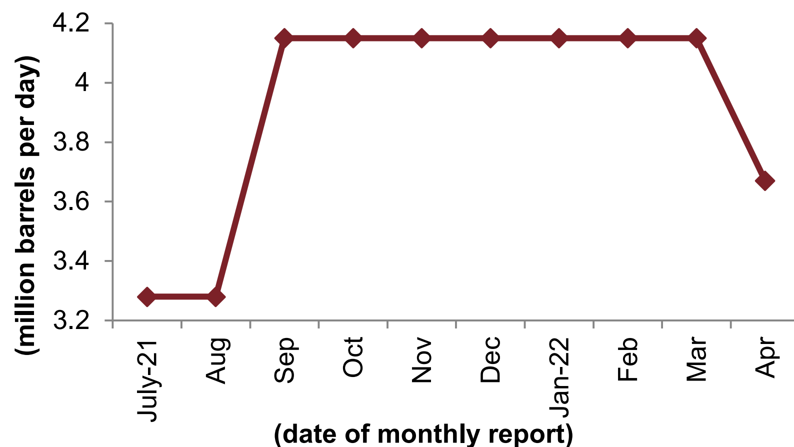
- Meanwhile, on the supply side, Q1 2022 data showed that the OPEC plus alliance struggled to achieve stated output targets. Looking ahead, the difficulties in sustaining output at targeted levels will become even more difficult as a mixture of economic sanctions, voluntary self-sanctioning, and expiration of many Western companies' long-term contracts, leads to a steep decline in Russian oil output.

- That said, there are a number of developments currently mitigating the risk of further substantial oil price rises in the near term. This includes i) Chinese oil demand being affected by renewed Covid-19 lockdowns, ii) general downside risks to oil demand as a consequence of slowing global economic growth and iii) the release of 240 million barrels of oil from International Energy Agency (IEA) member's strategic reserves over the next six months.

- Despite all of this, it is clear that the political situation around the Russian-Ukrainian conflict remains fluid. As such, the risk of a drastic turn of events that lead to a sudden spike in oil prices (such as direct sanctioning of Russian oil and gas by the EU) are still very much possible.

- Taking all the above into account, we have raised our full year 2022 Brent oil forecast to $102 pb, but, at the same time, acknowledge that risks do remain skewed to the upside.

Figure 1: OPEC's current and historical FY 2022 oil demand growth projections in corresponding monthly reports



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Global economic uncertainties have risen considerably with the outbreak of the conflict between Russia and Ukraine.

This uncertainty is reflected in OPEC's latest forecast, which downgraded annual oil demand growth by 12 percent for full year 2022.

A mixture of economic sanctions and voluntary self-sanctioning is now beginning to show in Russia's oil production…

...with steeper declines are likely to materialize in-line with the expiration of many Western companies long-term contracts with Russian suppliers.

Considerable downside risk to oil demand:

OPEC data showed global oil demand grew by a healthy 5.3 percent year-on-year, or 5 million barrels per day (mbpd), in Q1 2022. That said, and in line with OPEC expectations, (*please refer to our previous Oil Update*) oil demand declined by 1.2 percent (1.2 mbpd) quarter-on-quarter during the first quarter of the year. Looking ahead, global economic uncertainties have risen considerably with the outbreak of the conflict between Russia and Ukraine. This uncertainty is reflected in OPEC's latest forecast, which downgraded annual oil demand growth by 12 percent for full year 2022, to 3.67 mbpd, although the organization still expects oil demand to hit all time highs of 102.8 mbpd in Q4 2022 (Figure 2). It is important to highlight that OPEC's current outlook on oil demand is based not only on the assumption that armed conflict in Ukraine does not escalate but that it eases in the second half of the year. Indeed, as OPEC concedes itself (with respect to its global economic growth forecast), further downside risks are estimated to be considerable, especially if the current situation extends (or even worsens) in H2 2022. At the same time, there is growing risk to oil demand emanating from China, as another wave of Covid-19 lockdowns in a number of areas adds to already strained global supply chains and risks lowering Chinese oil imports (Figure 3).

Russian oil output declining:

Since the outbreak of the Russian-Ukrainian conflict in late February, there has been a sizable price impact on a range of commodities, including wheat, oil and natural gas. An initial round of Western sanctions against Russia did not explicitly target energy exports, but, as the conflict intensified, the US took a unilateral decision to ban all Russian oil and gas imports. In-line with this, and despite no sanctions by the European Union (EU) on Russian oil, a number of international oil companies have sold-off energy assets and have stopped buying Russian crude on the spot market voluntarily. The mixture of economic sanctions and voluntary self-sanctioning is now beginning to show in Russia's oil production figures, with unofficial data for early April showing Russian oil output declining to circa 10.3 mbpd, versus an average of 11 mbpd during Q1 2022.

Looking ahead, whilst official Russian estimates suggest that Russian crude oil will decline by 4-5 percent month-on-month in April (compared to 11 mbpd in March), steeper declines are likely to materialize in-line with the expiration of many Western companies long-term contracts with Russian suppliers. Indeed, the International

Figure 2: Global oil demand
(quarterly average)

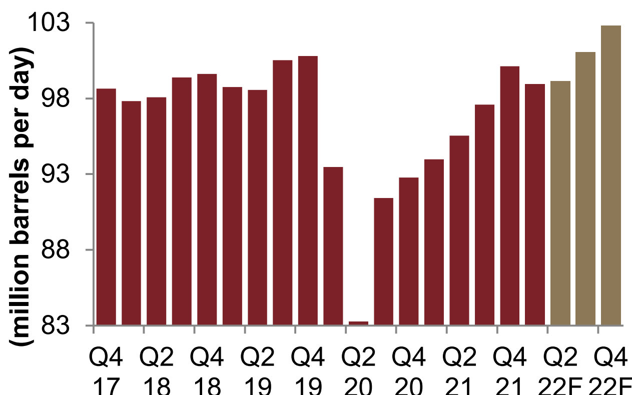
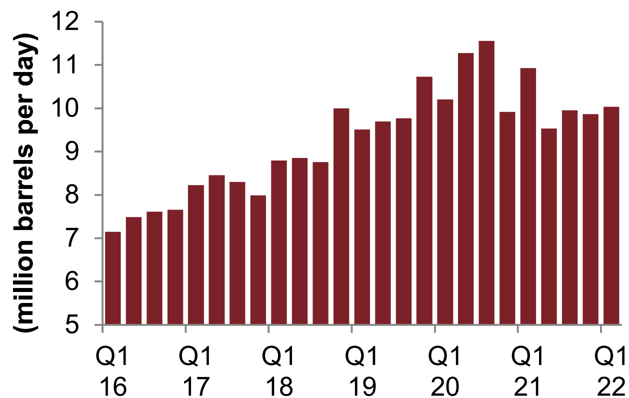


Figure 3: Chinese oil imports
(quarterly average)



Meanwhile, a sharp discount of Urals against Brent oil has encouraged larger spot purchases from opportunistic Asian buyers.

Looking ahead, the persistence of a steep discount in Urals for the foreseeable future will likely continue incentivizing Russian oil purchases.

Meanwhile, on the supply side, Q1 2022 data showed that the OPEC plus alliance struggled to achieve stated output targets.

Looking ahead, the difficulties in sustaining output at targeted levels will become even more difficult.

Energy Agency (IEA) estimates that Russian oil output will decline by an average of 1.5 mbpd in April, which will rise to 3 mbpd in May (Figure 4, Box 1).

Box 1: Russian exports holding up

Whilst European self-sanctioning has translated into a drop in oil volumes entering Russia's pipeline network (with around 1 mbpd of oil exported to Europe via pipeline before the conflict), seaborne oil exports to Asia have held up well up so far. Latest full month data showed that whilst there was a dip in Russian oil exports in February, this reversed during March, largely as a result of larger purchases from China (*please see our April Chartbook for more details*). It seems that a sharp discount of Urals (reference for pricing of Russian oil) against Brent oil (Figure 5) has encouraged larger spot purchases from opportunistic Asian buyers. Looking ahead, it remains to be seen how oil exports to China hold up in light of Covid-19 lockdowns in the near term, but beyond that, the persistence of a steep discount in Urals for the foreseeable future will likely continue incentivizing purchases of Russian oil.

OPEC plus output struggling:

Q1 2022 data showed that OPEC plus struggled to achieve stated output targets, with the alliance producing an average of 38 mbpd during the quarter, roughly 3 percent (or 1.2 mbpd) lower than targeted. A breakdown of output shows that four African countries (Eq. Guinea, Angola, Congo (Br.), Nigeria) and Malaysia produced sizably less than targeted levels. Looking ahead, the difficulties in sustaining output at stated OPEC plus levels is likely to continue due to i) structural issues over declining medium term output from the above African members and Malaysia (*please refer to our previous Oil Update*) ii) expected decline in Russian oil output over the next few months and iii) more recent risks related to Libyan oil supplies with Libya's National Oil Corporation recently declaring a force majeure due to political instability. At the same time, usable spare capacity within OPEC plus is also diminishing on a monthly basis. At the end of Q1 2022, OPEC plus spare capacity stood at 3 mbpd (with a vast majority of this residing with Gulf members). Looking ahead, under agreed output targets, this should decline to around 1.9 mbpd by the end of Q2 2022.

Figure 4: The IEA expects Russian oil output to decline sharply in the months ahead...

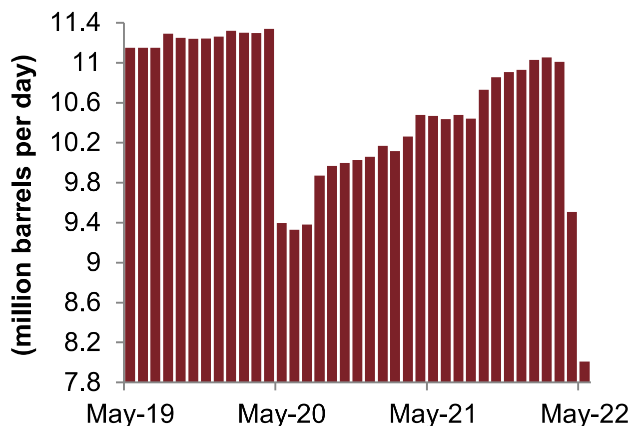
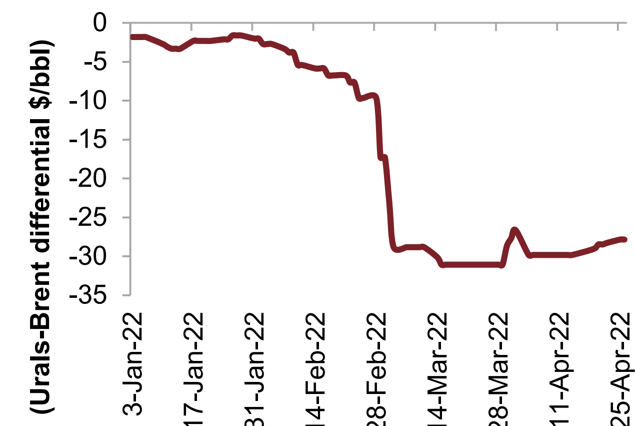


Figure 5:..but the persistence of a deep discount on Urals oil should help sustain Russian oil exports



US oil at record highs in 2023:

The US Administration's recent announcement to start charging fees to companies not utilizing their oil permits on federal lands…

...could result in a pick-up in oil output in the near-term

According to the US's Energy Information Administration (EIA), US oil output rose by 8 percent year-on-year in Q1 2022, to an average of 11.5 mbpd, but was down 1 percent on a quarter-on-quarter basis. Looking ahead, it seems that the EIA does not expect a sizable rise in oil prices to have a major impact on US oil output. This is highlighted by the fact that although the agency's current full year 2022 forecast for West Texas Intermediate (WTI) is almost twice as high from a year ago (at an average of $98 pb), it has only revised US oil output up by 4 percent (or 410 tbpd) over the same period, to an average of 12 mbpd. That said, the US Administration's recent announcement to start charging fees to companies not utilizing their oil permits on federal lands, could result in a pick-up in oil output in the near-term (Figure 6).

Looking further ahead in 2023, the EIA now expects US oil output to rise by a sizable 8 percent year-on-year.

Looking further ahead in 2023, the EIA now expects US oil output to rise by a sizable 8 percent year-on-year to an average of 12.95 mbpd (the highest level ever), despite the agency expecting a lower average WTI price of $87 pb next year.

Oil price outlook:

There are a number of developments currently mitigating the risk of further substantial oil price rises in the near term….

….although it is clear that the political situation around the Russian -Ukrainian conflict remains fluid...

...as such, the risk of a drastic turn of events that lead to a sudden spike in oil prices are still very much possible.

Brent oil prices jumped 29 percent quarter-on-quarter (to an average of $103 pb) in Q1 2022, the highest quarterly average since Q3 2014, and are currently trading at around $100 pb.

Looking ahead, oil markets are likely to remain pressurized as Russian crude oil production declines sharply over the coming months. This will add to major concerns over OPEC plus's ability to raise output to targeted levels, which had already been in question prior to the outbreak of Russian-Ukrainian conflict. Against this, however, there are a number of developments currently mitigating the risks of further substantial oil price rises in the near term. This includes i) Chinese oil demand being affected by renewed Covid-19 lockdowns, ii) general downside risks to oil demand as a consequence of slowing global economic growth and iii) the release of 240 million barrels of oil (Figure 7) from International Energy Agency (IEA) member's strategic reserves over the next six months. Despite all of this, it is clear that the political situation around the Russian-Ukrainian conflict remains fluid and so a drastic turn of events (such as direct sanctions on Russian oil and gas by the EU), that leads to a sudden spike in oil prices, cannot be ruled out.

Figure 6: Consistent month-on-month rise in US shale oil output since the turn of the year

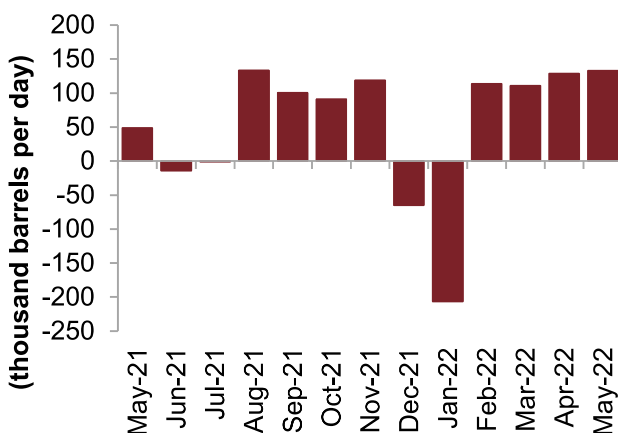
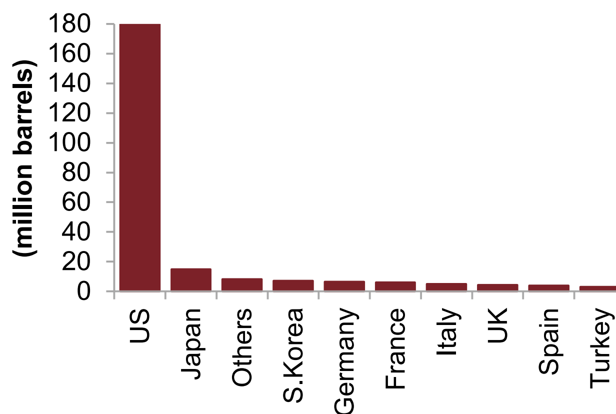


Figure 7: IEA members to release 240 million barrels from strategic oil reserves over the next six months



Taking all the above into account, we have raised our full year 2022 Brent oil forecast to $102 pb…

...but, at the same time, acknowledge that risks do remain skewed to the upside.

Taking all the above into account, we have raised our full year 2022 Brent oil forecast to $102 pb, with risks skewed to the upside (Box 2).

Box 2: Revised Saudi Fiscal Position

In light of our Brent oil price revision, the main change in our Saudi economic forecast is reflected in fiscal indicators. Thus, with Brent oil price of $102 pb and crude oil production of 10.5 mbpd in full year 2022, we see government oil revenue totaling SR935 billion (up 66 percent over last year's total) resulting in overall revenue of SR1.3 trillion. On the expenditure side, and in-line with the pattern seen over the last couple of years, we see 5 percent overspend versus budgeted levels, resulting in total expenditure of SR1 trillion. Taking into account revised revenue and expenditure forecasts, we now expect a significantly higher fiscal surplus of SR298 billion (or 7.8 percent of GDP) in 2022, versus a surplus of SR120 billion (3.4 percent of GDP) previously.

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Key Data

	2015	2016	2017	2018	2019	2020	2021	2022F	2023F
Nominal GDP									
(SR billion)	2,454	2,419	2,582	3,062	3,014	2,638	3,126	3,839	3,694
($ billion)	654	645	689	817	804	703	834	1,024	985
(% change)	-13.5	-1.4	6.8	18.6	-1.6	-12.5	18.5	22.8	-3.8
Real GDP (% change)									
Oil	5.3	3.6	-3.1	2.3	-3.3	-6.7	0.2	15.5	2.0
Non-oil activities	3.5	0.3	1.6	-3.2	3.2	-3.4	6.1	3.4	4.8
Government activities	2.3	0.2	0.3	3.5	1.5	0.2	1.5	1.0	1.0
Total	4.1	1.7	-0.7	2.5	0.3	-4.1	3.2	7.7	3.1
Oil indicators (average)									
Brent ($/b)	52	43	54	71	66	42	71	102	85
Production (million b/d)	10.2	10.4	10.0	10.3	9.8	9.2	9.1	10.5	10.7
Budgetary indicators (SR billion)									
Government revenue	616	519	692	906	926	782	965	1300	1151
Government expenditure*	1,001	936	930	1,079	1,059	1,076	1,039	1003	941
Budget balance	-385	-417	-238	-173	-133	-294	-74	298	210
(% GDP)	-15.7	-17.2	-9.2	-5.7	-4.4	-11.1	-2.4	7.8	5.7
Gross public debt	142	317	443	560	678	854	937	938	938
(% GDP)	5.8	13.1	17.1	18.3	22.5	32.4	30.0	24.4	25.4
Monetary indicators (average)									
Inflation (% change)	1.2	2.1	-0.8	2.5	-2.1	3.4	3.1	2.4	2.0
SAMA base lending rate (%, end year)	2.0	2.0	2.0	3.0	2.25	0.75	0.75	2.00	2.75
External trade indicators ($ billion)									
Oil export revenues	153	137	171	232	201	120	206	342	295
Total export revenues	204	184	222	294	262	174	280	419	376
Imports	159	128	123	126	140	126	142	157	153
Trade balance	44	56	98	169	121	48	138	262	223
Current account balance	-57	-24	10	72	38	-23	56	146	117
(% GDP)	-8.7	-3.7	1.5	8.8	4.8	-3.2	6.7	14.3	11.9
Official reserve assets	616	536	496	497	500	454	455	581	664
Social and demographic indicators									
Population (million)	31.0	31.7	32.6	33.4	34.2	35.0	35.4	35.8	36.3
Saudi Unemployment (15+, %)	11.5	12.5	12.8	12.7	12.0	12.6	11.0	10.7	10.4
GDP per capita ($)	21,095	20,318	21,114	24,438	23,485	20,089	23,557	28,597	27,158

Sources: Jadwa Investment forecasts for 2022 and 2023. General Authority for Statistics for GDP and demographic indicators, Saudi Central for monetary and external trade indicators, Ministry of Finance for budgetary indicators. Note: *2016 government expenditure includes SR105 billion in due payment from previous years.