Global Markets Daily: Oil: A Turning Point for Supply, Stocks, and Prices (Struyven/Grigsby)

- What explains the 35% decline in oil prices over the past year? Realized oil demand does not explain the selloff, as demand estimates have been consistently revised *higher* since last fall.
- We estimate that oil supply beats—especially from Russia but also record US SPR releases—explain over 80% of this selloff. However, OPEC+ supply has started to fall following some signs of a Russia cut and large declines in OPEC exports, consistent with high compliance to the latest OPEC cut.
- Rising fears of US recession and a China slowdown are likely weighing on oil prices too. Indeed, we estimate that forward curves are pricing all the main bearish risks to our $95/bbl December 2023 Brent forecast—no Russia cut, China demand misses, and a moderate OECD recession—but without any additional OPEC cuts. We thus view the oil market as too pessimistic and expect sustained deficits from June as OPEC+ production cuts fully realize and demand rises further.

Daan Struyven
+1(212)357-4172 |
daan.struyven@gs.com
Goldman Sachs & Co. LLC

Yulia Zhestkova Grigsby
+1(646)446-3905 |
yulia.grigsby@gs.com
Goldman Sachs & Co. LLC

Callum Bruce, CFA
+1(212)902-3053 |
callum.bruce@gs.com
Goldman Sachs & Co. LLC

Romain Langlois
+1(212)357-6395 |
romain.langlois@gs.com
Goldman Sachs & Co. LLC

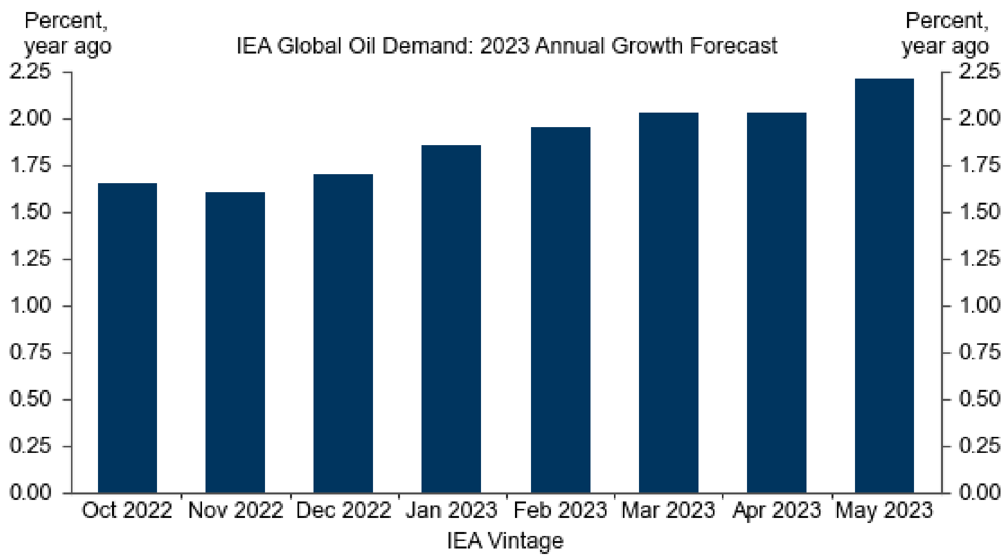
Jeffrey Currie
+44(20)7552-7410 |
jeffrey.currie@gs.com
Goldman Sachs International

Oil: A Turning Point for Supply, Stocks, and Prices

What explains the roughly 35% decline in oil prices over the past year, with Brent down to just $75/bbl?

Despite all the recessionary fears, realized demand is unlikely to explain this selloff. Indeed, the IEA and other forecasters, including ourselves, have steadily increased global oil demand forecasts. Exhibit 1 shows that the IEA has been raising demand growth projections every month since last November and as recently as last week. These demand upgrades reflect that strong EM and global services demand continue to outpace weaker DM and manufacturing environments.[1]

Exhibit 1: Consensus Expectations of Global Oil Demand Growth Have Risen

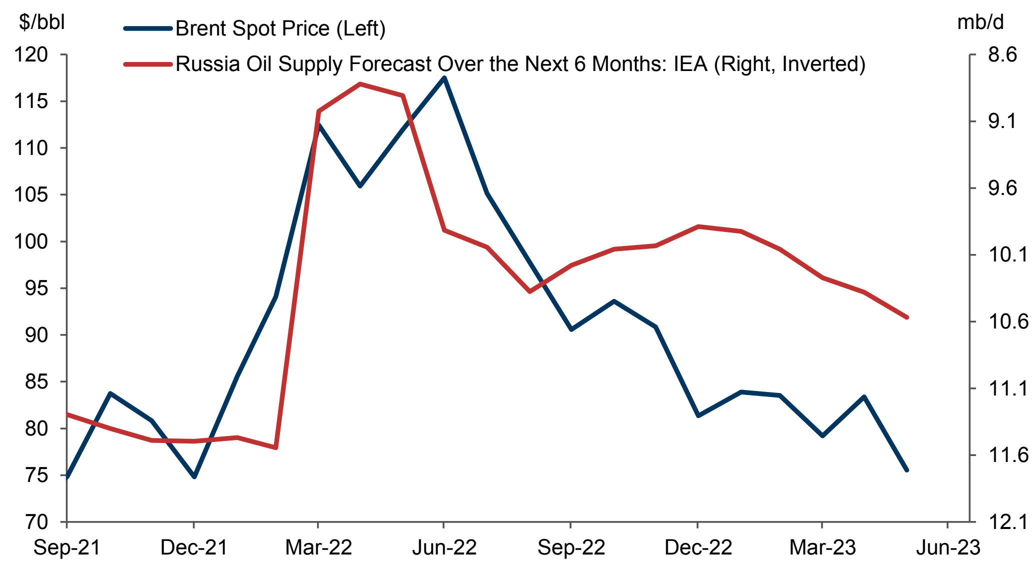


Source: IEA, Goldman Sachs Global Investment Research

That said, we and many other analysts have underestimated oil supply—particularly from sanctioned countries such as Russia—over the past year.

[1] These upgrades to global oil demand estimates have occurred despite a reduction in gas-to-oil substitution following the decline in global gas prices.

Exhibit 2: The Large Upside Surprise in Russia Oil Supply Has Coincided With the Fall in Oil Prices

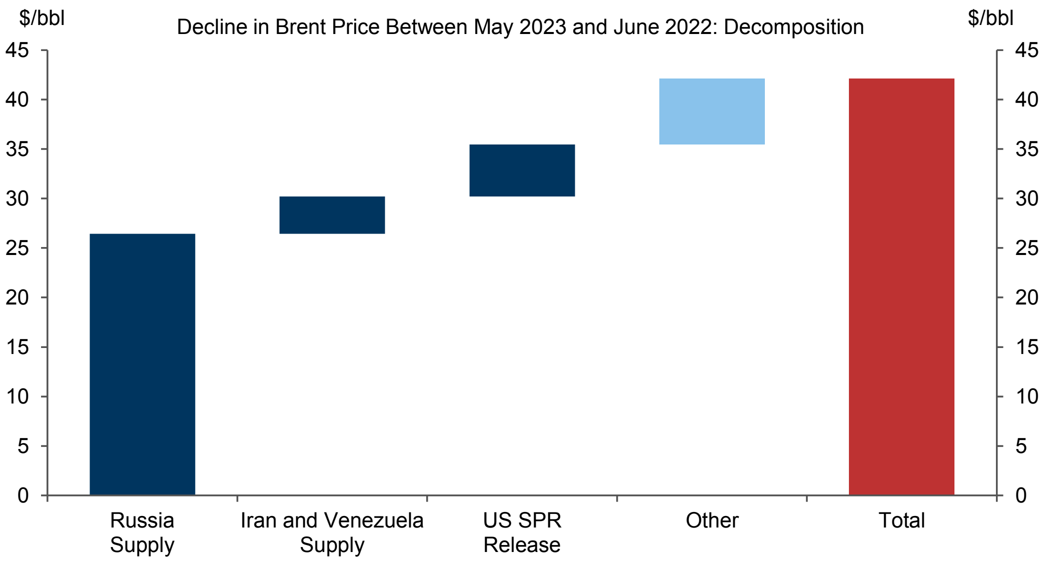


Source: IEA, Bloomberg, Goldman Sachs Global Investment Research

While IEA expectations of Russia oil supply initially collapsed after the invasion of Ukraine, they are now 1.7mb/d higher than a year ago (Exhibit 2). The more seamless redirection of Russian barrels, particularly to Asia and the Middle East, was further met by rising exports of Iranian barrels on a sharp decline in floating storage and by some additional exports from Venezuela. Moreover, the US SPR released about 220 million barrels last year in response to the war in Ukraine and the surge in inflation.

Using our pricing framework, we estimate that these positive non-OPEC supply shocks and the resulting rise in oil inventories together explain over 80% of the selloff since last year (Exhibit 3).

Exhibit 3: Higher Russia, Iran, and Venezuela Supply and the US SPR Release Explain Over 80% of the Decline in Oil Prices Over the Past Year



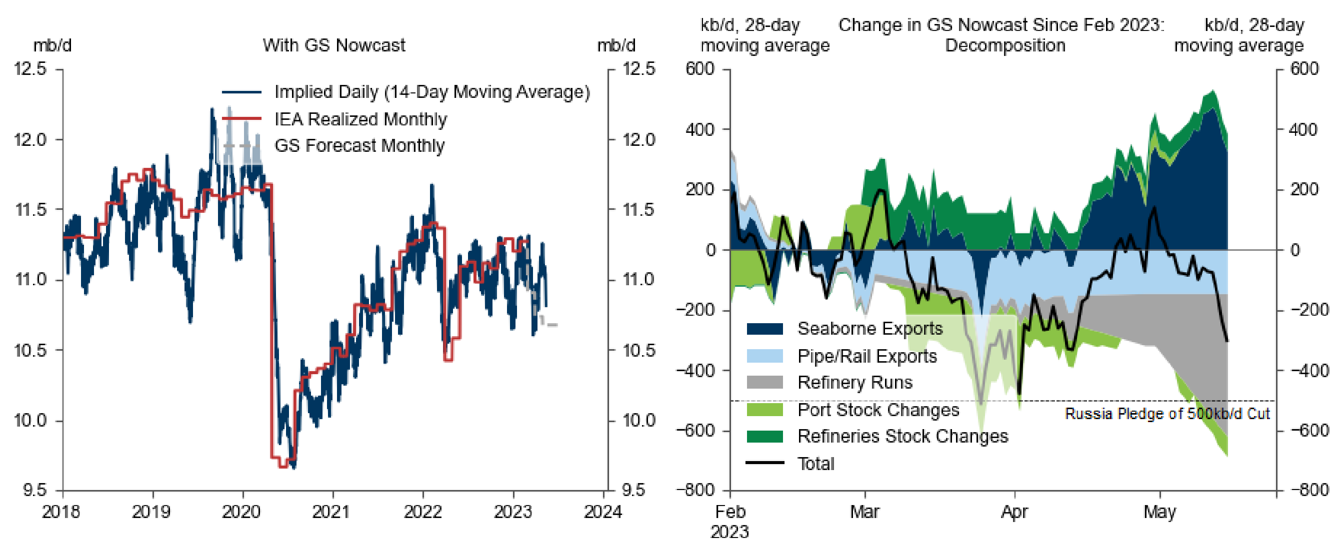
Source: Goldman Sachs Global Investment Research

Will oil supply continue to beat expectations? We believe the answer is no and think that global oil supply is at a turning point.

Starting with Russia, our nowcast of total liquids production has declined by 300kb/d since the February 2023 reference level (Exhibit 4). This decline reflects lower refinery runs and lower pipeline exports. We expect Russia to fully implement its pledge to cut by 500kb/d in the context of pressure from its OPEC+ partners. Despite the drop in our nowcast, we still see firmer Russia supply as a meaningful bearish risk to our constructive oil price forecast, as the drop may reflect seasonal refinery maintenance.

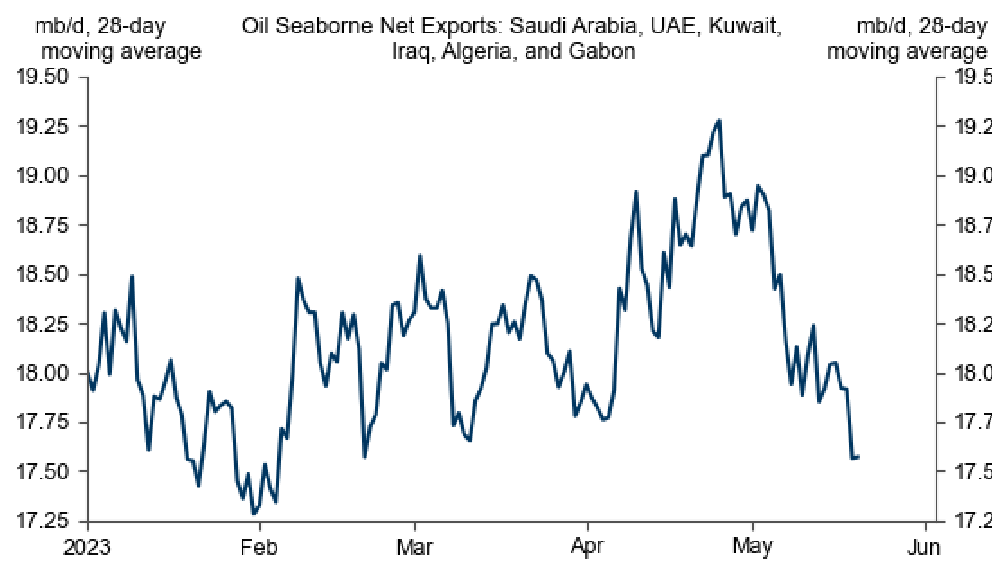
What about supply from the six OPEC countries—including Saudi Arabia—that simultaneously announced cuts on April 2nd? The sharp decline in their oil exports—worth about 1mb/d just over the past 2 weeks—strongly supports our forecast of a very high (90%) compliance rate to the cut announced in April (Exhibit 5).

Exhibit 4: Our Nowcasts Suggest That Production Cuts Have Started in Russia…



Source: IEA, Petro-Logistics, Kpler, Industrial Info Resources, Goldman Sachs Global Investment Research

Exhibit 5: … and its OPEC Partners



We show seaborne net exports—exports minus imports—for the six OPEC countries, which announced a cut on April 2nd 2023.

Source: Kpler, Goldman Sachs Global Investment Research

Finally, Friday's sharp drop in the US oil rig count—which is now down 8% since early December—supports our view that US crude oil supply growth is now slowing significantly to an annualized pace of just ¼ mb/d given elevated capital discipline and a maturing geology.

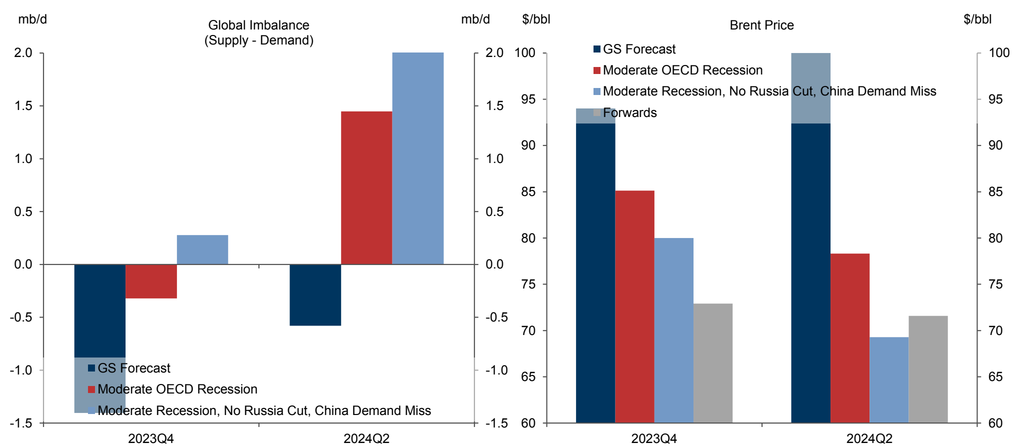
On top of positive supply shocks over the past year, rising fears of US recession and a China slowdown are now likely weighing on oil prices too.

On US recession fears, we recently showed that sharp Brent price moves have often coincided with big moves in US banks equity prices. Similarly, Brent declined by nearly

3$/bbl on Friday following a headline about a setback in the US debt ceiling talks.

Indeed, we estimate that forward curves are pricing all the main bearish risks to our constructive $95/bbl December 2023 Brent forecast—no Russia cut, China demand misses, and a moderate OECD-centric recession—but without any additional OPEC cuts (Exhibit 6).[2] Given how elevated OPEC pricing power now is, this strikes us as too pessimistic.

Exhibit 6: The Pessimistic Oil Market Appears to Be Pricing No Russia Cuts, Disappointing China Demand, and an OECD Recession



Source: Bloomberg, Goldman Sachs Global Investment Research

While above-average DM recession risk and some sequential softness in our China oil demand nowcast point to downside risk, we still expect rising EM demand and the turn in OPEC+ supply to push markets from a moderate Q1 surplus to large H2 deficits averaging 1½mb/d. And our nowcast of global visible stocks—published in our new Oil Tracker—also signals a turning point as inventory draws appear to have started.

Daan Struyven

Yulia Zhestkova Grigsby

[2] The recession scenario assumes a moderate OECD recession starting in 2023Q3, lasting 4 quarters. It assumes a peak 4% hit to the level of OECD GDP (relative to the GS baseline), which is slightly more moderate than the median historical recession in G10 economies, and modest spillovers to non-OECD economies of 1%. The China demand miss scenario assumes that the 0.3mb/d recent shortfall or our China demand nowcast relative to our monthly forecast persists.

Disclosure Appendix

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We, Daan Struyven, Yulia Zhestkova Grigsby, Callum Bruce, CFA, Romain Langlois and Jeffrey Currie, hereby certify that all of the views expressed in this report accurately reflect our personal views, which have not been influenced by considerations of the firm's business or client relationships.

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