

Crude Oil Outlook: Reality Bites

A Publication of BMO Capital Markets Economic Research • Douglas Porter, CFA, Chief Economist, BMO Financial Group

A new reality appears to have suddenly engulfed the oil market—the outlook for a sustained period of elevated prices has dimmed, at least for the time being. Market participants have been shaken by developments on both the global oil demand and supply fronts; specifically, slowing Chinese demand and OPEC+’s future production strategy. In response, **we recently lowered our annual WTI forecast** to US\$77.5/bbl in 2024 (or ~\$75 for the rest of the year) and \$77.5 in 2025 (previously \$79 and \$80 for the calendar years), but risks to these projections remain tilted on the downside.

China’s latest trade data have fanned fears that the country’s demand for crude oil—which has been the main incremental driver of global oil demand—is cooling quicker than previously envisioned. Measured in volume terms, imports of crude oil fell a hefty 7.0% y/y in August and are now down 3.1% y/y in the year-to-date. As a result, **growth in Chinese oil consumption is now expected to slow significantly**, to around 200 kb/d this year, compared to its average increase of 600 kb/d over the past decade. Note that the IEA was originally forecasting an increase of 700 kb/d at the start of the year. Beyond generally weak economic conditions, it appears that the country’s rapid adoption of electric vehicles (accounting for over 50% of new motor vehicles sales) along with the development of high-speed rail networks, is taking a greater toll on both gasoline and jet fuel demand.

Nonetheless, we are of the view that the more pressing factor revolves around **uncertainty over OPEC+’s production strategy**. After all, if not for the fact that the cartel is holding back 5.5 mb/d in output (or 5% of global oil supply), crude oil prices would be much lower. Thus, the big near-term issue facing the cartel is whether it will alter its June decision to gradually unwind the 2.2 mb/d in additional voluntary production cuts. Although OPEC+ decided on September 5 to delay the plan from the start of October to December, it seems quite evident that bringing barrels back online so soon would likely lead to larger supply surpluses based on the cartel’s outlined production targets. This decision to “kick the can down the road” likely explains why market participants remain unnerved. Many were hoping the cartel would reverse the plan to phase out cuts and instead, ideally, commit to taking more production offline.

The last two meetings suggest that intra-cartel relations remain intense and complex, perhaps more than what is commonly perceived. This is highlighted by the fact that a significant portion of OPEC+’s total production cuts are voluntary and that many members continue to breach their quotas (e.g., Iraq, Kazakhstan and UAE). Pressure on the cartel is likely to intensify further if crude oil prices continue to struggle before its next meeting. A critical factor that we believe the cartel is wrestling with is its rather optimistic outlook for global oil demand, which it projects to increase by a hefty 2.2 mb/d in 2024, followed by 1.8 mb/d in 2025. In contrast, the IEA is forecasting

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increases of 900 kb/d in 2024 and 950 kb/d in 2025, in line with the average annual increase of 1.0 mb/d during the previous ten years.

Key Takeaway: Although recent history shows that big swings in crude oil prices are not unusual, the prospect for a large, near-term snapback appears challenging at present. Future price developments will depend on whether OPEC+ relents on its decision to unwind its production curbs, in both speed and scale. We think the cartel will ultimately alter its production path, but it will remain a bumpy ride for prices.

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