

Energy monitor

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Higher oil prices due to economic recovery

- ▶ **Economic recovery driving oil prices higher**
- ▶ **US oil production not recovering as fast as expected despite higher prices**
- ▶ **OPEC+ reluctant to increase oil production**
- ▶ **Oil price forecast revised upwards**

Oil price rises above USD 75/barrel

The economic upturn is creating optimism in the market. As lockdowns have been eased in many major economies, expectations of oil demand are being revised upwards. Partly as a result of this, Brent oil prices have risen above USD 75/barrel. WTI has seen a similar trend and is now trading near USD 74/barrel. In addition, strong investor appetite for cyclical assets had also contributed to the positive sentiment and an important technical resistance level has been broken. This will likely see Brent oil prices rising to at least towards the USD 78/barrel level. Finally, OPEC+ is very reluctant to increase oil production, which is adding to the pressure on prices. OPEC+ may be cautious because the expected rebound in US shale oil production has not materialised yet.

Oil prices continue to rise



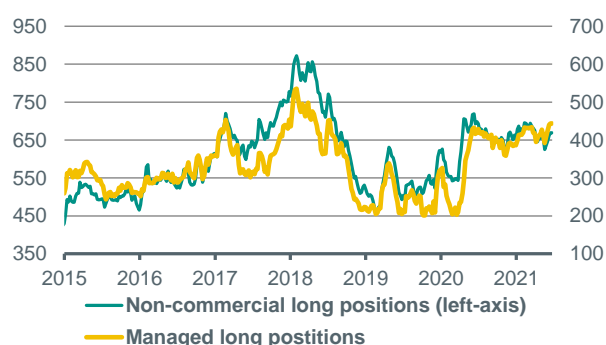
Source: Bloomberg

There are a number of notable developments that make this price rise possible. One development is market speculation. The recent price rise is not so much the result of more market participants expecting the price to rise further. The number of long positions (positions speculating on price rises) has remained virtually unchanged in recent months. It is mainly the market expectations for price decreases that have been strongly reduced in the recent period. This also puts upward

pressure on prices. We think this is mainly due to the fact that OPEC+ does not feel the pressure to increase production faster.

Speculative long positions are unchanged...

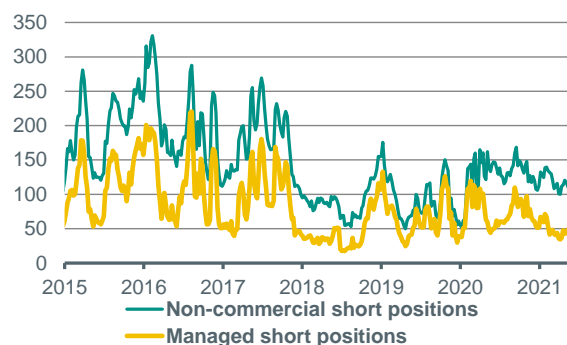
Number of open contracts (x 1,000)



Source: Bloomberg

But speculation on a price drop is waning

Number of open contracts (x 1,000)



Source: Bloomberg

US shale oil supply fails to step up sharply despite high oil price

In spite of the relatively high oil price, a major revival of the US shale oil industry has not yet materialised. Fears, especially on the part of Russia, that if oil prices were to trade above USD 50/barrel for an extended period, the US shale oil industry would experience a new upswing, have proved unfounded for the time being. According to Baker Hughes, the number of active drill rigs is increasing (from 172 in August to 365 now). Nevertheless, drilling activity is not yet approaching the 1.600 rigs that were operational in the second half of 2014, or even the level of the second, albeit lower, peak of late 2018 (888).

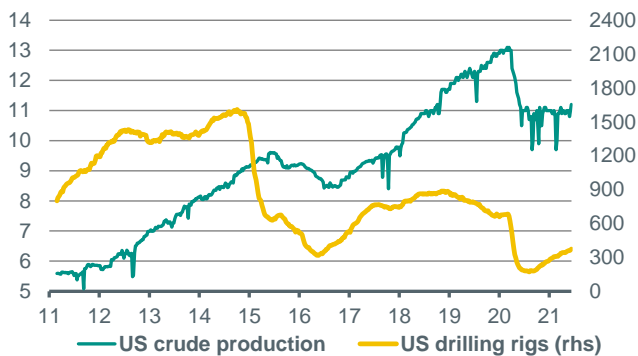
However, we do see that quite a few new wells were brought into production in the past year. The number of DUCs - *drilled-but-uncompleted* wells - has dropped in one year from 8874 in June 2020 to 6521 at the end of May this year. Most of this production is in the Permian Basin, in the states of Texas and New Mexico, USA. The DUCs can be seen as a kind of spare capacity that can be brought into production when the time/price is right. With new drilling activity increasing only slowly, and the average lifetime of a shale oil production well¹ being very short, this spare capacity needs to be tapped simply in order to maintain the overall level of US oil production.

The fact that US oil production is not increasing faster now that the oil price has risen sharply, reflects a number of factors. First, there is the stricter regulation put in place by President Biden's administration. With stricter requirements for methane leaks and the treatment of wastewater, the cost price is rising. In addition, Biden does not want to issue new permits for production on federal land. This would impact about 10% of the potential production. Yet a federal judge in Louisiana blocked Biden's plans last week by prohibiting the suspension of issuing new leases for oil and gas production on public lands and waters. The lawsuit was filed by thirteen states that want to continue oil and gas production and think Biden's ambitious climate plans go too far. The *American Petroleum Institute* is therefore asking the government to issue new licences as soon as possible.

¹ In shale oil production, the vast majority of production (+/-70%) takes place in the first year of production and about 20% in the second year. After that, the drilling rig often continues to produce for years, but the return is much lower and new investments have to be made to maintain total production.

Oil production in the US barely recovers

x million barrels per day



Source: Bloomberg

Another reason why US production is not recovering as quickly this time is related to profitability and access to financial resources. In recent years, the shale oil industry has proved to be very capital intensive. As explained above, most production from a well is extracted in the first year. In order to maintain production, continuous investment in new production wells/fields is required. This came at the expense of profitability. Many investors suffered losses on their investments, especially at the time of the sharp falls in oil prices. At present, there is much more attention for 'healthy' business management, with a better balance between investments and returns. Financial institutions are also much more critical about which projects they finance. This means that the more risky projects also have more difficult accessing financial resources. This leads to higher production costs. The access to financial resources and the focus on better returns is currently preventing a strong recovery of oil production. At the same time, it ensures that the companies that are still producing today can do so at better margins.

With US production not recovering, OPEC+ feels little pressure to increase production

When the oil price hovered around USD 50/barrel at the end of 2020, Russia indicated that it was time for OPEC+ (coalition of OPEC countries and other oil producing countries led by Saudi Arabia and Russia) to increase production. Russia's main fear was that market share would again shift from this group of oil producers to the US oil producers. Now that US production is not increasing rapidly, despite the higher oil price, there is also less pressure on OPEC+ to increase oil production. If there is any pressure at all, it comes from big oil importers such as China and India. In early March, the Indian Energy Minister already complained about the high oil price. And then it was more than 10% lower, at only USD 67/barrel.

OPEC+ will indeed increase oil production in the coming months. However, it is not yet clear by how much. During the last OPEC+ consultation, the Saudi energy minister indicated that production increases for the months of June and July will be implemented as planned (350,000 and 450,000 barrels per day extra, respectively). There was no mention of further production increases during the rest of the year. The main reason for keeping the market in the dark about production increases in the second half of the year is a possible new agreement on Iran's nuclear power programme, which would open the way to the country's oil supply. Indeed, the Biden administration is making fresh efforts to revive the nuclear deal previously cancelled by President Trump. The developments seem positive and a new agreement might be reached in the coming weeks/months. One of the conditions that Iran has attached to a new agreement is the lifting of sanctions against the country. This would mean that Iran would be allowed to export oil again. Given that Iran is an OPEC member and could increase its oil production/exports by at least one and a half million barrels a day, it is a player in the market that the current OPEC+ coalition are taking into account. Increasing production and exports from Iran must

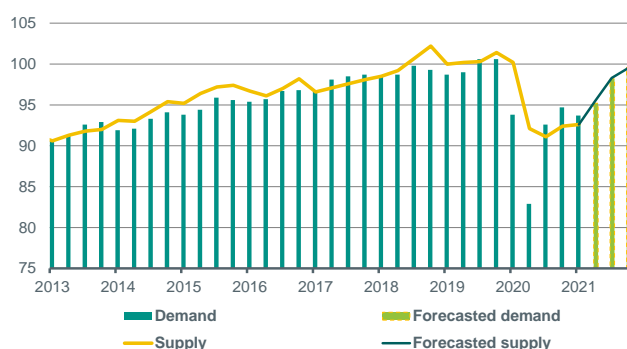
be facilitated by the other countries by 'managing' the remaining oil production to prevent a huge oversupply - and thus a price drop.

Oil price expectations revised upwards

The International Energy Agency (IEA) expects oil demand to return to pre-Corona levels by the end of 2022. To avoid problems such as shortages and large price increases, the IEA is calling on OPEC+ to increase production. It is to be expected that major oil importers such as India and China will also speak out again about the high oil price. One possible downside risk to prices is that new corona varieties will trigger new restrictions that could negatively affect the further recovery of oil demand. However, this is not our base case, which is for an ongoing lifting of pandemic-related restrictions.

Oil demand back on track for end 2022

x million barrels per day



Source: Bloomberg

The oil price rise has been driven mainly by sentiment and technical factors. There is sufficient production capacity available to absorb any increase in demand. OPEC+'s reluctance to do so and the fact that the demand for oil may have recovered faster than previously expected, have led to oil prices rising further than we had previously expected. US oil production will be closely watched in the coming months. Also, a possible nuclear deal with Iran could lead to more oil supply. But the most important factor for the direction of the oil price lies in the hands of OPEC+. Will OPEC+ further increase oil production? And if so, by how much?

We do not expect the oil price to rise much further. The price is already well above the unofficial OPEC+ target of around USD 60/barrel. Large consumers will start to stir and eventually this high oil price will also lead to more production in the US. Finally, there will be more supply from Iran and OPEC+ will feel compelled to increase oil production further to maintain market balance. At the same time, the downside potential will also be reduced. Unless a new corona virus emerges that causes new lockdowns and negatively affects oil demand, we expect the supply/demand balance to remain reasonably intact. An oil price fluctuating between USD 60-70/barrel would be consistent with this picture of the market. As this is above our current estimates, we revise our oil price estimates slightly upwards. Our year-end estimate for Brent has been raised from USD 60/barrel to USD 65/barrel. This will bring the 2021 annual average to USD 66/barrel (up from USD 62 previously). See the table on the next page.

Oil and gas price estimates

End of period		22-Jun	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23
Brent *	USD/bbl	74.94	65	65	65	60	62	65	64	65	63	62
WTI *	USD/bbl	73.52	63	62	62	57	59	62	60	61	59	58
Natural Gas (HH) *	USD/mmBtu	3.21	2.80	2.75	2.60	2.50	2.60	2.80	2.60	2.50	2.60	2.90
TTF *	EUR/MWh	22.80	19	21	19	17	19	20	19	18	20	22

Average		2020	Q3 21	Q4 21	2021	Q1 22	Q2 22	Q3 22	Q4 22	2022	Q1 23	Q2 23	2023
Brent	USD/bbl	43.21	70	65	66	65	63	61	64	63	65	65	64
WTI	USD/bbl	39.34	68	63	63	62	60	58	61	60	61	61	60
Natural Gas (HH)	USD/mmBtu	2.13	3.00	2.80	2.90	2.70	2.60	2.60	2.70	2.70	2.70	2.60	2.70
TTF	EUR/MWh	13.48	21	20	19	20	18	18	20	19	19	19	20

* Brent, WTI and Henry Hub: active month contract; TTF: next calendar year

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