Oil market volatility: 
Assessing the bullish and bearish narratives

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Oil market overview
Brent prices have exhibited high volatility amidst low liquidity, while refining margins have also fallen from their highs in recent weeks.

**Brent price**

<table>
<thead>
<tr>
<th>USD/B</th>
<th>Jan-19</th>
<th>Jan-20</th>
<th>Jan-21</th>
<th>Jan-22</th>
<th>Jan-23</th>
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**Refining margins**

<table>
<thead>
<tr>
<th>USD/B</th>
<th>Jan-20</th>
<th>Jul-20</th>
<th>Jan-21</th>
<th>Jul-21</th>
<th>Jan-22</th>
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</table>

Source: World Bank, ICE

Source: Argus
Market fundamentals

Preliminary estimates suggest that global demand grew y/y by 3.7 mb/d in H1 2022 and global oil supply also grew by 5.5 mb/d supported by the SPR releases.

**Global oil demand growth**

Notes: Estimate in 2022 refers to H1. Consensus averages estimates from IEA, US EIA and OPEC. Source: IEA, US EIA, OPEC, OIES

**Global oil supply growth**

Notes: Estimate in 2022 refers to H1. Consensus averages estimates from IEA, US EIA and OPEC. Source: IEA, US EIA, OPEC, OIES
Global balance

The oil market appears to have shifted to a small surplus of 200,000 b/d in H1 2022, albeit stocks remained extremely tight and as of May they were standing 322 mbbls below their 5-year average.

Global balance

OECD commercial stocks

Notes: Estimate in 2022 refers to H1. Consensus averages estimates from IEA, US EIA and OPEC. Source: IEA, US EIA, OPEC, OIES

Source: IEA, OIES
Bullish narrative
Bullish scenario 1: Russia disruptions (1/2)

The *high disruption case* sees the recent gains in Russian oil production reversing from August-onwards and falling 1.8 mb/d below its 11 mb/d pre-war level year-end and averaging 2.1 mb/d lower in 2023.

**Russia oil production scenarios: High disruption case**

Source: OIES
Bullish scenario 1: Russia disruptions (2/2)

The price impact is significant in Q4 2022 and Q1 2023, averaging $20/b higher than the baseline forecast, but it eases close to $10/b in the remainder of 2023 as negative demand pressures intensify.

Brent price forecast scenario: Russia high disruption case

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES
Bullish scenario 2: OPEC+ struggle (1/2)

The *OPEC+ low case* sees OPEC+ excluding Russia returning only 728,000 b/d versus the agreed 1.3 mb/d in July/August and underproduction in August reaching at 2 mb/d below set target.

**OPEC+ production increases by country**

*Source: OIES*

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Bullish scenario 2: OPEC+ struggle (2/2)

Brent prices could see an additional pressure between $2/b and $5/b building to the upside and persisting in 2023.

Brent price forecast scenario: OPEC+ low case

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES
Bullish scenario 3: Geopolitical risks

The *geopolitical risks case* sees the Iranian nuclear deal failing to materialise in 2022/2023, Libya’s production remaining volatile and no significant gains in Venezuelan output.

**OPEC(3) oil production**

![Graph showing OPEC(3) oil production from January 2010 to January 2023, with projections for 2023 and 2024.](source: OIES)
Albeit the impacts appear to be small, they add however nearly $1/b on annual terms to the Brent price in 2022 and $2/b in 2023, relative to the baseline forecast.

Brent price forecast scenario: Geopolitical risks

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES
Bullish scenario 4: Non-OPEC constraints

The low non-OPEC response case sees gains in non-OPEC production outside OPEC+, mainly NAM, undershooting expectations and driving prices higher by $1/b in 2022 and $4/b in 2023.

Brent price forecast scenario: Non-OPEC low response

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES
Bullish scenario 5: Oil switching (1/2)

The *gas-to-oil switching case* sees winter gas shortages resulting in a 600,000 b/d incremental demand between Oct-22 and Mar-23 (50% in Europe), associated with power generation, industry and refining.

**Oil switching assumptions**

Source: OIES
Price pressures are building year-end and persist for the entire H1 2023, adding $3.2/b versus the baseline case before gradually easing in the remainder of the year.

**Brent price forecast scenario: Oil switching**

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES
Bullish scenario 6: Chinese demand (1/2)

The *China high case* assumes that the Chinese demand rebound from H2-onwards exceeds expectations with growth overperforming by 100,000 b/d in 2022 and by 210,000 b/d in 2023.

**China oil demand growth scenarios**

Source: OIES
Upward demand pressure originating from China is seen gradually building towards year-end, but it is mostly confined in 2023 lifting prices by further $4/b on average compared to the baseline.

**Brent price forecast scenario: China high case**

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES
Bullish scenarios: Oil demand

Based on our bullish forecast scenarios, the upside potential for global demand growth reaches at 2.3 mb/d in 2022 and 2.1 mb/d in 2023.

Global oil demand growth forecast scenarios

Source: OIES
Analysis suggests that even if all these bullish factors converge together to generate a *perfect storm*, oil prices do not exceed $140/b and cannot be sustained for more than two quarters in the $130s.

**Brent price upside risks**

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES
Price ceiling (2/3)

The dominant bullish driver will be the eventual realization of the Russian disruptions, but for prices to reach and maintain high levels, one needs to make the unrealistic assumption that high prices due to the supply shock don’t impact demand.

**Brent price forecast scenario: Russia high disruption case (no demand impact)**

USD/B

- **Russia high case**
- **Russia high case (no demand impact)**
- **Other bullish factors**
- **Baseline**

Notes: *Other bullish factors* sums the price impact of all other bullish scenarios.

Source: OIES
If the demand response to the *Russia high case* is switched-off and all other bullish factors play out, only then Brent could break above $140/b, albeit 800,000 b/d of demand losses will be unaccounted for.

**Global oil demand impact in Russia high disruption case scenario**

Note: Modelled estimates based on the difference between the impacts of the two scenarios on global growth and global oil demand via price.

Source: OIES
Summary of the Bullish case

Perfect storm of:

- High Russian crude and products supply disruption.
- The associated sharp increase in oil and products price due to the Russian supply shock will not have significant impact on the global economy and oil demand.
- Strong rebound in China’s demand as the Chinese government stimulates the economy.
- Large substitution from gas-to-oil as natural gas prices remain elevated.
- Confluence of other supply factors, e.g., geopolitical outages, no Iran nuclear deal, moderate non-OPEC supply response.

Source: OIES

Brent price forecast scenarios: Bullish

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Bearish narrative
Bearish scenario 1: Russia resilience

The *low disruption case* sees Russian oil production averaging near the current levels of 200,000 b/d and 300,000 b/d below pre-war levels for the entire forecast horizon.

**Russia oil production scenarios: Low disruption case**

![Diagram showing Russia oil production scenarios: Low disruption case](source)

Source: OIES
Bearish scenario 1: Russia resilience (2/2)

The impact on prices is immediate and persistent to the end of 2023, pushing the baseline price lower by $5/b on average for the entire period.

Brent price forecast scenario: Russia low disruption case

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES

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The *Iran return case* assumes that a nuclear deal is reached in Q4 2022 with some 900,000 b/d of Iranian production gradually returning in H1 2023 and averaging 3.6 mb/d in H2.

**Iran oil exports and production**

*Source: Kpler, TankerTrackers, OIES*
Bearish scenario 2: Iran returns (2/2)

By design, the impact from the return of Iranian production on prices is confined in 2023 and averages $3.1/b for the year as whole, relative to our baseline.

Brent price forecast scenario: Iran return

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements. Source: OIES
Bearish scenario 3: Non-OPEC boost

The *high non-OPEC response case* sees modest improvements to the non-OPEC production outlook outside OPEC+ led by the US, trimming another $2/b from Brent versus the baseline price.

**Brent price forecast scenario: Non-OPEC high response**

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Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES

BULLISH NARRATIVE
The SPR release extension case assumes the US extending the scheduled release of crude from SPR beyond October to the end of the year, adding another 1 mb/d between November and December.

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements. Source: IEA, OIES
Negative price pressures of up to $2/b build anew towards Q1 2023, but the impact effect of the SPR release is temporary and ebbs in its entirety by the end of H1.

Brent price forecast scenario: SPR release extension

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements. Source: OIES
Bearish scenario 5: Recession (1/2)

The *global recession case* sees global growth slowing sharply to 0.7% in 2023 from 2.9% the year before, as supply-chain disruptions and persistent inflationary pressures squeeze the global economy.

Global growth scenarios

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: Oxford Economics, OIES

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A global recession appears to be the dominant bearish driver weighing heavily to the outlook, with price losses progressively becoming aggressive ending-2022 and accelerating in 2023 to average $11.6/b.

**Brent price forecast scenario: Global recession**

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES
Bearish scenarios: Oil demand

Based on our bearish forecast scenarios, the downside potential for global demand growth falls to 2 mb/d in 2022 and 0.7 mb/d in 2023 under the global recession case.

Global oil demand growth forecast scenarios

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES
Oil prices could potentially fall just under $70/b under a perfect storm of negative drivers, but this will require all supply/demand drivers to converge with the Russian supply shock potentially resolved.

Brent price downside risks

Notes: Baseline assumes only base growth assumptions, OPEC+ production hike in August and SPR releases till October as per agreements.

Source: OIES
Perfect storm of:

- Global economic recession that would have big negative impact on demand (the key determinant).
- The supply disruption remains limited as Russia continues to redirect its crude and products exports to other parts of the world.
- The full return of Iranian supplies to the market.
- Strong supply in response to higher oil prices, for instance US shale surprising significantly to the upside.
- The US continues to release stocks from SPR beyond October for few additional months.
Outlook
Many moving parts

Prospects for a perfect storm in either direction are very limited. There are many moving parts shaping oil markets and these are not moving in the same direction both on the demand and supply side.

- **Example on the demand side:** Higher oil and products prices and slower economic activity having their impact on demand, but pent-up demand and gas-to-oil substitution could offset some of the negative demand pressures.

- **Example on the supply side:** Russian disruption is lower than originally projected but risk of bigger Russian disruption still high and the capacity buffers in the system are low (OECD stocks below 5-year average, spare capacity thin) in an environment of heightened risks of outages (geopolitical, weather-related events)

Source: OIES
Brent price forecast averages $108.5/b in 2022 and $104.2/b in 2023, with Q4 2022 strengthening as price pressures are expected to return before easing again in the remainder of the year.

Source: OIES
Global oil demand growth is forecast to 2.2 mb/d in 2022 and 1.9 mb/d in 2023 but risks to the demand outlook are skewed to the downside.

Source: OIES
Pent-up demand is keeping OECD demand on track for another year of healthy recovery with some oil-switching coming into play ending 2022, while Chinese rebound supports outlook in 2023.
2020 was a particular tough year for US shale producers. Global oil supply is forecast to grow by 5.5 mb/d in 2022 and 0.7 mb/d in 2023, but outlook remains tight despite the recent easing of Russian disruptions.

Global oil supply

Notes: Non-OPEC includes the release of crude from strategic stocks.
Source: OIES

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2020 was a particularly tough year for US shale producers. OPEC+ underproduction outside the Middle East, non-OPEC growth constraints and elevated geopolitical risks outside Russia continue to dampen the supply outlook despite robust recovery in North America (NAM).

### Global oil supply growth by producer

- **OPEC**
- **US**
- **Brazil**
- **Canada**
- **Norway**
- **Other**
- **Non-OPEC**
- **NGL**
- **Bio + Misc.**
- **World**

**Notes:** Crude oil production only. Source: OIES

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2020 was a particularly tough year for US shale producers. We forecast a 0.9 mb/d surplus in 2022 followed by a -0.35 mb/d deficit in 2023, but the outlook is surrounded by elevated uncertainty in both the supply and demand sides of the market.
The replenishment of OECD stocks is seen slow-moving throughout, expected to keep providing strong support to prices well into 2023.

**OECD commercial stocks vs 5-year average**

Source: OIES
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Director, Oil Research Programme

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OIES Oil Monthly

Short-term oil market outlook to 2023

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