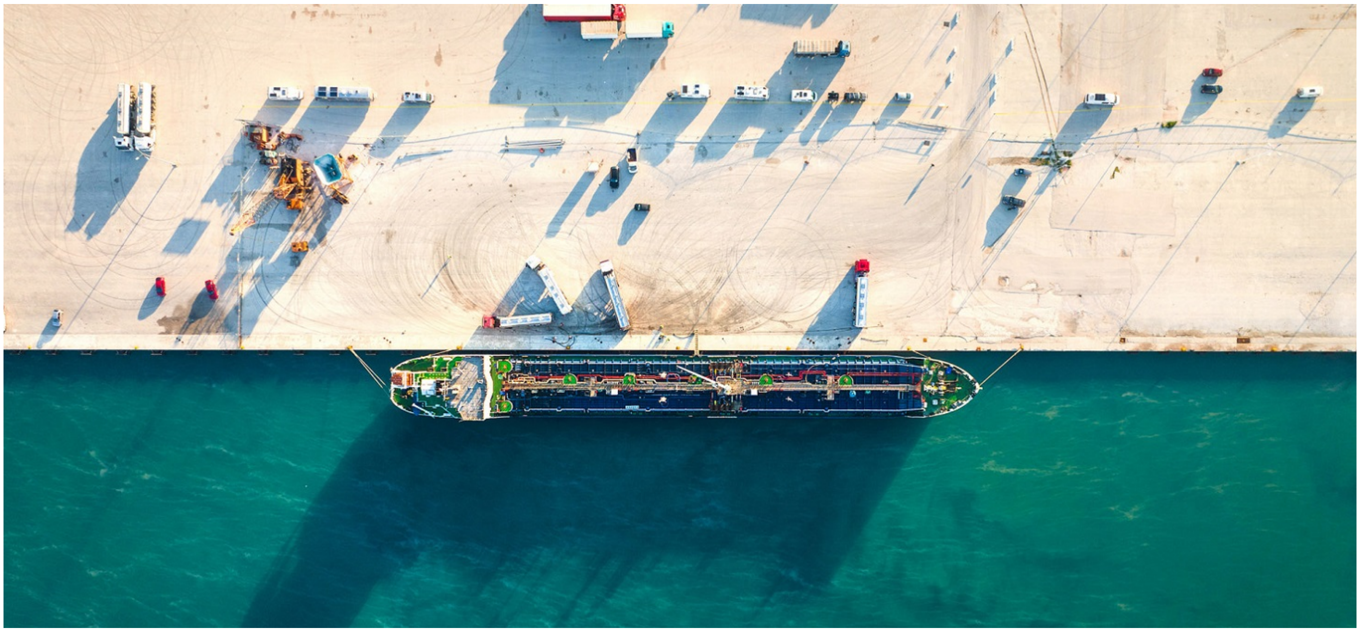

High-frequency demand indicators suggest total oil consumption has come in stronger than expected this year. (UBS)

Can oil's climb continue?

04 April 2024, 2:06 pm CEST, written by UBS Editorial Team

Oil prices this week hit the highest level since October last year, with Brent crude having traded close to USD 90 per barrel (and priced at USD 89/bbl at the time of writing). Year-to-date, this measure of oil prices has risen almost 16%, while the WTI benchmark has gained nearly 20%.

CIO believes the latest price increase has been driven by renewed geopolitical concerns. Ukraine has continued its attacks against Russia's oil refineries in a bid to reduce the latter's oil revenue, while conflicts in the Middle East escalated further following an attack on the Iranian consulate in Syria.

But market fundamentals have also underpinned the rally. While Brent crude may not move significantly higher from its current level, we think oil prices should remain well-supported in the near term amid a slightly undersupplied market.

OPEC+ reiterates commitment to compliance on production cuts. The OPEC+ Joint Ministerial Monitoring Committee (JMMC) this week noted a high compliance rate on the group's ongoing production cuts, but it also reintroduced an emphasis on improving compliance for countries that have overproduced in recent months. We think the renewed focus is likely to keep the oil market undersupplied. Earlier this week, preliminary estimates from Reuters showed that OPEC output in March fell 50,000bpd from February. If the countries that have overproduced so far compensate and reduce their output, OPEC+ production is likely to fall further during the second quarter.

Supply should stay restrained even after OPEC+ ends its voluntary cuts. Our base case remains that OPEC+ countries will unwind some of their output cuts in June. But as we have stated in the past, the group will not remove the production cuts if it doesn't believe the oil market can absorb additional barrels. Any loosening of production cuts will be gradual and an ongoing drop in oil inventories will be required for this to happen, in our view. The JMMC this week reiterated previous guidance that it "will continue to closely assess market conditions," and stands ready "to take additional measures at any time." Outside of OPEC+, supply growth is forecast to slow from last year's level.

Demand has been strong. High-frequency demand indicators suggest total oil consumption has come in stronger than expected this year. Last month, the International Energy Agency increased its assessment of first-quarter demand growth by 270,000bpd to 1.7mbpd year-over-year. Oil inventory buildup has also underwhelmed many market participants' expectations. With the US driving season coming up and global flight activity improving to near pre-pandemic levels, we continue to see robust demand. We forecast oil demand growth at 1.4mbpd for 2024 overall, higher than the growth rate of 1.2mbpd seen between 2000 and 2019.

So, with geopolitical conflicts remaining an ongoing risk, we continue to see benefits in holding oil in a diversified portfolio for diversification and hedging purposes. Investors with a high risk-tolerance can also consider either selling the risk of falling Brent prices to generate yield, or adding exposure to longer-dated Brent oil contracts.

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