While CIO could see some near-term price volatility on supply concerns, they retain a modestly positive outlook for crude prices. (UBS)

Oil should stay supported despite OPEC+ plans to restore output

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Oil markets see-sawed early Monday amid competing interpretations of the weekend OPEC+ agreement on production cut policy. Brent crude was trading below USD 81 per barrel at the time of writing, after three consecutive days of declines and a 7.1% monthly fall for May.

In its statement, OPEC+ said it would extend 1.66mn barrels per day (bpd) in group cuts to December 2025, but paired this with a small production quota increase for the UAE next year (300,000 barrels per day), and a clearer timeline on how it could begin unwinding 2.2mn barrels per day in voluntary cuts beginning October 2024.

While some bearish oil market participants may see reason for concern, we are more constructive on both the supply and price outlook for several reasons:

The voluntary curb taper appears conditional on market conditions. In describing its timeline to add back oil from the voluntary cuts, OPEC leadership said "the monthly increases can be paused or reversed subject to market conditions." Saudi Arabia accounts for the bulk of the voluntary cut, which will give it sway in controlling when incremental crude hits the market. An excessive build in supply or a sharp decline in prices would likely interrupt this proposed timeline in our view.

Transparency on OPEC+ returning oil to market will impact other producer plans, too. Lower oil prices have reduced drilling activity in the US, weighing on US oil production growth. Now, the prospect of more crude returning to market may encourage non-OPEC+ producers to further slow investment and capacity gains. US producer output growth year to date is less than half that seen last year, backing our expectations that non-OPEC+ production growth should slow to 1.4mbpd this year, down from almost 2.4mbpd in 2023.

Oil demand is holding up well. Real-time mobility data has indicated healthy oil demand growth, and we expect global oil inventories to fall in the coming weeks, as demand seasonally rises over the summer. Driven by emerging markets, we estimate demand growth of 1.5mbpd for 2024, above the long-term annual growth rate of 1.2mbpd.

So, while we could see some near-term price volatility on supply concerns, we retain a modestly positive outlook for crude prices. Additional barrels may come back to the market from October only if the market can absorb those supply increases, and OPEC+ has shown cohesion and will likely be gradual in their approach. We expect Brent to trade around USD 87/bbl at year-end, and we reiterate our recommendation for risk-seeking investors to sell the downside price risks in crude oil. Unresolved geopolitical tensions in the Middle East also support allocations to portfolio hedges like crude and gold, in our view.

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