KPMG

Oil market quarterly review

Deal Advisory

Q1 2021

Oil price forecasts

June 2021

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Executive summary

In January-February 2021, the market was seized by waves of optimism amid positive news about vaccination successes in some regions, a stable oil demand recovery, and effective OPEC+ actions to maintain market supply restrictions. This positive background resulted in a price rally to UDS70/bbl. However, a number of negative events towards the end of the quarter adjusted the price to the levels of USD60-65/bbl.

Significantly, the oil market has approached an equilibrium state. Due to the steady excess of demand over supply, free oil stocks in storage facilities are gradually decreasing. From a maximum level of 3.3 bln bbl in mid-2020 stocks have already decreased by more than 300 mln bbl. Unofficial supplies of oil from Iran to China in the amount of about 1 mln bbl/d prevented a more rapid achievement of equilibrium. These supplies allow China to hold back its strategic oil reserves, accumulated during the pandemic.

Despite all the informal signals from OPEC+ and Saudi Arabia, and indicated intentions to maintain the restrictions, on April 1, it was decided to gradually increase oil production from May to July. The additional volume to be brought to the market by OPEC+ within 3 months will amount to 1.15 mln bbl/d. At the same time, Saudi Arabia lifted the voluntary cap of 1 mln bbl/d. Taking into account the current restrictions in the amount of about 8 mln bbl/d, it can be expected that by the end of July the figure will decrease to nearly 6 mln bbl/d. However, it should be noted that OPEC+ will continue to monitor the market situation and, in case of negative events, may reconsider its decision at the next meeting in late April, even before it comes into force.

A wave of positive sentiment that swept through the markets at the beginning of the year, as well as the rally in spot prices to USD70/bbl could not but affect the long-term forecasts of analysts. Some forecasts emerged claiming the beginning of a new price growth wave and reaching the price of USD100/bbl in the coming years. However, there was no significant revision of long-term values which are based on fundamental factors. The consensus forecast added USD3/bbl as compared with the December 2020 review, coming very close to USD60/bbl (real values).

At the end of the quarter, OPEC+ switched to a policy of a gradual production volume recovery

Q1 2021 events

Demand

— Oil demand grew steadily during January-February 2021 against the backdrop of pandemic mitigation successes, the recovery of industrial production, as well as the abnormally low temperatures in some regions during this period. The slowdown in demand growth emerged towards the end of the quarter caused by the threat from the third wave of the pandemic in Europe, which began to unfold in March against a background of low rates of vaccination.

OPEC+ restrictions

— As of Q1 2021, supply restrictions of about 8 mln bbl/d were in effect, mainly from the Middle East. However, following the OPEC+ meeting on April 1, it was decided to start increasing production volumes by 1.15 mln bbl/d from May within a three month timeframe – by 350 thousand bbl/d in May and June and by 450 thousand bbl/d in July. At the same time, Saudi Arabia will gradually ease its voluntary production cut of 1 mln bbl/d. In May, the kingdom will increase production by 250 thousand bbl/d, and in June and July by 350 and 400 thousand bbl/d, respectively. The increase in production is partly due to a seasonal factor – domestic oil consumption in Saudi Arabia is growing in summer, which will make export growth more moderate. At the same time, OPEC+ will continue to hold monthly meetings to monitor the situation on the oil market and, if necessary, may correct the decision at the end of April, even before the new measures come into force.

Supply

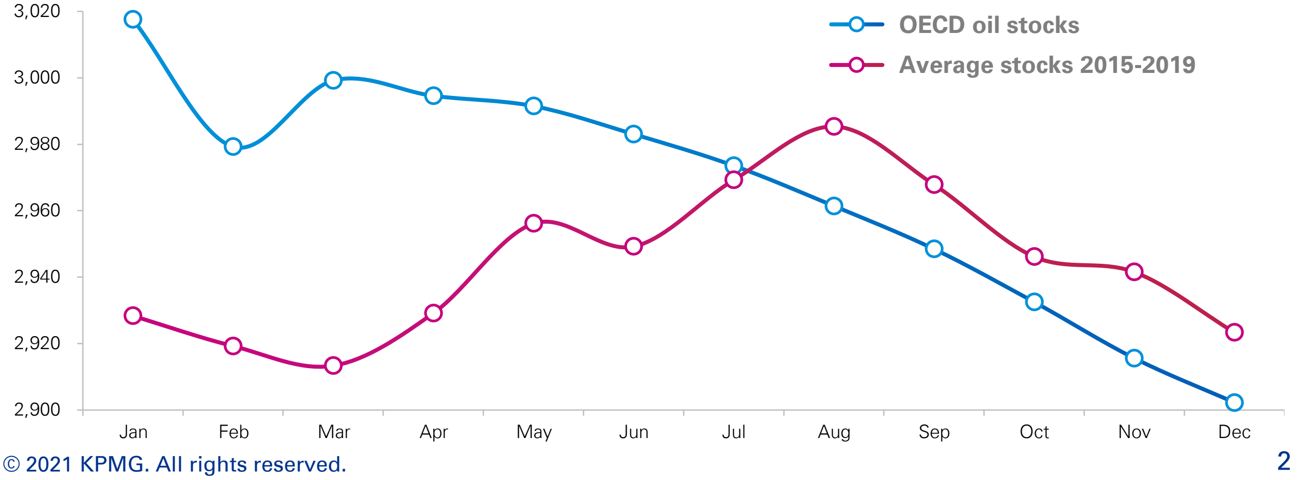
— The oil supply is almost fully controlled by OPEC+. In February, global supply fell to 91.6 mln bbl/d due to a number of attacks on oil production facilities in Saudi Arabia, a reduction in production in the US amid record cold weather and storms, as well as the OPEC+ decision to maintain production restrictions for most of the participating countries. The exceptions to the restrictions were Russia and Kazakhstan, which, following the January OPEC+ decision, were able to increase production by 65 thousand bbl/d and by 10 thousand bbl/d, respectively, during February and March. Following the OPEC+ meeting in March, these quotas were doubled to 130 thousand bbl/d for Russia and 20 thousand bbl/d for Kazakhstan. At the same time, the voluntary restriction of Saudi Arabia, of 1 mlnbbl/d, was upheld. In Q1 2021 the average supply volume was 94.6 mln bbl/d, which is 1.5 mln bbl/d higher than a quarter earlier.

— Additional pressure on the market is exerted by unofficial supplies of Iranian oil to China, which may be up to 1 mln bbl/d. Such "grey" imports do not allow oil stocks to decline faster, which forces OPEC+ to monitor the market situation more closely.

Oil stocks have been steadily decreasing over the past 3 quarters against the background of demand excess over supply. According to Q1 2021 statistics, stocks reached 3 bln bbl, which is only 40 mln bbl above the average for 2016-2020 (2,960 mln bbl). Since reaching a peak, stocks have already decreased by more than 300 mln bbl. According to OPEC forecasts, stocks will decrease by a further 445 mln bbl in 2021.

Oil stocks forecast for 2021, mln bbl

Source: OPEC+



According to forecasts, demand will gain back 60-70% of the crisis collapse of ~9 mln bbl/d by the end of 2021

Q1 2021 events

— The market balance is still quite fragile. The withdrawal of additional "temporarily suspended" supply may affect the market at any time. According to EIA estimates, in 2021, non-OPEC+ members may add 0.7 mln bbl/d to the market, gaining back about half of the 2020 decrease. The United States will lose about 0.2 mln bbl/d by the end of the year, according to the same forecasts.

— In terms of the future trajectory, most analysts agree that the bulk of the demand recovery will occur in the second half of 2021. There are clear grounds for this: some European leaders have stated that it will be possible to vaccinate the entire continent by autumn. The decline in consumption was most acutely felt in Europe – about 12% on average. The recovery in demand in this region is also expected to be the slowest.

— According to current forecasts by the IEA and EIA, demand may reach the level of 96.5-97.0 mln bbl/d by the end of the year, having won back about 60-70% of the crisis collapse of 9 mln bbl/d. Following a meeting of the OPEC+ technical committee at the end of March, OPEC's forecast for demand growth for 2021 was lowered by 0.3 mln bbl/d – from 5.9 mln bbl/d to 5.6 mln bbl/d. At the same time, the world oil supply growth was raised by 0.2 mln bbl/d – up to 1.6 mln bbl/d. The 100 mln bbl/d demand will be most likely be reached only in 2022-2023. The main factor behind the slowdown will be the air transportation industry, which lost about 3 mln bbl/d in 2020.

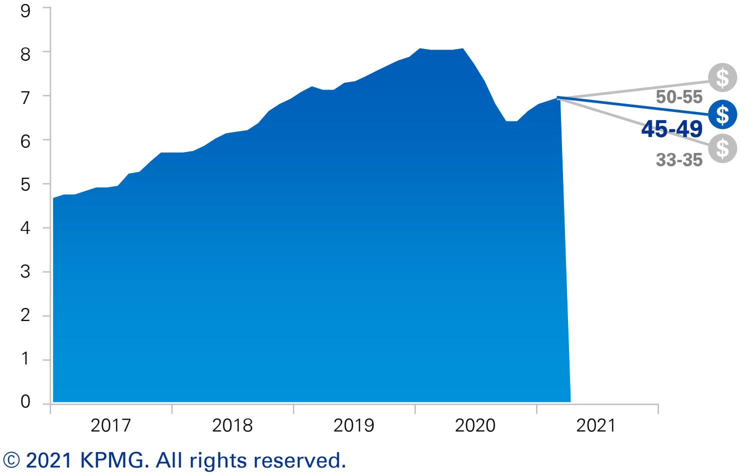
— Taking into account the current trajectory, reaching the equilibrium level can be achieved by mid-end 2021, when OPEC+ can begin to smoothly revise the policy of restrictions. At the same time, according to various sources, China still hasn't started to use the strategic oil stock accumulated during the period of low prices, and has in fact amassed even more stocks.

— Most experts agree that the US shale industry has lost the role of supply market regulator, and has given this role to OPEC+. In the coming years, the industry will recover financially and with high chances it will not be able to increase production to the former 13 mln bbl/d. EIA forecasts production of 11 and 12 mln bbl/d for 2021 and 2022, respectively. At the same time, a number of analysts, incl. BloombergNEF, and representatives of US oil companies are more conservative in their estimates, suggesting that production volumes will remain at the current level over the next two years. These assumptions are especially realistic given the new US Administration's policies on the renewable energy transition and the strengthening of the climate agenda.

— Despite the change of US administration, there were no signals regarding the possible lifting of sanctions against Iran, which makes it possible to consider this factor as a significant risk only on the horizon of 1-2 years. The supply of grey oil to China also does not help to resolve the situation. Despite the shortage of oil and oil products in the US, given the current political situation, even a partial lifting of sanctions against Venezuela looks unlikely in the medium term.

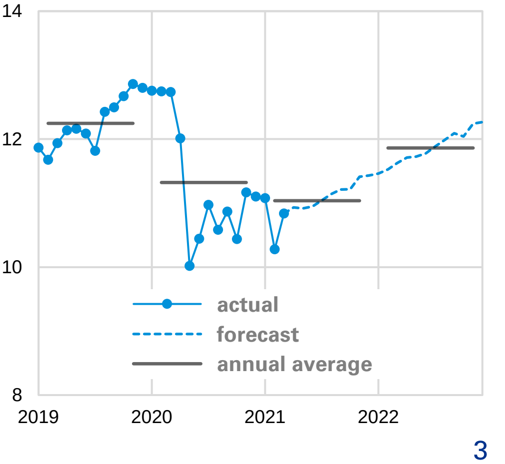
Forecast for oil production by shale producers in the United States, mln bbl/d

Source: DrillingInfo, BloombergNEF



Forecast for US oil production according to the EIA, mln bbl/d

Source: EIA SHORT-TERM ENERGY OUTLOOK



Despite the recent price rally, a price over USD 75/bbl during the next 3 years is considered an unlikely scenario by the majority of market participants

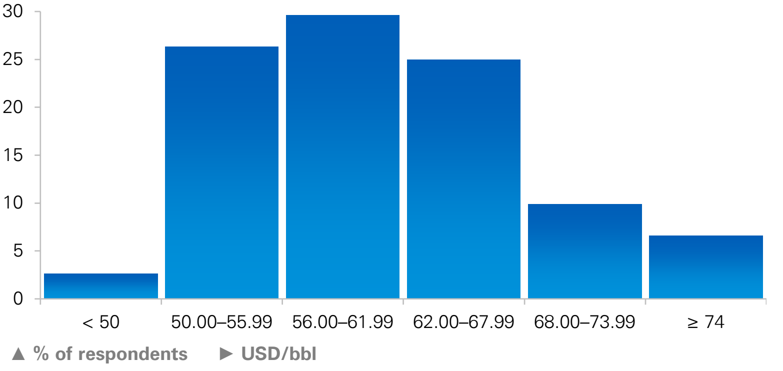
Against the backdrop of accelerated growth in oil prices in early 2021, many analysts began to talk about the beginning of a new energy cycle of price growth. A particularly positive background prevailed during the price rally, which lasted until mid-March. In particular, there were opinions on the market that oil prices could reach levels of USD100/bbl by the end of 2021 against the backdrop of accelerated demand growth and supply shortages. US investment banks: Goldman Sachs, Morgan Stanley and Bank of America were also quite optimistic about the market, expecting the price of Brent to increase to USD70/bbl in Q2 2021. However, the intensification of the 3rd wave of the pandemic towards the end of the quarter corrected the market situation, cooling off excessive optimism. Finally, it was leveled by the OPEC+ decision on a smooth increase in oil production. At the same time, many uncertainties and risks remain unchanged regarding any further recovery in demand.

The results of a survey conducted by the US Federal Bank of Dallas in March 2021 and covering about 150 oil and gas companies in the US are quite indicative. More than 80% of the respondents agreed that the price of WTI oil will be in the range of USD50 to USD68/bbl by the end of the year.

Thus, the majority of market participants and analysts agree that, taking into account all the current factors and risks affecting the market, price levels above USD75/bbl are unlikely, at least for the foreseeable future.

Expectations for the price of WTI crude oil

Source: US Federal Reserve Bank of Dallas research, March 2021

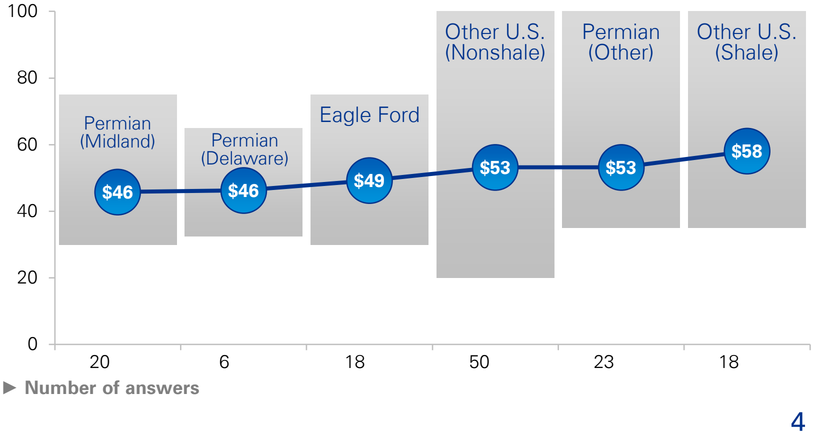


Price containment factors

1. OPEC+ decision to increase production volumes;
2. OPEC+ is not interested in maintaining too high oil prices, which may allow US shale companies to recover rapidly. According to the US Federal Reserve Bank of Dallas survey, the current total unit cost of shale production in the US is close to USD50/bbl (see the graph below). OPEC+ balances the market with this cost level in mind, limiting the sector's profits and preventing it from any unexpected rapid recovery;
3. The intent to restrict the development of alternative energy is an additional factor preventing a significant rise in prices, as "green" energy can receive additional incentives for development at high hydrocarbon prices;
4. Risks of a significant supply increase at high prices, incl. an increasing supply of sanctioned oil from Iran and Venezuela. The additional volumes will quickly balance the market and bring it back to equilibrium.

Thus, at the moment, according to the majority of market players, there are no fundamental factors supporting price growth above USD80-90/bbl. At the same time, in the event of a crisis, periodic short-term price increases are possible.

The minimum price for WTI crude oil required by US projects to achieve breakeven

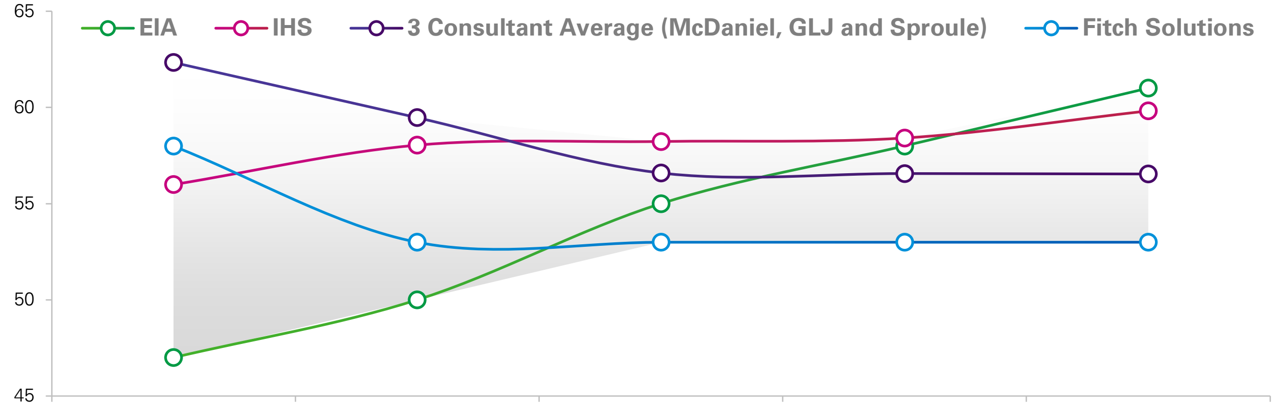


Source: Federal Reserve Bank of Dallas research, April 2021

The long-term consensus forecast for oil prices ranges from USD55/bbl to USD65/bbl

Brent crude oil price forecast based on analytical agencies*

Source: EIA, IHS, McDaniel, Sproule, Fitch



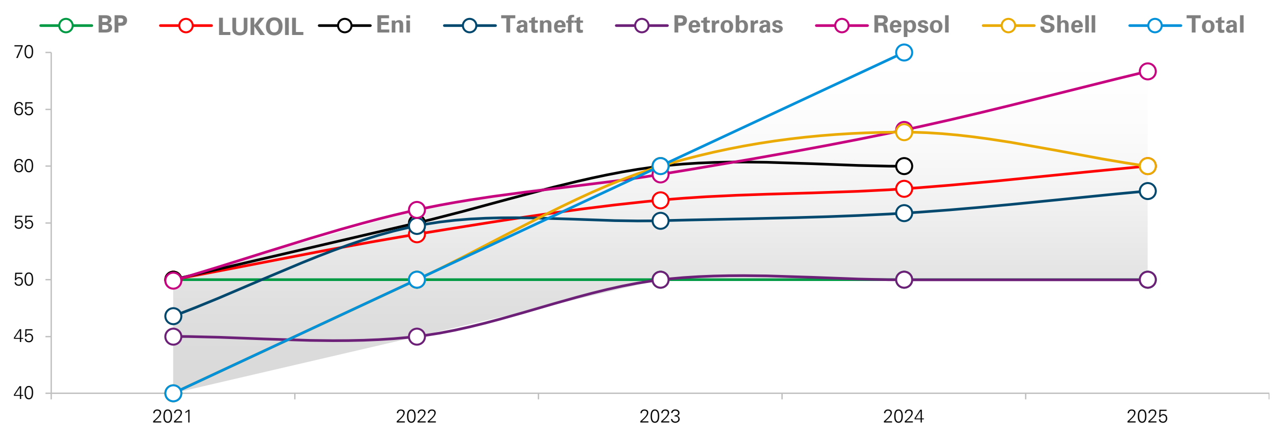
▲ USD/bbl (2021 prices)

* Only a number of forecasts is presented, the full list is presented in the appendix

- The average price of Brent crude in March 2021 was USD66/bbl, which is USD4 higher than the February average and more than USD20 higher than the average for the previous quarter.
- The price increase was largely influenced by the OPEC+ agreement to maintain production restrictions, as well as general optimism due to progress vis-à-vis COVID-19 and the launch of mass vaccination campaigns in certain countries.
- Most agencies expect the Brent price to stabilize at USD50/bbl during 2021. The current consensus forecast for the Brent oil price for 2025 is about USD59/bbl at 2021 prices (an increase of USD3/bbl as compared with the review for Q4 2020).
- Traditionally, oil companies give slightly more optimistic estimates on average – the average forecast for 2025 is USD60/bbl in 2021 prices.
- Industry and analytical agencies, as well as most investment banks, give a similar estimate of the long-term price – on average USD58-59/bbl in 2021 prices.
- The forecasts are highly homogeneous, and range from USD55 to USD65/bbl which accounts for more than 55% of all forecasts. A price level above USD65/bbl is expected by less than 20% of experts. At the same time, there are practically no price forecasts below USD50/bbl for 2025 in 2021 prices (just a single source).

Brent crude oil price forecast based on oil companies' data (annual reporting for 2020)

Source: companies' 2020 annual report data



▲ USD/bbl (2021 prices)

Appendix

Brent oil price, USD/bbl, 2021 prices	2021	2022	2023	2024	2025
Oil companies					
BP	50.0	50.0	50.0	50.0	50.0
Eni	50.0	55.0	60.0	60.0	
Equinor					65.0
Frontera Energy	49.4	51.8	53.7	54.4	54.4
Lukoil	50.0	54.0	57.0	58.0	60.0
OMV	52.5				
Petrobras	45.0	45.0	50.0	50.0	50.0
Premier oil	51.0	55.0	60.0		
Repsol	49.9	56.2	59.3	63.2	68.3
Santos	51.0	56.2	63.9	68.9	70.4
Shell	40.0	50.0	60.0	63.0	60.0
Suncor	35.0	49.0	66.1		
Total	40.0	50.0	60.0	70.0	
Woodside	45.9	57.0	60.7	64.2	67.7
Tatneft	46.8	54.8	55.2	55.9	57.8
Average	46.9	52.6	58.1	59.8	60.4
Median	49.7	54.0	60.0	60.0	60.0
Industry analysts					
EIA	47.0	50.0	55.0	58.0	61.0
IHS	56.0	58.0	58.2	58.4	59.8
McDaniel	62.5	60.0	56.5	56.5	56.5
Ryder Scott Company	51.2	52.9	54.9	56.8	57.2
Sproule	55.0	54.5	53.4	53.4	53.4
Average	54.3	55.1	55.6	56.6	57.6
Median	55.0	54.5	55.0	56.8	57.2
Investment banks					
ABN AMRO Bank NV	61.0	62.7	61.3		
ANZ	70.8	62.5	57.8	56.4	
Banco de Credito del Peru	65.0	63.7	62.3		
Banco Santander SA	56.0	53.9	52.7	51.7	50.7
Bank Julius Baer	65.0	53.9	52.7	51.7	50.7
Bank of Nova Scotia/The	50.0	53.9	57.5	61.1	
BMO	60.0	63.7	67.1	70.5	64.5
BNP Paribas	56.0	59.7			
Citigroup	70.0	52.9	52.7	48.9	47.0
Commerzbank AG	49.0	52.9			
Commonwealth Bank	65.0	55.8	55.6	61.9	64.0
Credit Suisse	60.0	61.7	57.5	57.4	57.3
Deutsche Bank AG	65.0	58.8	57.5	59.3	60.6
Emirates NBD PJSC	67.5				
Goldman Sachs	75.0	73.5	57.5		
HSBC Holdings PLC	65.0	63.7	63.5	58.7	58.7
ING Bank	70.0	68.6			
Intesa Sanpaolo SpA	68.8	73.5	72.8	73.4	73.8
Landesbank Baden-Wuerttemberg	61.5	61.7	65.2		
Liberum Capital	70.0	66.6	63.3	63.0	59.9
Morgan Stanley	60.0	53.9	45.5		
MPS Capital Services Banca per le Imprese SpA	62.0				
National Australia Bank	71.0	72.5	73.6	73.8	65.0
Natixis SA	54.5	60.5			
Rabobank International	60.3	60.6	60.0	58.6	57.1
RBC Capital Markets	67.5	67.1	58.0	51.7	50.7
Societe Generale	65.0	63.7			
Standard Chartered	56.0	58.8	52.7	54.5	55.3
UBS	65.0	58.8	57.5	56.4	55.3
Average	63.2	61.4	59.3	59.4	58.0
Median	65.0	61.7	57.6	58.6	57.3
Analytical agencies					
Capital Economics	75.0	60.2	55.6	53.6	54.4
Deloitte Access Economics	64.9	64.9	64.4	64.5	64.6
Deloitte Canada	62.0	60.4	58.8	58.9	58.9
Economist Intelligence Unit	68.0	69.5	63.3		
Euromonitor International	71.9	65.8	66.2	66.9	66.2
Fitch Solutions	58.0	53.0	53.0	53.0	53.0
GKI Research	70.0	68.6	67.1	61.1	59.9
Market Risk Advisory Co Ltd	53.3	55.8	56.5	56.4	57.2
Oxford Economics	61.0	59.0	57.8	57.1	57.9
P K Verleger	64.0	70.5			
Pezco Economics	67.5	62.7	60.9	59.8	58.6
Average	65,0	62,8	60,4	59,0	59,0
Median	64,9	62,7	59,9	58,9	58,6
Average across all sources	58.9	59.1	58.8	59.1	58.8
Median across all sources	60.3	58.8	57.9	58.2	58.6

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