

Oil prices are back up, but where are they headed?

COLUMBIA THREADNEEDLE ENERGY ANALYST TEAM

The energy sector took a substantial hit during the pandemic, as the effective shutdown of the world's economy pushed oil demand and production to unprecedented lows. Since then, the industry has rebounded and West Texas Intermediate (WTI) oil prices have recovered, up to \$69/barrel from \$48/barrel in January 2021.

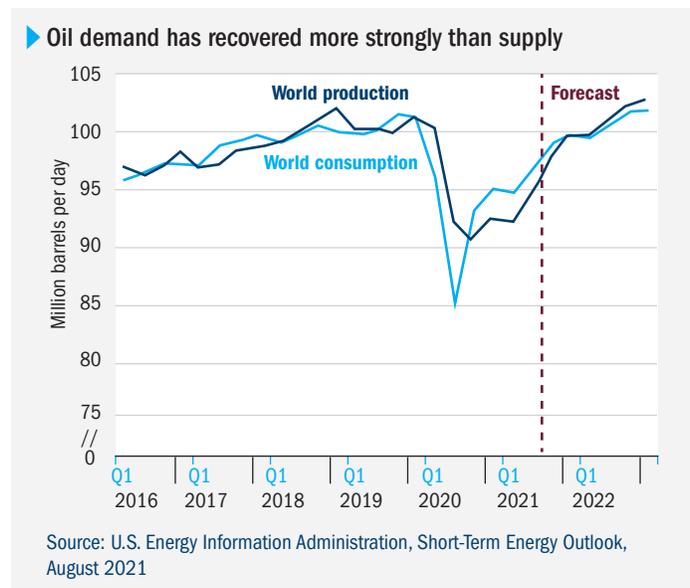
We expect global demand to rebound sharply in the third quarter of 2021 but remain below 2019 levels until mid-2022. At the same time, we believe supply will increase steadily but remain constrained.

Demand has recovered strongly post-pandemic

After declining by nearly 9% in 2020, we expect global demand to continue recovering, up 6% y/y (or 5.4 million barrels per day) in 2021, returning to prepandemic levels by mid-2022:

- United States.** After falling 12% in 2020, the Energy Information Agency (EIA) estimates crude demand will grow 7.9% in 2021 and 5.3% in 2022, which is consistent with our view.
- Emerging markets.** Emerging markets, which drove all 2019 global demand growth and currently make up more than half of global oil demand, will continue to drive longer term future demand growth. Specifically, demand from China this year, which approximately makes up 14%¹ of global demand, is expected to track well above 2019 levels.

The rest of the world is expected to experience slower recovery in demand on longer COVID-related shutdowns.



¹ Source: IEA, as of August 2021

Supply is increasing steadily but uncertainty remains

At the height of the pandemic in April 2020, OPEC+ members and energy ministers from the G20 nations reached an agreement to collaborate and reduce oil production levels to safeguard energy markets.

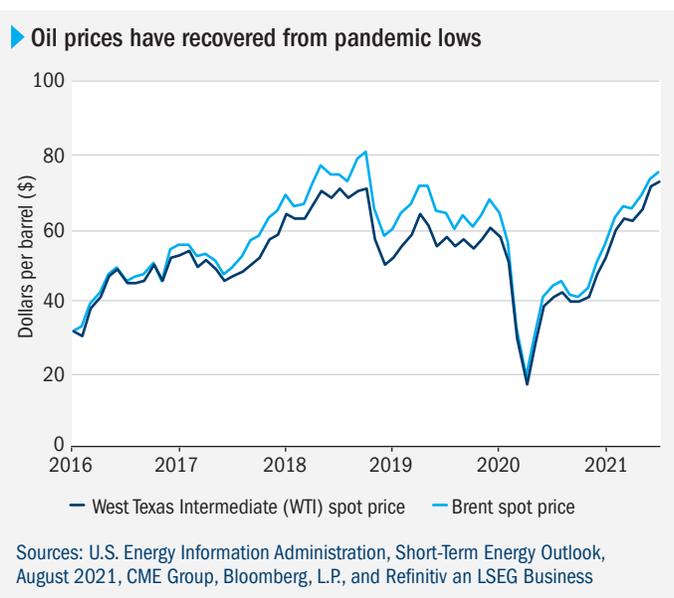
While oil production has increased since then, the path forward is unclear. Oil producers want to increase supply but are wary about the pace and scope. Continued coordination with non-OPEC allies is critical for the dynamics of supply. Assuming strong compliance from OPEC members, volumes are expected to steadily increase through 2021 in a controlled fashion. But if enforcement weakens, some producers could start to increase volumes even further. Meanwhile, in the U.S., oil production is back up after bottoming in May 2020, but it's still well below all-time highs reached in November 2019. Taken together, our estimate calls for rest of 2021 to be undersupplied.

Pricing is being driven by tight inventories and an undersupplied market

Compounding supply and demand dynamics, global oil inventories (i.e., crude oil in storage tanks) have declined materially from the mid-summer 2020 peak and are now below 2015–2019 historical averages. Inventories are currently indicating a tight market with OECD and U.S. crude stocks 6% and 5.5%² below the five-year average, respectively.

Given the constraints on supply, surging demand and tight inventory, our energy team is increasing WTI oil price forecast for 2021 to \$63/barrel on average (4% below the current 2021

forward curve) on larger inventory draws in the second half than previously anticipated. Passing through higher costs for oilfield service and labor inflation will also push prices up. Key downside risks to our views include looser enforcement of OPEC+ production quotas, a weaker than expected demand recover, and a potential increase in Iranian volumes if the U.S. reenters the Iran nuclear deal in a Biden administration. Looking ahead to 2022, we expect prices to decrease to \$59/barrel as OPEC+ barrels come back to the market and U.S. supply increases. These forecasts are \$3/barrel and \$6/barrel below the forward curve in 2021 and 2022, respectively, suggesting we are less constructive than the commodity market about prices holding up to increased supply.



² Source: IEA, as of August 2021

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