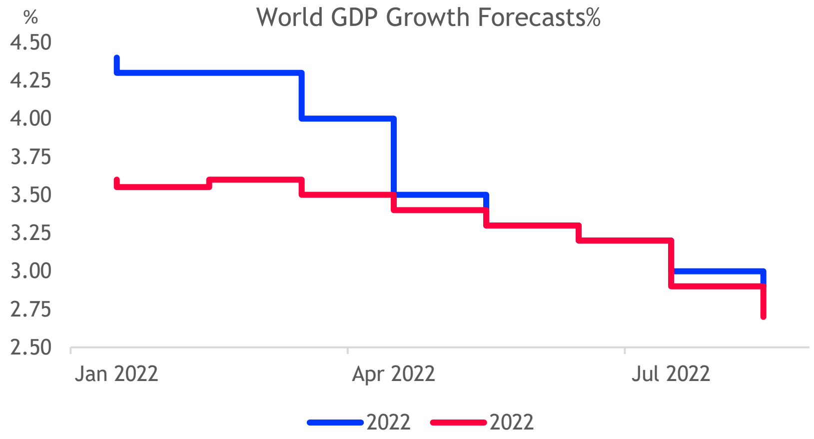
Elevated event risks for the remainder of this year continue to pose a challenge in forecasting crude oil's supply/demand fundamental dynamics and its target price range. In this note, we will highlight the potential events that could set the stage for possible volatile trading in the crude oil markets over the coming months, which could generate both opportunities and risks in the equities markets. We dedicate the later part of this note to highlighting Brent Crude oil's long and medium-term technical pictures.

Part 1: Macro highlights

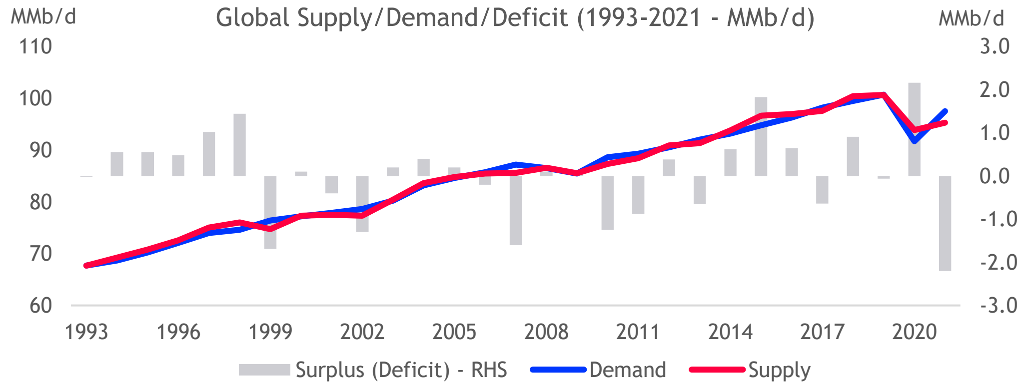
Recession fears partly contributed to crude oil price pullback. Bloomberg consensus forecasts for global GDP growth for 2022/23 have been trending down YTD, from a high of 4.4%/3.6% at the beginning of this year to the latest of 2.9%/2.7%. The fears of a global recession and by extension a possible collapse in the global demand for crude oil have removed some risk premium from the black gold in recent months. Looking at the International Energy Agency's global crude oil demand data between 1993-2021, annual demand for the commodity only dipped three times (2008, 2009 and 2020) as a result of severe economic shocks i.e., a financial crisis-driven contraction and the COVID-19 pandemic. In the 10 years leading up to 2020, global demand for crude oil was growing at an average rate of 1.65%.

Figure 1: YTD downward revision trend in global GDP growth - 2022/2023



Source: Bloomberg consensus

Figure 2: Crude oil demand has been growing every year except for during years of severe economic shock (2008, 2009, and 2020)



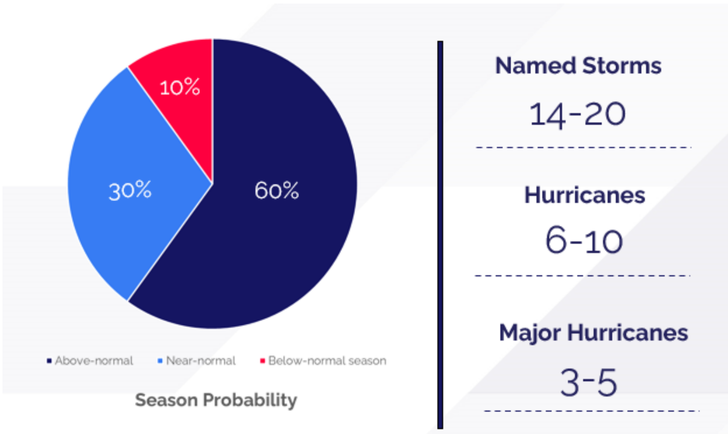
Source: IEA, Bloomberg

Despite the divergence in their latest global demand revisions, the International Energy Agency (IEA) and the Organization of the Petroleum Exporting Countries (OPEC) still expect global crude oil demand to grow in 2022/2023. In its Oil Market Report - August 2022, the IEA revised its 2022 global crude oil demand up by 380 kb/d (thousand barrels per day) to 2.1 mmb/d (million barrels per day). Global demand is expected to exit the year 2022 at 99.7 mmb/d, while for 2023 demand is forecasted at 101.8 mmb/d (above the pre-pandemic level of 100.7 mmb/d). The expected demand growth in 4Q2022 is premised on soaring oil use for power generation and gas-to-oil switching. Also, the agency is expecting the global crude oil market to exit 2022 with a supply surplus – a relief for crude buyers.

Not too long after IEA released its revised numbers, OPEC grabbed the headline with a downward revision of 260 kb/d to its 2022 demand growth to 3.1 mmb/d. For the year 2023, demand is expected to grow by 2.7 mmb/d – unchanged from the previous forecast. Despite the divergence in their latest revisions, what is more important is both are still seeing global crude oil demand growth for the remainder of 2022 and 2023.

Risk of hurricane-induced price volatilities. While the 2022 US hurricane season, which officially started on 1 Jun has been relatively non-event so far, the National Oceanic and Atmospheric Administration (NOAA) is maintaining its expectation for an above-average hurricane season. Hurricane season typically enters its peak during August-October period. NOAA expects 14-20 named storms (winds of 39 mph or greater), of which 6-10 could become hurricanes (winds of 74 mph or greater). Of those, 3-5 could become major hurricanes (winds of 111 mph or greater). NOAA provides these ranges with a 70% confidence. According to the Energy Information Administration, Gulf of Mexico accounts for 15% of total US crude oil production and over 47% of total US petroleum refining capacity is located along the Gulf coast. These combinations make the current hurricane season one of the most closely monitored events amongst energy market participants.

Figure 3: Entering the peak season of a possible above-average hurricane season



Source: National Oceanic and Atmospheric Administration (NOAA)

Strategic reserves release coming to an end on a backdrop of fluid geopolitical situations. The Strategic Petroleum Reserve releases by the US (totalling 180 million barrels equivalent to 1 mmb/d) are scheduled to come to an end on 31 October 2022. The releases have been critical in balancing the crude oil market over the recent months. It is known that OPEC's spare capacity (IEA estimate OPEC's spare capacity at 3.38 mmb/d) is currently limited with many member countries producing below their share in the cartel. On the bright side, recent newsflow suggests the prospects for Iranian's supply returning to the global market have improved as the nuclear deal talks are progressing despite some noises. However, even if a deal is concluded, the timing for the supply to return is still dictated by the readiness of Iran's O&G infrastructures and the timeline stipulated in the potential nuclear deal.

Adding to the uncertainty is European Union's partial embargo on Russian crude oil (effective 5 December 2022) and oil products (effective 5 February 2023). So far Russia has been able to divert its crude largely to Asia. However, it remains to be seen what counter-measures Russia would take to counter the upcoming EU embargo. If recent events are of any guide, it is hard to imagine Russia staying passive in face of the additional trade restrictions.

Elevated natural gas prices are supportive of crude oil. Natural gas benchmarks in Europe (Dutch TTF Natural Gas Futures) and the United States (Henry Hub Natural Gas) are trading near their record/recent years' highs. Russia is currently exporting its natural gas to Europe at 20% of the Nordstream 1 pipeline capacity, further reduction in the export volume or a colder than average winter season in Europe are the key risks in the coming months. Market followers are also watching the natural gas storage levels in Europe very closely. A spike in natural gas prices could induce a further gas-to-oil switch in power generation.

Figure 4: Dutch TTF Natural Gas Futures (EUR/ per-megawatt-hour)

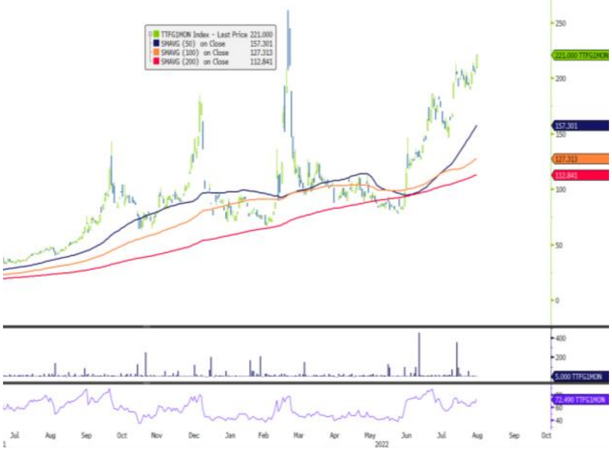


Figure 5: Henry Hub Natural Gas (USD/MMBTU)

Part 2: Brent Crude - technical observations

Broke out from its long-term resistance line. In Mid-January, Brent Crude crossed above its multi-year resistance line that stretched from the high in 2008. Its price momentum was further boosted by the Russia-Ukraine friction between end-Feb to early-March. After hitting a multi-year high in Early-March, the commodity has been developing a possible lengthy multi-month mid-cycle consolidation phase.

Figure 6: Brent Crude trading above its multi-year resistance line

Mid-cycle consolidation phase shows possible signs of extending. Brent Crude's possible mid-cycle consolidation has entered its fifth month of progression. After swinging around its 200-day SMA line over the recent weeks, the commodity finally gave up this SMA line. Typically, this is interpreted as a price signal that a correction/consolidation is likely to extend, at least over the immediate-term. Towards the downside, traders may see the commodity uptrend line that stretches from the pandemic's low as a support line – currently estimated in the range of USD85-USD87. In a worst-case scenario, the commodity may retrace towards USD75-USD80 area to re-test its breakout from the multi-year resistance line.

From the trend-following perspective and based on the commodity's current chart pattern (please refer to Figure 7), prices need to break away from the resistance line that stretches from the high in Jun to signal a possible interim low is in place and that a sustainable rebound is developing. Until this happens, the bulls are likely to stay cautious.

Figure 7: Mid-cycle consolidation phase shows signs of extending

Conclusion. Crude oil's recent pullback has been good news to the global economies that are working hard to bring inflation under control. However, as crude oil's event risks are still elevated into the next few months, investors should consider paying close attention to the sector for possible event-driven opportunities and risks.