29 September 2021

Energy & Petrochemicals | Regional Oil & Gas

Regional Oil & Gas

Overweight (Maintained)

Heating Up Again, Keep O/W

Stocks Covered	13
Rating (Buy/Neutral/Sell):	9 / 4 / 0
Last 12m Earnings Revision Trend:	Positive

- **OVERWEIGHT; Top Picks: MISC, Petronas Chemicals, Bumi Armada, PTT and PTT Exploration & Production (PTTEP).** We increase our 2021-2022 Brent crude oil price projections to USD71.00/bbl and USD69.00/bbl, while maintaining our long-term crude oil price forecast at USD60.00/bbl. Near-term oil prices could be fuelled by optimism over an oil demand recovery, as well as the commitment and willingness of OPEC+ to balance the market. The continuous inventory drawdown also suggests that the impact of the COVID-19 Delta variant could be milder than initially expected.
- **We raise our Brent crude oil price forecasts to USD71.00-69.00/bbl (from USD68.00-65.00/bbl) for 2021-2022**, after OPEC upgraded its projection for global demand. Global crude oil demand is now expected to increase by 4.2 mbpd to 100.8 mbpd – similar to pre-pandemic levels – in 2022 (vs 6 mbpd in 2021). The continuous inventory drawdown would also suggest that the impact of the COVID-19 Delta variant could be milder than initially expected. Based on the current oil production agreement, the remaining 3.65mbpd production cut will be fully resumed by Sep 2022. Our numbers still point to a gradual moderation in prices by 2022F, as the market would then enter into a surplus of 2.0 mbpd that year if demand is in accordance with OPEC's latest projection.
- **Are we seeing the price of oil at USD100.00/bbl again?** In this report, we re-examine some major factors – OPEC's position and its associated risk premium, US production as well as the potential destruction of demand when oil prices are at high levels. We see an increased possibility of the price of oil hitting USD100.00/bbl, but stronger catalysts are required to propel it. The demand upside surprise would be the key factor that could lift oil prices to another level. This would further compress OPEC's spare capacity, and the risk premium is likely to heighten when its spare capacity is lowered to 2 mbpd (vs an estimated 3.3 mbpd in 2022). Furthermore, OPEC's current strategy, in our view, is still in its favour and price-positive. The easing of the fiscal breakeven price will bring more OPEC members closer to their biggest ally, Russia, keeping them intact as long as the US is not deemed as a competitive threat.
- **Limiting factors: US and Iran supply, potential demand destruction.** US production is expected to grow by 0.6 mbpd or 6% to 11.7 mbpd in 2022, and higher prices will trigger more funds to accelerate drilling. Iran remains a big swing factor, as it is still seeking to recover lost ground due to the imposition of international sanctions in recent years. Lastly, demand destruction – more apparent in Organisation for Economic Co-operation & Development (OECD) countries – could also cap the price upside.
- **OVERWEIGHT on Malaysia's and Thailand's oil & gas sectors.** Exploration & production and petrochemical companies should continue to enjoy a strong recovery in earnings in 2021 – riding on better commodity prices – while services players should gradually benefit from higher domestic capex allocations.

Company Name	Rating	Target	% Upside (Downside)	P/E (x) Dec-21F	P/B (x) Dec-21F	ROAE (%) Dec-21F	Yield (%) Dec-21F
Bumi Armada	Buy	MYR0.57	23.3	4.6	0.7	17.4	-
Dialog	Buy	MYR3.14	27.6	28.7	3.2	12.1	1.5
Malaysia Marine & Heavy Engineering	Neutral	MYR0.44	4.8	na	0.4	(6.9)	-
MISC	Buy	MYR7.60	9.4	20.4	1.0	4.7	4.7
Muhibbah Engineering	Neutral	MYR0.88	(0.4)	28.6	0.4	1.4	0.9
Petronas Chemicals	Buy	MYR9.11	5.3	14.3	2.1	15.3	3.5
Petronas Dagangan	Neutral	MYR19.73	2.4	34.7	3.4	9.8	2.7
PTT	Buy	THB45.80	13.1	12.3	1.2	10.4	3.9
PTT Exploration & Production	Buy	THB132.00	10.9	11.6	1.2	10.9	3.4
PTT Global Chemical	Buy	THB73.00	14.5	9.4	0.9	16.4	5.1
PTT Oil and Retail Business	Buy	THB34.00	22.5	29.6	3.4	14.4	0.9
Thai Oil	Neutral	THB49.00	(7.5)	30.8	0.9	6.4	3.3
Yinson	Buy	MYR5.81	9.5	17.4	2.8	16.9	1.1

Source: Company data, RHB

Top Picks	Target Price
PTT (PTT TB) – BUY	THB45.80
PTTEP (PTTEP TB) – BUY	THB132.00
MISC (MISC MK) – BUY	MYR7.60
Bumi Armada (BAB MK) – BUY	MYR0.57
Petronas Chemicals (PCHEM MK) – BUY	MYR9.11

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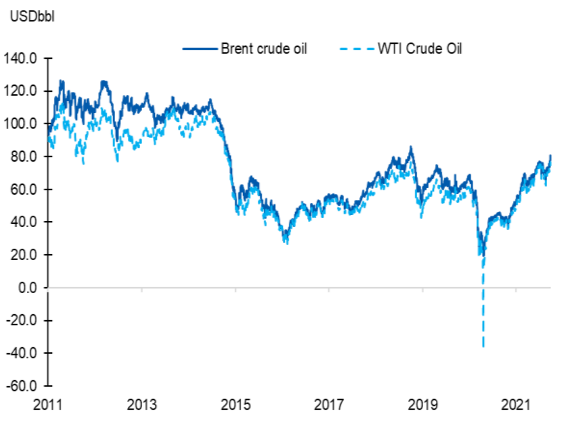
Crude oil price trend



Source: Bloomberg

Crude Oil Price Forecasts

We increase our Brent crude oil forecasts to USD71.00-69.00 per bbl for 2021-2022 (from USD68.00-65.00 per bbl) while our long-term forecasts are kept at USD60.00 per bbl. 3Q21 crude prices averaged at USD73.10 per bbl, and performed in line with our expectations. However, given the strong performance of global oil demand as evidence of the continuous inventory drawdown, we now expect Brent crude oil prices to remain near current levels for the remainder of 2021, averaging USD80.00 per bbl in 4Q21. This will bring the 2021F average to USD71.00 per bbl (YTD: USD67.70 per bbl).

For 2022, we also increase our average oil price forecast to USD69.00 per bbl (from USD65.00 per bbl) on the back of the stronger demand projection from OPEC. Based on the available data, the crude oil demand increase will moderate to 4.2 mbpd, vs 6 mbpd in 2021. Also, while OPEC+ targets to phase out the remaining 5.8 mbpd production adjustment by Sep 2022, supply pressure could further increase – as evidenced by the gradual increase of Iran's production levels in 3Q21, and the potential return of US production as the country's rig count is still on the rise. As such, we have a relatively lower YoY projection of USD69.00 per bbl for 2022F.

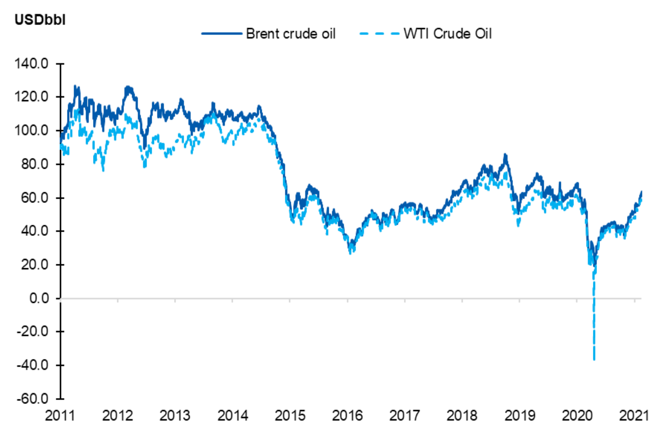
Upside for crude oil prices rising above and beyond our revised forecasts should be from:

i. OPEC+ being unable to increase production on time;
ii. Global oil demand being higher than expected;
iii. A stronger-than-expected boost from various economic stimulus packages.

Further downside to our crude oil prices should stem from:

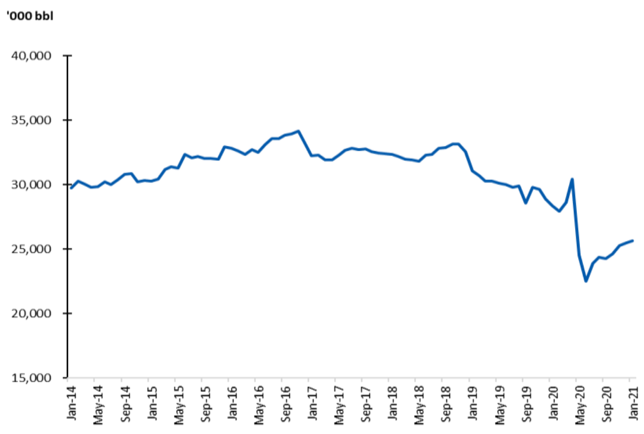
i. Weaker-than-expected crude oil demand;
ii. Higher-than-expected production from the US;
iii. Weaker-than-expected compliance from OPEC+;
iv. Slowdown in the global economy.

Figure 1: Crude oil price trend



Source: Bloomberg

Figure 2: OPEC – crude oil production



Source: Bloomberg

OVERWEIGHT on Malaysia and Thailand's oil & gas sectors. Despite having a lower oil price forecast of USD69.00/bbl YoY for 2022, which is rather in line with the consensus projection, we have seen the turning point of price trend expectations being delayed. This was due to a better-than-expected recovery in demand, and a high level of compliance on the part of OPEC+. Our OVERWEIGHT sector rating is very much fuelled by a continuous positive price trend, and we could see a tactical downgrade when the turning point materialises. Exploration & production and petrochemical companies should continue to enjoy a strong earnings recovery in 2021 – this may even spill over into 2022, while they ride on improved commodity prices. Meanwhile, oil & gas service providers should gradually benefit from an increase in domestic capex allocations.

Upgrade in the crude oil demand growth forecast for 2022

In OPEC's monthly report for September, oil demand for 2021 remains unchanged from that of August. Oil demand in 3Q21 has proved to be resilient, supported by rising mobility and travelling activities. OPEC is projecting a gradual recovery in oil demand to 99.7 mbpd in 4Q21, from 98.5 mbpd in 3Q21. On average, it expects oil demand to increase by 6.0 mbpd YoY in 2021, led by the OECD and non-OECD regions at 2.7 mbpd and 3.3 mbpd. OPEC has also lifted its global oil demand growth estimate to 4.2 mbpd YoY (0.9 mbpd higher than its previous projection) to 100.8 mbpd for 2022, assuming a better recovery in the demand for fuel by both OECD and non-OECD countries against a backdrop of steadier economic growth. With that, global oil demand may exceed the 100mbpd mark in 2Q22.

Continuous inventory drawdown. The International Energy Agency's August Oil Market Report also suggested that OECD industry oil stocks dropped by 34m bbl to 2.85bn bbl in July, or 186m bbl below its 5-year average. While the latest global inventory data is not available, Reuters reported that OPEC+ is expecting the oil market to be in deficit – at least until the end of 2021 – and stocks to stay relatively low until May 2022. Global inventories could fall by 825k bbl/day over the next four months.

Key date to watch: 4 Oct. OPEC+ decided to maintain the overall production increase by 0.4 mbpd in October, as expected, and continues to phase out the 3.65 mbpd production cuts decided in the previous meeting. Overall, OPEC+'s compliance with the production adjustments was at 110% in July. It has scheduled its 21th ministerial meeting to discuss the production levels for November on 4 Oct. We do not expect any major adjustment to the current production ramp-up schedule.

Figure 3: Demand and supply, and crude oil prices and forecasts

	2018	2019	2020	1Q21	2Q21	3Q21F	4Q21F	2021F	1Q22F	2Q22F	3Q22F	4Q22F	2022F
Crude oil price (USD/bbl)													
Brent, RHB (new)	71	64	43	61	69	73	80	71	75	70	65	65	69
Brent, RHB (old)	71	64	43	61	69	73	69	68	65	65	65	65	65
Change				0	0	0	11	3	10	5	0	0	4
World oil demand and supply balance (mbpd)													
Total demand	99.1	100.3	90.7	92.8	95.6	98.5	99.7	96.7	98.0	100.2	102.3	102.8	100.8
YoY change	1.5	0.9	-9.3	-0.8	12.3	6.9	5.4	5.9	5.2	4.5	3.8	3.1	4.2
Total non-OPEC	63.4	65.6	62.9	62.4	63.2	64.1	65.6	63.8	66.2	66.5	66.7	67.8	66.8
OPEC NGLs	5.3	5.2	5.1	5.1	5.1	5.2	5.2	5.2	5.3	5.3	5.3	5.3	5.3
Total non-OPEC +OPEC NGLs	68.7	70.8	68.0	67.5	68.3	69.4	70.8	69.0	71.5	71.8	72.0	73.1	72.1
YoY change	3.1	2.1	-2.8	-4.6	2.2	2.8	3.7	1.0	3.9	3.4	2.6	2.3	3.1
OPEC	31.3	29.4	25.7	25.2	25.5	27.0	28.3	26.5	29.1	30.6	31.7	31.8	30.8
Total production	100.1	100.1	93.6	92.7	93.9	96.4	99.1	95.5	100.5	102.4	103.7	104.9	102.9
Balance	0.9	0.1	2.9	-0.1	-1.8	2.1	0.6	1.2	-2.5	-2.2	-1.4	-2.1	-2.0

*Note: *All numbers presented are from OPEC, while OPEC production number forecasts and the resulting crude oil balance are our estimates*
Source: OPEC (as at September), RHB

Still a deficit market in 4Q21. Based on the current production deal, if we assume OPEC 10 to account for two-thirds of the 0.4 mbpd monthly increment quota and the production of other three non-complying OPEC countries to average at 4.1 mbpd, OPEC average production should increase by 1.2 mbpd from 27.0 mbpd in 3Q21 to 28.3 mbpd in 4Q21F. Under the current assumptions of demand and non-OPEC supply based on the latest OPEC monthly data, we should still see a deficit of 0.6 mbpd in 4Q21F.

A potential surplus market in 2022? We believe the key questions will be how much OPEC+ are willing to increase its production. Based on the current production deal, the remaining 3.65 mbpd production cut will be fully resumed by Sep 2022. With that, OPEC production could increase from 29.1 mbpd in 1Q22F to 31.8 mbpd in 4Q22F, averaging at 30.8 mbpd in 2022F. Such production levels are already higher than the pre-pandemic level of 29.4 mbpd in 2019. The market would then enter into a surplus of 2.0 mbpd in 2022F if demand is in accordance with OPEC's latest estimates. Having said that, we believe OPEC would then adjust the production schedule more slowly, to avoid overproduction. The monthly meeting is a good mechanism to reassess the market in order to respond accordingly.

Maintaining long-term oil price at USD60.00/bbl

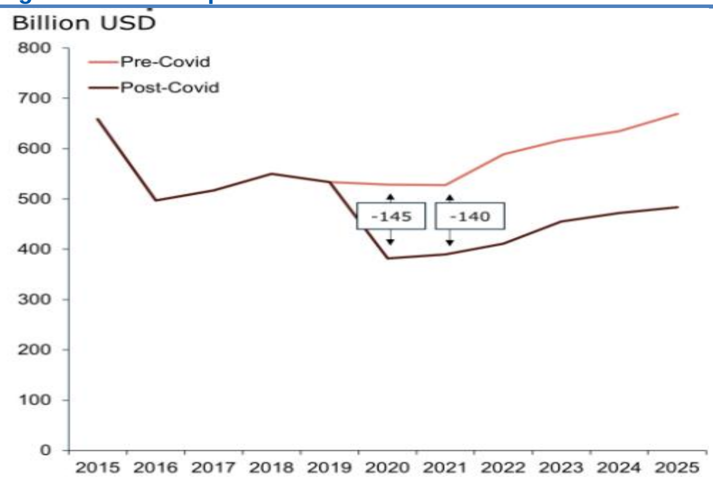
The adoption of electric vehicles (EV) has gone from a niche idea to mainstream policymaking in recent years, and numerous governments currently have policies in place to incentivise consumers to buy EVs (Please refer to our regional thematic report titled *The Future Is EV: Is ASEAN Ready?* for more details). We expect such efforts to continue and this could dampen long-term oil demand and result in an earlier-than-expected peak. While demand could stop rising, this does not really mean that oil will become much cheaper as it ultimately depends on the supply-demand dynamic.

Besides this, what is happening now is that the oil industry is confronted by earlier-than-expected peak oil demand and rising pressure from shareholders and climate activists to reduce carbon emissions. This puts further pressure on conventional fossil fuel players, as ESG is now a long-term factor in assessing new investments and getting financing. As of now, we see a different approach among the oil majors. It appears that the US heavyweights are lagging behind European firms when it comes to the energy transition. The relatively more aggressive steps taken by European companies are driven by both regulatory and societal expectations. It is matter of time, in our view, before the laggards play catch-up.

While there is a potential downside bias to our forecast after 2040 – should there be a significant progression in technology advancements driving clean energy and electrification – we also see a potential structural bull cycle. This would be driven by a global supply shortage, led by underinvestment in fossil fuels anytime in the medium term, when the world has yet to fully embrace EV and clean energy. In 2020, upstream spending was slashed by 27% to USD382bn, compared to the original budget. Despite oil prices trading above USD70.00 per bbl, Rystad Energy forecasted that the investment level of all public upstream companies will only grow by c.2% to USD390bn in 2021. This is much lower than what was budgeted prior to the pandemic. In the medium term, global upstream spending is estimated to register a CAGR of 5% to USD480bn in 2025.

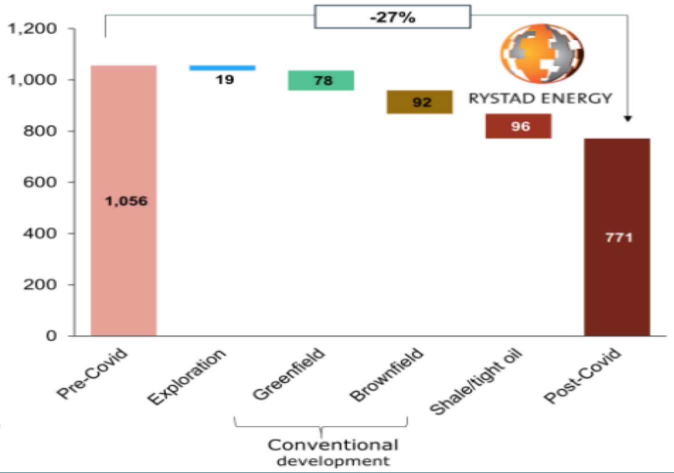
As such, our long-term oil price estimate remains at USD60.00 per bbl. We believe the supply demand dynamic will achieve an equilibrium in the long term, as the drop in oil demand could be offset by the supply fall as a result of the re-allocation of resources into other new energy investments.

Figure 4: Global upstream investments forecasted to 2025



Source: Rystad Energy

Figure 5: Global upstream spending loss



Source: Rystad Energy

OPEC's Role And Geopolitical Tensions

In the past 20 years, geopolitical tensions have been a common factor to spike oil prices. According to S&P Global Platts Oil Security Sentinel, events threatening security – such as physical attacks on petroleum infrastructure, or shipping, in the Persian Gulf and the Arabian Peninsula region – have tripled on an annualised basis since 2017. The number of incidents reported by Platts was the highest this year, with 27 confirmed security events identified. While it is almost impossible to predict the next cause of geopolitical tensions, maintaining a higher level of global spare capacity and strategic petroleum reserves expansion will help to cushion the price impact caused by the fear of supply disruption.

Figure 6: Biggest events that shocked the oil market since 2000

	Key time slot	Production hit	Dated Brent	IEA stocks released	Spare capacity
VENEZUELA'S SLIDING OUTPUT ▪ A spiraling economic crisis has led to a dramatic decline in production ▪ A general oil strike between Nov. 2002-Feb. 2003 severely crippled its output	Nov. 2002-Feb. 2003	2.3 million b/d	Jumps by more than $5/b on **oil strike**	NO	Medium
US HURRICANES ▪ Hurricanes regularly impact US oil production and refining ▪ In Aug. 2005, Hurricanes Katrina and Rita hit the oil sector hard	Aug. 2005	2.0 million b/d	Soars to $67.33/b; a **record high** at the time	YES	Low
MILITANCY IN NIGERIA ▪ Regular attacks on oil infrastructure due to Niger Delta militancy ▪ Unexpected cut in production in early-2007 amid OPEC pressure	H1 2008	0.4 million b/d	Rises over $120/b in May 2008 as **attacks intensify**	NO	Medium
LIBYA'S OIL WOES ▪ Civil unrest since 2011 has constantly undermined production ▪ 2014 and 2020 also saw huge output collapses	H1 2011	1.5 million b/d	Jumps to a **three-year high** of $126.53/b on April 28	YES	Medium
MIDDLE EAST RISKS ▪ Regional tensions have resulted in a spate of attacks on key oil infrastructure ▪ Saudi Arabia's oil facilities were attacked in 2019, hitting its oil output	Sept. 2019	5.7 million b/d	Rises almost $8/b after **Saudi's Abqaiq** and **Khurais facilities** were **hit**	NO	Medium

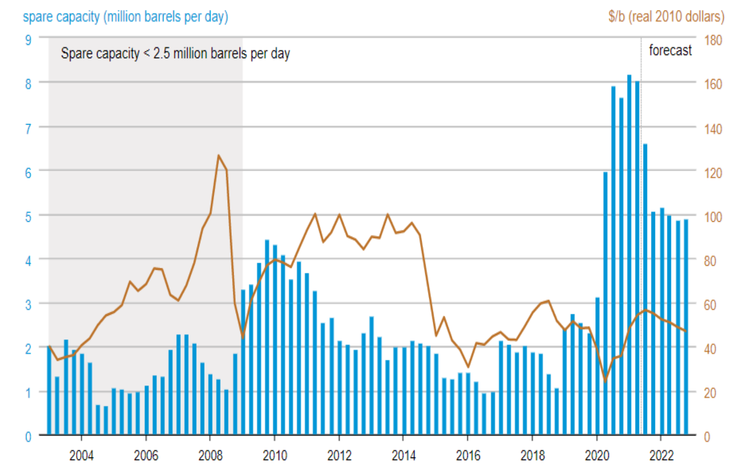
Source: S&P Global Platts Oil Security Sentinel

How much spare capacity does OPEC have?

OPEC has been playing a very crucial role in rationalising the supply market in the past. Accounting for more than one-third of the crude supply market share, OPEC's spare capacity is an indicator to assess global oil market tightness. Over 2003-2008, its spare capacity was below 2 mbpd – which limited its ability to respond to any demand and price rally. On the flip side, OPEC's decision to flood the market will also dent oil prices, as evidenced by what happened in 2H14.

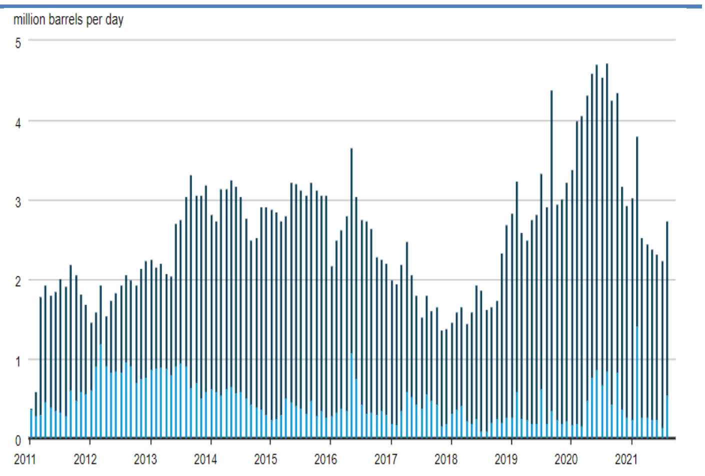
International Energy Agency stated in its Jun 2021 Oil Market Report that OPEC will still have 6.9 mbpd of spare capacity after meeting production ramp-up requirements up to Jul 2021. This means that even OPEC's spare capacity is still left with 3.3 mbpd, after gradually reversing the remaining production quantum of 3.7 mbpd until Sep 2022. Therefore, we are of the view that OPEC has the ability to accommodate any sudden surge in demand next year. The market is likely to price in a higher risk premium, if OPEC's spare capacity falls below 2.5 mbpd.

Figure 7: OPEC's spare production capacity and WTI crude prices



Source: EIA

Figure 8: OPEC and non-OPEC supply disruptions

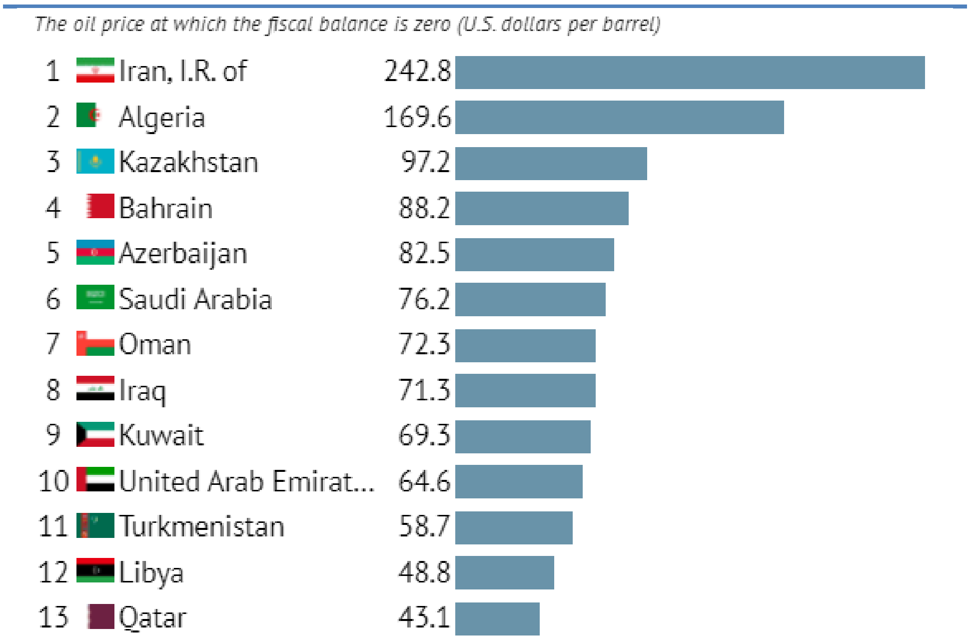


Source: EIA

Can OPEC maintain high compliance and what's next?

In the past one year, we have seen a divergence of strategy between Saudi Arabia and Russia as well as Saudi Arabia and the United Arab Emirates (UAE). Being the leader within the OPEC cartel, Saudi Arabia is regarded as a relatively stable supplier and usually keeps 1.5-2mbpd of spare capacity if there is a need to balance the market. Such resilience could have been with minimal disruptions to its oil exports amidst multiple attack incidents to the oil infrastructure. The International Monetary Fund (IMF) highlighted that the oil exports from the Middle East and North Africa (MENA) – except for Iran – will see lower fiscal breakeven oil prices in 2022F. Saudi Arabia and the UAE's fiscal breakeven oil prices per bbl are expected to drop to USD65.70 and USD60.40 (from USD76.20 and USD68.20 this year). The easing of fiscal breakeven prices will bring more OPEC members closer to that of their biggest ally, Russia (USD30.00-40.00/bbl).

Figure 9: Fiscal breakeven oil prices by country



Source: Knoema

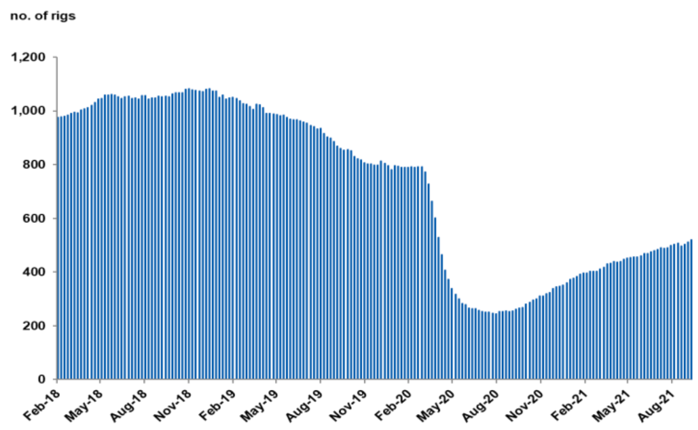
Current strategy is still in favour of OPEC. Overall, we believe OPEC is likely to stay intact, even though some members such as Iran and Algeria are still having unattainably high fiscal breakeven oil prices, at USD242.80 and USD169.60 per bbl. The current production ramp-up schedule, in our view, allows OPEC+ members to increase their output and capitalise on the higher oil prices. It may not be worthwhile to aggressively increase production for a higher market share at the expense of weaker oil prices, especially when US production may not be seen as an immediate threat with its subdued numbers. Having said that, we do not discount the possibility of OPEC changing its strategy, if oil prices were to move up all the way to USD100.00 per bbl and US production was to rebound at a greater momentum.

Iran is the swing factor. Iran is not part of the OPEC 10 that participated in the production cut. Hence, its production is not subjected to the agreement. However, it could still be a big swing factor, as the country is still seeking to recover lost ground due to the imposition of international sanctions in recent years. Iran's oil production has been growing since the beginning of the year, to 2.5 mbpd in August, according to OPEC. This is still almost 1 mbpd lower than the 2017-2018 peak of c.3.5 mbpd. The peak production record in the past 20 years was 4.1 mbpd in 2008. We believe Iran may not able to ramp up production so swiftly due to technical and financial bottlenecks, but it still could add some supply pressure in 2022F with its unutilised spare capacity.

Are US Production Levels On a Rebound?

The Energy Information Administration (EIA) expects US crude production to improve to 11.3 mbpd in 4Q21, recovering from Hurricane Ida which caused evaluation and shut-downs of platforms in the Gulf of Mexico. EIA projected US total crude oil production to increase by 6% to 11.7 mbpd in 2022. This would make the US the producer that delivers the strongest output outside OPEC+ in 2022. The US rig count is still growing – it exceeded 500 in September. This is double from last year's number, but still a gap from the 900-1000 levels recorded in 2018-2019.

Figure 10: US rig count



Source: Bloomberg

Figure 11: US crude oil production

Source: Bloomberg

Figure 12: US annual oil production to resume in 2022

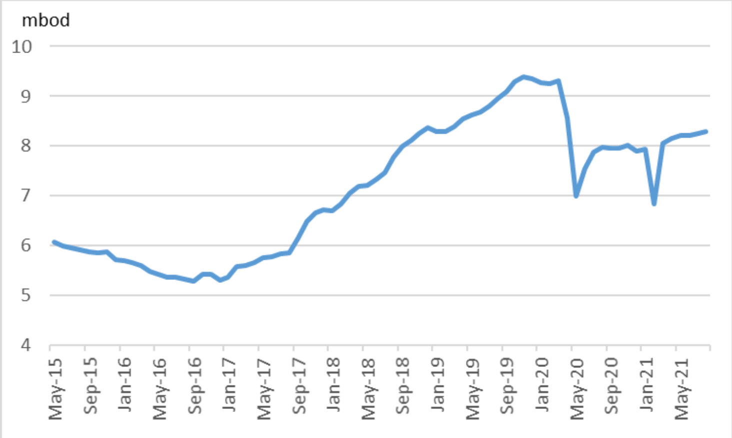
(mbpd)	2015	2016	2017	2018	2019	2020	2021	2022
US crude oil production	9.44	8.84	9.35	10.99	12.29	11.28	11.08	11.72
US crude oil production growth	-3.91	-0.6	0.51	1.64	1.3	-1.01	-0.2	0.64

Source: EIA, RHB

Number of live drilled but uncompleted wells (DUC) is low. The amount of oil a well produces typically declines over time, as pressure is depleted. As shale oil wells have rapid decline rates (70% in the first year, with a well life averaging three years), funding remains critical for the shale oil producers. Investors and creditors have demanded that shale oil companies spend less, and pay more dividends. Once funding dries up, declines in total production may eventually follow. Based on EIA's latest Drilling Productivity Report, the total DUC in US was still on a decline (-4% MoM), ie to 5,713 in Aug 2021, ie the lowest level since Jul 2017. DUC numbers have started to normalise after abnormally peaking at 8952 in Jun 2020, which means fracking is still picking up faster than drilling activities. A higher magnitude of new well drilling activities are needed to boost up DUC, as we think that a portion of the remaining DUCs are "dead" after 24 months of drilling but remain uncompleted.

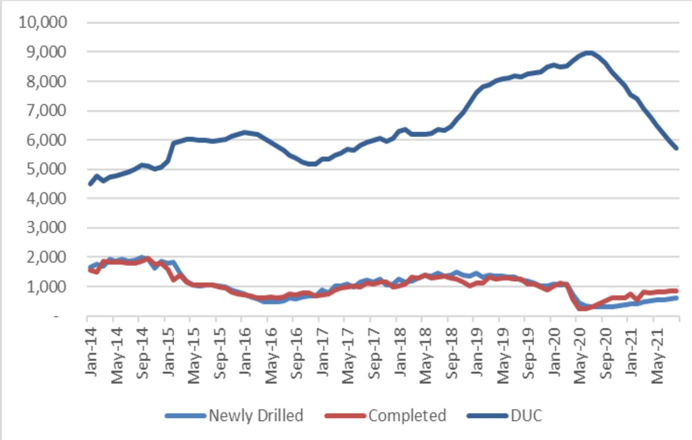
Drilling pace to accelerate in 2022. It was quoted that Pioneer Natural Resources (Pioneer), a shale oil & gas producer, believed that US shale oil growth was "not going to grow that much" in the coming years, as oil and gas companies continue to focus on capital discipline and shareholder returns. Pioneer's top executive also highlighted that the output in the Permian basin is estimated to grow by roughly 5%. This is in line with Pioneer's planned production growth over the coming years, while other basins will be flat or even decline. Despite such a comment, we are of the view that shale drillers would accelerate their drilling pace in order to ride on the uptrend of oil prices – especially the private drillers which have no public shareholders to be accountable to.

Figure 13: US shale production



Source: Bloomberg

Figure 14: Newly drilled, completed wells and DUCs in US



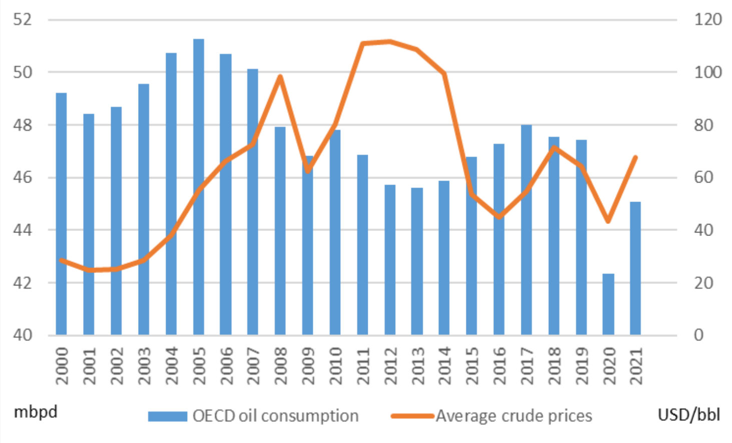
Source: Bloomberg

Watch Out For Oil Demand Destruction

We believe there is no specific price threshold where oil demand will start to decline, but the expectation of oil prices to go higher and sustain at such levels could dent consumer spending patterns. It is also rather tough to backtrack the data, given that oil consumption could also be affected by other factors such as economic growth and income levels, and each country would have a different magnitude of price elasticity.

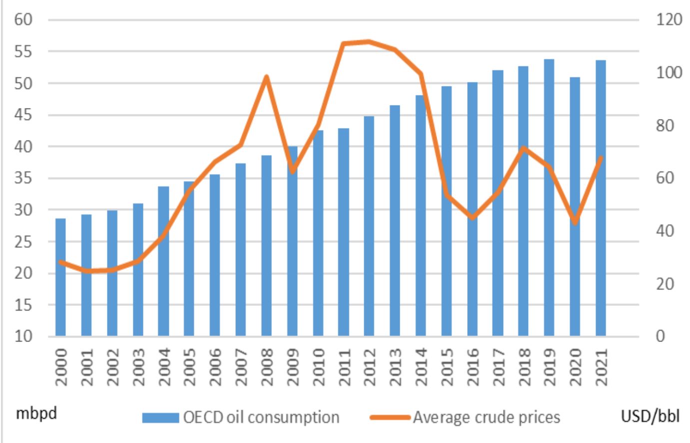
We take a closer look at the relationship of oil prices and consumption, and the inverse relationship appears to be more evident for high-income OECD countries. In the past 20 years, the oil consumption of OECD countries decreased over 2000-2001, 2006-2009, 2011-2013, and in 2008 and 2020. Except for 2020 pandemic year, almost all of these periods are associated with higher oil prices. Oil consumption in both the transportation and industrial sectors has noticeably slowed in 2011, when oil prices first hit USD100.00 per bbl. This was also particularly obvious between 2011 and 2014, when oil prices averaged above USD100.00 per bbl. We also saw a turning point of OECD oil consumption in 2H14, following the sharp decline in oil prices.

Figure 15: OECD oil consumption



Source: Bloomberg

Figure 16: Non-OECD oil consumption



Source: Bloomberg

On the other hand, oil consumption in non-OECD countries has increased in the past 20 years, with the exception of 2020 due to the COVID-19 pandemic. These low- and middle-income countries still offer relatively higher economic growth and, as such, the higher oil price impact could not be seen easily – being masked by rising household incomes and higher vehicle ownership.

While it is hard to estimate the exact impact of the price elasticity of oil demand, we see complaints or reactions from top oil-consuming countries like the US. In August, US President Joe Biden urged OPEC+ to increase oil production to address rising gasoline prices. The same call was made by his predecessor, Donald Trump via his tweet in Apr 2018, complaining the artificially high oil prices were no good and not acceptable when oil prices were at USD70.00 per bbl. As such, we can somewhat derive that oil-consuming countries start to feel the pain when prices move above USD70.00 per bbl, but the impact is still bearable.

Talking About USD100.00/bbl Again

The soaring gas prices have lifted power prices to record-high levels, particularly in markets that heavily rely on gas for electricity generation such as the UK and other European countries. Natural gas prices have spiked to record levels, driven by growing demand and lower supply – especially when a potentially colder winter season is coming. This turns out to have a knock-on effect on production costs for businesses within the consumer and industrial sectors. We can expect oil and coal power generation to increase in the near term, as the Northern Hemisphere enters the winter season. At the same time, the world's largest independent oil traders, Trafigura, is of the view that recovering oil demand could lift oil prices to USD100.00 per bbl at the end of 2022. With oil prices approaching USD80.00 per bbl levels, does the rally have enough steam to lift oil prices to its first USD100.00 per bbl since Jul 2014?

What did the history tell us? Oil prices first exceeded USD70.00 per bbl in mid-2006 as a consequence of higher gasoline consumption and geopolitical tensions including North Korea's missile launch, the on-going Iraq war, and Lebanon's strained ties with Israel. The first decline in oil demand for developed countries in 20 years also happened in 2006, which is also regarded as a response to unexpectedly high oil prices. It only took less than six months for oil prices to climb up to USD100.00 per bbl after breaching USD80.00 per bbl in Sep 2007. Prices were pushed higher by the US dollar weakness, which encouraged higher interests in the paper-oil market, as investors sought to hedge against inflation and currency fluctuations amidst the geopolitical developments in the Middle East.

The golden era of oil began in 2011. Brent prices climbed back to USD100 per bbl since 2008 in Feb 2011, in response to the curtailment of oil production as a result of the first Libyan civil war and sustained high price levels (averaging at USD111.00 per bbl in 2011) to reflect supply tightness in the global crude oil market. This marks the first time that the global benchmark price averaged above USD100.00 per bbl for a year. In the next two and half years, oil prices remained volatile, but the commodity still traded in the high range of USD90.00-130.00 per bbl. The oil market ended its best era in 2H14, with a steep plunge dragged by increased US production and OPEC's reluctance to defend prices to slow down its competitors in US, amidst a global oversupply situation.

Our View

We re-examine some of the major factors – OPEC's position and its associated risk premium, US production, as well as potential demand destruction when oil production is at high levels. While current projections still point to a potential surplus in 2022, we see the increased possibility of oil prices reaching USD100.00 per bbl, but stronger catalysts are needed to spice things up. The demand upside surprise would be the key factor that could lift oil prices to another level. This would then further compress OPEC's spare capacity, and the risk premium is likely to heighten when its spare capacity is lowered to 2 mbpd (vs estimated 3.3 mbpd in 2022). Furthermore, current OPEC's strategy, in our view, is still in its favour – and still price-positive. The easing of fiscal breakeven prices will bring more OPEC members closer to their biggest ally, keeping them intact as long as the US is not deemed as a competitive threat.

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