What's Hot: Supply risks point to higher oil prices

Published 25 November 2022

Aneeka Gupta
Director, Macroeconomic Research, WisdomTree Europe

Oil prices were whipsawed this week with swings of more than 6%1 after a report from the Wall Street Journal suggested that Organisation of the Petroleum Exporting Countries (OPEC+) is looking to possibly increase output by 500,000 barrels per day (bpd). The rumour could have easily been justified by President Biden's decision to offer sovereign immunity to the Saudi Crown Price Mohammed bin Salman in a civil lawsuit, as geopolitics could influence decisions. However, the Saudi's shortly denied the report that OPEC+ was not considering an output increase, helping oil prices claw back losses on the day. This makes logical sense, given that OPEC+ reduced its oil production noticeably since the beginning of November, in accordance with its early October decision. The price action on 22nd November goes to show that it takes only a small amount of movement in trades to cause a large price effect in oil. The oil market remains susceptible to further volatility amidst a backdrop of low liquidity into year end.

Looking ahead, the oil market remains vulnerable to a number of key events starting with the OPEC+ meeting on Dec 4 followed by the European Union (EU) embargo on Russian oil alongside G-7 plans to launch a price cap on Russian crude sales on Dec 5.

Price cap on Russian oil is hardly bearish

Expectations are that the G-7 will soon announce the level at which they intend to set the price cap on Russian oil. The latest reports suggest a cap of US Dollar 65-70 per barrel, which would be well above Russia's cost of production. Russia is already selling its crude at a significant discount, so a cap at these levels would likely have minimal impact on trading and inflict minimal harm to Russia. Russia's Deputy Prime Minister Alexander Novak has once again made it clear that Russia will not supply crude oil or refined products to countries which follow the G-7 price cap. In fact, oil will either be redirected to those nations who choose to ignore the price cap or Russian output will be reduced. This appears to be more supportive for higher prices. So far, EU diplomats are locked in negotiations over how strict the Russian mechanism should be, after Poland and Greece rejected the proposal. They would prefer to see a cap closer to the cost of production at US$30. EU leaders are now expected to seek a deal at a 15-16 December summit, in follow up to the energy minister meeting this week on 24 November.

Source: Bloomberg, WisdomTree as of 23 November 2022.

Historical performance is not an indication of future performance and any investments may go down in value.

EU embargo on the import of Russian oil is approaching fast. This comes into effect on 5 December for crude oil and 5 February 2023 for oil products. In the last three months, Russia has remained the largest external supplier of diesel to the EU, delivering 540kbd2. According to IEA estimates, the EU was still importing 1.5mbd of Russian crude oil in October, which corresponded to just under 15% of total EU crude oil imports. In the coming months, the EU will need to find alternative suppliers. Replacing these supplies is not going to be easy. Russia will need to find other buyers leading to further uncertainty on the oil markets. India, Turkey and China have increased their purchases of Russian oil, thereby enabling Russia to continue exporting large quantities of oil.

Weak demand dominating sentiment on the oil market

Oil prices are down nearly 35% from its peak as sentiment remains dominated by concerns over weaking demand as the global economy enters a recession alongside an unprecedented release from the US Strategic Petroleum Reserve (SPR). Net speculative positioning in WTI crude oil futures is more than 1-standard deviation below the 5-year average underscoring extreme bearishness on the oil market3. Its worth noting that speculative positioning in oil was on a downtrend prior to the peak in oil prices. That indicates for one investors were probably taking profits on earlier holdings and higher volatility in oil market kept buyers at bay.

Source: Commodity Futures Trading Commission (CFTC), Bloomberg, WisdomTree as of 15 November 2022.

Historical performance is not an indication of future performance and any investments may go down in value.

Although in a severe recession, oil demand can decline sharply, we are anticipating a much shallower recession for both the US and Eurozone economy. In the middle of the year, China's oil demand was hit severely by lockdown restrictions, with demand falling below April 2020 and 2021 levels by 1-2mbd4. Although their remains uncertainty about China re-opening, we expect oil demand to recover from Q2 2023 onwards and accelerate towards year end. This should help oil demand from China grow in contrast to the prior two years.

Conclusion: The oil market still seems structurally undersupplied over the next few years. The International Energy Agency (IEA) assumes by the end of Q1 2023 oil production will be 2mbd lower than prior to the invasion of Ukraine. We expect the Chinese re-opening, Russian supply risk, the end of SPR releases and lower levels of investment in the energy sector to contribute to a tighter oil market in 2023.

1 Source: Bloomberg intraday price movement of WTI crude oil futures on 21 November 2022.

2 Source: Kpler as of 31 October 2022.

3 Commodity Futures Trading Commission (CFTC) as of 15 November 2022.

4 Source: S&P Global Platts.

Related products

+ WisdomTree WTI Crude Oil (CRUD)

+ WisdomTree Brent Crude Oil (BRNT)

+ WisdomTree WTI Crude Oil 2x Daily Leveraged (LOIL)

+ WisdomTree Energy (AIGE)

+ WisdomTree Natural Gas 3x Daily Leveraged (3NGL)

+ WisdomTree WTI Crude Oil 1x Daily Short (SOIL)

+ WisdomTree Bloomberg Brent Crude Oil (BRND)

+ WisdomTree Brent Crude Oil - EUR Daily Hedged (EBRT)

Important Risks Related to this Article

Important Information

Marketing communications issued in the European Economic Area (“EEA”): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an oer for sale nor a solicitation of an oer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and aer seeking independent investment, tax and legal advice.

The application of regulations and tax laws can oen lead to a number of dierent interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and aer seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public oering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any ailiate, nor any of their respective oicers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.