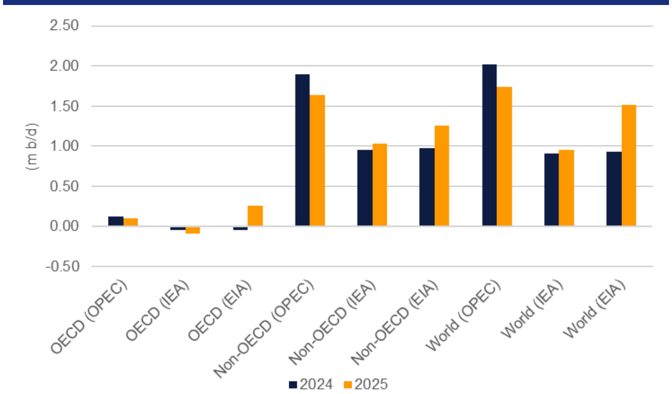
Oil outlook 2025: dimming

Research | 26 September 2024

- **Oil markets will face another year of a soft demand in 2025 as major economies record weaker headline growth and structural factors like a growing electric vehicle fleet eat into demand.**
- **OPEC+ has run out of room to add barrels back to the market with limited price impact as demand ebbs and non-OPEC+ supply continues to grow.**
- **OPEC+ members are likely to doubt the effectiveness of restraining production if it means market share is eroded with no parallel support for prices.**
- **Oil markets will swing into a surplus in 2025 even if OPEC+ were to delay returning output.**
- **We expect oil prices will decline on average in 2025. We target Brent futures at an average of USD 73/b and WTI at an average of USD 71/b, down roughly 9% and 7% year/year respectively.**
- **A disorderly end to the Declaration of Cooperation (OPEC+ production management) would mean substantial downside risk for prices if producers fought for market share.**

Oil demand projections for 2025 vary substantially between the major forecasting agencies. OPEC is the most robust, expecting global oil demand to grow by 1.7m b/d, down from more than 2m b/d estimated for 2024 but still representing above OPEC's own long-term estimates for trend growth in oil demand. Emerging economies will represent the bulk of oil demand next year according to OPEC at 1.6m b/d, but OECD markets will still show growth of slightly more than 100k b/d in 2025, roughly the same with where demand is estimated for 2024.

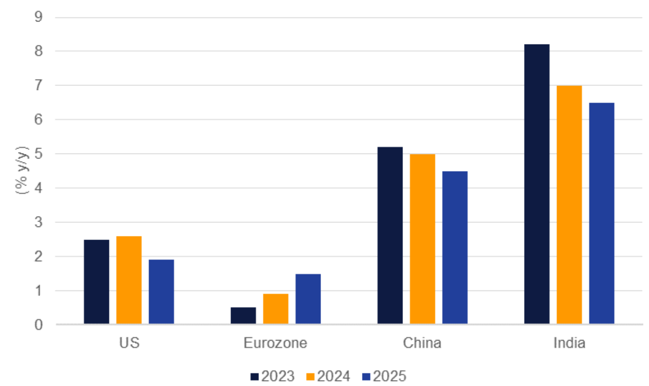
Is oil demand hot or cold?



Source: IEA, OPEC, EIA, Emirates NBD Research.

In contrast, the IEA has been much more downbeat on oil demand next year, expecting global consumption growth of just 0.9m b/d,onlymarginally higher than their estimate for 2024. Like OPEC, the IEA expects emerging economies to account for all the demand growth next year as a drop in OECD demand of about 90k b/d is offset by slightly more than 1m b/d of non-OECD consumption growth.

IMF global growth projections



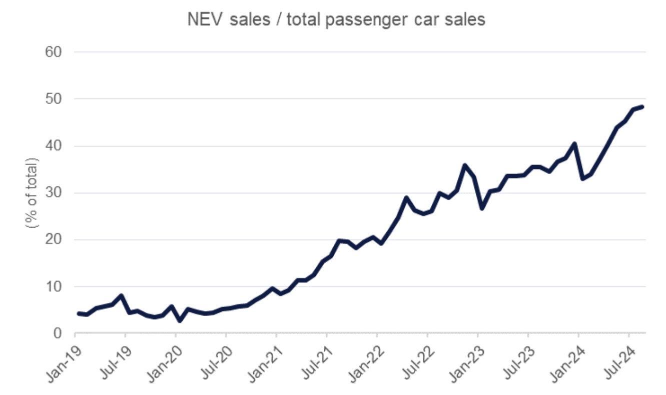
Source: IMF, Emirates NBD Research.

The EIA sits roughly between OPEC and the IEA with a global demand growth forecast of 1.5m b/d, representing an acceleration from their estimate of 0.9m b/d for this year. But the EIA stands out in expecting a sharp improvement in OECD demand for 2025.

Consensus projections for major economies in 2025 is a slowdown in activity. For China, growth is projected to dip to 4.5% from consensus estimates of 4.8% this year even as the government is taking significant stimulus steps to try and improve consumer and investor confidence. The US economy is set to cool to 1.7% real GDP growth in 2025 from 2.5% this year as the Federal Reserve attempts to keep a soft landing in place.

While the headline growth numbers don't imply an outright collapse in activity, they don't build a robust case for oil demand. Oil consumption, on an apparent demand basis, has dropped year/year in China for five of the first eight months of 2024 as distillates demand has been trending downward for nearly the last 18 months. An even slower Chinese economy in 2025 will threaten moderate demand growth projections of about 260k b/d from the IEA. An even larger structural challenge for robust oil demand in China will be the take-up of hybrid and electric vehicles. Total sales of new energy vehicles rose to 48% of total sales as of August 2024, denting the outlook for gasoline consumption in particular which had been holding up relatively better than distillate demand.

Electric vehicle sales rising rapidly in China



Source: Bloomberg, Emirates NBD Research.

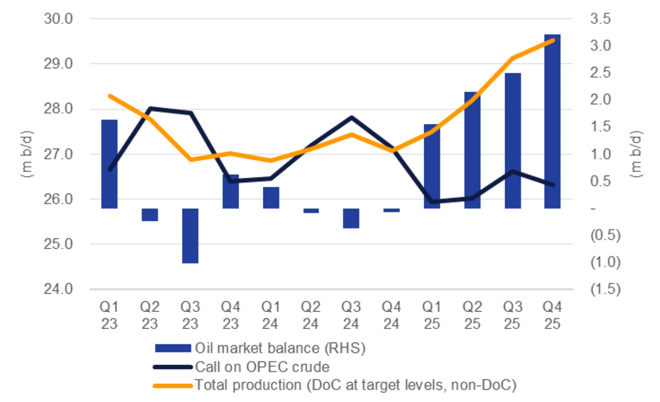
For the US, gasoline and distillates consumption has also been soft this year. Gasoline consumption (product supplied from EIA data) has declined by about 1.5% y/y as of monthly data up to the end of August, compared with growth of more than 4% in the same period a year ago, while diesel demand is worse at about a 4.2% drop on average. Cooling growth in 2025 could extend the soft oil demand picture in the US even if more affordable fuel prices provide a baseline level of demand.

Beyond China and the US few other major oil consumers will show robust demand next year. India will be the strongest case for higher oil consumption in 2025 with the IEA expecting 220k b/d of growth, providing more than a fifth of forecast demand growth. But elsewhere, the long-running trends of diminishing oil demand, particularly for transport fuels, will make themselves felt again with demand set to decline in European economies as well as Japan.

OPEC faces few good options next year

Against this flat-lining demand outlook OPEC+ producers face challenging prospects for 2025. OPEC+ has already had to delay returning production to markets in October 2024 as planned. But with producers outside the Declaration of Cooperation (OPEC+) not subject to policy restraint on their output, OPEC+ is running out of low-risk opportunities to restore production close to capacity and recapture market share.

Sticking to the plan would overwhelm markets



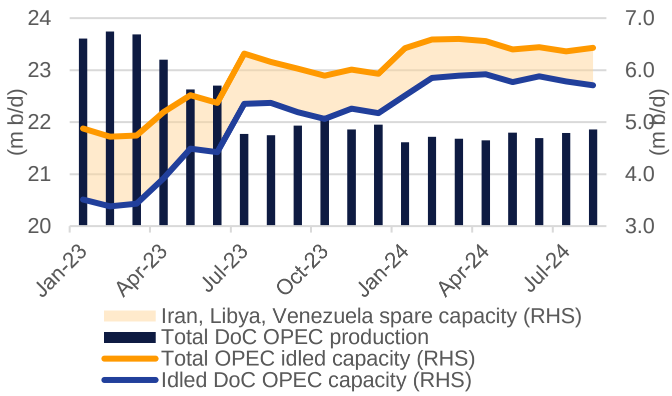
Source: OPEC, IEA, Emirates NBD Research.

For OPEC, the amount of oil they will need to produce to keep oil markets in balance will fall to an average of 26.2m b/d in 2025, down from 27.2m b/d in 2024. This "call on OPEC crude" nets non-OPEC crude and OPEC natural gas liquids from demand, leaving the room available for OPEC countries to fill. If OPEC countries increased output in line with the OPEC+ targets for next year, oil markets will shift into a substantial surplus even with an assumption that Iran holds production at current levels and there are incremental increases from Libya and Venezuela. Changes in the international sanctions stance on Iran or Venezuela in 2025 would make the potential oversupply even worse if both countries were able to maintain the modest increase in output they have recorded this year.

An oil market surplus of much more than 2m b/d on average would be calamitous for oil prices and the expectation of an over-supplied market next year has more than likely been the catalyst for the drop in oil prices over the last several weeks, taking Brent to less than USD 70/b briefly in September from nearly USD 90/b as recently as July.

OPEC+ production restraint is evidently having a limited impact on supporting prices and has eroded the OPEC+ share of global oil markets. Since April 2023 when new voluntary cuts from some OPEC+ members were announced, production among the OPEC members of the DoC has dropped to less than 22m b/d and has pushed collective idled capacity (voluntarily cut and spare capacity buffer) to nearly 6m b/d. Adding in spare capacity from OPEC members outside of the DoC, total spare capacity is about 6.5m b/d.

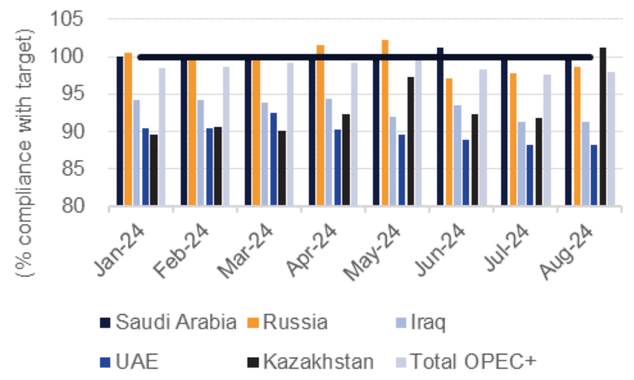
Compliance, as ever, is key



Source: Bloomberg, Emirates NBD Research

We expect that OPEC+ will plan to increase production gradually over the course of 2025 to avoid ceding market share any further to competing producers. But adherence to target levels remains a challenge to the effectiveness of OPEC+ stewardship of oil markets. Aggregate compliance with OPEC targets this year has been a fairly strong average of 98.6% in the first eight months of 2024. However, there has been some substantial over-production from UAE, Iraq, Kazakhstan and Russia among the large producers in the alliance.

Compliance, as ever, is key



Source: IEA, Emirates NBD Research

The risk of a breakdown in OPEC+ integrity is high as falling oil prices fail to satisfy any members. Market reports suggest that Saudi Arabia may be prepared to increase production next year to re-capture market share, even at the expense of higher prices. An initial move from a producer as large as Saudi Arabia is likely to be followed by others, risking a rapid flood of oil coming onto the market.

Non-OPEC+ gaining ground

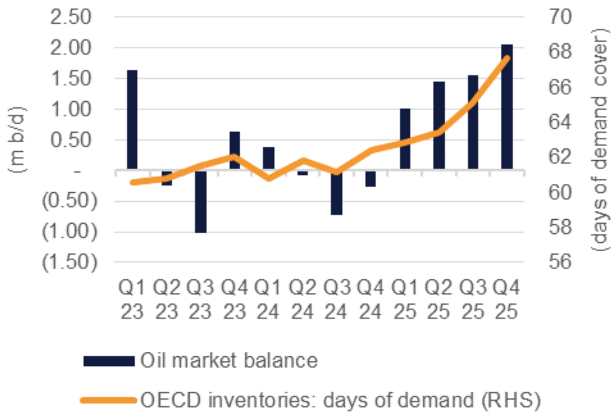
Apart from a softer demand profile for 2025, non-OPEC+ production will also be another headwind for prices. Oil production in the US is projected to increase by 420k b/d to 13.7m b/d on average and end the year just short of 14m b/d according to the EIA's latest short-term energy outlook. Production is also due to increase from Brazil, Canada and Guyana with the EIA projecting a total of 90k b/d of non-OPEC+ supply increases outside of the US.

While the US will remain the world's largest producer of oil next year, the pace of additional supply growth is slowing. A survey of exploration and production firms from the Dallas Fed in September suggested activity in the main region of production growth was cooling and that plans for capital expenditure in the next year was dropping. Firms were fairly optimistic on pricing, expecting WTI to get back up above USD 80/b by the end of 2025 but also showed a major increase in market uncertainty, not least affected by the upcoming US presidential election.

Oil market balances will weigh on prices

We expect that oil markets will swing into a considerable surplus in 2025 of an average of about 1.5m b/d compared with a modest deficit of about 200k b/d estimated for this year. On its own, that scale of deficit should be a major headwind for oil prices to test higher levels.

Oil market balances to loosen in 2025

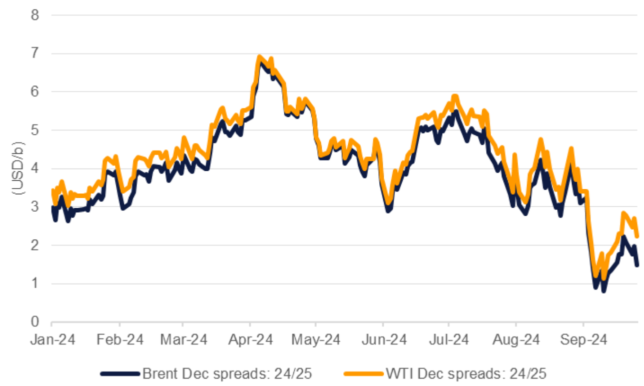


Source: IEA, Emirates NBD Research.

Market pricing has been shifting from anticipating tight to looser oil markets in the year ahead. The backwardation in December time spreads for Brent futures has dropped to less than USD 2/b as of late September from more than USD 5/b at the start of the quarter. A similar compression has also taken place in WTI markets. This front-loading of the pending weakness in 2025 may flatten the slope of falling prices but fundamentals will still exert a substantial downward pull on oil next year.

If OPEC+ does add substantial volume back to the market in 2025 then it will weigh on prices on the front-end and push market structures into contango. An upward sloping curve tends to be more attractive for independent producers who can hedge output further out, rather for than state-controlled oil producers such as OPEC+ members which have sought to keep the curve in backwardation.

Time spreads haven't flipped, yet



Source: Bloomberg, Emirates NBD Research.

Oil price assumptions for 2025

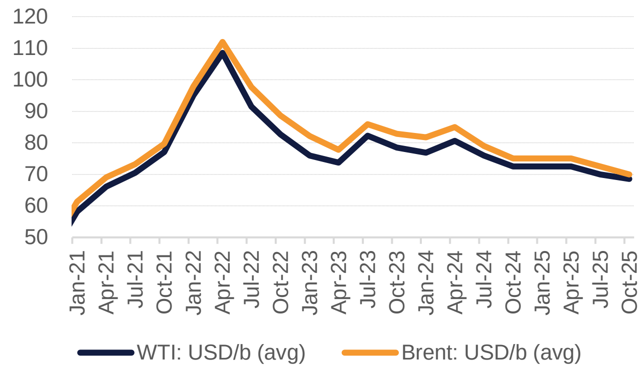
We exepct oil prices in 2025 to be lower on average than our target for 2024. For Brent futures, we expect they will slide from an average of USD 75/b in Q1 25 to USD 70/b by Q4 25 for an average of USD 73/b, down 9% from an expected average of USD 80/b for 2024. For WTI, the trend will be similar, moving from USD 72.50/b in Q1 to USD 68.50/b by Q4 for an average of USd 71/b, down 7% from an expected average of USD 76/b for 2024.

Emirates NBD Research oil price assumptions

	Q1 25	Q2 25	Q3 25	Q4 25	2025	% chg y/y
Brent USD/b avg	75.00	75.00	72.50	70.00	73.13	-8.8%
WTI: USD /b avg	72.50	72.50	70.00	68.50	70.88	-7.4%

Source: Emirates NBD Research. Note: avg of period.

Oil prices to drift lower in 2025



Source: Bloomberg, Emirates NBD Research.

Upside risks to our oil price assumptions stem from an escalation of geopolitical risks that directly impact production or shipment of oil, particularly in the Middle East and North Africa region. Prices have been relatively inured to geopolitical risks in 2024, even as oil tankers have been attacked and disrupted in making crossings of the Red Sea and Suez Canal chokepoints. A better than expected demand profile may also emerge, abetted by looser fiscal or monetary policies as policymakers seek to support growth. However, the pass-through to higher oil demand from lower rates is contingent on underlying physical demand receiving a boost, more so than a weaker US dollar pushing prices higher.

The major downside risk for prices in our view is if the OPEC+ alliance fragments as individual members question the value of restraining output only to receive lower prices and to lose market share. OPEC+ countries are highly diverse in their individual socio-economic pressures and perspectives on the pace of energy transitions away from high dependence on oil in particular. A complete break-down of OPEC+ integrity would prompt a contest for market share, similar to what occurred in Q2 2020 when oil prices ended up in free fall.

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