

## Economics in Focus

19 December 2024

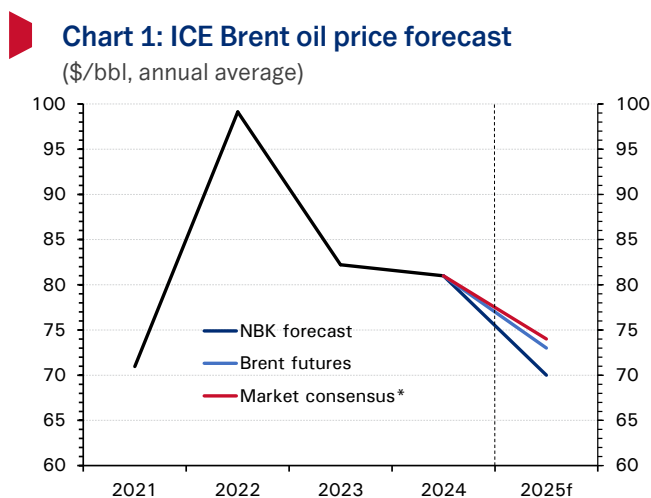


# Oil outlook 2025: Prices on the defensive amid developing supply overhang

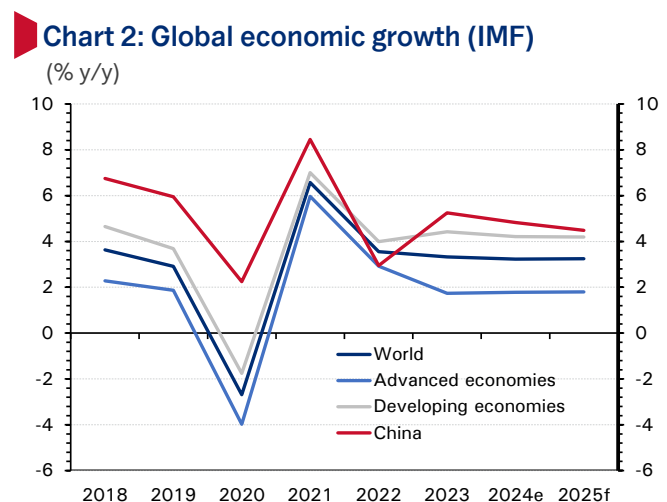
We expect oil prices to remain at the lower end of the current trading range in 2025, averaging \$70/bbl, amid continued soft oil demand growth and strong non-OPEC supply gains that will combine to deliver a market supply overhang. OPEC+ may have to extend already-delayed production rises beyond Q1 2025 or risk further downward price pressures. Downside risks to this already subdued price outlook include more-severe-than-expected weakness in the Chinese economy, the global impact of US trade tariffs and higher US supply growth under incoming president Trump's pro-energy agenda. Moreover, OPEC+ could decide to increase supply to recapture market share. On the upside, stricter US sanctions policies could remove more Iranian oil from the market – although OPEC+ output could rise to compensate. Meanwhile, ongoing strength in the refined products market and still-low global petroleum inventories may be underappreciated.

### Market sentiment turned bearish in H2 2024, dominated by oil demand concerns

Oil prices were rangebound for much of the second half of 2024, with Brent trading in the \$70-75/bbl range and set to average \$80/bbl for the full year. This would mark a second consecutive annual decline, from \$82/bbl in 2023 and \$99/bbl in 2022. (Chart 1.) Prices were pressured by global macroeconomic and oil demand concerns, especially linked to China, outweighing developments in regional geopolitics linked mostly to the conflicts in the Middle East that would traditionally be bullish for oil. Bearish sentiment in H2 saw the Brent futures curve often flirting with flipping into a contango structure (where spot prices are lower than prices for delivery in the future) – which would be a first in four years – as a sign of an oversupplied market. Decisions by OPEC+ to delay unwinding output cuts seemed to have little price impact, with markets reassured by ample global spare production capacity (at least 5.4 mb/d among OPEC members, the IEA estimates) linked to OPEC+ production cuts and US Shale's impressive gains. Reflecting the bearishness,



Source: Bloomberg, NBK; \*mean of Bloomberg poll



Source: IMF World Economic Outlook (October 2024)

forecasters lowered their oil price estimates for both 2024 and 2025, with the consensus now at \$73/bbl for 2025, though this masks wide variation of \$60-92, according to those surveyed by Bloomberg.

**Price softness reflects expectations of much looser fundamentals in 2025**

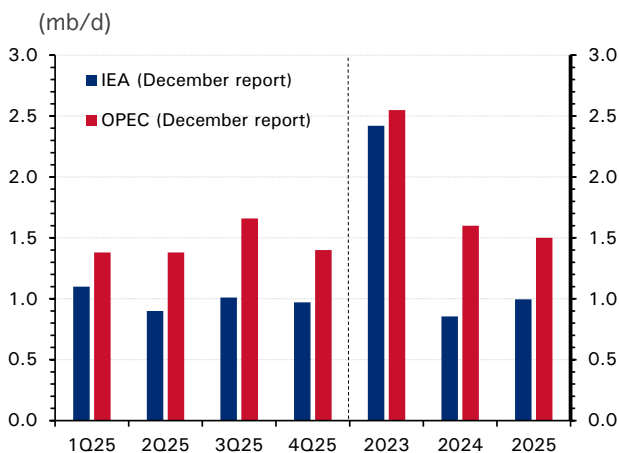
Consensus expectations are for oil market fundamentals to loosen quite considerably in 2025, with demand undershooting supply leading to a further build in oil inventories. In terms of oil demand, the International Energy Agency (IEA) expects it to grow by 1.1 mb/d to 103.9 mb/d, faster than the 840 kb/d estimated for 2024. However, this is still well down on the 10-year pre-pandemic average growth rate of around 1.5 mb/d. In the IEA's view, 2025's gain will be supported by demand for petrochemical products, but in general terms, growth remains constrained by a combination of still-subdued global economic activity, the tapering off of the post-pandemic boost in consumption as well as increased uptake of cleaner-energy alternatives to oil. The IEA's projections often take their cue from the economic forecasts of the IMF and the OECD, both of which have global growth at 3.2-3.3% in 2025, broadly unchanged from 2024. Important, though, is the projected deceleration in Chinese economic growth, which in 2025 is expected to slow for the second consecutive year (to 4.5%), according to the IMF. (Chart 2.)

Among other energy houses, the US Energy Information Administration (EIA) is the closest to the IEA in its forecast, seeing oil demand growing by 1.3 mb/d to 104.3 mb/d in 2025, faster than the 0.9 mb/d expected in 2024. (Chart 3.) OPEC, on the other hand, remains by some margin the outlier, predicting growth at a robust 1.5 mb/d, even after revising down its estimate in December for a fifth time in a row.

**The China effect**

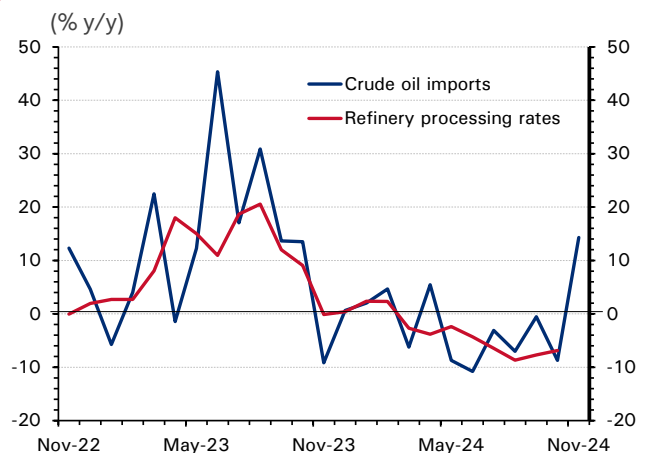
The difference between the three reporting agencies' assessments tends to boil down to how they see oil consumption in China playing out in 2025. OPEC is at the more bullish end (+300 kb/d), more than 50% higher than the IEA's forecast (+190 kb/d). This IEA estimate, if it materializes, would see China's oil demand growth in 2025 down a whopping 86% in two years. The impact of the slowdown in Chinese consumption growth is critical given the country's dominant role in driving oil demand over the last thirty years, accounting for more than 40% of annual global consumption growth (1.1 mb/d on average) to the extent that it is by some way now the world's largest importer of crude oil (>11 mb/d). China's economic woes were central to the narrative around weakening in global oil demand growth in 2024.

**Chart 3: Global oil demand growth**



Source: International Energy Agency (IEA), OPEC

**Chart 4: China crude imports and refining rates**



Source: NBS, China Customs

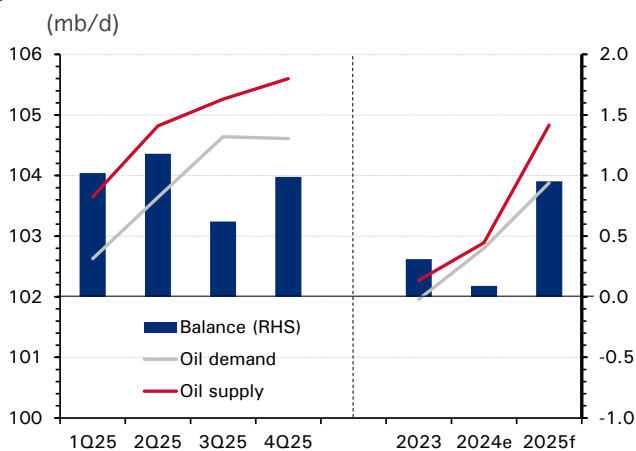
Markets grew increasingly concerned about Chinese oil consumption, especially in Q3 after data showed the annual decline in China’s crude oil imports and refinery run rates approaching double-digits. The latter was still in negative territory in October—a run of eight straight months. (Chart 4.) Compounding the bearishness, as the IEA noted, was that demand for transportation fuels is declining amid faster adoption of electric vehicles and the substitution of LNG for diesel in heavy duty vehicles. Diesel and gasoline consumption probably peaked in 2019 and 2023, respectively, and the view that global oil demand will peak by 2030 is increasingly gaining currency. The structural shift in Chinese oil consumption is real and accelerating, with profound consequences for oil demand, leaving petrochemicals (for plastics etc.) and jet fuel as the primary drivers of oil demand at the product level. A turnaround in sentiment towards demand growth would be helped by more aggressive economic stimulus by the Chinese authorities, but longer term, markets will be increasingly looking to India, Indonesia and the Middle East in the future to help offset declines in China.

**Non-OPEC+ supply gains in 2025 drive largest supply overhang since the pandemic**

The picture on oil supplies in 2025 is, outside of the OPEC+ group, fairly bullish. Non-OPEC+ supply gains in 2025 are projected at a strong 1.5 mb/d according to the IEA and the EIA and at 1.2 mb/d according to OPEC, led by the US, Canada, Brazil, Guyana and Argentina. Against a backdrop of soft oil demand, these supply gains help increase the likelihood of a large oil market surplus in 2025. The IEA sees this surplus at around 950 kb/d, substantially up on 2024’s expected surplus of less than 100 kb/d. (Chart 5.) The EIA and OPEC, by contrast, expect the market in 2025 to remain in deficit, albeit a narrower one of -100 kb/d (from -440 kb/d in 2024) and -1.5 mb/d (from -1.6 mb/d in 2024), respectively. The extreme variation between these and the IEA’s estimates reveals the still-high level of uncertainty regarding the supply outlook in 2025.

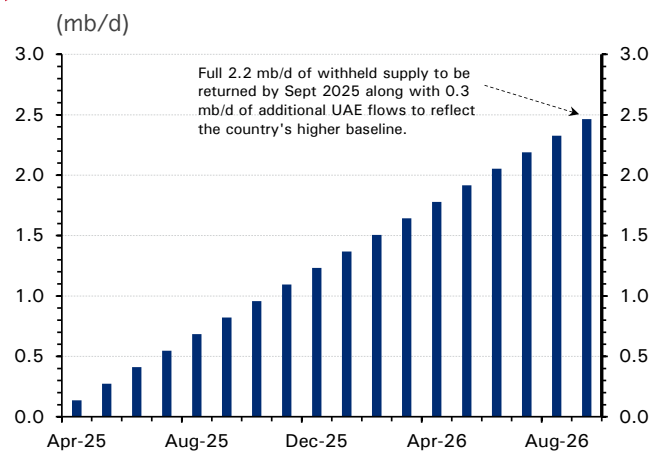
Taking the IEA’s figures as the reference, the large market surplus leaves no space for OPEC+ to unwind their 2.2 mb/d of members’ voluntary cuts in 2025. The IEA has the “call” on OPEC+, the volume of the group’s crude that is needed to balance the market, at 40.95 mb/d in 2025. This is well down on where it estimated OPEC+ production in November 2024 (41.4 mb/d). Therefore, even without factoring in a potential unwinding of OPEC+ cuts from April 2025 onwards, according to the IEA’s figures, the group’s current output is already substantially in excess of the call. The logic dictates that only deeper OPEC+ production cuts in 2025 would be sufficient to balance demand and prevent oil prices from falling. As things stand, were OPEC+ to press ahead with tapering their supply cuts as per their schedule through 2025, then the supply overhang could increase to 1.4 mb/d.

**Chart 5: Oil market balance (IEA figures)**



Source: IEA

**Chart 6: OPEC+ ‘Group of 8’ resupply schedule\***



Source: OPEC; \* excludes compensatory cuts by Iraq etc.

**OPEC+ delays unwinding cuts, though may need to focus on compliance in 2025 to mitigate surplus**

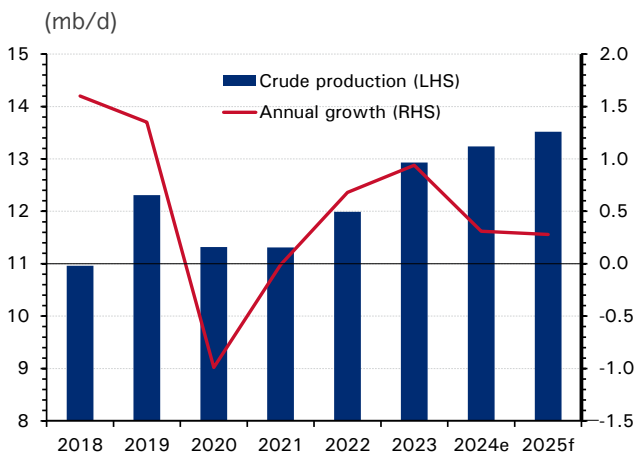
The decision by OPEC+ in December 2024 to delay for a third consecutive time its plan to unwind members' voluntary production cuts reflected the realities of softening oil demand and buoyant non-OPEC supplies. The new schedule sees group production on hold until at least April 2025, after which the 2.2 mb/d of voluntary cuts (announced in November 2023) will be released to the market at a slower pace over eighteen rather than twelve months. Another 3.65 mb/d of cuts from 2022 and 2023 will be extended until 2027 (they were due to be unwound in 2026). (Chart 6.) The UAE also agreed to defer its production increases of 300 kb/d by three months to April and extend the duration over eighteen months as well. The UAE had successfully lobbied OPEC for a higher baseline to reflect its higher production capacity. The changes should see roughly only half that volume (1.1 mb/d) returned in 2025, with the monthly pace reduced to about 120 kb/d from 180 kb/d over the entire course of the resupply schedule.

But even this seems a lot for the market to absorb, so the chances of a further extension of OPEC+ cuts beyond Q1 2025 are high in our opinion. To help minimize the supply overhang, OPEC+ would need to ensure not only 100% member compliance with existing cuts, which is no easy feat given the routine overproduction by several members, but to insist on Iraq and Kazakhstan's adherence to the compensatory cuts plan they signed up to (averaging a total of -152 kb/d per month over 14 months). This would more than offset any planned increase in OPEC+ volumes over the same period. Another step would be for OPEC+ to bring Libya and Iran into the quota system, as production from both has risen following earlier unrest and/or sanctions. Iran was the largest source of supply growth within OPEC in 2024 (+151 kb/d) and its production has defied sanctions by rising by more than 700 kb/d to 3.3 mb/d in two years.

**Uncertainty, volatility expected in 2025, with oil price risks skewed to the downside**

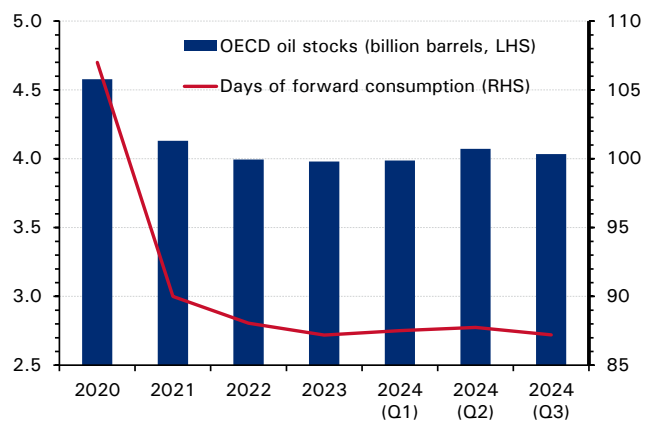
We have set an oil price expectation of \$70/bbl (average) in 2025 with a balance of risks skewed to the downside, although there are pockets of opportunity for higher prices. We see the most significant downside threat to oil prices coming on the supply side, from either non-compliance within the OPEC+ group or from a shift in policy to abandon supply cuts in favor of recapturing market share. While the probability of this is limited at the moment, OPEC+'s patience with serial quota violators is not limitless. Nor would the OPEC+ group be content with the growing ranks of non-OPEC producers making more headway with OPEC's traditional customers.

**Chart 7: US crude production**



Source: US Energy Information Administration (EIA)

**Chart 8: OECD oil inventories**



Source: OPEC

Outside of OPEC+, the US shale patch remains the largest single source of potential supply gains in 2025, although supply growth will slow to 280 kb/d from 310 kb/d in 2024 according to the EIA – the second consecutive year of slower gains. (Chart 7.)

Much has been made of the incoming Trump Administration’s “Drill, Baby, Drill” mantra, threatening a further sharp ramp-up in US oil supplies. But while President Trump will encourage production through fossil fuel tax breaks and subsidies and by repealing fossil fuel-limiting regulation, including those in President Biden’s landmark Inflation Reduction Act (IRA), we take a conservative view of the upside potential. Jurisdictional constraints – the president’s remit is limited to federal land, under which shale reserves are either small or already tapped – and financial considerations of US oil operators (especially at lower oil prices), will likely weigh on the scale of future expansion. The CEO of one major oil firm even advised Trump against withdrawing from the Paris Climate Accords, while others view some of the IRA incentives, such as tax credits for capturing carbon and producing hydrogen and sustainable aviation fuel as sensible and valuable.

More likely, Trump could have his greatest influence on the international rather than domestic oil market, directly through stricter enforcement of sanctions on Iran and, indirectly, through tariff policies that could result in a stronger US dollar and potentially tighter monetary policy. But here too the outlook is nuanced. Even with his move to sanction Iran, removing Iranian barrels would require cooperation from China, Iran’s primary customer, which could be tough to secure given Trump’s plans to raise US tariffs on imports from China. Moreover, even if Iranian production did fall, OPEC+ could use this as a window to proceed with their own output increases with greater conviction. Finally, Trump has indicated several times that he will pursue a settlement to the Russia/Ukraine conflict. An associated easing in geopolitical risk and any release of Russia from sanctions/price caps would be materially detrimental to oil prices in 2025 and beyond.

On the demand side, a greater-than-expected slowdown in global economic activity represents the largest risk to the outlook. Again, the Trump effect could play a large part in this, with tariff policies risking a trade war that hits global economic and oil demand growth. In addition, China’s economy may not respond as well as hoped to the authorities’ stimulus efforts, while long-term structural shifts in Chinese oil consumption are likely to continue.

Positive oil price drivers in 2025 could include global economic growth that responds positively to central bank monetary policy easing, and geopolitics. Irresolution to the ongoing Russia-Ukraine and Middle East conflicts would be price-supportive. Moreover, oil product markets are also signaling some tightness, heading into 2025, especially gasoline. This appears partly related to expectations of planned refinery outages and the observation that inventory drawdowns in 2024 have surprised on the upside, leaving stock levels well under seasonal averages. (Chart 8.) With oil markets seemingly focused on crude fundamentals, these trends have flown under the radar. Also, oil prices could stand to benefit from a slower pace of decarbonization as governments across the globe recognize that they and their publics do not have the technology in place yet and/or are largely unprepared for the costs and lifestyle changes that an accelerated energy transition timetable would place upon them. We have already seen some pushing back of net zero targets in the EU and the UK energy and transportation sectors.

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