Investec Treasury
Commodities

Oil Hedging Considerations for 2025

15th January 2025

Will weak demand trump OPEC+?

Oil prices rallied significantly at times during 2024 and Brent reached a high of just over 92 $/b. These rallies were mainly driven by geo-political risk premiums connected with the unfolding conflict in the Middle East. An escalation in the confrontation between Israel and Iran looked possible at times, but in the end, the situation was largely contained and did not disrupt oil supplies.

With that risk out of the way, or at least diminished, the oil market refocused on the other main narrative of 2024 – demand weakness stemming from China. Commentators steadily revised down their demand growth forecasts throughout the year as growth failed to materialise. On a number of occasions Brent tested the 70 $/b area as speculators established short positions in line with this gloomy outlook in the hope of a further leg lower.

OPEC+ was able to prevent gravity taking over by repeatedly delaying the start of a planned steady increase in output that is not now due to start until the 1st April this year. OPEC+ has indicated that it will continue to watch market developments raising the prosect of the production increases being delayed further if needed. An additional threat to demand this year could come from the disruptive tariffs being planned by Donald Trump who is inaugurated as the next US president next week. On the other hand, Brent is currently trading at its highest level since August 2024 due to fresh sanctions introduce by the outgoing president Biden.

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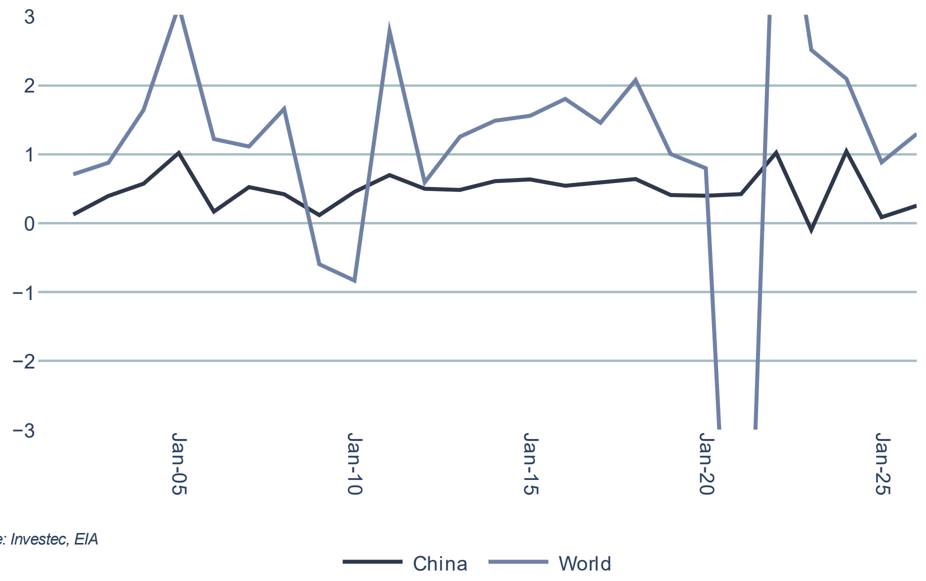
Global Oil Demand

Chinese demand disappoints

In its first monthly report of 2024, The International Energy Agency (IEA) forecast that Chinese oil consumption would grow from an average of 16.4 mb/d in 2023, to an average of 17.1 mb/d in 2024 – an increase of 700 kb/d. In its final report of 2024, that forecast increase had been pared back to an increase of only 200 kb/d. As we start 2025, the IEA's outlook on Chinese demand is much more circumspect. They anticipate a further 200 kb/d on average this year, above the average for 2024.The US Energy Information Administration (EIA) has a similar view.

Before the gyrations around covid, China had typically been adding 500 kb/d of demand each year, which was a very significant contribution to overall demand growth.

EIA Annual Demand Changes

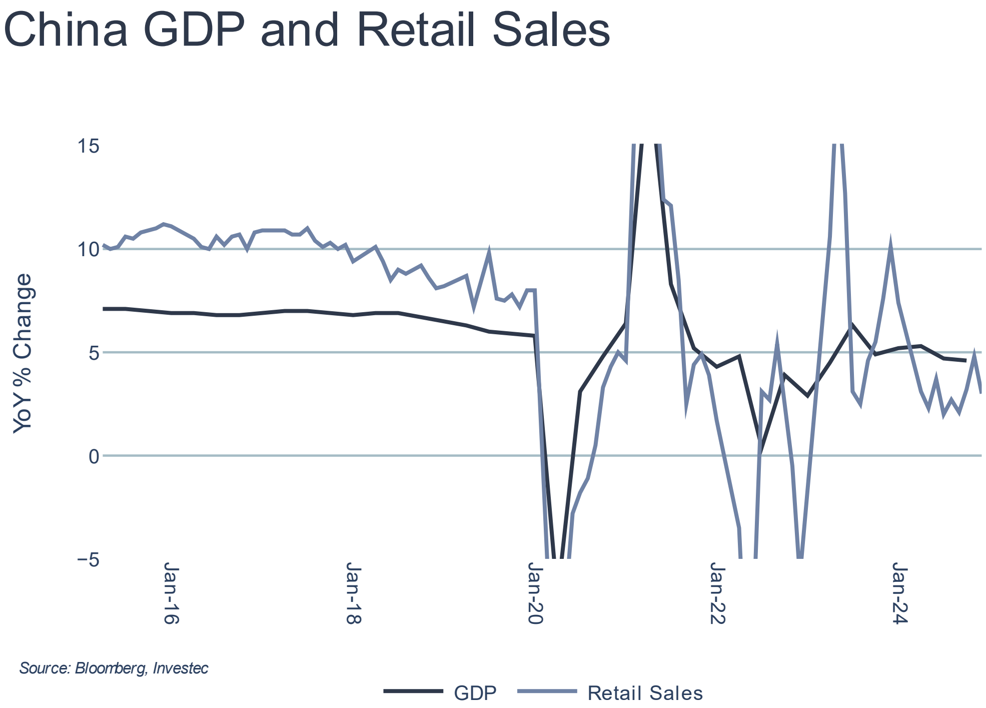


Source: Investec, EIA

China no longer the engine of oil demand growth

However, the days of China powering ever increasing global oil demand, look to be over. The are two keys' reasons for this. The first is an economic one, which might resolve itself over time, but there is not much optimism currently.

Leaving aside the wild variations during the COVID period (which range have been truncated in the chart below – a practice that will be repeated throughout this section), GDP growth looks to be stabilising at just under 5% while retail sales growth is somewhat below 5%. This contrasts with the years before covid, when GDP growth rates were well over 5% and retail sales growth was often over 10%.



China may have moved on from its period of rapid growth, when it was possible to paper over problems that did emerge along the way with state-sponsored infrastructure spending, to one where structural problems are more difficult to ignore. One example is the property market, where overambitious construction in the recent past, is still making itself felt in weak commercial and residential property sales figures.

China Property Sales

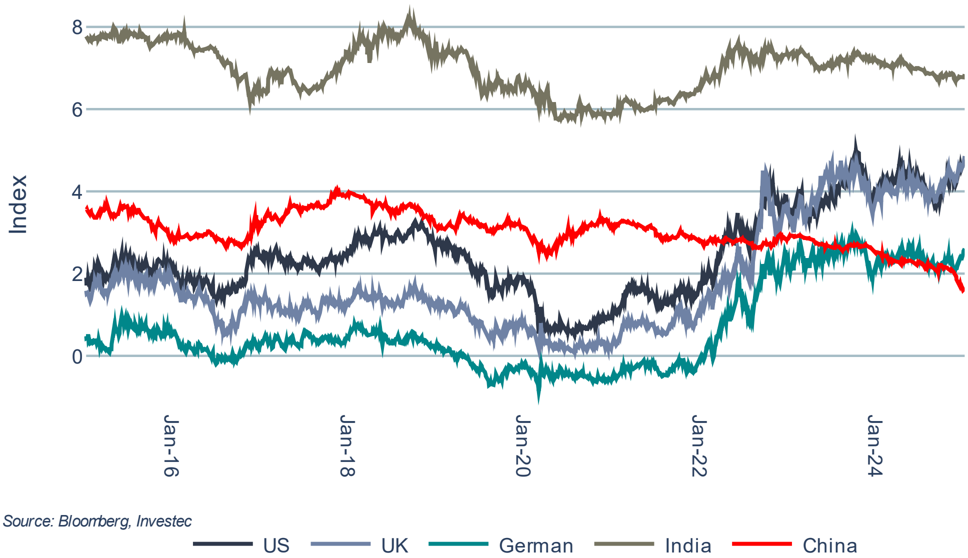
Source: Bloomberg, Investec

To alleviate negative sentiment which had dragged the Shanghai Composite stock index back down towards its covid lows (around the same time as Brent traded under 70 $/b in September 24), the Chinese authorities announced a series of policy measures over the remainder of 2024. This included a recently announced expansion of a trade in scheme where consumers are offered state subsidised discounts to trade in old consumer goods for new ones[1]. This is a direct attempt to boost domestic consumption, which the retail sales figures suggest might be needed. Sentiment in Chinese markets did improve sharply on the initial announcement of policies to support the economy, but some of these gains have been lost after the detail failed to impress markets.

Bond market have also taken a dim view of Chinese economic prospects. At a time when government bond yields are raising around the globe, yields on Chinese 10yr government bonds have fallen below 2%.

[1] Reuters, Jan25, https://www.reuters.com/world/china/china-expands-scope-consumer-trade-ins-home-appliances-2025-01-08/

10yr Goverment Bond Yields



Source: Bloomberg, Investec

All of this is consistent with China no longer being a driver of strong oil demand growth. On top of this is a structural change that is even more challenging for oil markets in the long term.

Switching to EVs (and LNG for heavy trucks)

The main source of oil demand (road transport) is being undermined by an extraordinary roll-out of EVs in China. The incredible efficiency of electric motors, falling battery prices and rapid growth in renewable generation (especially solar) are supporting EVs rising share of auto sales in the country. Around half of car sales in China are now battery EVs or plug-in hybrids[2]. China accounts for over 15% of world oil demand which means its road vehicles must account for over 5% of world demand. Given that its vehicle fleet is transitioning to electricity at a current rate of half of new sales, it seems clear this trend in China alone must have an impact on overall oil demand.

[2] Source: Reuters, Oct24, https://www.reuters.com/business/autos-transportation/global-ev-sales-up-305-september-china-shines-europe-recuperates-2024-10-14/

Other Countries to pick up the slack?

Demand in developed economies has been stagnant for the last couple of years and there seems no reason to expect this to change this year. In which case, global demand growth relies on emerging markets ex-China. The IEA sees 400 kb/d of its 900 kb/d ex-China growth coming from the rest of Asia. India is a key driver accounting for about half of that. The Middle East is expected to add 150 kb/b, while Non-OECD Americas (which included Brazil) provides only 100 kb/d of growth as does Africa.

Global Oil Demand in 2025

As usual, OPEC’s forecasts are the most optimistic on oil demand growth in 2025 (+1.5mb/d), meanwhile the IEA are at the other end of the spectrum and the EIA are in between. All expect demand growth to be stronger in 2025 over 24, than they estimated to be the growth rate in 2024 over 23.

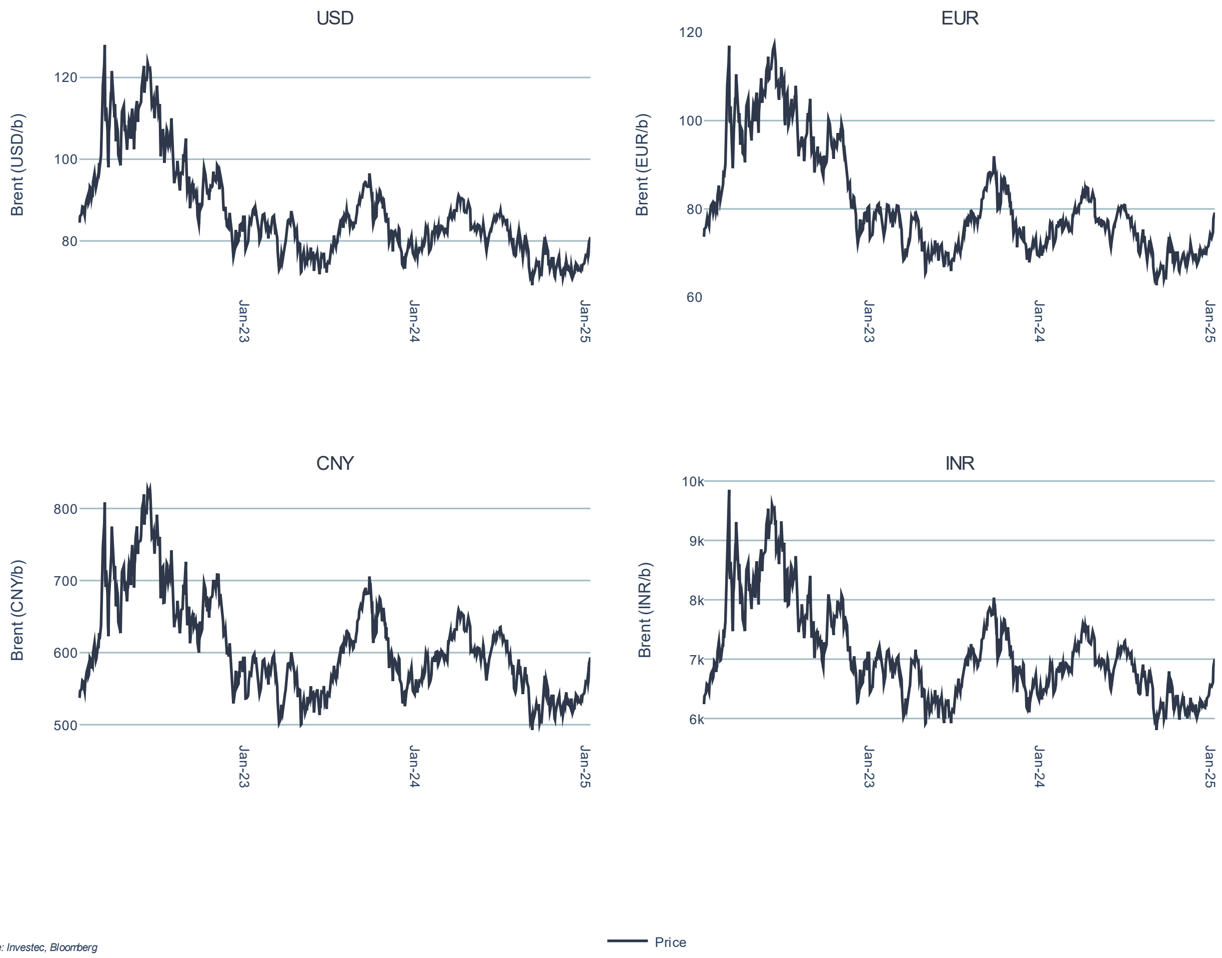
World demand forecasts

Global demand forecasts (mb/d)

Commodity	2024	2025	Change
EIA	103.0	104.3	+1.3
OPEC	103.8	105.3	+1.5
IEA	102.8	103.9	+1.1
Average	103.2	104.5	+1.3

The relatively narrow range of disagreement between the agency’s forecast increases for this year, perhaps belies the potential uncertainties facing oil demand. In particular, the incoming Trump administration in the US is threatening to impose tariffs on a range of countries. The potential for a trade war could be negative for oil demand growth through its dampening effect on economic growth and reduced spending power as the costs of imported goods rise. A weakening in the currencies of consuming currencies is already exacerbating increases in the local cost of oil in those countries.

Brent in various currencies



Source: Investec, Bloomberg

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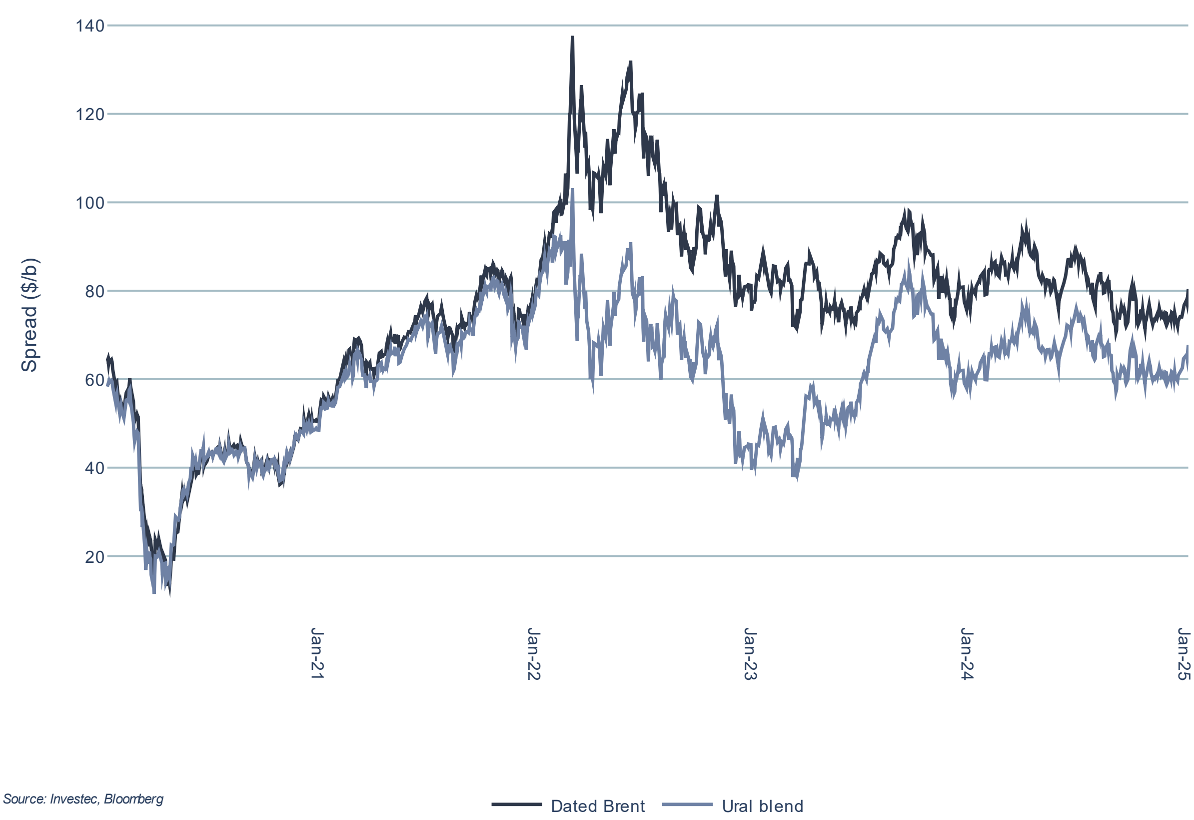
Global Oil Supply

In 2023 the oil market was faced with having to re-route trade flows due to various sanctions and restriction associated with Russian oil. In 2024 the market was faced with a fresh headache in 2024 – attacks on shipping in the Red Sea due to the conflict in the Middle East which made using the Suez Canal very challenging. There was also the possibility of the war escalating and perhaps leading to a more serious disruption to supply. Though there were a number of occasions when a significant supply risk premium was added into prices as events in the conflict unfolded, no actual supply disruptions occurred and the risk premium tended to wither away in the days and weeks following each event.

Sanctions on Russia and Iran

In 2025, the theme of sanctions has already come racing back to the surface. In the final days of the Biden presidency, a fresh wave of sanctions have been unleashed, directed at the so called *shadow fleet* of aging vessels that carry Iranian and Russian crude to refineries in India and China (mainly). This system enabled Russia to transport its crude to refineries in Asia without needing to use the shipping and insurance companies that would have required evidence that the cargos had complied with the 60 $/b price cap for crude as per US and EU sanctions. As can be seen in the chart below, the price of Russian Ural crude has been able to close the gap with Brent and often price over 60 $/b because of this system.

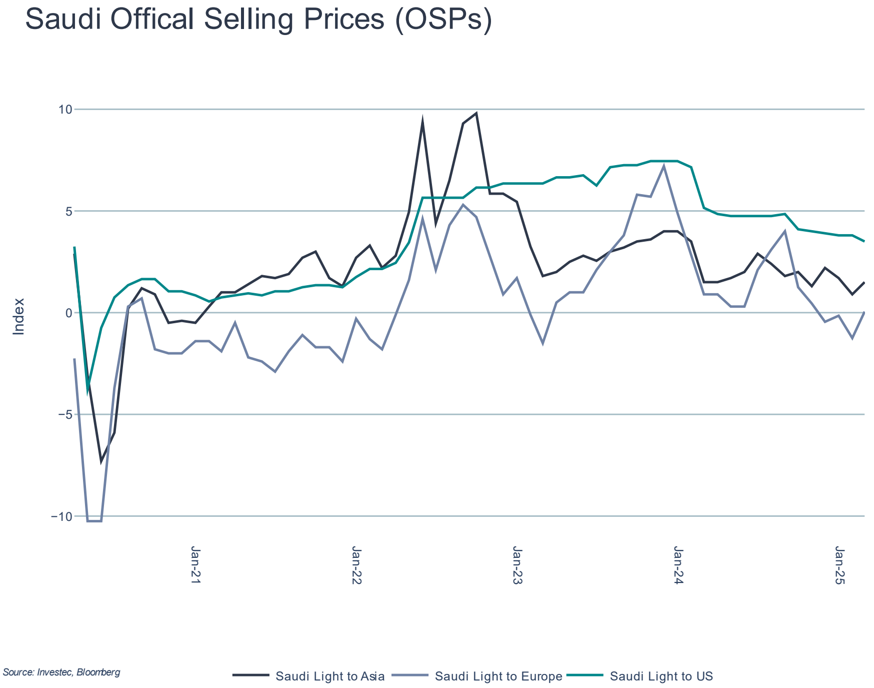
Russian Urals versus Brent



Source: Investec, Bloomberg

The latest wave of sanctions could disrupt this system, forcing Russia to go back to using the price cap and perhaps limiting Iran's output all together. Crude prices strengthened as a consequence. However, it is always hard to judge the lasting impact as the tendency is for loopholes to be found over time that reduce the effectiveness of sanctions.

Following the news of the fresh sanctions, refineries in Asia have been reviewing their supply arrangements and there are already signs they have been looking to others in the Middle East. Saudi Aramco announced a modest increase in their Official Selling prices to Asia and Europe, whereas these spreads had been on a downward trajectory due to previously strong competition to sell into those markets.



Source: Investec, Bloomberg

Geopolitical risk

The conflict in the Middle East has kept the oil market on its toes throughout 2024, particularly at times when Israel and Iran came into direct conflict and there was a real risk that tit for tat retaliation and counter-retaliation, could spiral out of control. In the end there was no direct disruption to oil production, Iran did not make any attempts to disrupt shipping out of the Arabian Gulf (always a big fear for oil markets) and attacks in the Red Sea were generally avoided. On top of which, at the time of writing, Israel and Hamas appear to be close to agreeing a ceasefire deal.

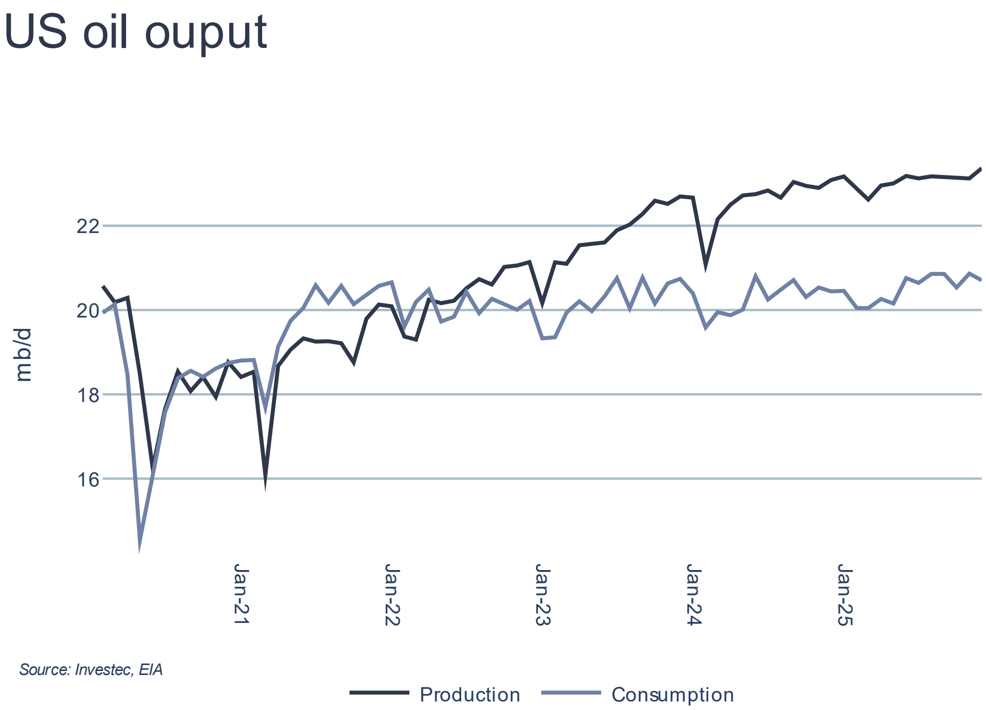
This is does not mean we can be confident that 2025 will be trouble free. The fall of Assad in Syria could lead to greater stability and peace in Syria, or peace might remain elusive. There are a number of groups within the country to satisfy, not least the Kurds who were active in opposing Assad, but also have connections with their groups in southern Turkey and northern Iraq.

That the fall of Assad was associated with the withdrawal of Russia from an active role in Syria, reminds us that it is connected with another key conflict of far reaching geo-political and energy market significance: the Russian war against Ukraine. The war is now entering its third year and there is still no clear route to its ending.

Hanging over all of this is the question of what Trump will do when he enters the Oval office on 20th January.

US Supply

The Americas is likely to be the key source of supply growth in 2025. US output dwarfs other producers in the region and so is seen as the main source of growth. Trump has talked enthusiastically about the prospects for increasing fossil fuel output and often used the “drill, baby, drill” mantra. However, as the chart below shows, oil output was increasing anyway and at a much faster rate than the growth in US demand. This looked set to continue irrespective of who won the 2024 US election.



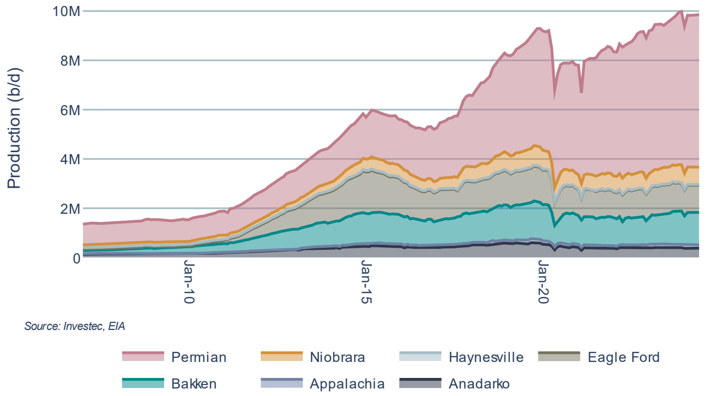
The EIA does expect US output to increase, but at more moderate rate of growth than last year.

Year	Output	Change
2022	20.4	+1.36
2023	22.0	+1.59
2024	22.7	+0.67
2025	23.1	+0.43

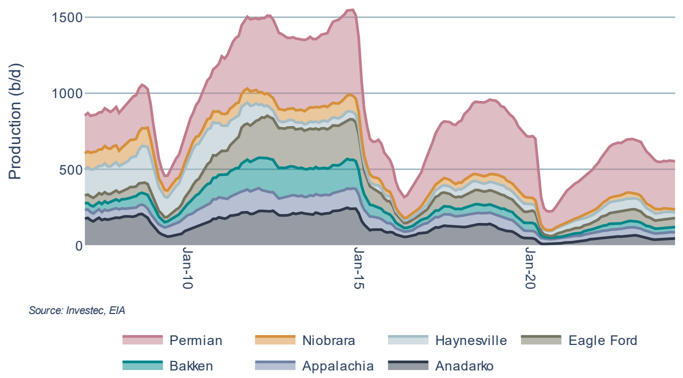
The IEA expects that US output will grow by more than 500 kb/d.

Output in the US shale patch has plateaued of late, but the decline in new drilling activity has stabilised as has the number of wells drilled that have not yet been put into production (Drilled UnCompleted wells – DUCs). In 2025, it is expected that further efficiency gains and infrastructure to remove by-product gas, will enable further shale oil output increases.

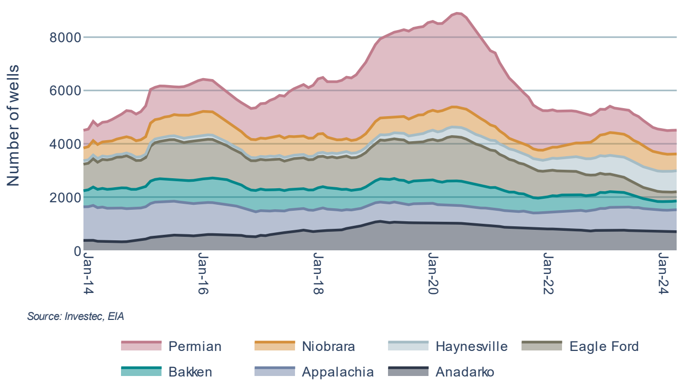
US Shale Production By Region



Shale Drilling Activity



Drilled but Uncompleted Wells



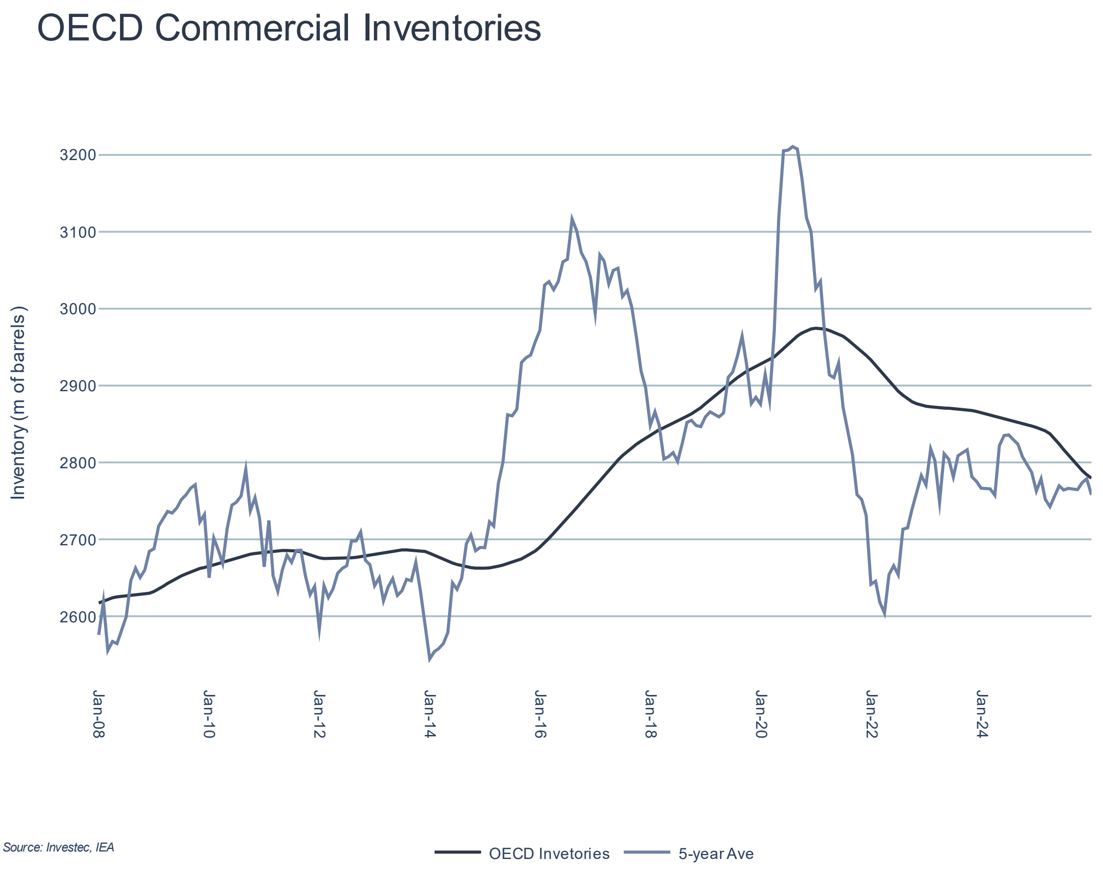
Gulf of Mexico output is also expected to increase. Production will ramp up at Shell's Whale, Chevron's Anchor and Beacon's Shenandoah projects. Anchor and Shenandoah have very high well pressures and will be firsts for the oil industry demonstrating that innovation is continuing to enable increased oil output and that US output is not just about shale.

Other non-OPEC+ output

Outside of the US and OPEC+, Latin America is set to be the main growth region driven by Brazil that could grow by +300 kb/d in 2025. Gains in other regions (Africa, Asia and Europe) look to be marginal.

Inventories and Reserve Balances

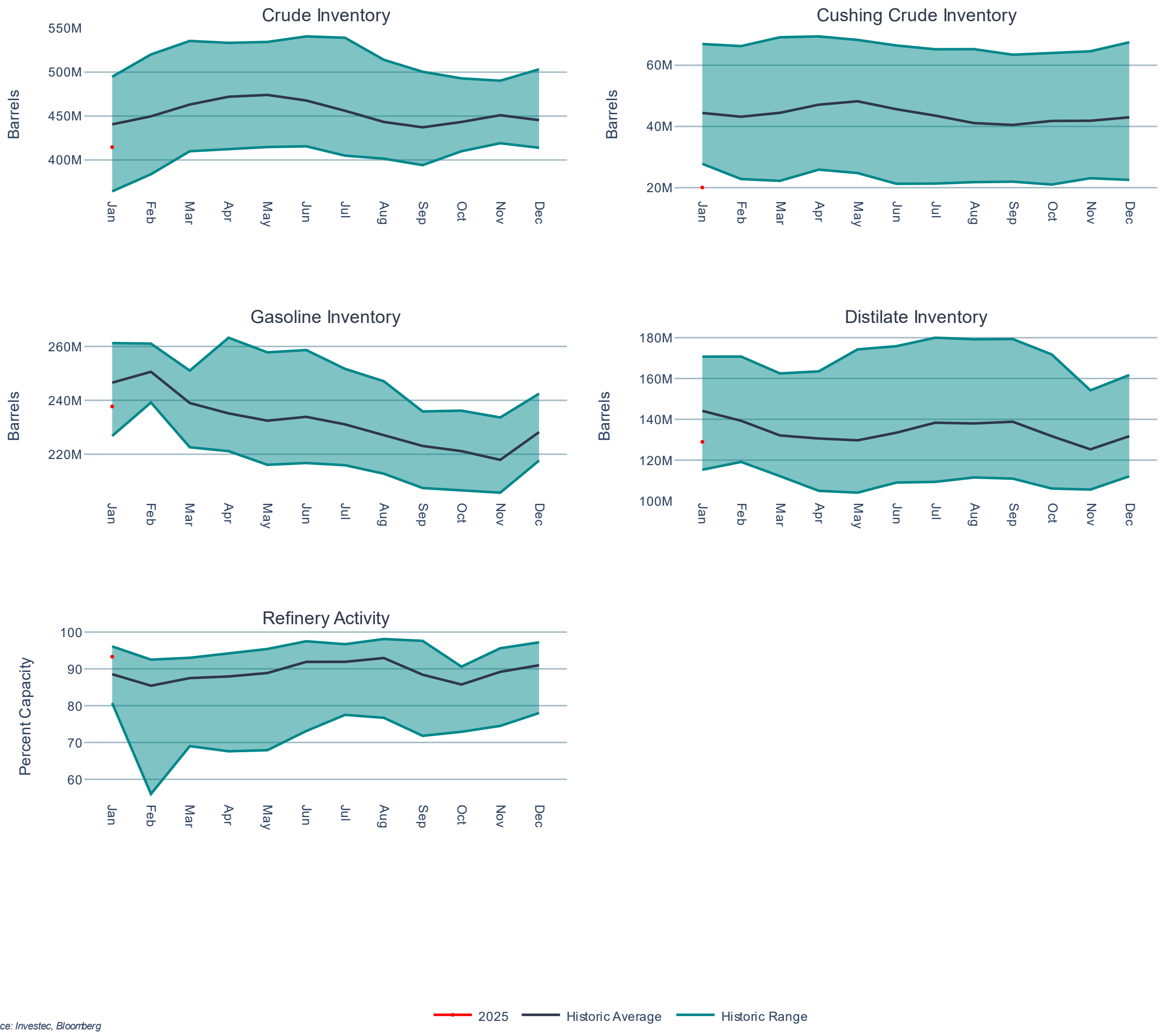
While oil markets were worried about oversupply in the latter part of 2024, there have been no signs of that in feeding through to inventories. OECD inventories are broadly unchanged on the year and are in-line with the 5-year average of inventories – a metric that OPEC+ often targets.



Source: Investec, IEA

Focusing on US inventories, the picture is quite tight for the start of the year. The red dots in the charts below indicate current balances and show that they are bellow seasonal norms.

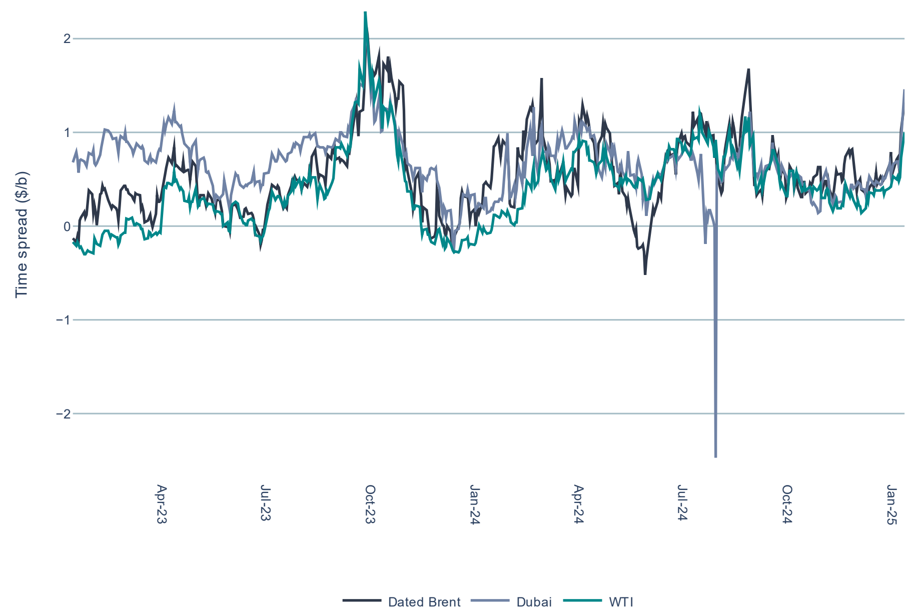
US Inventory and Refinery Activity Data



Source: Investec, Bloomberg

This is consistent with the downward sloping (backwardated) nature of forwards curves in crude markets which indicates that buyers are prepared to pay a premium for oil for immediate delivery. This can be seen as a positive reading in the chart below – note the recent increase in the downward slope as the market has rallied.

Global time spreads. m1 - m2

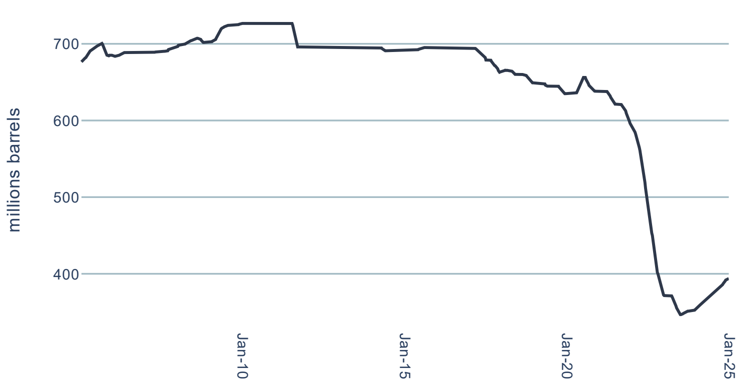


Source: Investec, Bloomberg

US Reserve Activity

In November, the Biden administration announced that its last tranche of oil purchases to re-fill the strategic reserve were complete, but the reserve is still a very long way from the levels before the reserves releases began. Trump has announced that he will refill it, so this is another area where we will need to carefully watch what happens in practice.

US Strategic Petroleum Reserve

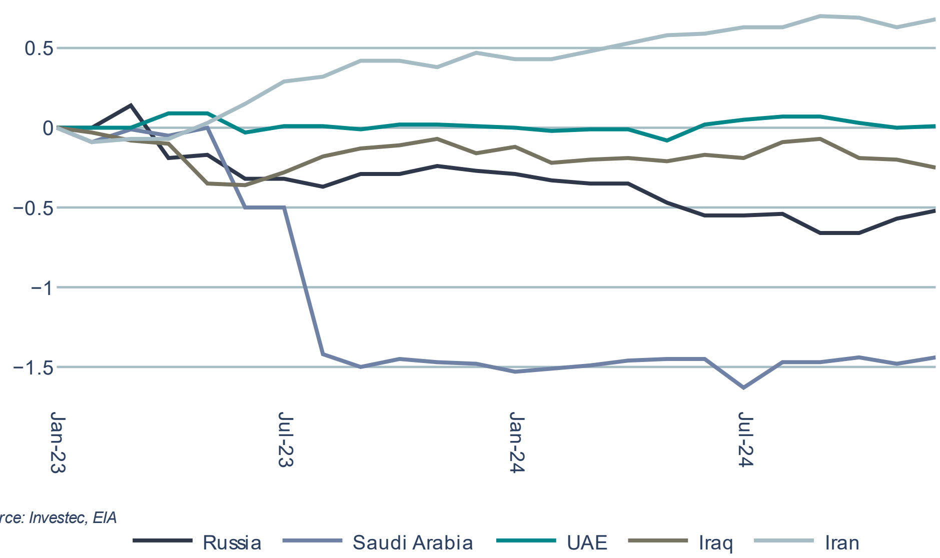


Source: Investec, EIA

OPEC+ Supply

At their December meeting, OPEC+ members agreed to roll over their existing production arrangements to the end of March 25, thus delaying (again) the commencement of their planned increases in output. It is not straightforward to keep track of the layers of additional cuts and other tweaks that OPEC+ has introduced over the last few years to create a semblance of clear purpose. The chart below aims to cut through this complexity by showing how figures reported by the IEA in its monthly report for Saudi Arabia, Russia, UAE, Iraq and Iran, have changed relative to those reported in January 2023. The most obvious change is Saudi Arabia when has cut output by 1.5 mb/d. Russia has contributed a further 500 kb/d of cuts, Iraq less then half that at most and often less. The UAE has not changed at all and Iran, which is not subject OPEC+ limits, but is under pressure from sanctions has increased output by over 500 kb/d.

OPEC+ member production changes



Source: Investec, EIA

Though managing OPEC+ has clearly been challenging for Saudi Arabia over the last year, they might be reasonably satisfied with the results at present. As noted above, OECD commercial inventories have been at or below their 5-year average, is consistent with an often cited OPEC+ objective. Also, the market remains in backwardation which favours those who, like OPEC+ members, sell at the spot price over producers that hedge in the forward market as US shale producers have traditionally done.

OPEC+ has also signalled a willingness to be flexible and react to market developments. Hence the decisions to roll over the current raft of arrangements, which opens up the possibility of continuing to do so beyond March if needed.

Not-withstanding the agreed limits, even if they do continue to be rolled over, it is expected that Saudi Arabian output will increase due to higher Natural Gas Liquid (NGL) from the new Japura gas field, perhaps by 100 kb/d. NGLs are not covered by OPEC+ quotas. Meanwhile, the Kazakh Tengiz field expansion is due to be completed this year which will add a further 250 kb/d to Kazakhstan’s average output figures that it has indicated it will use.

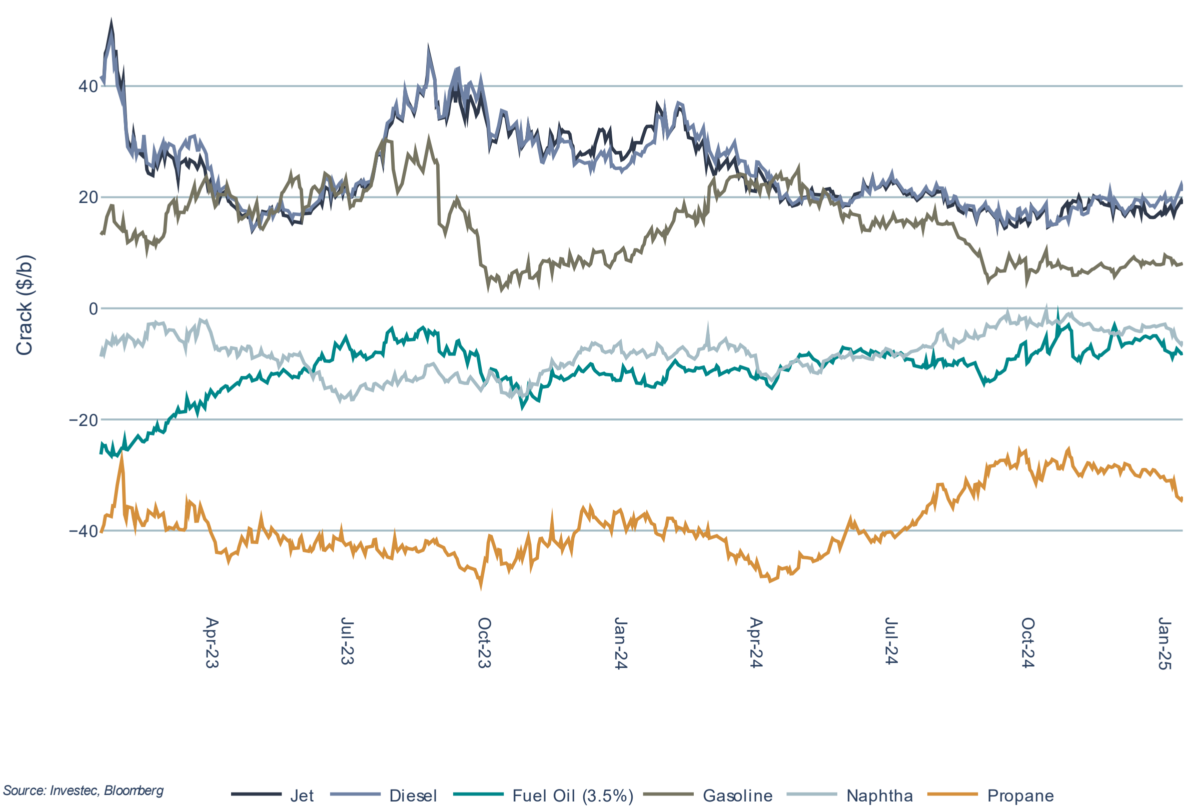
Oil and Refined Products

In early 2024, cracks spreads that were taking time to normalise from the on-going disruption from sanctions on Russian petroleum products, were exposed to fresh uncertainty due to disruptions of shipments through the Red Sea after Houthi rebels in Yemen began targeting shipping. This had a more pronounced effect on refined product markets than it did on crude markets. In part, this was because most crude from the Middle East flows east to Asia rather than West to Europe and the US, but also because the largest crude carriers are too large to fit through the Suez Canal anyway. In contrast, refined product vessels are smaller and tend to travel from refineries in Asia to markets in Europe via the Suez Canal, bring middle distillates (like diesel and jet fuel). Consequently, the crack spreads for middle distillates widened.

Fuel oil from Europe is also used as a feedstock in Asian refineries and would typically travel east via the Suez Canal. These flows were also disrupted leading to a narrowing in the discount of fuel oil to crude oil.

Over the course of 2024, the impact of these disruptions waned and crack spreads normalised, only to widen again in recent weeks due to the new US sanctions. The availability of cheap Russian and Iranian barrels had enabled Indian and Chinese refiners to pass on some of this benefit in the form of lower middle distillate prices as they are shipped back to Europe. As the current uncertainty is forcing Asian refiners to look at other, more expensive crude supplies, refined product cracks have widened again exacerbating the effect of rising crude prices on refined products.

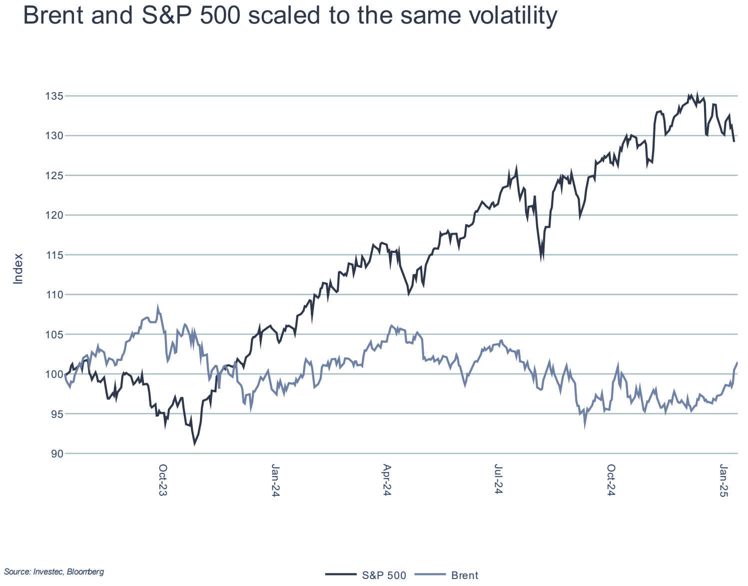
European Crack Spreads



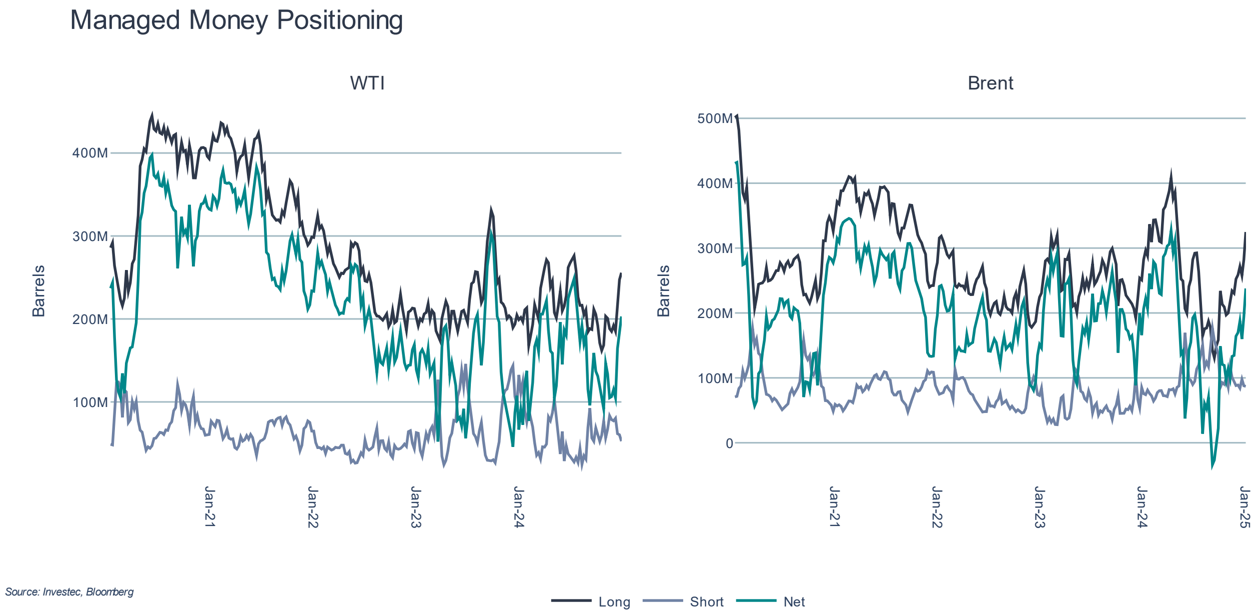
Source: Investec, Bloomberg

The Market

Just as in 2023, the oil market was not correlated with equities last year. Indeed, the last few weeks have been characterised by downward pressure and uncertainty for equities, while oil has rallied.



The disconnect between oil and equity market sentiment, does not appear to have been driven by a lack of interest from speculators. Indeed, these financial players been very important in explaining some of the movements in Brent over the last 6-months. They have exhibited a remarkable volte-face since last September when, for the first time ever, the net position of speculators became short, to the situation now where speculators have significantly reduced short position and added longs, leading to the net length approaching levels last seen in the first half of 2024, when the market was still concerned about the potential impact of the conflict in the Middle East on supplies.



Over the last 3-years the Brent front contract has tested the 70 $/b area a number of times. It has traded below that level, most recently in September, but only briefly and never far below it. Consequently, 70 $/b is a very important support level.

Long Term Brent History

Looking more closely at the period since the Russian invasion of Ukraine, there has been a down-trend into an ever tightening range. The last few months of 2024 saw Brent inhabit a uncharacteristically tight range from 71 to 75 $/b, which has now been broken by the recent move higher that also broke the down-trend from 2022. This break higher does not necessarily represent the start of a significant move higher, however, it might just be returning to the wider trading range of late 2023 / early 2024.

Brent Front Contract

Summary

The demand outlook for this year remains challenging, not least because of a possible Trump induced trade war. Still, forecasters are expecting stronger growth than last year, perhaps leaving room for disappointment. Afterall, Trump does seem to be very insistent in his plans to introduce tariffs on imports from various countries which could hamper global growth. Added to which, the rising oil price and weakening local currencies, is reducing affordability.

The US features heavily in Non-OPEC+ supply growth estimates whereas the US EIA, which should have the best insight, sees slower supply growth in the US this year than last. If oil remains at its current 80ish $/b level though, this could help to support the expansion of output early this year and it is well known that Trump is keen to support the industry.

OPEC+ may have limited scope to carry out its planned increase to output over the course of this year judging by the demand outlook and potential downside risks. Though the latest sanctions have increased demand for crude from non-sanctioned OPEC+ members, it is unclear to what extent and for how long, the new sanctions will actually limit supply. It is known, however, that Trump is particularly keen to limit Iranian supply which might lead to a more prolonged reduction in Iranian output that would create opportunities for other OPEC+ members. This could satisfy some of the pent-up up demand from members that want to increase output.

It might be that 2025 evolves in a similar manner to last year. Beginning strongly on worries over supply risks, but coming under pressure later in the year after high prices have stimulated non-OPEC+ supply, demand growth has proved to be disappointing and OPEC+ is trying to increase output. The 70 $/b level will be a very important one to look out for if there is any major weakness in oil prices. History suggests that oil prices won’t be able to bounce off it indefinitely and a break through it opens the door to lows that we have not seen since the post-covid recovery.

Appendix A – Reporting Schedules and Key Dates

IEA Oil Market Report

Publication dates in 2025 are as follows:

- Wednesday 15 January
- Thursday 13 February
- Thursday 13 March
- Tuesday 15 April – *Forecasts extended to 2026 for the first time*
- Thursday 15 May
- Tuesday 17 June (2)
- Friday 11 July
- Wednesday 13 August - *Annual Statistical Supplement 2025 published*
- Thursday 11 September
- Tuesday 14 October
- Thursday 13 November
- Thursday 11 December

The report is published at 09:00 London time

OPEC 2025 Meetings

28th May and early December

US Inventory Numbers

15:30 each London time Wednesday
(Except in weeks with a US public holidays when the release is at 4:00pm on Thursday)

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