

## A Tale Of Two Worlds

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Oil and gas prices have come under upside pressures into 2025, adding to concerns about the direction of inflation and interest rates. The reasons for their increase out of recent doldrums are varied but quite familiar. The ratcheting up of U.S. sanctions on Iranian and Russian oil exports. A third Organization of the Petroleum Exporting Countries (OPEC+) extension of self-imposed limits on oil supply. Another pipeline gas distribution arrangement from Russia to Europe terminated as of January 1. Growing expectations that China may finally jumpstart its economy after several failed government attempts. A spell of cold winter in the U.S. and Europe. Last, but not least, unreliable solar-and-wind power generation.

Not surprisingly, Europe has been at the epicenter of the mini commotion, once again scrambling to meet domestic energy demand. With the coldest weather in four years, unfavorable solar and wind power generation conditions, technical glitches in Norway, and natural gas inventories declining at the fastest pace in seven years, its domestic gas prices surged to about \$16/MMBtu<sup>1</sup>, the highest level in more than a year and four times the U.S. equivalent.

Though still benign compared to \$70 to \$100/MMBtu at the peak of the 2022 energy crisis triggered by the start of the Russian-Ukraine war, rising natural gas prices are hardly welcome given already depressed economic conditions in Europe's largest manufacturing and export-oriented economies, particularly Germany. Encouragingly, however, global oil and gas investment appears sufficient to meet softening global demand for both fuels through 2030. Absent supply disruptions caused by geopolitical conflicts or other shocks, oil-and-gas prices are thus unlikely to derail the current global expansion.

For example, while Europe no doubt faces both immediate energy supply challenges and structurally higher energy prices than the U.S. and China due to its choices over the years, global liquefied natural gas (LNG) export capacity is projected to increase 8% in 2025 and almost 50% by 2030, dominated by the U.S. and Qatar. U.S. LNG export capabilities, for instance, are seen growing 15% in 2025 and 80% by 2028, according to the EIA.<sup>2</sup>

According to the International Energy Agency (IEA), this massive new global LNG wave outpaces demand growth estimates, likely keeping LNG prices in check. In fact, with global natural gas demand expected to peak before 2030 and then contract, projected capacity will likely be sufficient to more than meet LNG demand to 2040, resulting in loose market conditions and heightened competition between exporters.

With a more pragmatic approach, less government regulation, exceptional technological prowess, and unparalleled entrepreneurial spirit, the U.S. is thus continuing to expand its role as a key global energy powerhouse, helping keep energy prices tame both here and abroad. Even as it emerged as the world's largest LNG exporter and Europe's biggest supplier—accounting for about 50% of European LNG imports versus 17% from Russia and around 12% from Qatar—its abundant domestic resources and technological capabilities have kept U.S. natural gas prices in check. At around \$4.0/MMBtu so far this winter, they are almost four times lower than in Europe and at rock bottom levels when adjusted for inflation (Exhibit 1A).

The U.S. is also playing an important role in stabilizing the oil market, with Brent oil prices fluctuating between \$70/barrel and \$90/barrel for the past two years. Given its large resource base and price sensitivity, much higher prices would incentivize greater U.S. production, while lower prices would hamper shale-oil project economics, reducing supply and supporting prices.

### Portfolio Considerations

Ample energy supply and stable oil prices should support global growth in 2025 and the profits outlook, a positive for risk assets.

<sup>1</sup> one million British thermal units.

<sup>2</sup> Energy Information Administration, *Short-Term Energy Outlook*, December 2024.

While oil prices have perked up from the bottom of this range, with Brent rising about 14% from \$71/barrel to about \$81/barrel over the past month for reasons noted above, upside oil price pressures are unlikely to persist for too long. First, though accelerating from tepid growth in 2024, global oil demand is still expected to increase only moderately this year. Demand trends have been particularly weak in advanced economies, with U.S. oil consumption barely inching up in 2024, for example.

Rapid adoption of electric vehicles (EVs), especially in China, where they have already reached 50% of new cars sold, is eroding demand growth faster than expected. According to the IEA, EVs currently have a share of around 20% in new car sales worldwide, which rises towards 50% by 2030 based on current policies, displacing a massive 6 mb/d<sup>3</sup> of oil demand in the process.

Although structural headwinds to global demand are generally seen causing consumption to plateau by 2030, global oil supply is still projected to increase substantially. Non-OPEC supply growth plans remain strong, while OPEC+ has announced intentions to gradually unwind its self-imposed supply restrictions starting in April. With demand projected to lag supply, some inventory buildout is expected in 2025 after declining last year. As a result, oil prices are generally seen averaging below the \$80/barrel average of 2024, with about a \$72/barrel price in Q4. According to BofA Global Research, Brent and West Texas Intermediate (WTI) may average even lower this year, at \$65/barrel and \$61/barrel<sup>4</sup>, respectively.

Looking further out, oil prices are likely to only move higher with inflation, as they typically do over the long term (Exhibit 1B), probably trending toward \$90/per barrel on average by the end of the decade, although rising U.S. productivity per well suggests downside price risks. Uncertainty remains high, though. Escalating Middle East tensions and a stronger enforcement of sanctions against Iran, Russia and the like, would create upside price risks. Still, the experience of the past three years shows that world leaders are unlikely to impose sanctions to a degree that endangers economic conditions. In any case, a significant projected increase in OPEC+ surplus capacity as non-OPEC gains market share could help mitigate some of these upside risks.

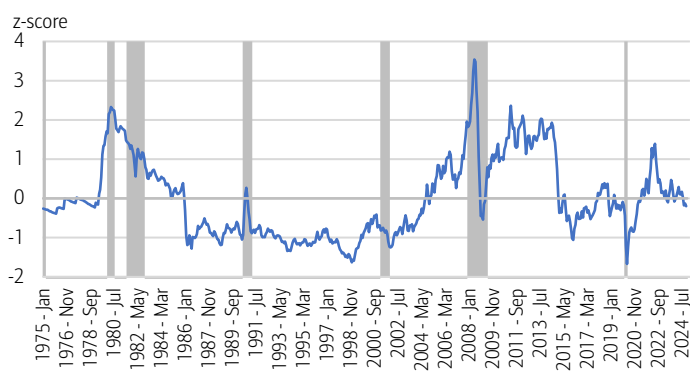
In sum, ample expected supply and stable relative prices should allow the ongoing global expansion to continue for the foreseeable future, supporting profits growth and relative risks-asset performance.

### Exhibit 1: U.S. Shale Oil-and-Gas Revolution Has Stabilized Relative Energy Prices.

1A) U.S. Natural Gas Price Adjusted for Inflation (Z-score\*).



1B) WTI Crude Oil Price Adjusted for Inflation (Z-score\*).



\*z-score=number of standard deviations from the mean of a data set. Gray bars represent recessionary periods. Exhibit 1A) Source: Haver Analytics. Data as of January 8, 2025. Exhibit 1B) Source: Haver Analytics. Data as of January 8, 2025.

<sup>3</sup> million barrels per day.

<sup>4</sup> As of January 8, 2025.