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MACRO PICTURE:

Oil and Energy Markets: Outlook and Risks

By

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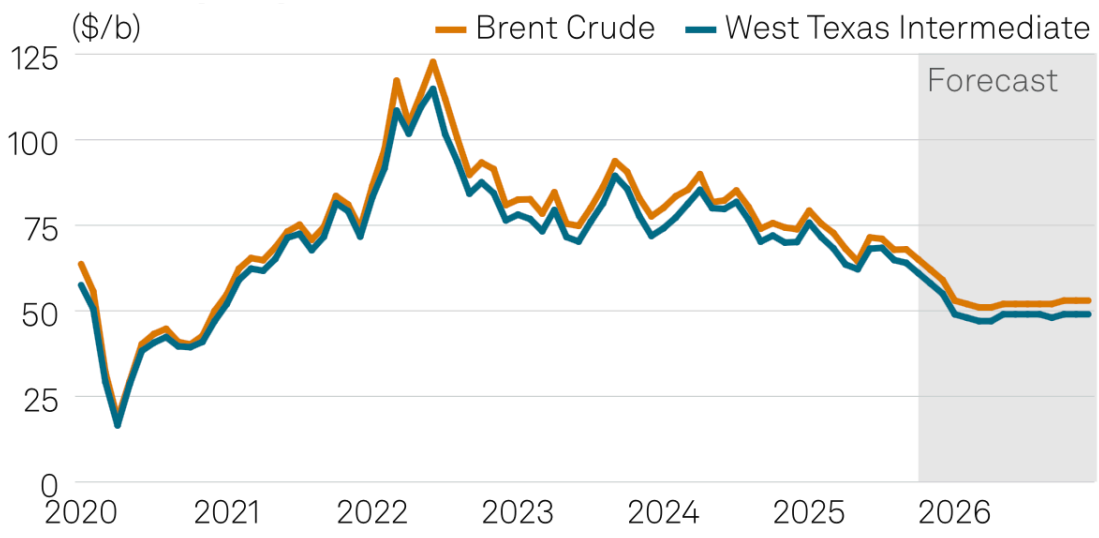
Executive Summary

- Oil prices stayed elevated early in the year on geopolitical risk and Chinese stockpiling, fell toward five-year lows as peace and sanction-easing hopes shifted the market to surplus, then rebounded late on renewed geopolitical shocks tied to Venezuela.
- The oil market is set to move deeper into surplus in 2026 as supply growth (~2.1 mb/d) far outpaces demand growth (~800 kb/d), keeping sustained downward pressure on prices, with banks forecasting Brent mostly in the mid-$50s to low-$60s range.
- While the IEA sees an even larger surplus (nearly 4% of global demand), sanctions on Russia and Venezuela are creating supply disruptions and quality mismatches, raising the risk of tight fuel markets and refinery bottlenecks despite ample crude overall.
- Price risks remain asymmetric: easing sanctions or peace talks could push Brent into the low $50s, while tighter sanctions or OPEC+ cuts could lift prices; prolonged low prices would strain producers' finances, particularly Saudi Arabia, making a prolonged market-share strategy increasingly risky.
- Output has stayed resilient despite lower prices and a sharp drop in drilling, but sustained WTI below $60/bbl is likely to slow production from 2026, with sharper declines possible from 2027 as new drilling becomes uneconomic.
- Despite rising domestic production, China remains heavily dependent on imports, with Iran overtaking Saudi Arabia as its top supplier—deepening geopolitical risk as Beijing's oil needs increasingly hinge on sanctioned producers.
- Russia is rapidly deepening its energy pivot to China, with LNG imports surging and new pipeline projects like Power of Siberia 2 set to lock in long-term gas flows as Moscow shifts away from Europe and Beijing diversifies away from US LNG.
- The EU plans to fully phase out Russian gas by 2027, banning new contracts this year and ending remaining pipeline and LNG imports, despite Russia still supplying nearly one-fifth of EU gas and Europe spending €23bn on Russian energy in 2024.
- The strategy relies on securing alternative LNG from the US and other suppliers, with policymakers expecting limited long-term price impact as new global LNG capacity comes online after 2027.

Key Picture: Crude Oil Spot Prices



Source: S&P Global

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How Geopolitics Shaped Oil Prices This Year

For much of the year, the global oil market seemed to defy gravity. Despite a softening global economy, prices remained stubbornly resilied, anchored by a "geopolitical risk premium" that refused to dissipate and a relentless apetite from China as it quietly hoarded millions of barrels for its strategic reserves.

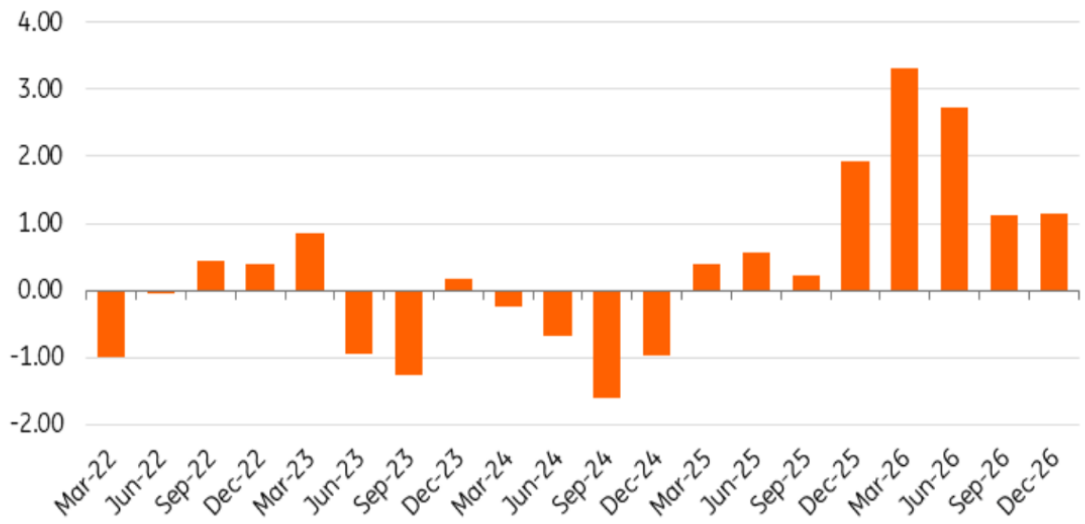
As the year progressed, oil has settled near five-year low, as the prospect of a Russia-Ukraine peace deal appeared to strengthen and increasing expectations sanctions could be eased. The narrative shifted from scarcity to surplus.

The year closed with a series of geopolitical shocks from the Trump administration. With top aides like Stephen Miller now asserting that the US 'created the oil industry in Venezuela', the concerns over Venezuelan oil exports pushed up the market again.

Outlook for Global Oil Supply and Demand

The oil market is set to move deeper into surplus in 2026, putting sustained downward pressure on prices. As production around the world exceeds growth in demand, it is expected to push the surplus above 2 mb/d, according to the average of the five banks (**Figure 1**). Global supply is forecast to rise by 2.1 mb/d next year, while demand growth remains modest at around 800 kb/d.

Figure 1: Oil Market Faces A Large Surplus (monthly, b/d)



Source: ING Research

Goldman Sachs is the most bearish, forecasting an average oil price of $56 a barrel, while Citigroup is the most bullish at $62 — a reversal of their usual positions. Goldman expects delayed, Covid-era projects to add fresh supply, while Citi argues that continued Chinese stockpiling will cushion prices. JPMorgan sees the surplus as overstated, expecting OPEC+ to cut output mid-2026, whereas Bank of America assumes the group will resume production increases after a first-quarter pause.

However, the surpluses projected by the banks are lower than those estimated by the International Energy Agency (IEA) (**Figure 2**). Recently, the IEA has trimmed its forecast for the 2026 global oil surplus to 3.84 million bpd, down 250,000 bpd from last month, citing stronger demand and weaker supply growth due to sanctions. While still large — nearly 4% of global demand — the revision marks the first downward adjustment since May. The agency raised demand growth forecasts for 2025 and 2026 as the macro outlook improves, tariff concerns fade, and lower oil prices and a weaker dollar support consumption, particularly in non-OECD economies. Demand is now seen rising by 860,000 bpd in 2026.

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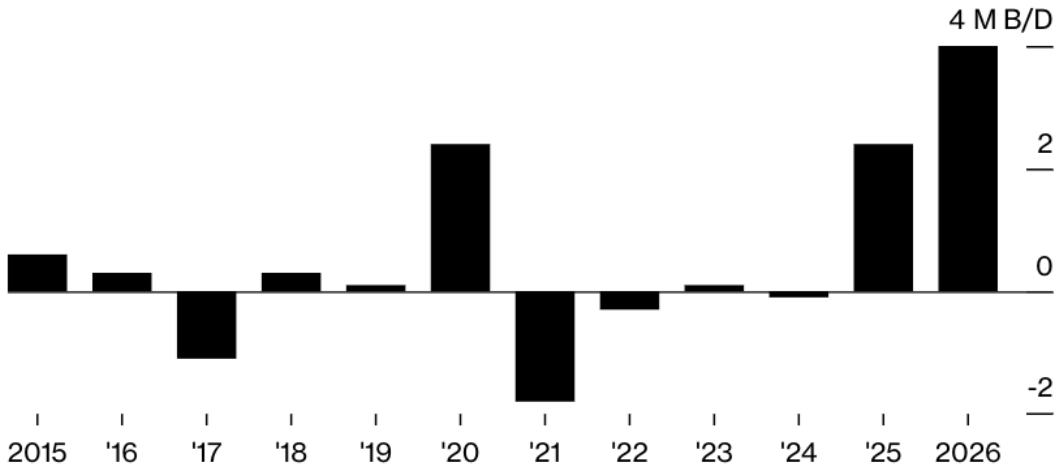
On the supply side, sanctions on Russia and Venezuela have disrupted exports, prompting the IEA to cut its supply growth forecast to 2.4 million bpd. This disruption creates a critical quality mismatch in the market. While US shale production is hitting records, it produces 'light sweet' crude. However, complex refineries—particularly along the US Gulf Coast—are designed to process the 'heavy sour' crude that Venezuela exports. If sanctions cut off this heavy supply, US refiners could face a feedstock squeeze, potentially spiking diesel and gasoline margins even if the headline WTI price remains low

OPEC+ has paused output increases in early 2026, while non-OPEC+ supply growth remains concentrated in the Americas. Despite ample crude, the IEA expects tight fuel markets to persist due to limited refining capacity outside China and EU restrictions on Russian fuel exports.

Figure 2: IEA Sees A Record Surplus in 2026



Source: IEA Data

Upside risks stem mainly from sanctions: if restrictions on Russia prove more effective than expected, prices could rise. However, Russia has maintained exports since 2022 through intermediaries and deeper discounts. Downside risks include a potential easing of sanctions following peace talks, which could remove supply risk premiums and push Brent into the low $50s. Oil demand is expected to rise by around 700 kb/d in 2025 and a further 800 kb/d in 2026. Next year's growth is set to be driven mainly by non-OECD economies, particularly Asia excluding China, which will account for about half of the increase. Chinese demand growth is expected to remain subdued at under 200 kb/d.

While oil markets have shown unusually low volatility despite geopolitical shocks, expectations of surplus and large OPEC spare capacity have muted price reactions. As OPEC continues to draw down this buffer, markets may become more sensitive to future disruptions, increasing volatility. OPEC+'s shift from price defense to market-share defense reflects frustration over lost share to non-OPEC producers and internal compliance issues. Whether this strategy persists will depend on how Russian supply evolves and how much fiscal strain lower prices impose on producers, particularly Saudi Arabia. This strain is becoming existential; Saudi Arabia's fiscal breakeven price is estimated to be near $96 per barrel once domestic spending is included. This explains why a drop to the low $50s—as forecast by Goldman—would pose a severe threat to the Kingdom's Vision 2030 goals, making a full-blown price war a dangerous gamble.

US Oil Production Resilient Despite Lower Prices

US oil production has remained resilient this year despite weaker WTI prices and a sharp drop in drilling activity. The US rig count has fallen more than 15% to its lowest level since September 2021, yet output has continued to rise, hitting a record above 13.8 mb/d in September 2025 and averaging around 13.6 mb/d for the year.

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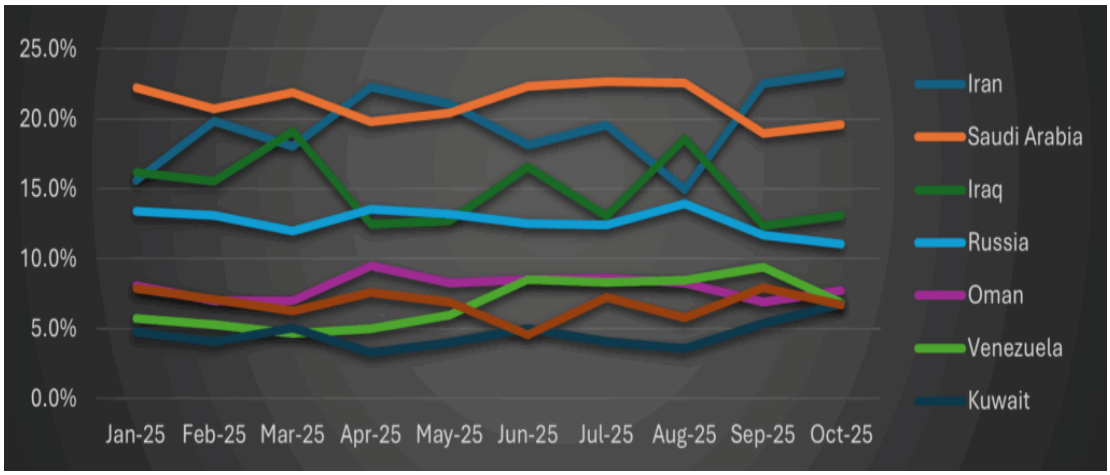
However, sustained low prices are expected to curb production going forward. We anticipate US output will begin to soften in 2026, with downside risks increasing if WTI remains below $60/bbl. According to the Dallas Fed Energy Survey, new drilling typically requires prices around $65/bbl, above the current forward curve, suggesting stronger declines could emerge in 2027.

China's Energy Security: The Oil & Gas Pivot

As a global superpower, oil is necessary for China's massive economy, but the country is also the world's largest importer of crude oil and a global leader in clean energy, strategically seeking to reduce its foreign dependence. As a big oil consumer, China's oil consumption is increasing year by year with fluctuating growth rates. However, as oil supply still cannot meet the demand, China mainly relies on imports (**Figure 3**).

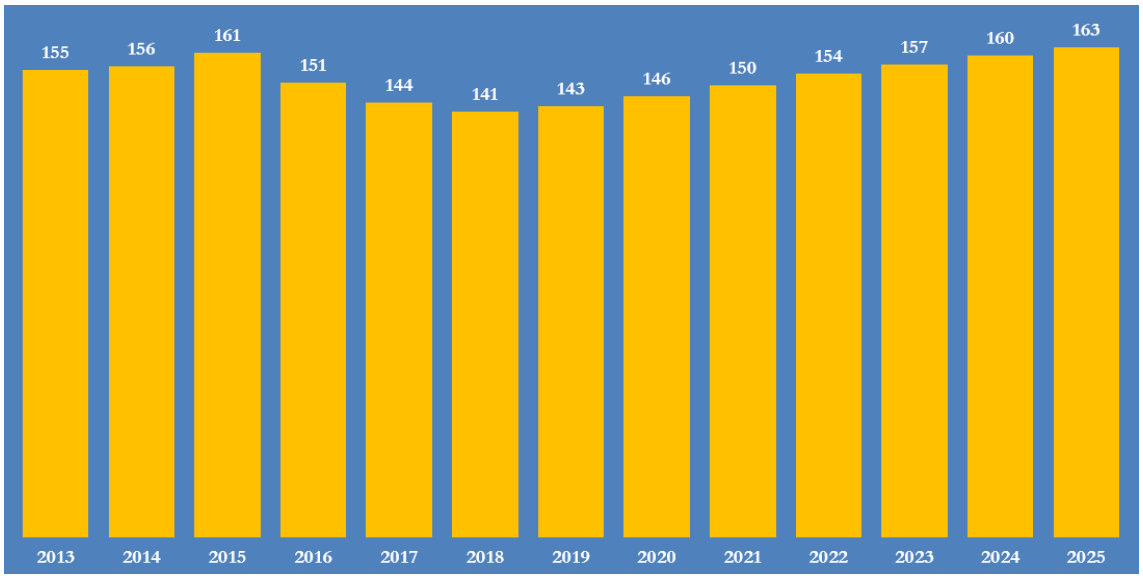
Figure 3: Share of Crude Exports to China by Countries



Source: FDD

Meanwhile China's crude oil output has climbed to its highest level in more than a decade as Beijing pushes to expand domestic production (**Figure 4**). Output rose to 163 million tonnes in the first nine months of the year, up from 160 million tonnes a year earlier and well above the 2018 low of 141 million tonnes. Despite the increase, imports still account for nearly three-quarters of China's oil consumption.

Figure 4: China Domestic Crude Oil Production 2013-2025 (mln tonnes, each year from Jan through Sep)



Source: JKempEnergy

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At the same time, Iran has overtaken Saudi Arabia as China's top oil supplier, even as US forces last month boarded a China-bound cargo ship en route to Iran, according to the Wall Street Journal, highlighting a more aggressive US maritime stance under President Donald Trump.

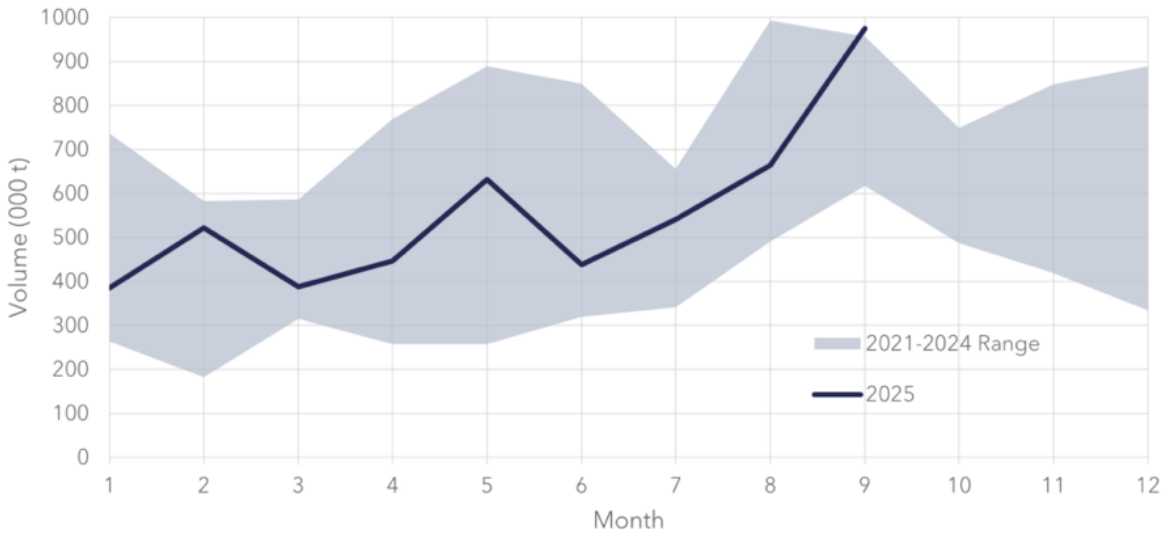
Russia Deepens Its Gas Pivot to China

Russian LNG accounted for 22.5 per cent of China's total imports, nearly double its 11.4 per cent share from a year prior, while month-on-month shipments rose by 33.1 per cent from September. Chinese customs data released on Thursday showed that imports from Russia jumped by 76.7 per cent, year on year, to 1.3 million tonnes – the first time monthly volumes from across the northern border topped 1 million tonnes, according to financial data provider Wind.

Siberia 2 (PoS2) project, a new pipeline via Mongolia for 50 billion cubic meters (bcm)/year of Western Siberian gas, alongside increasing existing PoS1 deliveries and developing a Far Eastern route, significantly boosting Russia's pivot to China after European market losses. A binding deal for PoS2 was signed in September 2025, marking a strategic shift, though final terms and construction timelines (potentially a decade) are still pending.

The deal would deepen Beijing's energy options while reducing dependence on liquefied natural gas (LNG) imports from the United States. China has already received liquefied natural gas shipments from Russia's sanctioned Arctic LNG 2 project, signalling its readiness to defy Western pressure.

Figure 5: China's Monthly LNG Imports from Russia (September volume bove 2021-2024 range)



Source: Global LNG Hub

EU Gas Strategy

The EU plans to propose a ban on Russian gas imports by end-2027. Under proposals due in June, new contracts and spot purchases — around one-third of imports — would be banned by year-end, while remaining pipeline and LNG supplies under long-term contracts would be phased out by 2027. Despite a sharp drop in Russian gas flows since 2022, Russia still supplies Europe via Turkey and LNG shipments, accounting for 19% of EU gas imports in 2024. The bloc spent €23bn on Russian energy last year, more than its military aid to Ukraine.

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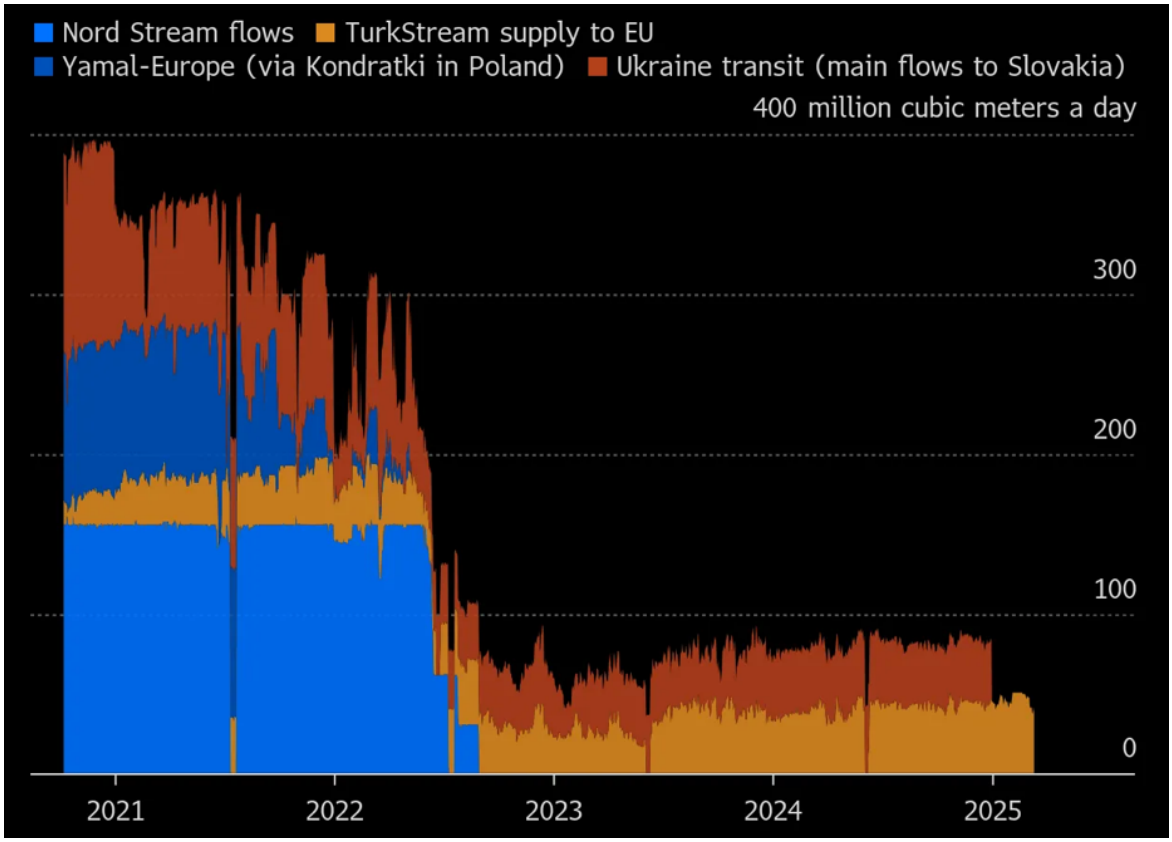
Figure 6: Russia's Pipeline Gas Supply to the EU Has Slumped



Source: Bloomberg

The plan hinges on securing alternative LNG from the US, Qatar, Canada and Africa, with US supplies also featuring in trade talks with the Trump administration. While supply remains tight as Europe rebuilds reserves, the EU expects limited price impact as new global LNG capacity comes online from 2027.

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