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Oil Market Shaken by Reserve Release, Omicron Variant, OPEC-plus Decision

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At its online ministerial meeting on December 2, the OPEC-plus group, which consists of the Organization of the Petroleum Exporting Countries and non-OPEC oil-producing countries such as Russia, analyzed the current international oil market status and an oil supply and demand outlook for 2022 and decided to increase its production in January by 0.4 million barrels per day. The decision meant the continuation of its plan to raise production by 0.4 million bpd every month. Before the ministerial meeting, whether the group would continue the plan into January was attracting global attention amid jitters about the future course of the global economy and the crude oil price trend shaken by the emergence of the new Omicron COVID-19 variant.

In response to the OPEC-plus decision, crude oil futures prices plunged nearly 5% temporarily before rising back above the previous day's closing levels. The front-month futures contract closed December 2 at $66.50 per barrel for West Texas Intermediate, up $0.93/bbl from the previous day, and at $69.67/bbl for Brent, up $0.80/bbl. Crude oil prices declined briefly due to the news of the decision to continue increasing production but rallied in reaction to an OPEC-plus message indicating that the group would monitor the international oil market and adjust (cut) production flexibly and promptly as necessary.

In the past 10-odd days, the international oil market was greatly shaken by a series of key events. The first key event was a U.S.-led coordinated release of oil reserves announced on November 23. As noted in A Japanese Perspective on the International Energy Landscape (560), the U.S. Biden administration decided to release strategic petroleum reserves to lower crude oil prices, which remained above $80/bbl until early November, as well as gasoline prices linked closely to the U.S. administration's approval ratings. It also requested Japan, South Korea, China, India and the United Kingdom to cooperate in releasing oil reserves, leading to the unusual coordinated release of oil reserves to push down crude oil prices. The oil reserve release was apparently discounted into the market when crude oil prices fell by some $8/bbl in a week before the announcement of the U.S. decision. Crude oil prices failed to plunge in response to the announcement. However, how the OPEC-plus group would react to oil-consuming countries' market intervention to lower crude oil prices became a focus of attention. Market participants were closely watching whether the group at its ministerial meeting on December 2 would scale down or cancel its plan to gradually increase production.

Then, a totally unexpected huge shock rattled the world. The emergence of a new COVID-19 variant and its potential threat became a global matter of concern. On November 26, the World Health Organization named the new COVID-19 variant as Omicron and designated it as the most dangerous variant. On November 29, WHO Director-General Tedros Adhanom Ghebreyesus warned that Omicron infections could rapidly increase in the world due to the new variant's characteristics. The WHO report on Omicron and the warning about its rapid spread, or a new pandemic, turned the global situation around. Alarmed by the potential spread of Omicron infections, major countries including Japan fundamentally toughened immigration controls.

The growing concerns about a new pandemic caused great uncertainties about the future global economy. Reflecting the concerns, the stock market plunged. On November 26, the Dow Jones industrial average on the New York Stock Exchange lost more than 900 points to 34,899. The plunge on the Omicron shock came after the average fell back below 36,000 on concerns about inflation and high crude oil prices after hitting a record high of 36,432 on November 8. In response, the key WTI futures price dropped by $10.25/bbl to $68.15/bbl. The substantial decline in crude oil prices came on apparent speculation that the potential Omicron pandemic, its impact on the global economy, lockdowns and a decrease in international air transport demand would sharply reduce oil demand.

Omicron's potential impact on the future global economy and oil demand was coupled with growing market uncertainties and insecurity to trigger a capital flight from risk assets, affecting crude oil futures trading, according to some analysts. In this way, the Omicron variant's impact has brought about a huge change in crude oil prices through various paths.

Then, the next focus of attention was what would the OPEC-plus decision would be. Before the ministerial meeting, many oil market participants expected that in reaction to oil-consuming countries' coordinated oil reserve release, the group would decide to reduce its monthly production increase by reforming its plan to gradually increase production (narrow production cuts). The latest OPEC-plus analysis indicated that the oil market would have abundant supply or even oversupply from the fourth quarter of this year to early next year, backing up the expectation of the decision to reduce the monthly production increase.

Amid speculation about the coming OPEC-plus decision, the emergence of the Omicron variant triggered insecurity about the future global economy and led crude oil prices to immediately lose some $10/bbl. Then, some market participants expected that the OPEC-plus group would substantially reduce or cancel its production expansion. As noted at the outset of this report, however, the group chose to maintain the current gradual production expansion plan, which calls for raising its production target in January by 0.4 million bpd from December.

Given the impact of the U.S.-led coordinated release of oil reserves on the international oil market, the need for measures to counter the market intervention by oil-consuming countries and the uncertain fate of the market under the Omicron impact, the suspension of the production expansion might have been a measure that the OPEC-plus group should seriously consider. However, a decision to substantially reduce or cancel the production expansion could become a considerably strong message to oil-consuming countries, indicating the group's tough intention to raise oil prices even in the current situation. Oil-producing countries might have politically considered that at a time when relations with oil-consuming countries including the United States became sensitive due to the oil reserve release, any decision to complicate the relations or anger oil-consuming countries would fail to work to the advantage of the OPEC-plus group. In this sense, OPEC leader Saudi Arabia might have been required to make a difficult choice.

The OPEC-plus group might have eventually made the difficult decision to give consideration to its relations with oil-consuming countries by retaining the gradual production expansion plan while sending a message that the group would monitor market conditions and adjust production promptly and flexibly as necessary.

For the immediate future, oil market players will closely watch how the Omicron impact would affect the world. If any sign of the impact's adverse effects on the global economy and mobility demand is seen, downside pressure may grow on crude oil prices. Then, how the OPEC-plus group would respond to the pressure will become a focus of attention. In a run-up to the group's next meeting in January, we will have to keep close watch on oil market conditions and OPEC-plus moves.

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