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International Oil/Gas Markets Destabilized by Economic and Supply Insecurity

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Since early July, energy supply and global economic insecurity have exerted great influence on energy prices on international markets. Interestingly, however, the influence has led energy prices to go in different directions according to the respective market conditions. While crude oil prices plunged below $100 per barrel in the international market due to market participants' concern over global economic insecurity, natural gas prices in the European market shot up above $300 per barrel of oil equivalent amid Russian gas supply insecurity and concern about gas supply shortages in the coming winter. In the Asian spot liquefied natural gas market that has been increasingly linked to the European gas market, prices have also soared.

In the international oil market, global economic uncertainties have become a key matter of concern to market participants, prompting prices to decline. In the European gas market, however, Eurasian geopolitics involving the Europe-Russia gas confrontation pushed up prices. As a result, oil and gas prices have gone in different directions. For overall international energy markets, however, global economic insecurity is as important as energy supply insecurity. We must take note of the possibility that international crude oil and European gas prices could rise or fall sharply depending on how these factors work.

In late June, the key Brent crude futures price stood near $120/bbl and the key West Texas Intermediate crude futures stayed above $110/bbl. In early July, however, they accelerated their declines. On July 5, Brent fell by $10.73/bbl to $102.77/bbl. WTI lost $8.93/bbl to $99.50/bbl, slipping below $100/bbl for the first time in some two months since May 10. On July 6, WTI and Brent prices fell further to $98.53/bbl and $100.69/bbl, the lowest levels since early April. On July 7, they rebounded, including the WTI price that rose back above $100/bbl. From late June, however, WTI was down some $10/bbl. It has plunged from levels above $120/bbl that were retained until mid-June.

The background factor behind the crude oil price plunge is growing concern over global economic deceleration. In its world economic outlook released on June 7, the World Bank predicted this year's global economic growth at 2.9%, far lower than 5.7% last year, revising its forecast growth by 1.2 percentage points downward from 4.1% as announced last January. Factors behind the downward revision of the global economic growth forecast include the impacts of energy price spikes and a food crisis caused by the Ukraine crisis, subsequent serious inflation, and relevant European and U.S. interest rate hikes. However, the June 7 World Bank outlook might have reflected economic conditions up to May. Given inflation acceleration and full-blown interest rate hikes in and after June, market participants might have naturally been concerned that global economic deceleration would be even more serious.

Crude oil prices' stay above $120/bbl until the first half of June was supported by the European Union's embargo on Russian oil announced in late May and concern over a subsequent tighter supply-demand balance. In early June, the OPEC-plus group of oil-producing countries decided on an additional production increase at last, but oil market participants interpreted the additional production expansion as insufficient. The supply side (potential supply shortages) thus drove up oil prices. Since then, however, global economic insecurity and demand deceleration have replaced the Russian oil embargo as the focus of market attention. Then, the International Energy Agency pointed out that China's oil demand in 2022 could decline from the previous year, affecting oil market sentiment. In fact, crude oil prices may come under strong downside pressure depending on how the global economy and oil demand in China and other major oil-consuming countries will change in the second half of this year and next year.

However, oil supply insecurity could also become the focus of attention in the oil market. If Russian oil supply to countries outside the Group of Seven and EU embargoes on Russian oil is affected by restrictions under consideration by the EU on insurance for tankers that carry Russian oil, oil supply from Russia may plunge. Another factor that could drive down Russian oil supply may be price caps on Russian oil proposed at the latest G7 summit. Although various technical problems must be resolved before the realization of the price caps, Russia may reduce oil supply to counter the price cap initiative depending on future developments regarding the initiative. Future developments are uncertain. We must keep watch for the possibility that oil supply insecurity could loom as the focus of oil market attention again.

In the European gas market, meanwhile, Russian gas supply insecurity has rapidly grown, prompting gas prices to shoot up. The Dutch Title Transfer facility price, or the European benchmark for natural gas, began to rise in mid-June. From around $25 per million British thermal units then, the price rose beyond $40/MMBtu in the second half of June and beyond $45/MMBtu in early July. It topped $50/MMBtu on July 7 and $54/MMBtu on July 8. The price surpassed $50/MMBtu for the first time in some four months since March 9. The price level translates into more than $300 per barrel of oil equivalent. In line with European gas prices, Asian LNG spot prices have risen beyond $40/MMBtu.

The benchmark European gas price topped $70/MMBtu ($400 per barrel of oil equivalent) in shocking response to the United States' announcement of a Russian energy embargo in early March. As any European embargo on Russian gas was dominantly believed as difficult later, with the winter gas demand season ending and LNG procurement increasing, however, the price declined gradually before moving around $20/MMBtu in the first half of June. This downtrend was reversed by Russian moves to cut gas supply to Europe that emerged around May. Particularly, a substantial cut in supply through the Nord Stream 1 pipeline known as a major Russian gas supply channel to Europe from mid-June has contributed much to driving up gas prices. Russia has explained that the supply cut was attributable to Western economic sanctions that made it difficult for Russia to get equipment for the pipeline. The European side has increasingly criticized Russia for using gas as a weapon to threaten Europe. Anyway, the Russian gas supply cut affected market sentiment by leading to concern about gas shortages in the coming winter. Regarding Russian pressure on Western countries joining economic sanctions on Russia, we must pay attention to Russia's decision to transfer the operation of the Sakhalin 2 oil and gas development project to a new company, which has been interpreted as a Russian move to take over the project, in which Japan takes part, and led to insecurity about Japan's LNG procurement from the project. In the gas market, the perceived Russian supply insecurity has become the largest factor to affect prices and the supply-demand balance at present and for the rest of this year.

In this way, prices have gone in different directions in the international oil market shaken by global economic insecurity and the European gas market plagued with Russian supply insecurity since early July. When analyzing future market and price trends, however, we must pay attention to potential supply insecurity in the oil market and potential weak demand in the gas market amid European economic deceleration and high gas prices. In any case, international energy market prices will remain destabilized and highly volatile, sandwiched between global economic insecurity and Russian energy supply insecurity amid the Ukraine geopolitical crisis.

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