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Crude Oil Prices Shaken by U.S. and Chinese Economic Outlooks

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On March 7, markets were rattled by Federal Reserve Chairman Jerome Powell's remarks on interest rate hikes. In his testimony at the Senate Committee on Banking, Housing and Urban Affairs, Powell recognized that inflationary pressure is higher than assumed. Citing economic conditions and data, he indicated that the Fed is ready to accelerate interest rate hikes and that the final policy interest rate level could be higher than earlier projected.

Since the Fed began to raise interest rates in response to growing inflation at a meeting of the Federal Open Market Committee in March last year, it has continued to increase interest rates substantially. Last June, the Fed decided on an unusually large increase of 75 basis points in the federal funds rate. Last November, it adopted the same hike for the fourth consecutive FOMC meeting. Later, the Fed narrowed the hike. In February, the rate hike decelerated to 25 basis points. However, the latest remarks by Powell have led market participants to anticipate that the Fed at a March 21-22 FOMC meeting may accelerate the hike again to 50 basis points

Naturally, markets responded strongly to Powell's remarks on interest rate hikes. The stock market plunged on concern that the U.S. economy would be affected. The Dow Jones average on the New York Stock Exchange lost 575 points or 1.7% to 32,856. The S&P500 index slipped below the psychologically important level of 4,000 to 3,986. The foreign exchange market also moved. The dollar rose above 137 yen. In response to concern on U.S. economic deceleration, crude oil futures prices took a plunge. The front-month futures contract on West Texas Intermediate suffered a sharp fall of $2.88 per barrel or 3.6% from the previous day to $77.58/bbl. In London, the front-month futures contract on Brent lost $2.89/bbl to $83.29/bbl.

Later, stock and crude oil prices dropped further. The Dow Jones average fell to 32,255 on March 9. The key WTI futures price sank to $75.72/bbl and the Brent futures price to $81.59/bbl. The heavy stock and crude oil price plunges indicated how far markets were affected by economic outlooks for the United States as the world's largest economy and oil consumer. For the immediate future, market players will closely watch the next FOMC meeting decision that could trigger new developments.

In the first half of 2022, crude oil prices almost remained above $100/bbl, including the highest levels since the global financial crisis recorded in early March. In the second half, however, crude oil prices followed a downtrend on concern about global economic deceleration amid U.S. and European interest rate hikes. In response to the downtrend, the OPEC-plus group of oil-producing countries began to cut production. It launched a substantial production cut in November, preventing crude oil prices from falling persistently. Since the second half of last November, Brent and WTI have remained in a narrow range between $70/bbl and $90/bbl.

Crude oil prices' four-month stay in the $70-90/bbl range may be attributable to a sensitive balance among various factors. Western countries introduced a cap on Russian crude oil prices in December and ceilings on Russian petroleum products prices in February, while falling short of affecting the overall oil supply so much.

On the other hand, concern about global economic deceleration has continued to exert downside pressure on crude oil prices. Global economic growth this year is predicted to decelerate to 2.9% from last year's 3.4%. However, crude oil prices are supported by market speculation that if crude oil prices decline on downside pressure, the OPEC-plus group may respond. The present crude oil price levels may be viewed as being within a tolerable range for the OPEC-plus group in various senses.

For oil-producing countries, higher crude oil prices mean higher revenue. As various spending needs increase, rather than tolerating lower crude oil prices, oil-producing countries may pursue higher prices. If crude oil prices rise substantially from the current levels, however, major oil-consuming countries including the United States and European countries may increasingly urge the OPEC-plus group to increase production. For Saudi Arabia and other major oil-producing countries that need careful consideration to prioritize relations with the United States, extremely high crude oil prices can trigger complex problems including consideration to and response to political issues. In this sense, the current crude oil price levels may be viewed as based on a strange balance among various factors.

Under such macroeconomic conditions accompanied by the sensitive balance of various factors, crude oil prices have seesawed. Apparently, however, two key factors have arisen recently to move oil prices under the strange balance. The first is the U.S. economic trend discussed at the outset of this report. Speculation on interest rate hikes based on the remarks of Fed Chairman Powell was recognized as a downside risk factor. For the immediate future, crude oil prices may nervously react to U.S. economic and financial market trends.

The second factor is Chinese economic trends. If the Chinese economy recovers and expands towards the second half of 2023, upside pressure may grow on crude oil and other energy prices. Since the beginning of this year, the Brent futures price rose above $85/bbl three times apparently in response to market players' perception on China's energy demand and import expansion.

China's economic growth in 2022 decelerated sharply from 8.4% in the previous year to 3.1%. Under the tough zero-COVID policy, the economy lost strength, leading energy demand to decline. According to the International Energy Agency's monthly Oil Market Report, China's oil demand in 2022 decreased by 0.42 million barrels per day from the previous year to 15.02 million bpd, the first decline in 32 years. Demand falls were not limited to oil. Natural gas and coal demand in 2022 slipped below the levels seen in the previous year. China gave priority to domestic energy production in the year in pursuit of a stable energy supply, leading energy imports to decline faster than energy demand. This was significant for international energy markets. If China's energy imports in 2022 remained unchanged from the previous year, energy price spikes last year could have been sharper.

China lifted the zero-COVID policy late last year, leading to an explosive increase in COVID-19 infections. No optimism can be warranted on the increase's impact and future developments. However, recent talks say that the Chinese economy may recover and get on a growth path towards the second half of this year. At the National People's Congress convened on March 5, an economic growth target for 2023 was set at around 5%. President Xi Jinping in his third term may give top priority to economic recovery and take various economic stimulus measures. Depending on the Chinese economic trends, upside pressure may arise on crude oil prices. China's liquefied natural gas imports are expected to turn up this year after plunging 20% in the previous year. Attention should be paid to China's LNG import trend and its impact as well.

For the immediate future, international energy markets may be influenced by U.S. and Chinese factors. Depending on the balance between the impacts of the two factors, prices may fluctuate wildly. I would like to pay attention to future developments.

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