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North Sea Brent Tops $120/barrel

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On April 4, the North Sea Brent crude oil futures (front-month contract) price closed at $121.06/barrel, finishing above $120/barrel for the first time in 33 months, since August 2008. The average price for the first quarter of this year came to $107.2/barrel, up $29.3 or 38% from a year earlier.

It may be needless to say that principal causes of the Brent price spike are the intensifying tension and turmoil in Libya and relevant oil supply interruptions. Behind the price spike, however, the Libyan situation is closely intertwined with growing geopolitical risks related to supply interruptions, impacts of financial factors, and international oil supply and demand.

As reported by A Japanese Perspective on the International Energy Landscape (36), European and U.S. attacks on military facilities of Colonel Muammar Gaddafi's dictatorial regime started on March 19, triggering a three-way struggle between the Gaddafi regime, dissident forces and Western countries. But the struggle has come to a deadlock, leaving the future course of the Libyan situation in the balance. Government and dissident forces have activated “diplomacy” with Europe and the United States, and as well with neighboring countries, complicating the situation. Amid the intensifying military clash, Libya's oil production has declined substantially. Libyan crude oil's supply to the international oil market has effectively been interrupted. On April 6, however, reports stated that dissident forces exported crude oil aboard tankers to secure their own financial resources, anticipating the struggle to be prolonged. But there were other reports that the Gaddafi side attacked oilfield facilities to block dissidents' oil exports and that they went on an offensive against dissidents in Misurata, the third largest city in Libya. Information has been snarled.

In addition, tensions have remained high in the Middle East. On April 3, the Gulf Cooperation Council members including Saudi Arabia held an emergency meeting of their foreign ministers and adopted a statement criticizing Iran for stirring up Shiites in Bahrain to help destabilize the Bahraini situation where antigovernment movements have intensified. Iran reacted strongly to the statement, leading tensions in the Middle East to intensify over the Bahraini situation. On April 6, U.S. Defense Secretary Robert Gates indicated Iran's involvement in the destabilization of Bahrain and criticized Iran after talks with Saudi Arabian King Abdullah during his Saudi visit. Tensions have thus continued over Bahrain and Iran. Saudi Arabia and other Persian Gulf countries are also considering and coordinating measures to make a breakthrough in the Yemeni situation where antigovernment movements are intensifying. But no path to the stabilization has been seen, contributing to increasing turmoil in the Middle East.

In response to these developments, “money” might have continued to flow into the Brent crude oil futures market. Libyan crude oil supply interruptions have affected the oil supply/demand situation in the European market more seriously than in other markets, while the Brent’s presence has increased in comparison with the West Texas Intermediate that reflects a unique supply and demand environment for a region in the United States due to the so-called Cushing inventory problem. As a result, Brent futures transactions have expanded substantially. In the first quarter of this year, Brent futures trading volume increased 34% from a year earlier to 32.76 million contracts. Open interest for Brent futures trading at the beginning of April stood at 927,000 contracts, up 24% from a year earlier. While the WTI futures market is brisk, the Brent market’s robustness has attracted attention. While “money” flowed into these markets, crude oil futures prices continued to rise.

At the same time, attention-attracting developments may have been progressing with respect to oil supply and demand. While the international oil market now features sufficient supply with no overall shortage0 seen, careful observers may find the global supply-demand relationship moving for tightening gradually. Among supply and demand buffers in the market, OPEC’s surplus oil production capacity has been falling. IEA data put OPEC’s surplus capacity at 5.06 million barrels per day for February 2011. This level is not necessarily low. But there are some important problems. First, the surplus OPEC capacity continued to decline for three months from 6.14 million bpd in November 2010. Second, the February level of 5.06 million bpd included the Libyan portion of 420,000 bpd. The effective capacity excluding the Libyan portion came to 4.64 million bpd. Third, the surplus OPEC capacity might have decreased further on an expansion in Saudi output from March. Fourth, Saudi Arabia accounted for 3.2 million bpd or about 70% of the effective surplus at 4.64 million bpd. Particularly, the last problem of the surplus OPEC capacity’s concentration in Saudi Arabia could be combined with speculations about a spillover of North African and Middle Eastern destabilization to Saudi Arabia to affect the market. The OECD countries’ private-sector crude oil and petroleum products inventories in January 2011 were close to 2004-2010 averages and not necessarily low. But both crude oil and petroleum products inventories have been falling since the second half of 2010. These developments indicate that the oil supply-demand relationship is going in the direction of tightening, although the market has no particular supply and demand problem for the immediate future. Amid these supply and demand developments, the growing tensions in the Libyan and Middle Eastern situations have been stimulating market speculations. In response, the money factor might have been working.

In addition to these opaque factors, uncertain factors including unknown impacts of the great Eastern Japan earthquake and tsunami on the Japanese economy and the world economy and on Japan's oil demand, as well as a potential resurgence of a sovereign debt crisis in Europe, are clouding the future course of the international oil market. The Japanese disaster is expected to exert two conflicting impacts on oil demand – an oil demand slowdown accompanying Japan's economic deterioration and an increase in power generation fuel demand amid an expansion in thermal power generation, complicating future prospects further. How these factors will work is difficult to predict, and so is which factors market participants would pay attention to. The future course of crude oil prices has been growing even more uncertain.

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