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IEA Oil Reserves Release and International Oil Market

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The international oil market has seen various turbulent developments emerging one after another in the first half of 2011. In an effective last development for the period, the International Energy Agency made a decision on June 23 to release 60 million barrels in oil reserves over 30 days, surprising oil market participants.

In a press release, the IEA specified the reserves release as designed to make up for oil supply losses on the Libyan crisis. The IEA estimates that the unrest in Libya had removed 132 million barrels of light, sweet (low-sulfur) crude oil from the market by the end of May. As is well known, Saudi Arabia has increased oil output to cover part of the supply losses. Overall, however, low-sulfur crude oil supply has clearly been far less than in a case without the Libyan crisis. Given the current Libyan situation, no one can expect substantial recovery in Libyan oil production, with the “supply disruptions” being likely to continue. This point might have been a major factor behind the IEA decision to release oil reserves.

The IEA member countries have thus agreed to take such actions as the reserves release to make 2 million barrels per day, or a total of 60 million barrels, available over 30 days in the market. These countries will take their respective actions, including the United States’ release of strategic oil reserves (30 million barrels) and Japan’s reduction in the oil stockpile obligation (number of day cover) for the private oil companies.

In fact, the recent IEA decision represents the third IEA-coordinated oil reserves release, following those that responded to the 1991 Persian Gulf crisis and the 2005 Hurricane Katrina disaster in the U.S. What the three cases saw in common were conspicuous oil supply disruptions accompanying geopolitical risks or disasters. But the time span between the emergence of supply disruptions and the decision to release oil reserves and the crude oil market price trend in the latest case differs from the time spans in the two earlier cases. In this sense, the latest decision may be interpreted as unique. Specifically, the decision to release oil reserves came four months after supply disruptions emerged amid the Libyan crisis. Regarding the oil market price trend, the decision interestingly came amid a downward trend for crude oil prices. The benchmark West Texas Intermediate crude oil futures price has followed a downward trend while seesawing, since it topped $110 per barrel in early May. It slipped below $100 on June 10 before falling further below $95. The downward trend has been clear amid uncertainties about the future course of the world economy.

Even amid the downward trend, the crude oil price levels above $90 cannot be described as “cheap.” Although we now see the downward trend amid economic uncertainties, oil supply/demand, geopolitical and financial uncertainties indicate that crude oil prices could turn up again toward the second half of the year. For the world economy, particularly for industrial countries plagued with many anxieties regarding economic recovery, the present and future crude oil price trends are a risk factor to which responses are important. The latest IEA decision to release oil reserves came amid such market environment. In this sense, I suspect that oil market participants might have taken the IEA decision as designed not only to respond to the physical supply disruptions but also to stabilize oil market prices.

In this respect, the U.S. situation might have been the biggest focus of attention behind the IEA decision. In the United States, crude oil price hikes trigger gasoline price rises and can easily become a social or political problem. Ahead of next year's presidential election, a full-blown economic recovery or the prevention of economic deterioration is a very important political challenge. In this sense, the U.S. administration has been required to appropriately address all economic risk factors as much as possible. Before the Federal Reserve ended its Quantitative Easing 2 policy in June, the administration was looking for the next action to take. Under such situation, crude oil price hikes were a great matter of concern to the United States. When crude oil price hikes grew remarkable in April and May, arguments grew for a unilateral U.S. action to release strategic oil reserves and for market regulations to address speculative and financial factors behind the price hikes. Market observers seemed to speculate that the administration enhanced pressures on major oil producing countries to increase oil supply in the international market. Under such circumstances, the Organization of Petroleum Exporting Countries at its latest meeting discussed a production quota increase. While OPEC shelved any official agreement on the production quota increase, such OPEC members as Saudi Arabia decided to effectively expand oil output. The development is still fresh in our minds.

The IEA decision to release oil reserves thus came amid expectations for crude oil price falls. In response to the decision, in fact, the WTI futures price temporarily slipped below $90/barrel before closing $4.39 lower at $91.02 on June 23. The market development may indicate that the IEA decision, in addition to economic uncertainties, worked to push down the price. As far as the decision is an additional factor to push down crude oil price, however, how long the IEA decision would remain influential is uncertain depending on future economic conditions as the main factor.

The IEA decision to release oil reserves has thus exerted some influences on the international oil market and crude oil prices and has become a key factor to which attention must be paid in anticipating future market developments. If the two preceding IEA decisions to release oil reserves represented a traditional approach of responding promptly to large-scale oil supply disruptions, some may interpret the latest decision as an effort including some new factors. This point also attracts attention.

Regarding the attention-attracting IEA decision to release oil reserves, I am paying attention to the following three points for the future. The first point is how long the oil reserves release will remain influential for overall supply and demand in the international oil market. The second point is the IEA's relations with oil producing countries. OPEC has indicated strong opposition to the IEA decision, noting that oil supply has been sufficient in the market and that any intervention in the market or prices is undesirable. It may be desirable for IEA oil consuming countries and OPEC oil producing nations to cooperate in achieving their common goal of market stability. In response to the latest decision, their future relations, particularly the IEA members' relations with Saudi Arabia, may attract much attention. The third point is how the market will interpret the IEA decision. Attention may be paid to whether market participants including financial players will view the presence of the IEA and the oil reserves release as a new factor for considering the market.

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