Special Bulletin

A Japanese Perspective on the International Energy Landscape (161) February 24, 2014

Are We seeing the Start of a Turning Point for International Oil/Gas Market?

Ken Koyama, PhD
Chief Economist, Managing Director
The Institute of Energy Economics, Japan

At the Keidanren Hall in Tokyo on February 19, JX Nippon Oil & Energy Corp., JX Nippon Research Institute Ltd., the Committee for Energy Policy Promotion and the Institute of Energy Economics, Japan, cosponsored the 23rd International Panel Discussion, dealing with views about the future oil and energy situation. Fereidun Fesharaki from the FACTS Global Energy Group of Energy Market Consultants (UK) Ltd., Guy Caruso from the U.S. Center for Strategic and International Studies and Takayuki Nogami from the Japan Oil, Gas and Metals National Corporation attended the discussion as panelists and I served as moderator. The three famous experts on the oil and gas market had a very interesting discussion on the future oil and gas situation.

The panel discussion impressed me with talks about whether the year 2014 will see the start of a turning point for the international oil and gas market. Crude oil prices in the international oil market have remained above $100 per barrel for three years. There have been various factors behind the high crude oil prices including supply-side problems like the destabilization of the Middle East, growing geopolitical risks and supply interruptions in some major oil producing countries. The prices are still high and dominantly expected to remain so in the first half of this year. In the second half, however, the supply-demand balance in the international oil market is likely to ease as U.S. shale oil production leads overall oil supply to expand faster than demand, as agreed between the panelists.

On Iran's negotiations with the so-called P5+1 countries (the five permanent U.N. Security Council members and Germany) on the Iranian nuclear development problem, the panelists pointed to great uncertainties. But they noted that Iran's oil exports could increase slightly in the second half of this year if its present interim framework agreement with the P5+1 countries is extended, with their break-off avoided even without any comprehensive agreement. Given downside risks for the world economy, their remarks indicated that they were very conscious of the possibility that downward pressure will emerge on crude oil prices from the second half of 2014.

The supply-demand relationship change is significant because it could represent the start of a turning point. The shale oil production expansion is not limited to 2014 but is expected to continue until around 2020. In response to the present output expansion, a rising number of analysts have grown even more bullish, revising their shale oil production forecasts upward. In addition, the panelists pointed to many medium- to long-term factors that could exert downward pressure on crude oil prices. Mexico has decided to allow foreign firms to participate in its oil production. Canada is expected to increase unconventional oil production. Brazil will substantially expand oil production through deeper offshore oil development. Iran may be able to substantially increase oil production if economic sanctions on the country are eased. Iraq already has plans to greatly increase oil output. These supply-expanding factors may put downward pressure on crude oil prices beyond 2014. The panelists differed over a medium-term crude oil price range but commonly predicted that crude oil prices could slip far below $100/barrel.

The expected drop in crude oil prices is good news for oil consuming countries such as Japan. But the crude oil price decline would be a grave and unignorable problem for oil producing countries that depend on oil (and gas) export revenues for economic growth. Depending on the degree of the oil price drop, their domestic situation could be destabilized. Therefore, future policy management will grow more difficult for major OPEC countries as supply-demand coordinators, including Saudi Arabia. Regarding policy management, full discussions are emerging on lifting a ban on oil exports amid the shale oil output expansion in the United States, which has effectively banned crude oil exports since the oil crises in the 1970s. In this sense, the year 2014 could also see the start of a turning point.

The abovementioned possible decline in crude oil prices is important for anticipating the future natural gas/LNG market. In the Asian LNG market including Japan, how to reduce higher LNG prices than in other regions is an urgent issue. Asian LNG importers are trying to secure new LNG supplies including those from the United States to help diversify supply sources. They are also looking for LNG pricing approaches that could allow them to procure LNG at more competitive prices. If crude oil prices decline, present Asian LNG import prices linked to crude oil prices will drop irrespective of these efforts.

The possible LNG price drop accompanying an oil price fall, though being good news for Asian LNG importers, has complex implications. It could affect the economic efficiency of LNG imports based of the U.S. Henry Hub price. Any substantial crude oil price plunge could discourage LNG developers from deciding to invest in or launching high-cost LNG projects. As noted in the panel discussion, the United States is realizing massive LNG exports exceeding 60 million tonnes, while Australia and other LNG exporters are making progress in their LNG export projects. Such real changes in the LNG supply-demand balance could be coupled with a crude oil price fall to provide a major change and start a turning point for the Asian market. The Asian LNG market has two different (and mutually influencing) pricing problems – lowering absolute prices to achieve lower-cost procurement and developing a more reasonable pricing mechanism. I would like to pay attention to if a turning point would start for these pricing problems as the supply-demand relationship and prices change.

Contact: report@tky.ieej.or.jp

The back issues are available at the following URL
http://eneken.ieej.or.jp/en/special_bulletin.html