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Crude Oil Prices Plunge to This Year's 3rd Bottom

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On December 10, the West Texas Intermediate oil futures price (the closing level for the front month contract) on the New York Mercantile Exchange hit this year's new low of $36.76 per barrel, falling by $0.40/bbl from the previous day. The Brent futures price on the London market also fell by $0.38/bbl to $39.73/bbl, slipping below $40/bbl for the first time this year.

The lows are close to levels recorded in early 2009 during crude oil prices' plunge following the Lehman Shock, representing the lowest levels in about seven years. The WTI futures price bottomed at $43/bbl in March and at $38/bbl in August. The latest low is the third bottom for this year. The second bottom in August came as I was discussing crude oil prices with experts in the United States. Impressively, one of the experts said that the second bottom may be followed by third and fourth bottoms. The expert also noted that it was uncertain how far oil prices would go down. That forecast is now coming true.

Since November, both the WTI and Brent prices have gradually declined and slipped below $40/bbl at last. As a matter of course, the basic factor behind the decline is a substantial supply glut in the international oil market. Oil inventories are accumulating substantially. U.S. oil output still remains high, though having started a downward trend at last. Russia is increasing oil output moderately under the ruble's depreciation. Iraq has steadily increased oil output despite its fluid domestic situation shaken by Islamic State and other problems. Saudi Arabia has maintained its strategy to give top priority to keeping its share in the international oil market, without signaling any production adjustment (reduction). These factors have led oil market participants to be preoccupied with concern on oversupply.

As was well expected, the Organization of the Petroleum Exporting Countries indicated no intent to cut output and left its production quotas unchanged at its general meeting in Vienna on December 4. As some media reports noted, OPEC could have considered an option to cut production if non-OPEC oil producing countries' output cuts are secured. But such option failed to be adopted, indicating that none can support prices in the international oil market. In such circumstance, crude oil prices explored lower ground in the second week of December.

Market participants have recognized not only the current oversupply but also additional destabilizing factors and downside risks that could emerge toward next year. Fears about the future course of the Chinese economy, which led crude oil prices to hit this year's second bottom in August, have not necessarily been cleared, although stability in the economy has been restored for now. Given that China is important as a major potential importer of Iranian crude oil coming back to the international market as discussed below, the future course of the Chinese economy is a major destabilizing factor.

At a time when crude oil prices have declined so much and are likely to fall further, the deterioration of resource-rich economies is becoming a drag on the world economy. The U.S. Federal Open Market Committee's expected decision in the coming week to raise interest rates would influence (lower) crude oil prices. The largest factor affecting oil prices would be Iranian crude oil's comeback to the international market. If Western countries officially decide to lift economic sanctions on Iran, Iranian crude oil will come back to the market in 2016. Given the current market conditions, any limited volume of Iranian crude flowing into the international market may have a not-so-small impact on market sentiment. The anticipation of these events is a major factor behind crude oil prices' current dip to this year's third bottom.

Market changes can accelerate frequently. From December 3 before the OPEC meeting to December 10, crude oil prices fell for five market days on end. Even after hitting this year's lows at present, crude oil prices could accelerate their decline and explore lower ground. Whether the market could test the WTI futures price's decline below the lowest level after the Lehman Shock (above $33/bbl) is attracting much attention. Some market participants have forecast that crude oil prices could fall below $30/bbl to the lowest level in 12 years, since December 2003. Crude prices launched a spike in 2004 and could fall back to a 10-year low soon in a long term cyclical movement.

As a matter of course, crude oil prices have declined too much in a sense. The current low levels cannot be seen as sustainable from the viewpoint of the supply-demand equilibrium. If the current decline is considered to be a process where the accelerated market is testing the bottom for the immediate future, oil prices could turn upward from the bottom. If oil prices sink to remarkably low levels, the market may also test whether OPEC or Saudi Arabia can maintain the present policy. From the medium to long-term viewpoint, whether remarkably low oil prices would affect the demand side would be important. What negative impacts such low prices would exert on the supply side through investment drops would also be significant. The international oil market is now looking for sustainable equilibrium price levels. I view present prices as too low.

Low crude oil prices are expected to bring about economic benefits for oil consuming and importing countries like Japan. In fact, low oil prices have been contributing to improving the trade balance and lowering energy costs to boost corporate earnings and private consumption. Given remarkably low oil prices' negative impacts on resource-rich countries, their deflationary effects and emerging economies' deceleration or slump behind the oil price plunge, however, even Japan cannot be too simple to be pleased. The future course of crude oil prices will exert complicated influences on international politics, the world economy, business environment and lives of ordinary households and citizens. Irrespective of who the "winners or losers" of low oil price would be, we may have to conduct a cool analysis and take future responses or strategies based on such analysis.

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