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Outlook for Japanese and Foreign Oil Situations
(Summary)

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<u>Outlook for crude oil prices in 2016</u>

1. We forecast the average international price in 2016 at $50 per barrel for Brent, $48/bbl for Dubai and $46/bbl for West Texas Intermediate. Crude oil prices are likely to test lower ground under oversupply and high inventories for the immediate future before turning up with a supply excess being eliminated gradually toward the second half of 2016. If the Organization of the Petroleum Exporting Countries increases production excessively, if demand in China and other emerging countries decelerates, or if U.S. shale oil production is more resistant than expected to low oil prices, however, average crude oil prices may be $10/bbl less than the abovementioned forecasts.
2. The surplus oil supply is steadily shrinking in line with price drops. Global oil demand including U.S. and Chinese demand has been growing steadily. An annual oil demand increase is projected at 1.29 million barrels per day in 2016 following 890,000 b/d in 2014 and 1.68 million b/d in 2015, remaining above 1 million b/d. Contributing much to the demand growth may be lower prices that work to stimulate demand.
3. Non-OPEC oil producing countries, which have more high-cost oil fields than OPEC members, are growingly reducing production due to the slack oil prices. Although average non-OPEC production in 2015 increased by 1.08 million b/d from the previous year, such production in 2016 is expected to decline by 0.36 million b/d. U.S. production cuts may be the largest contributor to the decline. If crude oil prices remain below $50/bbl, the United States may continue to reduce output. Given that there are many drilled shale oil fields before commercial production and that shale oil development has continued to grow more efficient with costs reduced, however, U.S. crude oil output is expected to turn upward if crude oil prices rise back above $60/bbl.
4. Supply and demand adjustments (elimination of a supply excess) had originally represented an OPEC-adopted strategy. Ironically, however, OPEC countries' output expansion is now delaying progress in supply and demand adjustments.

Particularly, Iraq and Saudi Arabia have been aggressively expanding exports to Europe as well as Asia. Given Iran's expected oil output expansion, OPEC countries are likely to further intensify their competition for greater market shares. A U.S. lift a ban on crude oil exports for the first time in 40 years will be an additional factor to drag down oil prices.

5. As market participants focus their attention on supply and demand factors, influences of geopolitical and financial factors on oil prices are fading away. Islamic State militants are expanding their operations to cover Europe as well as the Middle East and North Africa, while the Syrian situation is growing more confused with great powers enhancing interventions. Civil war still continues in Yemen and Libya. Geopolitical risks have thus heightened too much. Nevertheless, crude oil market participants pay more attention to the supply excess, reducing opportunities for geopolitical factors to move the market. Among financial factors, the interest rate hike in December will induce the dollar's appreciation and a risk-off market, exerting downward pressure on crude oil prices.

Medium-term outlook for oil prices

6. Some people expect oil prices to slacken over a medium term for the reason that the present crude oil price fall is similar to that in the 1980s. But there are many differences. First, OPEC's surplus production capacity at present is much smaller than in the 1980s. Second, global oil demand is now still continuing to increase. Third, the transportation sector, where it is more difficult to replace oil with any other energy source, has a greater share of demand. Present geopolitical uncertainties are greater than in the 1980s or 1990s. Given these points, crude oil prices are likely to turn upward earlier than in the 1980s. The Brent crude price in 2020 is expected to rise to a $70-75/bbl range.

Japanese oil situation

7. A year-to-year decline in Japan's petroleum product demand in FY2015 is projected to narrow to 1.1% due to the large drop in the previous year and crude oil price plunges. But Japanese demand is certain to continue a structural decline due to falling population, improvements in vehicle fuel efficiency and fuel switching from oil to other energy sources.
8. Asian oil refining margins are now favorable for petroleum product exporters. But the margins may deteriorate on a demand slowdown in China and higher Chinese refinery operating rates resulting from China's approval of crude oil imports by private sector refiners.
9. In 2015, the Japanese oil industry saw major integration deals. While the Japanese

oil industry will remain exposed to fierce international competition, the birth of strong oil companies will make great contributions to Japan's energy security through the peacetime provision of competitive products and the enhancement of emergency oil procurement, decision-making and coordination capabilities. For the immediate future, Japanese oil companies are urgently required to reconstruct their earnings bases that have deteriorated due to excessive domestic competition. Over a longer term, however, they should enhance their business resources and investment risk-absorbing capacity to positively take advantage of Asian market growth for their own development.