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Domestic and Global Oil Conditions, 2017: Outlook and Issues

<Executive Summary>

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Outlook for crude oil prices in 2016-2017

1. Since crude oil supply and demand is expected to rebalance gradually in 2017, international crude oil prices in the first half of 2017 are forecast to be Brent $55/bbl, WTI $54/bbl, and Dubai $53/bbl, and in the second half of the year this is forecast to rise to Brent $60/bbl, WTI $59/bbl, and Dubai $57/bbl. Note however that there are factors that may work to curb price rises including U.S. interest rate increase and political/economic risks in Europe and the United States.

2. There is a possibility that prices could drop again if, for example, OPEC and non-OPEC production cuts are not complied with, U.S. production volumes recover more than expected, or financial markets focus on uncertainty surrounding politics in Europe and the United States.

Demand trends

3. During the first three quarters of 2016 global oil demand was firm with a 2% increase (1.6 million b/d) year on year (y/y)to 96 million b/d. In the third quarter in 2016 however the increase over the same quarter in 2015 slowed to 900,000 b/d (0.9%). Growth in the United States and China—the countries that have driven demand growth—has slowed.

4. Global oil demand in 2017 is forecast to increase 1% (1.2 million b/d) over 2016 to 97.5 million b/d. Demand is forecast to increase in tandem with economic growth.

5. Oil demand in the United States in the first three quarters of 2016 increased 1% (190,000 b/d) y/y to 19.6 million b/d. Although the rate of increase has dropped, firm

demand is also forecast for 2017. There are concerns however, that the Trump administration's exclusionism and isolationism may result in turmoil in financial markets and thereby cause crude oil prices to drop.

6. Oil demand in Europe in the first three quarters of 2016 was 14.45 million b/d, an increase of 2% (330,000 b/d) y/y. Although demand is likely to remain stable heading into 2017, there is a risk that financial markets may cause crude oil prices to drop in response to the result of Brexit negotiations or if anti-EU parties make gains in national elections in countries such as Germany, France, and the Netherlands.

7. Oil demand in China in the first three quarters of 2016 was 11.5 million b/d, an increase of 5% (520,000 b/d) y/y. Although slowing economic growth means industrial demand for fuel oil and diesel is weak, demand from the transport and residential sectors for products such as gasoline, LPG, and kerosene remains firm.

<u>Supply trends</u>

8. An agreement was reached at a general OPEC meeting in November 2016 to cut crude oil production to 32.5 million b/d for six months from January 2017 (this represents a decrease of approximately 1.2 million b/d compared with the production volume in September 2016). In addition, 11 non-OPEC countries concluded an agreement with OPEC on December 10 to cut oil production by 560,000 b/d over the same period.

9. On the other hand, OPEC crude oil production reached 34.2 million b/d in November 2016, the largest volume ever. There have many been cases in the past where OPEC production cut allocations have not been complied with and it will be necessary to watch production volume trends closely in 2017.

10. Crude oil production volume has been increasing since August 2016 and in November 2016 in non-OPEC countries reached 57.1 million b/d. Russia continues to maintain its highest-ever production volume (11.5 million b/d) and Canada has also recovered from the impact of the forest fire in Alberta Province.

11. U.S. production volume is currently bottoming out, and reached 12.44 million b/d in November 2016, the second consecutive month of increased volume. While oil price rises and the upcoming Trump administration's easing of restrictions on oil field development is good news for shale oil producers, some businesses prioritize improving their balance sheets over investing in oil fields, and increases in production

presumably will not get fully underway until the second quarter of 2017.

Domestic oil conditions

12. Oil demand (sales volume) from January to October 2016 was 145.15 million kl (2.99 million b/d)—a 3% decrease (4.65 million b/d) y/y. Although demand decreasing is continuing, refining capacity reduction and increased exports contributed to the maintenance of oil refinery utilization rates above 80%.

13. In the mid-to-long term, oil will continue to be a major energy source in Japan. To maintain domestic supply chains and facilitate the sustained growth of Japanese oil companies it will be necessary to improve competitiveness of domestic oil businesses, expand power and gas businesses in liberalized markets, and grow overseas oil-related business.

14. Since exports of oil products from South Korea, Taiwan, Singapore, and China are expected to increase, competition among Asian oil products will intensify. Under these conditions, it is crucial to further strengthen the competitiveness of the Japanese oil industry to enable it to expand overseas, whether that involves exports of oil products from Japan or refining/sales business overseas. The government ought to consider providing support by upgrading export infrastructure in Japan, and work to remove market entry barriers in countries especially in Asia to which Japan exports.

15. In October 2016, the Japan Oil, Gas and Metals National Corporation (JOGMEC) Law was amended to allow JOGMEC to acquire of shares in national oil companies. There are high expectations of the contribution this reform will make to the reinforcing of Japan’s energy security.

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