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Brent Averaged $42.11/bbl with Fluctuation Range of $50/bbl in 2020 1st Half

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Crude oil futures prices (front-month contracts' daily closing prices) averaged $42.11 per barrel for Brent and $36.82/bbl for West Texas Intermediate in the January-June 2020 period. From the same period last year, the average plunged by about $22/bbl or 34% for Brent and by about $21/bbl or 36% for WTI. The averages were far lower than the 2019 annual averages of $64.14/bbl for Brent and $57.04/bbl for WTI, characterizing the first half of 2020 as a low oil price period.

The first half of 2020 saw not only the far lower oil prices than the year-before levels or the previous year's averages but also unprecedentedly wild oil price fluctuations. Brent peaked at $68.91/bbl on January 6 and bottomed at $19.33/bbl, indicating a wide gap of $49.58/bbl. WTI recorded an even wilder fluctuation. Its peak in the period came at $63.27/bbl on January 6, and its bottom stood at minus $37.63/bbl. The simple gap between the peak and bottom was $100.90/bbl. The first ever negative price came in an abnormal situation caused by anomalous factors involving WTI futures trading, as is explained later. Even without the abnormal situation, the first half of 2020 can be characterized as a period of extremely wild oil price fluctuations.

I here would like to review the international oil market in the six months, consider factors behind such price fluctuations and explore a future outlook.

A factor behind oil prices' climb to the peaks in the first half of this year was the tense Iranian situation. U.S.-Iran tensions grew sharply as the United States killed Iranian Revolutionary Guard Commander Qassim Suleimani known as Iran's national hero. Iran implemented retaliatory attacks on U.S. military bases in Iraq, prompting the world to breathlessly watch whether the United States and Iran would go into an all-out war. The growing geopolitical tensions in the Middle East pushed oil prices up to the January 6 peaks.

However, the tensions ended up being short-lived. While continuing to bash each other, the United States and Iran refrained from further military attacks and indicated their hopes to avoid any all-out clash, leading the situation to calm down. Important then were supply and demand fundamentals. The supply-demand balance in the international oil market was expected to loosen in 2020. In the beginning of the year, oil demand was expected to steadily increase on moderate global economic growth in the year, but U.S. shale oil production growth was predicted to exceed oil demand growth. The Organization of the Petroleum Exporting Countries and some of the non-OPEC oil-producing countries, known as OPEC-plus, were required to continue and enhance their oil production cuts for supply-demand balance adjustments. Concern over geopolitical risks in the Middle East receded amid such bearish market sentiment, prompting oil prices to enter a downtrend.

The outbreak and expansion of the coronavirus disease 2019 and a subsequent decline in global oil demand accelerated the downtrend dramatically. The expanding COVID-19 pandemic plunged the global economy into the worst situation since the Great Depression, and lockdowns to prevent the expansion of the pandemic worked to dramatically cut oil demand, including transportation fuels, by 20-30 million barrels per day. Despite the evaporation of oil demand, the OPEC-plus group failed to enhance production cuts in early March and entered a price war, triggering a crude oil price crash. Oil prices thus plunged to the bottom levels in April in such market environment. The then front-month WTI futures contract entered negative territory in an anomalous situation in which long position holders failed to find buyers due to oil inventories' rise close to a storage capacity limit at the WTI delivery point of Cushing toward final trading in the contract and were required to pay costs for disposing of long positions.

However, such extremely low oil prices triggered strong responses from the supply side. After the OPEC-plus production cut commitment collapsed once, the group achieved a new deal to implement record production cuts from May, as mediated by U.S. President Donald Trump plagued with the oil price crash's serious effects on the shale oil industry and the stock market plunge's impact on the U.S. economy. As oil prices remained low, high-cost oil production was dealt a severe blow and decreased rapidly. A typical production decline was seen in U.S. shale oil. At the beginning of the year, U.S. oil production was expected to increase by more than 1 million bpd this year. At present, however, U.S. production is estimated to decline by more than 1 million bpd due to sluggish shale oil production. Weak oil prices have thus produced a strategic response from the OPEC-plus group and an economically driven response from high-cost oil producers, leading the oil market to go in the direction of rebalancing.

Furthermore, oil demand began to gradually rise back as many countries including European nations and the United States eased or lifted lockdowns and reopened businesses from May on their assessment that the COVID-19 pandemic peaked. The supply and demand side moves were combined to lead crude oil prices to hit bottom and turn up in late April and enter a moderate uptrend from May. In early June, Brent rose back above $40/bbl. WTI followed suit in late June. The international oil market in the first half of 2020 thus featured a downtrend from peaks at the beginning of the year to bottoms in late April and a later moderate upturn lasting until June.

Since June, however, crude oil price fluctuations have become narrower, with Brent seesawing in a $40-45/bbl range. Factors behind the narrow fluctuations include uncertainties about the global economy and the future trend of the pandemic. The latest World Economic Outlook by the International Monetary Fund predicts the global economy to contract by 4.9% in 2020. However, the negative growth rate would change dramatically depending on the future pandemic trend and other factors. The pandemic has been expanding consistently, with no end foreseen. In Europe, the United States and Japan that have reopened businesses, the pandemic is feared to expand again. We have no choice but to be conscious of the potential second or third pandemic expansion wave that would have serious economic and social impacts.

Market players are also uncertain about future strategies of the OPEC-plus group that has implemented record production cuts and backed up supply-demand rebalancing since May. Particularly, they are watching how Saudi Arabian and Russian strategies would change. In such situation, crude oil prices are seesawing after a moderate uptrend since May. Market players are trying to foresee what would the next moves or developments be. Various factors considered in this report will exert influence on oil prices. Particularly, we will have to keep close watch on the pandemic, the global economy and the OPEC-plus group's response.

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