

Brent Rose Back above \$50/bbl for the 1st Time in 9 Months

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

On December 10, the key Brent futures contract closed up \$1.39 per barrel from the previous day at \$50.25/bbl, rising back above \$50/bbl for the first time in nine months since it finished at \$51.13/bbl on March 4. On December 14 after the weekend, it closed at \$50.29/bbl, remaining above \$50/bbl. On the same day, the key West Texas Intermediate futures contract finished at \$46.99/bbl, the highest close since March 4 as well.

Crude oil prices started their crash in early March. The international oil market opened this year under downward pressure from abundant supply. After shooting up on a potential full-fledged military clash between the United States and Iran in the beginning of the year, crude oil prices gradually declined in line with market fundamentals amid the relaxation of military tensions. Oil prices accelerated their decline as oversupply grew amid global oil demand evaporation under the COVID-19 pandemic. Adding fuel to the decline was a collapse of the OPEC-plus production cut framework at a meeting of the Organization of the Petroleum Exporting Countries and non-OPEC oil-producing countries in early March, which triggered a price war between Saudi Arabia and Russia. Under a remarkable oil glut, the key WTI futures price sank to minus \$37/bbl in an abnormal development on April 20, prompting the OPEC-plus group to restore the production cut framework and launch historic production cuts around by 10 million B/D in May. At the same time, high-cost U.S. shale oil production was forced to substantially decrease in response to price weakness. Crude oil prices gradually rebounded later. From May, Brent remained around \$40/bbl.

Since late November, however, the market trend began to change. In late October, Brent fell below \$40/bbl as concern about global economic stagnation grew on the spreading serious impacts of the second or third COVID-19 pandemic wave in Europe and North America. Later, however, oil prices crept up despite the growing COVID-19 pandemic. Brent shifted to the \$45-50/bbl range in late November and topped \$50/bbl on December 10. What are the factors behind the oil price rebound?

The biggest factor was growing hopes on COVID-19 vaccines that have an impact on the oil market. As noted above, COVID-19 infections have rapidly increased again mainly in Europe and North America. Daily infections topped spring peaks. The situation has been serious particularly in Europe, where major countries have reintroduced lockdowns and travel restrictions, with top priority given to containing COVID-19 infections. In this sense, no end to the pandemic has come into sight. Since early November, however, large medicine companies in major countries began to file for emergency use of their COVID-19 vaccines. In early December, vaccination started for healthcare workers and elderly people in Russia, the United Kingdom, and the United States. As vaccination is now expected to expand, hopes have grown.

While the effects or by-effects of COVID-19 vaccines remain unknown and uncertain, it is hoped that vaccination would globally spread in a manner to consequently end the pandemic. The growing hopes on an end to the pandemic and its favorable effects on the global economy have led to stock market hikes. As the U.S. stock market has prepared for the incoming Biden administration following the November 4 presidential election, the Dow Jones Industrial Average on the New York Stock Exchange has crept up since November. Supported by hopes on COVID-19 vaccines, the average topped 30,000 to a record high on November 24. It has remained around 30,000 since then. An end to the pandemic and a global economic upturn would lead global oil demand to increase, boosting crude oil prices. Hopes on COVID-19 vaccines have improved market sentiment and pushed up crude oil prices, even though the effects of the vaccines have remained unknown.

Currently, China's oil demand recovery has exerted influence on the oil market in a manner to support oil demand growth. China, though having become the first country to suffer from the COVID-19 outbreak, has contained the outbreak ahead of other countries and continued positive economic growth since the second quarter of this year. Under the economic growth, energy demand has been robust, with oil demand recovering steadily. When crude oil prices crashed, China might have taken advantage of low oil prices for accumulating strategic oil reserves. Demand for oil for stockpiles has contributed to robust Chinese oil demand. Only China is expected to slightly increase this year's oil demand slightly from the previous year, while other major regions in the world are likely to reduce oil demand.

In view of such market conditions, the OPEC-plus group at its ministerial meeting on December 3 decided to ease the current production cuts from January 2021. The group has cut production by 7.7 million barrels per day since August and now plans to narrow the cut by 0.5 million bpd to 7.2 million bpd from January. How long production cuts would be continued is a key issue for the OPEC-plus group that has implemented the current record production cuts. It would be desirable for the group to phase out the production cuts while supporting crude oil prices. The group has announced a plan to review the production cut target every month while watching market conditions.

Hopes on COVID-19 vaccines and China's robust oil demand have been combined with the OPEC-plus production adjustment to lead Brent to rise back above \$50/bbl. However, future conditions remain uncertain. While great hopes are placed on COVID-19 vaccines, it is noteworthy that market players are still uncertain about when the pandemic would come to an end and whether the global economy would smoothly recover. Regarding the effects of the vaccines, we will have to closely watch the spreading second or third wave of the pandemic, future developments, and their impacts.

On the supply side, there are two points to which we should pay attention. The first point is the future course of high-cost shale oil production, which has been forced to decrease due to the oil price crash early this year. If the WTI price rises beyond \$50/bbl, shale oil production would increase again. In this sense, U.S. shale oil production will continue to exert downward pressure on crude oil prices. The other point is Iran's potential comeback to the international oil market. President-elect Joseph Biden has indicated that the United States could return to the Iran nuclear deal. In reality, however, the situations surrounding the United States and Iran have been complicated, leading many people to believe that it would not be easy for the Biden administration to return to the deal. As far as the return has been indicated, however, oil market players have no choice but to

become conscious of Iran's comeback to the international oil market at some time.

The OPEC-plus group will be required to adjust the supply-demand balance on the international oil market according to conditions that are difficult to predict. Given that different speculations are seen between OPEC-plus production cut participants including Saudi Arabia and Russia, however, future oil supply-demand adjustment could become difficult. The international oil market from 2021 is still greatly uncertain. We will have to closely watch relevant developments.

Contact: report@tky.ieej.or.jp

The back issues are available at the following URL

http://eneken.ieej.or.jp/en/special_bulletin.html