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Crude Oil Prices Hit 4-Month Highs with Brent Rising above $86/bbl

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On March 18, crude oil prices hit four-month highs. The front-month futures contract on the benchmark Brent crude oil rose by $1.55 per barrel from the previous market day to close at $86.89/bbl. The key futures contract on the West Texas Intermediate crude oil also increased by $1.68/bbl to close at $82.72/bbl. It was the first time in four months that Brent and WTI prices closed above $86/bbl and $82/bbl, respectively, since November 2 last year.

Since late 2023, crude oil prices had fluctuated within a narrow range. Since the beginning of February this year, particularly, the Brent price had remained in an $81-83/bbl range and the WTI price in a $77-79/bbl range, indicating a strange stability in a sense. A conceivable factor behind the stability is that the supply-demand balance had been in an equilibrium. Another such factor is that a kind of equilibrium situation existed as destabilizing factors had offset each other. This means that the market lacked drivers for price movement.

The specific background to this situation is that market participants had established the view that global oil demand would increase steadily by nearly 1.5 million barrels per day year on year, while global oil supply increases robustly mainly due to an increase in U.S. production to cover growing demand. Apart from the above market view, downward factors for crude oil prices, such as global economic instability including an economic downturn in China known as the world's largest oil importer, had offset upward factors like geopolitical risks such as the Middle East situation including the Gaza crisis, which has escalated and will become even more chaotic and volatile. With regard to the Middle East instability, it is important that the Gaza crisis, though being highly tense, has had no serious impact on actual oil supply. This is why the crisis has failed to become a decisive upward factor for crude oil prices.

Another important point is that the OPEC-plus group of oil-producing countries has continued to function as a supply-demand adjustment system for the international oil market. In response to a decline in crude oil prices that materialized in the first half of 2023, the OPEC-plus group enhanced coordinated production cuts, with Saudi Arabia and some other group members implementing voluntary additional production cuts, contributing to supporting crude oil prices. As a result, a certain floor has been formed for crude oil prices. In this sense, the OPEC-plus group has played an important role in narrowing crude oil price fluctuations.

The strange stability of crude oil prices can be attributed to the combination of these factors. However, crude oil prices have just hit four-month highs, above $86/bbl for the Brent and above $82/bbl for the WTI. Will the first major rise in four months make a breakthrough in the strange stability? In order to find the answer, we first need to consider why crude oil prices have posted the first major hike in four months.

Media reports have quoted market participants as saying that the recent major price increase was partly due to Ukraine's attacks on Russian oil refineries and the better-than-expected resilience of the Chinese economy. With regard to the former, the fact that a geopolitical risk affected actual oil supply seemed to become a bargaining chip for trading in the market. As mentioned earlier, the current Middle Eastern situation, though representing a very serious geopolitical risk factor, has so far had a very limited impact on oil supply. Therefore, the Middle Eastern situation has not become any major upward factor for crude oil prices. Instead, the Ukrainian situation might have become an upward factor. The Ukraine crisis led to an oil price surge in 2022 because the Western embargo on Russian oil became a source of anxiety for Russian oil supply. Expectations and fears that Russian oil supply would be significantly reduced as a result of the embargo caused a sharp rise in crude oil prices. However, the decline in Western oil imports from Russia was offset by an increase in Chinese and Indian imports, allowing Russian oil supply to the international oil market to be maintained. As a result, Russia's oil revenue, the main artery of the Russian economy, remained high, above $100 billion.

As the Ukraine war has been stalled and prolonged, however, Ukraine has recently shown moves to intensify attacks on critical facilities and infrastructure in Russia using drones and other means to counter Russia. Among them, it is believed that the attacks on refineries and other energy facilities are aimed at reducing Russian oil exports. Since late last week, news has been circulating that multiple Russian refineries including major ones have been attacked, with some forced to be shut down. Military attacks specifically affected oil or energy supply. Ukrainian attacks on Russian energy infrastructure have been predicted and gradually implemented. Recently, however, they have become a specific bargaining chip for trading in crude oil futures market for the first time.

Regarding the Chinese economy, stronger-than-expected economic data exerted an influence on crude oil prices. Among key economic data released by China's National Bureau of Statistics on March 18, industrial production in January-February this year increased by 7% year on year. This increase was higher than a 6.8% rise in December last year. The fixed asset investment in China, including plant construction, increased by 4.2% year on year, while the development investment declined in the troubled real estate sector. While concerns about the severe impact of the real estate recession have still been lingering, it is believed that the better-than-expected economic data have pushed up oil prices. After all, the impact of the outlook for the Chinese economy on the oil market is enormous.

Another major influencing factor is a change in the perception of the supply-demand balance in the international oil market. The International Energy Agency's latest monthly oil market report, released on March 14, showed that its global oil demand forecast for 2024 was revised upward by about 0.2 million bpd from the previous month's forecast, bringing about a year-on-year rise of 1.3 million bpd. While the projected increase is still lower than forecast by the Organization of the Petroleum Exporting Countries, it is important that the IEA has revised its oil demand growth forecast upward. Given non-OPEC oil production in response to the demand growth and OPEC production, the supply-demand balance in the international oil market is expected to shift from equilibrium in the first quarter of this year to an overdemand (undersupply) after the second quarter toward the year-end. This means that the supply-demand balance will tighten if the OPEC-plus group maintains the current production cuts.

The combination of these factors might have allowed crude oil prices to get out of a narrow trading range. The question is how these factors will influence crude oil prices from now on. Geopolitical risk factors, such as the impact of Ukrainian attacks, will almost certainly persist. It will also be interesting to see whether the Middle Eastern situation will be added as a new specific oil supply risk factor. Of course, it is also important to see whether the Chinese economy will hold up or come under downside pressure due to a deepening real estate recession and other factors. If the supply-demand balance in the international oil market tightens, however, oil prices will be supported and pushed up further. We must continue to pay close attention to future developments in crude oil prices.

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