Special Bulletin

A Japanese Perspective on the International Energy Landscape (692) June 5, 2024

Oil Prices under Downward Pressure even after Production Cuts Extension

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

On June 2, the OPEC-plus group of oil-producing countries at its online ministerial meeting decided to maintain its arrangements for coordinated production cuts and extend the production cuts until the end of 2025. The group, which had planned to implement the coordinated production cuts to support crude oil prices until the end of this year, made the decision in light of the current supply and demand environment in the international oil market and crude oil price trends.

It was also announced that voluntary production cuts by like-minded OPEC-plus members will be extended for three months until the end of September. The eight countries – Saudi Arabia, Russia, Iraq, the United Arab Emirates, Kuwait, Kazakhstan, Oman, and Algeria – held a face-to-face meeting in Riyadh and indicated their intention to extend their voluntary production cuts totaling 2.2 million barrels per day until the end of September to reinforce the OPEC-plus coordinated production cuts. From October, they decided to phase down the voluntary production cuts month by month until September 2025. However, they plan to respond appropriately while watching market conditions in regard to the coordinated and voluntary production cuts. The OPEC-plus coordinated and voluntary production cuts total 5.86 million bpd, equivalent to just under 6% of global oil demand.

After the OPEC-plus decision, however, crude oil prices declined. On June 3, the front-month futures contract on Brent closed at $78.36 per barrel, down $2.75/bbl from the previous market day. The contract on West Texas Intermediate also lost $2.77/bbl to $74.22/bbl. On June 4, Brent fell by $0.84/bbl to $77.52/bbl and WTI by $0.97/bbl to $73.25/bbl. Brent slipped below $80/bbl for the first time in about four months since February 7.

Why did crude oil prices come under downward pressure and fall by nearly $4/bbl in two days despite the OPEC-plus decision to extend production cuts? It has been pointed out that the main reason is that the decision had been expected and factored in by market participants. Some market players noted that the voluntary production cuts were scheduled to be phased down from October, the timing which is earlier than expected. In the absence of any particular surprise for market participants, they might have focused attention on potentially weak supply and demand fundamentals in the international oil market, pushing down crude oil prices.

The supply-demand balance in the international oil market is in a delicate situation. Demand for oil continues to rise, but it is by no means strong. According to the International Energy Agency's monthly report for May, global oil demand in 2024 is expected to increase by a moderate 1.06 million bpd or 1.0% from the previous year to 103.16 million bpd. In 2025, it is forecast to rise by 1.18 million bpd or 1.1%. The increase is expected to center on China and other emerging and developing Asian economies. China alone is predicted to account for half the global increase in 2024.

Recently, various uncertainties have emerged in the global economy, with stock prices being volatile. While economic slowdown concerns and risks continue to exist, there are also concerns about what will happen to global oil demand growth in the future. China, which has been driving oil demand growth, remains in a fundamentally uncertain economic situation, with concerns existing about its future economic conditions. Under these circumstances, it is difficult to find factors that support crude oil prices on the oil demand side, at least at present.

On the supply side, market participants share the view that non-OPEC oil production growth is expected to be sustained, with the United States driving the growth. According to the IEA, non-OPEC production is expected to rise by 0.97 million bpd from the previous year to 70.17 million bpd in 2024 and reach 71.78 million bpd in 2025. U.S. oil production will expand to 20.08 million bpd in 2024 and 20.65 million bpd in 2025. In 2024, the United States will account for two-thirds of non-OPEC production growth.

Thus, the IEA's view is that the increase in non-OPEC production alone will be almost equivalent to the global oil demand growth in 2024, meaning that there will be little room for OPEC to increase production. In this sense, the OPEC-plus group had no choice but to extend the production cuts. Given the uncertainties on the demand side, it was inevitable for downward pressure to work on crude oil prices for the time being.

Crude oil prices in the international market hit the highest levels since the 2008-2009 global financial crisis soon after the breakout of the Ukraine crisis in February 2022 and have basically remained high, around $70-80/bbl. While remaining high, however, they have fluctuated significantly in response to supply-demand balance changes and geopolitical risks from time to time. It seems that there were periodic changes in the fluctuations. After an upward period from June to September 2023, where they rose from $67/bbl to more than $93/bbl, they entered a downward period from October to December 2023, where they fell from around $93/bbl to around $68/bbl. From early January to early April 2024, crude oil prices remained in an upward period, where they rose above $86/bbl. Since then, they have basically stayed in a downward period.

During the protracted Ukraine crisis, other serious geopolitical risks, such as the breakout of the Gaza crisis in October last year and military attacks between Iran and Israel in April this year, rattled the international oil market. Even when these geopolitical risks grew significantly, however, there was no particular hindrance to oil supply from the Middle East, leading oil price premiums associated with geopolitical risks to be phased out in a relatively short period of time. In this sense, supply and demand fundamentals in the international oil market have continued to have the greatest influence on crude oil price trends and their cyclical changes. Going forward, oil market players will continue to watch the global economy including U.S. and European economic conditions and China’s economic situation, which is particularly important for oil demand. In addition, the expansion of U.S. and other non-OPEC oil production and relevant risk events will affect crude oil prices.

However, we must not forget OPEC-plus policy developments. Although the latest OPEC-plus decision, which had been priced into the market and included no surprise, exerted downward pressure on crude oil prices, it should be noted that the OPEC-plus group sent a signal to the market that it would continue its efforts to support crude oil prices. The signal reminded me of the group’s strong will to implement timely and flexible adjustments of oil supply and demand while monitoring market conditions to support oil prices and protect the national interests of oil-producing countries that depend on oil revenues. As long as the group retains this will and continues relevant efforts, a certain downside support line will be formed for crude oil prices. Sometimes, oil prices may come under strong downward pressure. Then, the OPEC-plus group may further enhance its efforts. As an important factor influencing crude oil prices, we must pay close attention to developments regarding the OPEC-plus group.

Contact: report@tky.ieej.or.jp
The back issues are available at the following URL.
http://eneken.ieej.or.jp/en/special_bulletin.html