Special Bulletin

A Japanese Perspective on the International Energy Landscape (705) September 2, 2024

Average Brent Price at $82.89/bbl for January-August 2024, Up $2.25/bbl

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

The average daily closing price of the front-month futures contract in the first eight months of this year came to $82.89 per barrel for the Brent crude oil, up $2.25/bbl or 2.8% year on year, and $78.58/bbl for the West Texas Intermediate crude, up $2.76/bbl or 3.6%. The average prices, though being nearly $20/bbl lower than the price of around $100/bbl seen in 2022, are not necessarily low; they have thus remained around $80/bbl so far this year, slightly higher than the average of the same period of the last year. The peak in the period stood at $91.17/bbl for Brent (April 5) and at $86.91/bbl (the same day), while the bottom came to $75.89/bbl (January 2) for Brent and to $70.38/bbl for WTI (the same day). While the gaps between the peak and bottom were between $15/bbl and $16/bbl, the prices hovered around $80/bbl mostly during the period.

However, crude oil prices followed a downtrend since October 2023, despite short-term fluctuations including (1) a rise to highs above $90/bbl in the wake of the outbreak of the Gaza crisis in October last year and a fall toward the year-end, (2) a rise over more than four months from late last year to early April this year, (3) a decline over two months to early June, (4) a rally over one month to early July, and (5) a downward trend after July with a steep fall triggered by the global stock market crash and a rebound in August. Since the beginning of this year, crude oil prices have thus gone through relatively short cycles of ups and downs.

From time to time, various factors affect crude oil price developments including a continuation of high levels, price fluctuations, and changes in the trend of fluctuations. However, I believe that the following three main factors have played an important role in crude oil price trends. The three are supply and demand fundamentals in the international oil market and their interpretation by market players, geopolitical risks and their implications, and the production policy of the OPEC-plus group of oil-producing countries. These three factors are closely related to each other and have driven the international oil market to date. In the following, I would like to consider international oil situation developments and crude oil price trends to date based on the three factors and provide a perspective for the outlook for future crude oil prices.

The Gaza Crisis that broke out in October last year was an extremely serious geopolitical risk in the Middle East, at the center of global oil supply, and brought great uncertainties and confusion to the entire situation in the Middle East. Hamas's large-scale surprise attack on Israel and Israel's counterstrike have brought about the worst ever human casualties and humanitarian crisis in Gaza. Market participants' interpretation of the Gaza crisis as undermining the stability of the Middle East to affect its oil supply led to a surge in crude oil prices just after the crisis breakout. While the Gaza crisis itself has remained serious and even continued to worsen, however, the market perception that it does not affect oil supply in the Middle East has become widespread, leading to the dissipation of the risk premium created by geopolitical risks on oil prices. Instead, other factors, especially oil supply and demand fundamentals, have begun to dominantly affect prices. Towards the end of 2023, many oil market participants began to anticipate oversupply in the oil market in the first half of 2024, pushing down oil prices towards the end of 2023.

An important event that reversed this downtrend was the decision of the OPEC-plus group to further cut production in December 2023. In addition to the overall coordinated production cuts, like-minded OPEC-plus countries decided to voluntarily reduce production by a total of 2.2 million barrels per day, sending a clear signal that they intended to support crude oil prices. The decision's impact was not small. At the time of the decision's announcement, oil prices remained sluggish as market participants were unsure of the effectiveness of the production cuts. Over time, however, oil prices reversed their downtrend and rallied. This upturn became the keynote for the oil price trend at the beginning of 2024.

The uptrend in crude oil prices from the beginning of the year highlighted the unprecedented attacks between Iran and Israel in April. On April 1, Iran announced that Israeli airstrikes near the Iranian embassy in Syria killed a senior member of the Iranian Revolutionary Guard Corps, raising tensions between Iran and Israel sharply. Iran carried out retaliatory strikes, followed by Israel's counterattack. Geopolitical risks in the Middle East thus became the focus of global attention. In line with this situation, crude oil prices rose sharply, hitting their highest levels so far this year. This price hike came as market players interpreted the exchange of fire between Israel and Iran as indicating that the situation in the Middle East would become turbulent due to their conflict, affecting oil supply. However, both countries exercised self-restraint to avoid a full-scale military confrontation, while oil supply remained unaffected. Then, the risk premium on crude oil prices disappeared once again, leading market players to pay attention to the weakness and growing uncertainties of the Chinese economy. As a result, crude oil prices entered a downtrend towards the middle of the year in line with supply and demand fundamentals.

Once again, this downtrend was followed by the OPEC-plus group's announcement in early June of a decision to extend the voluntary production cuts totaling 2.2 million bpd beyond the earlier-set expiration date of June 30 until the end of September. The decision countered the oil price downtrend and clarified oil-producing countries' intention to support oil prices, becoming a key factor in changing the oil price trend.

Crude oil prices continued their uptrend until early July before weakening again. In late July, tensions between Iran and Israel grew again on the shocking killing of a senior Hamas official by Israel in Iran and Iran's announcement to make retaliatory attacks, exerting upside pressure on crude oil prices. In August, however, a global stock market crash heightened global economic insecurity and induced a capital flight from risk assets, leading crude oil prices to fall rapidly. Crude oil prices thus became turbulent in August. As Middle Eastern oil supply has remained unaffected and the stock market has regained stability, however, crude oil prices have entered a moderate downtrend in line with supply and demand fundamentals. In this regard, the next focus of attention may be how or whether the OPEC-plus group would begin to phase out the voluntary production cuts from October as earlier planned.

This year's crude oil price developments demonstrate that the influence of oil supply and demand fundamentals is important. The influence may remain important in the future. The outlook for the global economy, including the U.S. and Chinese economies, will continue to have an important impact on the future of international oil supply and demand. Furthermore, the impact of geopolitical risks especially in the Middle East cannot be overlooked. Over the past year or so, geopolitical risks have served as a basso continuo for the oil market. Until now, the impact of the risk premium on crude oil prices has been the main focus. However, the question is whether geopolitical risks will affect the actual oil supply or not. This factor should not be underestimated, given the recent example of Libyan oil supply disruptions driving oil prices. Finally, the influence of the OPEC-plus group, which has played an important role in supporting oil prices, will continue to be closely watched. Whether or not the group will successfully support oil prices will remain an important factor in influencing oil prices.

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