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Crude Oil Prices Hit 2-Year High

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Crude oil price hikes have gained momentum since early November. The West Texas Intermediate crude oil futures price closed November 7 at $87.06/barrel, the highest level in two years and one month, since October 8, 2008, just after the Lehman Shock.

As noted in my earlier report titled "Monetary Easing Competition and Crude Oil Prices" (A Japanese Perspective on the International Energy Landscape (13) dated October 7), the ceiling and floor of this year's $68-86/barrel crude oil price range has been tested. The hike, as pointed out in the report, resulted from the international financial situation where massive liquidity has been generated under the U.S. Federal Open Market Committee's decision on November 3 on a monetary (quantitative) easing measure to purchase $600 billion in government securities and has flown into crude oil and other commodity markets and into emerging countries.

In this sense, we can view crude oil prices as growing “bubble”. Excess liquidity has flown into risky assets and commodities, boosting stock, crude oil and gold prices. Gold has shot up beyond $1,400 per Trojan ounce. Meanwhile, the U.S. dollar has weakened. As far as the United States sustains its accommodative monetary policy and retains a policy of tolerating a weak dollar, there may be no major change in the world's financial situation. Under the situation, crude oil prices are likely to rise further.

As a matter of course, the international financial and crude oil situations are so complicated that crude oil prices are unlikely to post any simple or constant hike. But the above-noted overall situation may be interpreted as indicating that crude oil prices could remain high for the immediate future. Under such circumstances, key market players have begun to send messages regarding hikes in perceived crude oil prices. For example, media reports in early November stated that Saudi Arabian Oil Minister Ali al-Naimi had raised the appropriate crude oil price range from

$70-80/barrel to $70-90/barrel. On November 10, the International Energy Agency announced its World Energy Outlook 2010, giving a new policy scenario in which the benchmark crude oil price would rise to $113/barrel in 2009 dollars toward the year 2035. "The era of cheap energy is over," the IEA said.

Such high price perceptions or views are based on analyses of actual market conditions. Key market players' announcement of these perceptions can influence price perceptions of many other market players and prices themselves. Key market players' price perceptions and actual market prices thus have mutual relations. Actually, such relations emerged for crude oil prices. In this sense, we may have to remain alert to messages about crude oil prices from key market players and relevant organizations.

Meanwhile, fundamental factors for boosting crude oil prices have remained unable to be found in the supply/demand balance in international oil markets. High level oil inventories indicate that markets have (excessively) sufficient supply. In this sense, prices are now deviating further from real supply/demand fundamentals. A conclusion may depend on whether we expect supply/demand fundamentals to exert great influences on crude oil prices some time or whether any deviation would have no problem. If we remember what happened to crude oil prices upon a plunge in global oil demand amid a steep recession following the Lehman Shock, however, we may not be able to brush off the importance of supply/demand fundamentals.

The international economic and financial situations have grown more complicated and destabilized. Although I predict the United States to sustain its accommodative monetary policy, international views about adverse effects of excess liquidity and currency devaluation measures as economic stimuli have grown more critical. Given concerns about the dangerousness of such policies, fundamentalists doubt if these policies would be sustainable. Among economies other than the United States, Europe is still plagued with serious fears growing over budget crisis and sovereign debt problems. The Chinese economy, as the driver of the world economy, has grown more uncertain due to the deceleration of growth, rising inflation, real estate price spikes and other problems. From next year, the world economy, though benefitting from economy-boosting effects of monetary easing measures over a short term, may face more and more worries.

While crude oil prices remain in a high range, downside risks are increasing. Crude oil market developments are now ambivalent. The world economy, international oil markets and crude oil prices are likely to grow more turbulent next year.

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