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Crude Oil Prices Shaken by European Crisis, Fundamentals, Iran Problem

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Crude oil prices in international oil markets have grown even more volatile. The benchmark West Texas Intermediate crude futures price rose back above $90/barrel in late October after hitting a low just above $75/barrel on October 4. The price continued an upward trend while seesawing in early November. On November 10, it rose to $97.78/barrel, the highest level in three months, since late July. The price is likely to rise above $100/barrel. The Brent crude futures price, another benchmark, has followed a similar trend, moving above $110/barrel since early November. At a time when various fears exist about the world economy, crude oil price hikes are expected to attract attention as a new problem.

What has been behind such price trend? We have frequently seen various factors mixed complexly behind crude oil price trends. Here, I would like to take up three factors.

The first factor is the world economy and financial market trends. Recently, the trends have remained as the most influential crude oil price driver. Most recently, European economic and sovereign debt crisis developments have shaken financial and crude oil markets. Crude oil prices' downward trend resulted from the deepening debt crisis and default fears in Greece, as noted in *A Japanese Perspective on the International Energy Landscape (62): G-20 Communiqué and International Energy Market.* Encouraged by market-stabilizing efforts including those specified in the Group of 20 communiqué, crude oil prices turned up. Another key development was an agreement at an October 26 European Union summit on the Greece rescue and banking system stabilization measures including a cut widened to 50% in banks' Greek debt holdings, the expansion of the European Financial Stability Facility to about 2 trillion Euros and the recapitalization of banks in the euro zone. The agreement contained market fears, supporting stock and crude oil prices.

Soon after the EU summit agreement, however, many experts warned that the pact fell short of resolving problems fundamentally and postponed the resolution in some sense. On October 31, in fact, Greek Prime Minister George Papandreou suddenly offered a referendum on Greece's acceptance of the comprehensive EU Greece rescue plan based on the precondition of Greek budget austerity, throwing markets into confusion. Later, Papandreou withdrew the referendum offer and resigned as prime minister. The destabilization of Greece's domestic situation affected European and global financial markets. In addition, credit fears spilled over to Italy. The benchmark Italian government securities yield shot up to a dangerous zone above 7% on November 9. Then, Italian Prime Minister Silvio Berlusconi announced his resignation, confusing the Italian situation. Markets have grown vigilant to a possible spillover of the debt crisis to other European countries. No optimism can be warranted on the European debt crisis. Under such circumstances, global stock markets have fluctuated wildly. Crude oil prices have followed suit. Since early November, the Dow Jones industrial average on the New York Stock Exchange has fluctuated around a relatively higher level of 12,000. In response, crude oil prices have soared.

In tandem with the world economy and financial market trends, oil supply and demand conditions have recently been influencing crude oil prices, according to a growing number of analysts. The International Energy Agency's monthly Oil Market Report released on November 10 pointed to a tightening oil supply-demand relationship as indicated by a downward trend of inventories in the member countries of the Organization for Economic Cooperation and Development. It also noted that the relationship could tighten further as the "call on OPEC (Organization of Petroleum Exporting Countries) crude oil" (global oil demand's gap with non-OPEC output), a harbinger of the future oil supply-demand balance, is expected to exceed actual OPEC output in 2012 as well as in 2011. Oil supply and demand fundamentals have thus been behind the upward trend of crude oil prices since the second half of October, according to the report. In this respect, we may have to closely watch future supply and demand conditions including global winter oil demand and oil output in major oil exporting countries. As a matter of course, the future course of the world economy is the largest driver of oil demand. Therefore, the world economy and financial market trends cited as the first factor may turn out to be even more important.

The third factor is geopolitical risks that have recently been attracting attention. Specifically, they represent the Iranian problem. On November 8, the International Atomic Energy Agency released a report on the Iranian nuclear problem, citing specific information to point out that Iran has implemented operations to develop nuclear weapons. While Iran has denied and fiercely protested the report, the international community including the United States has indicated an even tougher attitude against Iran. As speculations grow about tougher anti-Iran sanctions and military operations, tensions have grown among the region. The emergence of geopolitical risks might have prompted crude oil prices to gain momentum for their further hike. For the immediate future, tensions over the Iranian situation may have to be positioned as a key factor affecting market sentiment.

From late this year to early next year, various turbulence factors may arise in international oil markets while occasionally exerting great influences on the markets. The international energy situation is likely to see stormy developments successively.

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