WTI Slips below $90/barrel for 1st Time in 7 Months on European Economic Fear

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On May 23, the West Texas Intermediate crude oil futures price (the closing price for the July contract) lost $1.76/barrel from the previous day to $89.90/barrel, slipping below $90/barrel for the first time in seven months, since October 21, 2011. The WTI futures price was not the only loser. The Brent futures price also fell $2.85/barrel to $105.56/barrel.

It may be needless to say that factors behind the crude oil price drops include renewed serious fears of the European credit crisis and a subsequent increase in insecurity and uncertainty over the future course of the world economy and the international monetary situation. The Dow Jones industrial average on the New York Stock Exchange turned downward at levels above 13,200 in early May and lost some 800 points in some three weeks to 12,496 on May 23. As noted in the previous Japanese Perspective on the International Energy Landscape, the market trend has changed in response to the Greek parliamentary and French presidential election results on May 6.

In Greece, political parties have failed to form a coalition government and launched campaigns for a new election on June 6. The main issue seems to have shifted from whether to choose austerity or stimulus for the May election to whether to stay in the euro zone for the next one. The Radical Left Coalition (SYRIZA), which rose to the position of the second largest party by harshly criticizing the austerity policy, still continues to attack the policy while indicating an attitude emphasizing Greece's solidarity with Europe or the euro zone. As election results, Greece's post-election economic policies and its stance for negotiations with other euro zone countries on austerity measures remain uncertain, and speculations and fears about Greece's secession from the euro zone are shaking markets.

Among major euro zone countries, Germany and France under new President François Hollande have agreed to help keep Greece in the zone and are considering all options, including a balanced combination of austerity with growth strategies, to prevent European credit fears from worsening. But they remain unable to prevent market turmoil and fears from increasing. Since the May 6 Greek election, Britain’s Financial Times has carried stories or editorials on Greece's possible secession from the euro zone and its impact almost every day, indicating that economy watchers in Europe and the world are tracking the European trend with bated breath.
Analyses on the impact of Greece’s possible secession from the euro zone indicate various possible developments. The worst scenario envisages the entire European and world economy being affected seriously and entering a recession. Some analysts have said that the impact of Greece’s possible secession from the zone could be far more serious than the Lehman Shock.

The June 6 Greek election will be an immediate focus of attention. At least for the immediate future, concerns over the future course of the European and world economy concerning Greece’s possible secession from the euro zone will remain a major driver of crude oil prices. Therefore, these prices may slacken.

In my crude oil price outlook for 2012 as released last December, I put forward the main reference scenario where the WTI crude oil futures price would average $100/barrel, rising to around $110/barrel on the emergence of geopolitical risks regarding the Iranian nuclear standoff, or falling to around $90/barrel on economic fears including those on the European economic crisis. So far, market developments have followed the reference scenario. But turbulent factors could exert great influences on the future market. Any optimism cannot be justified.

If the European credit crisis deteriorates to exert the same impact as or a greater impact than the Lehman Shock in the worst scenario, crude oil prices may drop rapidly. There may be various market responses to a crude oil price plunge. Therefore, their feedback effects may have to be taken into account. Over a short term, responses from oil-producing countries, particularly the Organization of Petroleum Exporting Countries, will attract attention. OPEC will hold its 161st general meeting in Vienna on June 14. Depending on crude oil price changes just before the OPEC meeting, oil market players will pay attention to the meeting, which has so far attracted little market attention.

Meanwhile, geopolitical risks seem to have lost their influences on the oil market. But their impact in the immediate future remains in the balance. The Iranian situation is now seen as a factor to weaken crude oil prices as Iran has maintained talks with the international community, as indicated by International Atomic Energy Agency Director-General Yukiya Amano’s visit to Tehran and talks there, and the May 23-24 P5+1 meeting. Given the European Union’s tougher economic sanctions on Iran from July 1, however, the Iranian situation can be expected to become a market-moving factor from June. Even some attention-attracting emergency situation is still possible. In this sense, we may have to pay close attention to future market developments, even though oil prices are expected to remain weak in the immediate future.

In some sense, any crude oil price decline would be good news for Japan that has been plagued with a rapid increase in fuel import costs and in a trade deficit. As far as factors behind the change include global economic fears and a possible recession, however, the oil price fall may be a great cause for worry rather than a happy development for the Japanese economy. We cannot deny that a global recession stemming from the European economic crisis could coincide with the
emergence of geopolitical risks such as the destabilization of the Middle East situation, causing the worst double punch on the Japanese and world economy. We may have to keep close watch on the international energy landscape toward the second half of this year.

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