 August 17, 2012

WTI Hits 3-month High

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Crude oil price hikes have gained momentum again. On August 16, the West Texas Intermediate crude oil futures price (the closing price for the front-month contract) on the New York Mercantile Exchange rose by $1.3 per barrel from the previous day to $95.6/barrel. It exceeded $95/barrel for the first time in about three months, since May 11. The benchmark crude oil price had followed a downward trend since early May on the resurgence of the European economic problem, hitting a low below $78/barrel in late June. The price soared by nearly $20/barrel from the low in one and a half months, approaching close to $100/barrel. The Brent crude oil futures price on London's International Commodity Exchange has risen even faster. On August 16, the price reached $116.9, being closer to $120/barrel.

What are the factors behind the latest crude oil price hikes? Coming first are economic and financial factors. As noted above, the resurgence of European credit fears contributed greatly to crude oil price drops from early May. But the European financial situation has recovered stability through the European Union's enhanced efforts including the June 28 EU summit agreement, the avoidance of the worst scenario featuring Greece's secession from the eurozone and default, and the implementation of a bailout program for Spain. No optimism can be warranted about the deep-rooted European sovereign debt problem that has yet to be resolved fundamentally. But the European situation has recovered and kept status quo for now.

Financial markets have firmed on signs of a U.S. economic rebound as indicated by retail sales growth, the industrial production index and employment data, while the European debt crisis has come to a pause. The Dow Jones industrial average on the New York Stock Exchange fell to around 12,100 in June from levels above 13,000 in early May. But it later turned upward and has risen to around 13,200. Under such financial and economic conditions, funds have flown into commodities on a risk tolerance improvement, with funds shifting from the bond market for inflation-hedging purposes. These financial factors might have contributed to the crude oil price hikes.

In the meantime, crude oil futures transactions in Europe have grown robust and increased their presence amid the overall crude oil price hike. NYMEX had dominated crude oil futures transactions before the London ICE expanded its presence over the past one to two years. In the first seven months of this year, Brent crude oil futures transactions on the ICE totaled about 88.8 million contracts, surpassing about 87 million contracts for WTI crude futures on NYMEX. This change apparently indicates that the Brent futures price might have become more influential than the WTI futures as a benchmark reflecting the global supply-demand balance due to their widening price gap. A substantial decline in North Sea crude output might have contributed to the sharp rise in the Brent futures price as well. One particular factor is that production of the Forties crude as a component of the Brent blend is expected to drop by 200,000 barrels per day from September due to maintenance operations for the Buzzard oilfield, a major Forties production site.

Another oil price driver is geopolitical risks. Leading the oil price hikes early this year were geopolitical risks centering on the Iranian situation. At present, however, the Iranian situation as a destabilization factor has been combined with the destabilizing Syrian situation amid the deterioration of the civil war. An armed conflict between President Bashar al-Assad’s government and antigovernment rebels has escalated, increasing victims including civilians. The Syrian situation has grown tense, indicating a possible collapse of the al-Assad regime. The expansion of Arab Spring movements as demonstrated by the Syrian situation might have been coupled with the Iranian nuclear problem to further destabilize the Middle East situation, increasing geopolitical risks in a wider context. The growing geopolitical risks and the abovementioned financial factor might have been combined to support the crude oil price hikes.

Under such conditions, the international oil situation has grown more uncertain. Despite the present crude oil price hikes, supply and demand conditions in the international oil market do not necessarily indicate any supply shortage or any tightening supply-demand balance. Rather, factors indicating a looser supply-demand balance have been seen on a global economic deceleration, including a fall in oil demand growth, downward revisions to oil demand projections and a non-OPEC oil output expansion led by the United States where unconventional oil production has increased. Since early this year, Saudi Arabia, Libya and Iraq have expanded crude oil output amid a production cut in Iran, leading output within the Organization of Petroleum Exporting Countries to easily exceed 31 million bpd. The robust OPEC output has contributed to stabilizing or loosening the oil supply-demand balance.

The International Energy Agency in its latest monthly Oil Market Report stated that oil supply far exceeded demand in the international oil market in the first half of this year, leading inventories to expand by 1.85 million bpd. The IEA revised its projection of call on OPEC (demand for OPEC crude oil, including inventory fluctuations) sharply downward from the previous month to 31 million bpd for the third quarter of this year and to 30.1 million bpd for the fourth quarter and future years. The IEA estimated July OPEC output at 31.39 million bpd. How OPEC will adjust its output would be a key point in anticipating future oil market conditions.

While economic and financial factors have been changing sharply, with geopolitical risks growing uncertain, supply and demand fundamentals are uncertain in various ways. Crude oil price fluctuations depend on the direction each factor takes and which factor is the most important at any specific time. The Dubai crude price has risen above $110/barrel again, while the Brent price has remained in a particularly high range. In Japan, oil and liquefied natural gas have increased their weight in total primary energy supply and demand and in electricity generation since the March 2011 Great East Japan Earthquake. For Japan that has substantially increased its dependence on oil and LNG in making up for a sharp fall in nuclear power generation, changes in the future international oil market and crude oil price are a major matter of concern in analyzing crude oil import prices and LNG import prices linked to crude prices.

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