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# Crude Oil Prices Rising under World Economy Pleased with Stock Market Upsurge

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

Moves to which we must pay attention are emerging in the world economy and markets in general. Since the turn of the year, a global stock market upsurge has emerged rapidly. The Dow Jones Industrial Average on the New York Stock Exchange rose beyond 13,100 late last year from levels below 13,000 in November and continued an upward trend in January. On February 1, it climbed beyond 14,000 to a 64-month high of 14,009, only about 150 points shy of the all-time high of 14,165 as recorded in October 2007 well before the September 2008 Lehman Shock.

The stock market upsurge has not been limited to New York. Japan's 225-issue Nikkei stock average soared to 11,191 on February 1, reaching a 22-month high exceeding levels just before the March 2011 Great East Japan Earthquake. The Nikkei rose for the 12th consecutive week, recording the longest winning streak since the record 17-week streak logged during Japan's longest ever economic expansion around 1960. Stock prices have also risen in China (Shanghai) and Europe. Although the paces of stock price hikes are mixed, stock market gains have become a global trend.

It may be needless to say that global monetary easing has been behind the stock market upsurge. The U.S. Federal Reserve offered its third quantitative easing program, known as QE3, last September, earlier than expected by market players, vowing to continue the easing program unless substantial improvements are seen in the employment outlook. After a new government led by Prime Minister Shinzo Abe in Japan gave priority to bold monetary easing as a key policy to overcome deflation, the Bank of Japan Policy Board decided on its monetary easing program with an inflation target put at 2% at its policy-setting meeting on January 22. Monetary easing has also continued in Europe amid credit fears. Large-scale monetary easing has continued globally, providing massive liquidity.

Under such circumstances, the European situation remained stable on the surface from late last year to early this year. In the United States, Congress achieved a compromise to avoid the so-called "fiscal cliff." The Chinese economy sees signs of an end to a slowdown that lasted throughout 2012. The inauguration of a new government in Japan has led to growing expectations and hopes that deflation could be overcome. Events exerting great impacts on a sense of market risks in a direction to reduce risk sentiments have been accumulated within a short period of time. Expectations of a global economic recovery and ample liquidity provisions have been coupled with changes in a sense of risks to change global money flow and bring about the recent stock market upsurge.

The upturn in global economic sentiment and money flow into risk assets have been coupled with real changes in market fundamentals to naturally cause changes in the crude oil futures market. The West Texas Intermediate benchmark crude oil futures price in New York rose beyond $90/barrel in late December after remaining below the mark and continued an upward trend in January, standing at $97.77/barrel, close to $100/barrel, on February 1. The Brent futures price, which has become a more influential benchmark than the WTI, came to $116.8/barrel, a little shy of $120/barrel.

As well as economic and financial factors, oil supply and demand changes have also made great contributions to crude oil price hikes. The International Energy Agency in its monthly oil market report for January 2013 revised its global oil demand projection for 2013 upward by 240,000 barrels per day from its previous monthly report. The revision reflected global economic sentiment changes and a demand growth recovery in China. Although the IEA in the January report raised its non-OPEC oil production estimate as well as the oil demand projection in consideration of a rise in U.S. tight oil output, the enhanced anticipation of demand growth may naturally exert some impact on market views. A production cut by the Organization of Petroleum Exporting Countries, based on a looser 2013 oil supply-demand balance as expected dominantly as of late last year, has also contributed to tightening the supply-demand balance more than expected earlier. The IEA report estimated the 12 OPEC countries' crude oil output in December at 30.64 million bpd, down 0.26 million bpd from the previous month. While any estimate for January has yet to be given, market players have suspected that OPEC has continued its stance to restrain crude oil output.

Late last year, I forecast an average price in 2013 of $105/barrel (plus or minus $10/barrel) for the Brent futures and $90/barrel (plus or minus $10/barrel) for the WTI futures under a reference case covering moderate demand growth, a steady rise in non-OPEC oil output and OPEC's possible production adjustment. Under the higher price scenario where the supply-demand balance would tighten on a faster-than-expected global economic recovery, I predicted the Brent futures at $115/barrel and the WTI futures at $100/barrel. Developments in the past month indicate that actual prices came between the reference and higher price scenarios. As a matter of course, the past month's developments alone cannot be used for anticipating future developments. Depending on whether the expectations for economic recovery symbolized by the stock market upsurge will grow further or whether the expectations turn out to be real, market views and actual fundamentals may change greatly. An attention-attracting point of the current crude oil price hikes is that geopolitical and supply risks have had little impact on the oil market. We must take note of the possibility that risks including those linked to the Middle East situation could emerge in the future.

As the restart of nuclear power plants in Japan still remains uncertain, Japan is likely to continue to be heavily dependent on fossil fuel imports in 2013. Under this situation, the crude oil price trend has become an important issue that affects not only oil procurement costs but also prices of liquefied natural gas, now a main source of electricity in Japan. As the dollar has risen beyond 92 yen and is expected to rise further against the Japanese currency under the so-called Abenomics policy, the dollar-denominated crude oil price hikes may be coupled with the dollar's appreciation to substantially inflate Japan's yen-denominated energy procurement costs. In 2012, Japan posted a record trade deficit of 6.9 trillion yen on a substantial increase in fossil fuel imports. Massive national wealth outflow and energy cost hikes could drag down the Japanese economy that is growingly expected to recover. In this sense, the future course of crude oil prices is likely to exert a great impact on the Japanese economy. We must closely watch future developments.

Contact: report@tky.ieej.or.jp

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