Special Bulletin

A Japanese Perspective on the International Energy Landscape (136) July 2, 2013

2013 January-June Average Price at $107.9 for Brent and $94.3 for WTI

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

The daily closing levels of the front-month futures price averaged $107.9/barrel for the benchmark Brent crude oil and $94.3/barrel for the other benchmark brand of West Texas Intermediate in the January-June period this year. Compared with $113.6/barrel for the Brent and $98.1/barrel for the WTI in the same period last year, they were slightly lower. But they can still be viewed as having remained high. Global crude oil market realities lead us to see that crude oil prices remained above $100/barrel in the first half of 2013 as well.

During the period, the Brent futures peaked at $118.9/barrel and bottomed at $97.7/barrel, deviating upward and downward by around $10/barrel from the average. Its quarterly average fell from $112.6/barrel in the first quarter to $103.4/barrel in the second, indicating a gradual downward trend.

While there may be various factors behind the price trend, a key factor may be a change in sentiments about the global economy. At the beginning of 2013, expectations of an economic recovery in the United States and Japan and China's signs of bottoming out exerted upward pressures on crude oil prices. In the second half of the six-month period, however, expectations of an economic recovery in major countries grew uncertain, imposing downward pressures on crude oil prices. Particularly, a major contribution to the pressures has come from various destabilizing factors emerging in China that has driven growth in global demand for oil (and other commodities).

Another key point in the first half of this year might have been a change in the relationship between stock and other financial markets and crude oil prices, which has attracted attention from oil market participants throughout the world over the past years. The Dow Jones industrial average on the New York Stock Exchange rose from levels just above 13,000 early this year to a record high above 15,000 in May. Later, the average seesawed amid wild global stock market fluctuations. The stock market upsurge since the beginning of this year has coincided with a downward trend of crude oil prices, causing the oil price trend to deviate from the stock market trend. One factor behind the deviation might have been that oil market participants focused their attention on market fundamentals rather than financial factors.

The first fundamental factor is that oil supply has basically remained abundant and sufficient in the international market. Second, growing uncertainties on expectations of a global economic recovery and fears of China's economic slowdown have made oil demand projections bearish, as noted above. Third, non-OPEC oil production has been firm as unconventional oil production in the United States has substantially increased. Fourth, risk premiums on oil prices have declined as Iranian problems (including the impact of economic sanctions and possible military options) and other geopolitical factors faded away after driving up the oil market until the first half of last year. These fundamental factors might have exerted influences on crude oil prices.

What will the international oil market be like in the future after the abovementioned trend in the first half of this year? In anticipating the international oil market in the second half of this year, we may have to take into account various uncertain and destabilizing factors and possible crude oil price fluctuations to be caused by these factors. Destabilizing factors include not only those exerting downward pressures on oil prices but also those imposing upward pressures.

As factors to drive up oil prices, we may have to pay attention to geopolitical factors. In Iran, Hassan Rohani, a moderate conservative, has been elected president, indicating that the Iranian government may seek to have dialogue with Europe and the United States over its nuclear development problem in the immediate future. In this sense, tensions are likely to fall short of growing as far as Iran is concerned. But the Middle East situation is generally destabilizing. Geopolitical tensions regarding Syria, Egypt and Turkey have grown in the aftermath or prolonging of the Arab Spring democratic movement. Even in Iraq that has smoothly expanded oil production, the security situation has been remarkably deteriorating due to terrorists attacks. Destabilization in the Middle East including Iraq may affect the region's oil supply. Deterioration in the Middle East situation, though depending on the degree and scale, will remain a key factor in anticipating the future international oil market.

But I expect that downward pressures on crude oil prices may attract more attention in the immediate future. No decline can be expected in U.S. light tight oil production that has continued robust growth. The International Energy Agency has projected that U.S. oil output will increase by 0.84 million barrels per day in 2013 after expanding by 1.03 million bpd in 2012. While global oil demand is decelerating, the United States, known as the largest oil consumer and importer in the world, is expected to reduce oil imports due to its own oil output expansion and consumption reduction. This trend is likely to have a great impact on the oil supply and demand environment.

Uncertainties are growing over China that is the world's second largest oil consumer and importer. As rumors anticipate a Chinese economic crisis in July, oil market players are paying attention to various problems in the Chinese economy. As the new Chinese leadership headed by President Xi Jinping has been expected to shift priority from growth to reforms, bearish projections have emerged about Chinese demand for oil and other commodities. In addition, "shadow banking" and other structural Chinese economic problems are now expected to emerge or deteriorate, making the future course of the Chinese economic bubble problem more uncertain. After China's demand expansion had been driving up global demand for energy and other resources including oil until recently, these structural problems' deterioration is likely to greatly shake the market. As a matter of course, the Chinese government may make utmost efforts to prevent such deterioration and minimize these problems' impact on its economy. Nevertheless, we may have to keep close watch on Chinese factors in anticipating the future international oil situation or the overall global energy situation.

Contact: report@tky.ieej.or.jp
The back issues are available at the following URL
http://eneken.ieej.or.jp/en/special_bulletin.html