

Coexistence of Substantial Middle Eastern Confusion and Low Oil Prices

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On December 2, the benchmark West Texas Intermediate oil futures slipped below \$40 per barrel to \$39.94/bbl, the lowest since August 26. The key WTI futures, which rose back above \$41/bbl the next day, has remained low below \$43/bbl since early November. Behind the slack oil prices have been a sense of oversupply overshadowing the market and an inventory increase as an observed oversupply, as well as future negative factors such as the effects of Iranian crude oil's expected comeback to the international oil market and a possible U.S. interest rate hike, etc.

When looking at the overall international situation apart from crude oil market supply-demand fundamentals, however, we see important security and geopolitical events that could shake the world and boost oil prices. On November 13, terrorist attacks in Paris left more than 130 people dead. France declared a state of emergency, making counterterrorism and security the government's top priority. In response to the terrorist attacks, France expanded bombing on the Syrian city of Raqqa, known as a base for the Islamic State group that claimed responsibility for the Paris attacks. Europe-wide efforts came to enhance cooperation in fighting against terrorism and the IS group. The United Kingdom launched bombing on IS militants in Syria, after acquiring parliamentary approval on December 2.

The background for these developments includes the confused Syrian and Iraqi situations and IS militants' operations throughout these countries. Even before the Paris terrorist attacks, multinational forces led by the United States had implemented and enhanced bombing on IS strongholds. They had fallen short of containing IS militants while Syrian government forces and IS militants continued a back-and-forth ground battle. On September 30, Russia launched Syrian bombing, joining the fight against IS terrorists. But Western countries claimed that Russia's bombing targets included non-IS rebels confronting Syrian President Bashar Assad, indicating a complicated situation in which Western countries were not necessarily united with Russia to fight against terrorism. On November 1 after Russia participated in bombing Syria, a Russian airliner crashed following its departure from Sharm el-Sheikh International Airport in Egypt, killing 224 passengers and crew members. The Russian government attributed the crash to a terrorist attack on November 17 and expanded retaliatory bombing on Syria.

In an event that complicated the situation further, Turkey shot down a Russian military aircraft. On November 24, Turkish Air Force fighters shot down the Russian bomber, alleging that the Russian military aircraft intruded into Turkish airspace. Turkey claimed that the Russian bomber violated Turkish airspace and that the Turkish fighters gave warnings before shooting down the Russian military aircraft. But Russia denied the Turkish claim, leading to rapid escalation of their tensions. Russia on November 28 imposed economic sanctions on Turkey, including a trade embargo on certain products (including farm products) and restrictions on traveling. Russia escalated its criticism of Turkey, asserting that Turkish President Tayyip Erdogan and his relatives were smuggling oil from the IS. President Erdogan immediately denied the smuggling and vowed to resign if his alleged smuggling is proven. The blaming game between Russia and Turkey could lead to greater tensions between Western countries and Russia, bringing a very complex factor into what should be concerted efforts to address terrorism, IS and Syrian problems.

As the Syrian and Iraqi situations are confused amid continued bombing on IS strongholds, relations are growing more complicated among Western countries, Russia, Turkey and Middle Eastern countries including Persian Gulf nations like Saudi Arabia and Iran. As Syrian and Iraqi problems remain unsolved and are deteriorating, massive refugees from these countries are flowing into Europe. Hundreds of thousands of refugees have flowed into Europe so far this year. Even in Germany that has positively accepted refugees from the humanitarian viewpoint, the massive refugee inflow has become a great social problem. Furthermore, security concerns are growing in regard to the acceptance of refugees as participants in the terrorist attacks in Paris included people who flowed into France as refugees. The confused Middle Eastern situation has caused serious security problems in the whole of Europe including Turkey.

Usually, it would not be strange for the emergence and spread of such grave or serious geopolitical risks and international tensions involving the Middle East as the gravity center of global oil supply to exert influences on the crude oil market as a price-boosting factor. In fact, however, these geopolitical risks or international tensions have had no significant effects on oil supply from the Middle East. A persuasive explanation would be that such risks or tensions may have no effect on crude oil prices unless they affect oil supply. But price predictions on the futures market are always sensitive to market psychology or speculations. Rather, I think that the current sense of oversupply is too strong to be affected by geopolitical risks in the Middle East. This means that geopolitical risks in the Middle East that do not have real adverse effects on oil supply cannot become market-moving factors in the current market environment. Serious tensions and geopolitical risks in the Middle East can coexist with low crude oil prices in such environment.

What factors would change the current situation? First, a fading sense of oversupply in the international oil market could change the situation. While oversupply is expected to remain for the immediate future, some people note that supply and demand are being rebalanced. As the Middle Eastern confusion is expected to remain over a long term, we may have to pay attention to the future

oil supply and demand environment. Another factor may be that Middle Eastern geopolitical risks would exert real adverse effects on oil supply, although such factor is not seen now. It may be difficult to predict how and when these risks would begin to affect oil supply. But we cannot necessarily expect that these risks will have no influence on the market as in the past. At a time when geopolitical risks and international tensions in the Middle East are complicated, how Saudi Arabia and Iran that hold the key to oil supply and policy in the Middle East would develop their relations would also be significant for analyzing the future Middle Eastern situation and oil problems. We may have to pay close attention to such development.

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