Brent Topped $70/bbl Temporarily

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

Crude oil prices are rising remarkably. On January 11, the key Brent futures price hit an intraday high of $70.05/bbl. It closed the day at $69.26/bbl, rising for the fourth straight trading day though falling short of ending above $70/bbl. The Brent futures price topped $70/bbl briefly for the first time in three years and one month since early December 2014. On the same day, the key West Texas Intermediate futures price closed at $63.80/bbl, the highest in three years and one month, approaching $65/bbl.

What happened to crude oil prices? Has the situation changed really? Energy stakeholders are now interested in these questions. In a crude oil price fall that started in the second half of 2014, Brent slipped below $70/bbl in December of the year as noted above and remained slack for more than three years. In 2017, the average price stood at $54.7/bbl for Brent and $50.9/bbl for WTI, falling short of exceeding $55/bbl as an average. However, Brent hit the year’s low below $45/bbl in June and gradually and basically crept up before rising back above $60/bbl in late October for the first time in two years and three months. At last, it is reaching $70/bbl.

There are various factors behind the recent oil price hikes, which have been combined to push up oil prices. Basically, however, a market change toward a supply-demand equilibrium is important, symbolized by declining oil inventories. Inventories have declined on firm growth in global oil demand and OPEC and non-OPEC oil producing countries’ coordinated production cut that started in the beginning of 2017. OECD oil inventories declined to 2.94 billion barrels in October 2017 after standing at 3.07 billion barrels, far above the past five-year average in January 2017. They might have fallen toward the end of 2017. Even though oil inventories are still higher than the past average, the market has undoubtedly gone in the direction of a supply-demand equilibrium.

In addition, some new important factors have been influencing the oil market since the second half of last year. First, they include geopolitical risks. Behind Brent’s rebound above $60/bbl were tensions involving the Kurdish situation in Iraq. Later, many royal family members and cabinet ministers were arrested and detained in Saudi Arabia and protests came against U.S. President Donald Trump’s recognition of Jerusalem as the capital of Israel. These events to increase geopolitical risks in the Middle East shook the oil market. Late last year, large-scale anti-government rallies occurred in Iran, attracting global attention. These geopolitical risks have not necessarily exerted direct influence on oil supply in the region. Geopolitical risks in the Middle East as a global oil supply center, though having failed to attract attention from market players amid oversupply in the past few years, have been importantly recognized as factors pushing up crude oil prices in a run-up toward a direction for supply-demand equilibrium.
Market players have become sensitive to events affecting oil supply, including an oil supply decline (about 100,000 bpd) caused by an oil pipeline bombing in Libya late last year and a production decline (about 200,000 bpd from the middle to the end of 2017) in Venezuela amid economic and social destabilization under heavy inflation. The market has grown more alert to destabilization in the Middle East and other major oil producing regions and its impact on oil supply.

Second, expectations of continuously robust global economic growth have exerted influence on the market. The International Monetary Fund has forecast global economic growth to accelerate slightly from 3.6% in 2017 to 3.7% in 2018. In addition, the U.S. economy has been growingly expected to gain momentum on the enactment of a massive tax cut bill late last year after sustaining firm growth. As a matter of course, greater global economic growth can accelerate oil demand growth. As oil supply is expected to expand in 2018 on a shale oil production increase as discussed below, whether oil inventories will decline in 2018 as seen in 2017 is difficult to predict. In any case, however, expectations of economic growth acceleration may be supporting and pushing up oil prices.

In the United States, particularly, stock price hikes have accelerated in a manner to reflect expectations of tax cut effects, contributing to raising expectations of economic growth. The Dow Jones industrial average on the New York Stock Exchange rose above 25,000 in the beginning of 2018 and increased to 25,575 on January 11. Stock price hikes have been seen not only in the United States but also in other countries including Japan, indicating that the global economy has made a good start in 2018. In addition to economic growth, record U.S. cold waves and other severe winter conditions in major countries have contributed to boosting oil demand and pushing up oil prices.

Third, a financial factor is pushing up oil prices amid robust economic growth and global stock market hikes. Continuous stock price hikes have led to a “risk-on” market environment in the world, encouraging investors to pour money into crude oil futures and other relatively “higher risk” assets. On the New York crude oil futures market, the latest net buying by “non-commercial” traders including speculators reached an unprecedentedly high level well above $600 million barrels equivalent. Behind the money inflow into the oil futures market is a complex combination of moves toward an oil supply-demand equilibrium, growing geopolitical risks and their influence. Various factors involving the oil market have been combined to bring about oil price hikes so far.

While the international oil market faces this new situation, it is uncertain whether crude oil prices will remain at current levels or rise continuously. In this respect, we must pay attention first to oil supply growth resulting from price hikes. Particularly, how U.S. shale oil production will be accelerated is attracting attention. Shale oil production features short investment cycles and increases several months after oil price hikes. U.S. oil production growth in 2018 is estimated at about 1 million bpd or more. How the growth would accelerate on the recent oil price hikes will greatly influence the future supply-demand balance in the world oil market.

Another focus of attention is how many “bubbly factors” are among those supporting oil price hikes at present. If there are any “bubbly factors”, the problem may be how long such factors would be sustained. One such factor is the stock market upsurge. Some analysts are alert to the future course of stock prices. Some development could prompt money to flow out of the current
“risk-on” market, into which money is now flowing, exerting great influence on oil prices. We should closely watch future developments in the global economy and international financial markets.

As a matter of course, we must not forget the current market situation in which oil price hikes could accelerate in the event of faster global economic growth or the emergence and deepening of geopolitical risks or oil supply disruptions. Any change in the market situation and its direction are attracting much attention.

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