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Will International Oil Market Rebalancing Make Progress in 2018?

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Since a crude oil price crash in the second half of 2014, the international oil market has seen various changes, with oil prices continuing wild fluctuations. In the beginning of this year, crude oil prices rose back above $70 per barrel for the first time in 37 months, leading some market players to temporarily expect a full-blown uptrend. In response to wild stock market fluctuations in February, however, the uptrend took a pause, with oil prices remaining in a $60-70/bbl range. Behind such oil price fluctuations, various factors have worked, including Middle Eastern and other geopolitical risks, global economic trends and financial market trends. However, the most important factor is the trend of global oil supply and demand fundamentals.

In this respect, the most important question to ask is whether, how quickly and to what extent rebalancing, or the reduction of oversupply, will make progress in 2018 and beyond. The reason oil prices rose above $70/bbl in the beginning of this year after averaging in a $50-55/bbl range in 2017 is that the reduction of oversupply made steady progress in 2017. How will oil prices move this year? Let me consider this question based on a monthly “Oil Market Report” released by the International Energy Agency on March 15.

First, demand, the most important factor for the market and supply-demand balance, is still expected to robustly increase in the world. The IEA forecast global oil demand in 2018 at 99.3 million barrels per day, up 1.48 million bpd or 1.5% from the previous year. The forecast was revised upward from the previous month, indicating robust oil demand growth under the assumption of a firm global economy. The impact of a U.S. stock market plunge and a global stock market decline in the first half of February is not discounted into the IEA forecast. The U.S. or global economy is still expected to grow. Robust oil demand has potential to tighten the oil market supply-demand balance and support crude oil prices.

However, the problem is that oil supply growth is outpacing demand growth due primarily to a strong supply expansion by oil producing countries outside the Organization of the Petroleum Exporting Countries. The IEA projected non-OPEC oil production in 2018 at 59.92 million bpd, up 1.79 million bpd from the previous year. The projected supply growth exceeds the forecast demand growth. By country, the United States accounts for as much as 1.51 million bpd of the projected supply growth, followed by 290,000 bpd for Canada, 140,000 bpd for Brazil and 100,000 bpd for the United Kingdom. The United States and Canada in combination thus command almost all of the non-OPEC supply expansion. North America including the United States is driving non-OPEC oil production growth. In contrast, other non-OPEC oil producing countries are predicted to keep production flat or reduce it. Thus, U.S. oil production including shale output is expected to post remarkably outstanding growth. How U.S. oil production will increase is thus expected to exert great influence on the global oil supply-demand balance or crude oil prices.

Incidentally, my recent talks with experts on oil market in the world have led me to feel that a growing number of experts are estimating U.S. shale oil production growth potential at higher levels, while great uncertainties are still lingering. Shale oil production has been increasingly, if not dominantly, expected to expand not only over a short term but also over a medium to long term. Actual developments regarding U.S. shale oil production will be a key point for predicting the oil supply-demand balance and crude oil prices over a medium to long term.

Crude oil price hikes in the beginning of this year are important for predicting U.S. shale oil production over a short term or in 2018. While the benchmark West Texas Intermediate crude price rose above $66/bbl temporarily and averaged around $63/bbl in January and February, shale oil producers reportedly conducted hedging. Even if crude oil prices weaken from now on, hedging may make it easy for them to keep and expand production.

The call on OPEC, or OPEC crude oil supply required to balance supply and demand in the global oil market, is calculated by subtracting non-OPEC oil production and OPEC natural gas liquid (NGL) supply from global oil demand at 32.4 million bpd for 2018, down 400,000 bpd from 32.8 million bpd for 2017. NGL is exempted from OPEC production quotas. The call on OPEC for balancing global supply and demand is set to decline this year. Actual OPEC crude oil production in 2017 stood at 32.3 million bpd, 500,000 bpd less than the call on OPEC at 32.8 million bpd for the year. This is the reason the supply-demand balance tightened with global oil inventories shrinking in 2017.

How will actual OPEC oil production change in 2018 as the call on OPEC decreases from the previous year? How will the 2018 supply-demand balance be in 2018? The result will determine the state of rebalancing. If OPEC produces 32.5 million bpd to meet its production limit, OPEC output would slightly exceed the call on OPEC, leading to an inventory increase instead of progress in rebalancing. If OPEC production remains unchanged from 2017 at 32.3 million bpd, inventories will continue a slow downtrend. In this sense, the future OPEC oil production trend will attract much attention.

According the IEA, OPEC crude oil production stood at 32.17 million bpd in January and at 32.1 million bpd in February, slipping below the production limit of 32.5 million bpd. However, the production levels are almost equal to the call on OPEC at 32.1 million bpd for the first quarter of 2018 (not for the whole of the year), indicating a delicately matching supply-demand balance. Production cuts in such OPEC member countries as Venezuela are a key point for analyzing present OPEC production. Venezuelan crude oil production declined to the recent level of less than 1.6 million bpd from more than 2 million bpd in the beginning of 2017 due to prolonged economic and social unrest. While some other OPEC members are reducing production slightly, most OPEC members are keeping their production unchanged or increasing it slightly. Attention would have to be paid to whether or how quickly Venezuela would reduce production further and whether problems would arise with oil production in Libya and Nigeria that are actually increasing output in the recent months. Meanwhile, an interesting point is what policy or strategy OPEC will adopt as the United States that OPEC must view as its strong rival expands its global market share. Another major factor exerting great influence on rebalancing would be whether or not, and how OPEC and some non-OPEC oil producing countries may extend or revise their oil production limit in response to future oil price changes.

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