International Oil Market Shaken by “Ghost of Jakarta”

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Crude oil prices have seesawed since early August. The front-month futures contract price has remained in a relatively narrow range of $65-69 per barrel for West Texas Intermediate or $70-75/bbl for Brent. In a sense, this trend indicates that crude oil prices have restored some level of “stability” at relatively lower levels than the higher prices seen in May.

As a matter of fact, the May highs came on the United States’ announcement to withdraw from the Iran nuclear deal and relevant developments. Particularly, Brent briefly topped $80/bbl as the United States signaled a tough stance by asking major countries importing Iranian crude oil to cut Iranian oil deliveries to zero. In a bid to deter further oil price hikes and stabilize the international oil market by making up for a decline in Iranian oil exports, the Vienna Group oil producing countries including the Organization of the Petroleum Exporting Countries and Russia decided to effectively increase production at their meetings in June. The decision can be taken as leading the market to restore stability for the immediate future.

The supply-demand balance on the international oil market could tighten depending on uncertain factors such as how far Iranian crude oil exports or Venezuelan oil production would decline and whether there would be disruptions to oil supply from other major oil producing countries. Even if OPEC, including Saudi Arabia, increases production to cover such supply drop, Saudi Arabia’s surplus production capacity, an indispensable supply buffer for oil market stability, may decrease greatly. Such decrease could be combined with growing geopolitical risks in the Middle East to push up crude oil prices sharply.

However, recent oil price trends apparently include developments indicating a price fall risk as well as a price hike risk. While OPEC and other oil producing countries have vowed to increase production, the global economy is feared to slump on trade war deterioration, leading oil demand growth to decelerate. As a result, the supply-demand balance on the international oil market could ease sharply, pushing down oil prices. Market players are apparently growing conscious of such scenario.

The combination of OPEC production expansion and oil demand growth deceleration through global economic deterioration has been seen before. In November 1997, for example, OPEC expanded its production quota by 2.5 million barrels per day while the Asian economic crisis triggered by the Thai baht’s plunge was expanding. In 1998, the crisis spilled over to Russian and Brazilian economies, plunging the global economy into serious stagnation. As a result, annual global oil demand growth decelerated rapidly from 2.1 million bpd (3.0%) in 1997 to 0.4 million bpd (0.5%). Then, crude oil prices slipped below $10/bbl and remained low throughout 1998.

As a matter of course, the world economy and international oil market at present differ
from those in the 1997-98 period. No simple comparison can be made. Nevertheless, it is important that the combination of oil producing countries’ production expansion with global economic deceleration and oil demand slump can exert strong downward pressure on crude oil prices. At a time when we have no choice but to be conscious of global economic deterioration due to escalating trade wars between major economies such as the United States’ trade dispute with China or the European Union, the world can be interpreted as being haunted by the “Ghost of Jakarta”, a trauma from 20 years ago. We also remember that after Saudi Arabia and other oil producing countries at their meeting in Jeddah in June 2008 decided to increase production to hold down crude oil prices rising beyond $100/bbl then, the Lehman Shock came in September 2008, triggering a global recession that led crude oil prices to plunge below $40/bbl.

At present, the World Economic Outlook of the International Monetary Fund forecasts global GDP growth at 3.9% for 2018 and 2019, indicating robust economic expansion. However, trade war deterioration is affecting market forecasts regarding economic expansion. Turkish economic deterioration amid Turkey’s recent confrontation with the United States has also become a matter of concern to market players.

However, market players are focusing attention on China’s economic trend. The escalating U.S.-China trade war has increased concerns about the future course of the Chinese economy. The IMF predicts China’s economic growth to gradually decelerate from 6.9% in 2017 to 6.6% in 2018 and 6.4% in 2019. The trade war could work to further decelerate the Chinese economic growth. In fact, the Chinese yuan has been depreciating against other currencies, with the Shanghai stock index hitting a 31-month low. As the Chinese economy is expected to decelerate growth, copper, zinc and other nonferrous metal prices being affected by such deceleration have been declining, prompting market players to grow sensitive to future Chinese economic developments.

If U.S. President Donald Trump levies an additional 45% tariff on Chinese products amid trade war deterioration in line with his presidential election campaign commitments and China counters with a retaliating action, economic growth could be cut by 0.6 percentage points for the global economy, by 2.1 points for the United States and by 2.9 points for the Chinese economy, according to an analysis by the Institute of Energy Economics, Japan. If Chinese economic growth is halved from the IMF-forecast level, it may have great impacts on copper and other nonferrous metal prices, commodity prices in general and crude oil prices. The abovementioned IEEJ analysis indicates that oil consumption would decline by 300,000 barrels per day in China and by 200,000 bpd in the United States. The combined oil consumption decline would come to 500,000 bpd, indicating a great impact given that the International Energy Agency predicts global oil demand growth in 2019 at about 1.4 million bpd.

As global economic risks are growing, oil market players have no choice but to be prepared for downside risks for crude oil prices. Particularly, Saudi Arabia and other OPEC countries have no choice but to pay attention to global economic and oil demand trends after their decision to expand production. Their future policy and response management are growing more difficult. While a potential scenario indicates substantial oil oversupply and rapid oil price falls depending on future developments, oil prices can be expected to spike depending on Iranian and other geopolitical risks in the Middle East. Market players are thus required to address a complex, uncertain situation. While being conscious of the “Ghost of Jakarta”, Saudi Arabia and other OPEC countries will have to accurately foresee the future course of the international oil market and prudently adjust their

1 Bloomberg, August 19, 2018
production policy. Oil consuming countries as well will have to foresee the future course of the market and take prudent, strategic responses to future developments.

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