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WTI Slips below $60/bbl on Inventory Increase and Economic Deceleration Risk

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Oil market players' perceptions about prices have turned around in the past one month. The benchmark Brent crude futures price rose above $80 per barrel in late September and hit this year's high of 86.29/bbl on October 3. Then, market participants were strongly conscious of the possibility of Iranian crude oil exports declining substantially on the United States' revival of Iran economic sanctions following its withdrawal from the Iran nuclear deal. The possibility was combined with other growing Middle Eastern geopolitical risks to push up crude oil futures prices. Then, the Brent futures price was widely expected to rise beyond $90/bbl to close to $100/bbl.

On October 18, however, the Brent futures price slipped below $80/bbl. It fell below $70/bbl on November 13 and hit this year's low of $62.53/bbl, the lowest in 11 months, on November 20. Following a similar trend has been the West Texas Intermediate futures price that is $5-10/bbl lower than the Brent price due to the infrastructure bottleneck amid the expanding shale oil production. The key WTI futures price hit this year's high of $76.41/bbl on October 3 before turning down and dropped below $60/bbl on November 12. On November 20, it sank to this year's low of $53.43/bbl. Both the Brent and WTI futures prices plunged by more than $20/bbl or 30% from their respective peaks in October.

What have the factors been behind such rapid changes? They include the current oversupply indicated by increasing oil inventories and the risk of future global economic deceleration.

As for the current oversupply or the easing supply-demand balance, market participants are interested in the fact that while global oil demand is firmly increasing, supply is growing even more rapidly. According to the latest oil market report by the International Energy Agency (IEA), global oil demand in 2018 is expected to post a steady increase of 1.3 million barrels per day (bpd) from the previous year. On the supply side, however, production by oil producing countries other than the members of the Organization of the Petroleum Exporting Countries (OPEC) in 2018 is projected to rise by 2.35 million bpd. Particularly, U.S. oil production is predicted to log a robust increase of 2.12 million bpd, accounting for most of the non-OPEC oil production growth. The annual growth would be the largest in the United States' long oil production history that started in the second half of the 19th century. U.S. shale oil production achieved cost cuts to increase its competitiveness during an oil price plunge from the second half of 2014 and has expanded rapidly on the back of price hikes from early 2018.

While U.S. oil production growth has far exceeded the global oil demand increase, OPEC oil production has recently expanded even under adjustment. The OPEC members' joint production cut with some non-OPEC oil producing countries since 2017 had been implemented more strictly than expected, resulting in their overcompliance with their supply-cutting deal. As a decline in Iranian oil exports became a focus of attention in the market following the United States' withdrawal from the Iran nuclear deal, however, OPEC at its meeting decided on an effective production increase, sending the market a message that the oil cartel would provide enough supply to the market. Production by 13 OPEC countries excluding Equatorial Guinea and Congo increased from the bottom of 31.56 million bpd in June to 32.58 million bpd, indicating a rise of 1 million bpd in four months.

As OPEC and non-OPEC oil production continued to increase substantially, the supply-demand balance began to ease. Oil inventories in the member countries of the Organization for Economic Cooperation and Development (OECD) continued to decline from January 2017 before hitting the bottom in June 2018 and turning upward later. OECD oil inventories continued increasing until September for which data have just become available. They might have retained an uptrend until now. Oil prices turned downward in October as market participants became strongly conscious that the supply-demand balance was going in the direction of loosening.

However, serious concerns about future global economic deceleration have exerted greater influence on market participants' perception than the loosening supply-demand balance. As noted in regard to the current supply-demand balance, global oil demand has been growing firmly. This trend is expected to continue in 2019. As the world economy grows by about 3.7% in 2018 and 2019, global oil demand in 2019 is expected to increase by 1.39 million bpd from the previous year, according to the IEA. The supply-demand balance is now loosening despite steady demand growth. If oil demand growth plunges on a global economic deceleration, oversupply may become even more serious.

Important in this respect are the potential escalation of the U.S.-China trade war and its adverse effects on the world economy. As far as oil demand growth is concerned, the potential deterioration of the Chinese economy now driving the oil demand growth may be significant. As the United States and China step up their confrontation, their trade war cannot be easily expected to be resolved. Their serious confrontation was demonstrated when the Asia-Pacific Economic Cooperation forum unprecedentedly gave up on compiling and releasing an APEC Leaders' Declaration due to the U.S.-China confrontation at an annual APEC summit that ended on November 18. In such situation, economic data indicating China's economic deceleration have been observed, leading analysts to pay attention to the future course of the Chinese economy. In a summer analysis this year, the Institute of Energy Economics, Japan, estimated that the maximum assumed adverse impact of additional tariffs through the U.S.-China trade war would push the Chinese economy down by 2.9% and China's oil demand by 300,000 bpd. In my recent talks with people close to oil producing countries, I felt that they were alert to similar risks regarding the global economy and the Chinese economy, as well as to oil demand growth deceleration.

We must also pay attention to unfavorable signs in the booming U.S. economy. As long-term interest rates increased in the United States, the New York stock market plunged several times this year in a manner to cause global stock market crashes. Earlier, the market had rebounded after crashes, limiting the crashes to short-term corrections. Oil market players are paying attention to whether the U.S. economy would remain robust, whether the present robustness indicates bubbles or whether bubbles would burst sometime.

On November 21, the OECD released a world economic outlook, revising projected economic growth rates for 2018 and 2019 downward by 0.2 percentage points to 3.5%. Such growth rate indicates cruising speed growth. However, any global economic growth slowdown steadily decelerates oil demand growth. Market participants' perceptions of future oil demand exert great influence on pricing in the oil futures market. While the United States has announced a 180-day waiver period for eight major oil importers from Iran to phase out oil imports from the Islamic republic in an oil embargo, future Iranian crude oil exports after the 180-day waiver period are left uncertain. Given such uncertainty and high geopolitical risks lingering in the Middle East, any optimism about the international oil market and crude oil prices in 2019 cannot be justified. We may have to be prepared to see very wide fluctuations of oil prices next year.

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