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Prospects for Future Oil/Energy Situation

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On February 6, an international panel discussion took place at Tokyo's Nikkei Hall on the future oil/energy situation, cosponsored by JXTG Nippon Oil & Energy Corporation, JX Nippon Research Institute, Ltd. and the Institute of Energy Economics, Japan. The panelists at the meeting were FACTS Global Energy Group Chairman Fereidun Fesharaki, U.S. Center for Strategic and International Studies Senior Vice President Sarah Ladislaw and the author. Nikkei Shimbun editorial writer Hirofumi Matsuo served as moderator. The 28th annual international panel discussion on the matter became a thriving meeting attracting more than 600 participants on a registration basis. The vigorous panel discussion covered supply/demand, financial and geopolitical factors behind wild crude oil price fluctuations from 2018, technological, policy and geopolitical factors influencing long-term oil supply and demand, short-term and medium to long-term prospects for the international oil market and natural gas problems mainly in the Asian LNG market. In the following, I would like to summarize the points that were particularly impressive to me at the panel discussion.

First, a mainstream prospect for the international oil market and crude oil prices over a short term was that if no major destabilizing factor arises, crude oil prices may rise with the supply-demand balance tightening moderately toward the second half of 2019. As supply and demand fundamentals, financial factors and geopolitical factors are very uncertain, it is very difficult to anticipate the direction of the international oil market. However, the mainstream prospect means that the supply-demand balance may moderately be tightened, given that Iran's oil exports may decline after the expiration of the 180-day waiver on the Iran oil embargo amid steady oil demand growth and the OPEC-plus oil production cut. As a matter of course, the market could be greatly affected, depending on the extent of U.S. shale oil production expansion or the emergence and escalation of global economic risks. No optimism can be warranted about future market conditions.

Second, an in-depth discussion came on the Iran issue among geopolitical risks seen as potential market-destabilizing factors. The U.S. Trump administration, though maintaining a tough stance against Iran basically, has made major changes to its Iran sanctions policy in a manner to shake the market. It requested major oil-importing countries to cut imports from Iran to zero before coming up with the 180-day waiver on the Iran oil embargo. The Trump administration's policy after the expiration of the waiver has been attracting attention, while the regional situation involving Iran has remained tense under strong U.S. political and economic pressure on the Iranian regime. As the high-level tensions are feared to trigger some geopolitical risks, we must keep close watch on the Iranian situation. In addition to the Iranian situation, the Middle East has many global attention-attracting issues including a rivalry between Iran and Saudi Arabia as well as those involving the regime and stability of Saudi Arabia. The United States' involvement or engagement in these problems is important.

Regarding the United States’ involvement in geopolitical risks, an interesting discussion came on Venezuela. The South American major oil producer has halved its oil production from more than 2 million barrels per day to around 1.2 million bpd amid political, economic and social unrest. As European and American countries have grown critical of dictatorial Venezuelan President Nicolas Maduro, U.S. President Donald Trump has indicated potential military intervention in Venezuela, leading the Venezuelan situation to grow more uncertain. In the panel discussion, participants reaffirmed that the future course of Venezuela would be very important for anticipating the future international oil market. Importantly, it was noted that as the protracted unrest has seriously affected the Venezuelan oil industry with experienced oil industry people being lost, the Venezuelan oil issue would take much time to be solved even after the possible resolution of the current political unrest.

Third, panel discussion participants were conscious that Asia has been the center of global oil and gas demand growth, including China whose oil and gas demand has great influence on the global supply-demand balance. The speed or scale of China’s future economic and energy demand growth attract global interest. As a significant factor affecting the growth, the U.S.-China trade war has become an urgent challenge. Under the recognition that the U.S.-China confrontation represents not only trade disputes but also structural clashes involving technological supremacy and other strategic problems, and global order, many people believe that it is difficult to expect bilateral structural talks to produce any easy solution during the 90-day truce. However, President Trump conscious of the approaching next presidential election and Chinese President Xi Jinping facing economic growth deceleration may be eager to avoid economic deterioration and could strike some “deal” for a soft landing over a short term. Future developments involving U.S.-China relations will continue to exert great influence on global order and on the international energy market.

Fourth, it was important that a view that market conditions in Asia including Japan would remain favorable in the immediate future for improving profit margins in the downstream oil sector was given at the panel discussion. Japan’s downstream oil market has dramatically changed as the operation of oil refining facilities has grown more efficient through industrial realignment. It is also important that oil refiners’ profit margins can be expected to improve further as the International Maritime Organization imposes regulations on the sulfur contents of shipping fuels in 2020. Given that Japan’s oil demand is likely to decline in a long run even amid positive prospects for the downstream oil sector, it was argued that appropriate industrial strategies for the future should be developed and implemented while the market environment remains favorable for the next several years. This means that the Japanese downstream oil sector should take advantage of the current good opportunity to get prepared for the next generation.

Fifth, how the long-term trend toward a low-carbon or decarbonized society would affect demand for natural gas as one of the fossil fuels is uncertain. Over a short or medium to long term, however, natural gas and LNG demand will continue robust growth mainly in Asia thanks to air pollution concerns, according to a dominant view at the panel discussion. China has been symbolically driving growth in natural gas demand. It replaced South Korea as the world’s second largest LNG importer in 2017 and is growingly expected to become the world’s largest LNG importer in place of Japan in the mid-2020s. A prospect given at the panel discussion was that the global LNG supply-demand balance will reach an equilibrium around 2020 following the present oversupply and tighten later as LNG demand expands in China, India, Southeast Asia and South Asia. However, such tightening may bring about the next investment boom and price hikes working to decelerate demand growth, leading to the next relaxation of the supply-demand balance. Given massive initial investment required for any LNG project, a boom and bust cycle is likely to be repeated. Amid such cycle, buyers and sellers in the LNG market must pursue truly sound development of the market.

In both oil and LNG markets, stakeholders will be continuously required to decide on policies, investment or procurement even amid an uncertain or unclear market environment. Prospects for the future oil and energy situation will remain important for the world and for Japan.

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