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Prospects for Future Oil/Energy Situation

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On February 5, an international panel discussion on the future oil/energy situation took place at Tokyo's Nikkei Hall, 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 I. Nikkei Shimbun editorial writer Hirofumi Matsuo served as moderator. The 29th annual international panel discussion on the matter was very vigorous, covering prospects for the oil market and prices in the immediate future, short- and medium-term outlooks on the natural gas market including the Asian LNG market, and long-term challenges regarding oil and LNG. In the following, I would like to summarize the points that were particularly impressive to me at the panel discussion.

On the first topic of prospects for the international oil market and prices in the immediate future, talks focused on geopolitical risks in the Middle East and global economic risks posed by the spreading new coronavirus pneumonia epidemic originating in China's Wuhan, which have shaken the international oil market since the beginning of the year. Regarding the Middle Eastern geopolitical risks, arguments were made from various angles about background factors behind short-lived oil price spikes triggered by large-scale oil supply disruptions following terrorist attacks on key oil facilities in Saudi Arabia last September and by growing military tensions following the United States' killing of Iranian Revolutionary Guard Corps Commander Qassim Suleimani in early January.

It was pointed out that the oil market recovered its stability thanks to Saudi Arabia's faster-than-expected restoration of 5.7 million barrels per day in oil supply disrupted by the terrorist attacks and to the avoidance of a full U.S.-Iran war in the absence of any U.S. counterattack responding to an Iranian retaliation against the U.S. killing of the Iranian Revolutionary Guard Corps commander. At the same time, abundant oil supply or market concern about oversupply was cited as another key factor behind the market's rapid stabilization following both oil price spikes. Regarding the factor of abundant oil supply, panel discussion participants pointed to U.S. oil production expansion that has driven sharp growth in oil production outside the Organization of the Petroleum Exporting Countries. These factors were intertwined to prevent growing geopolitical risks from excessively destabilizing the oil market. As a structural U.S.-Iran confrontation is left untouched, however, the Middle Eastern situation remains tense. We will have to closely watch how future geopolitical developments would affect oil prices depending on supply and demand fundamentals at the time of the next possible serious geopolitical problems and supply interruptions.

Shaking the oil market at present are global economic slowdown risks caused by the spreading new coronavirus pneumonia epidemic. By February 4, the new coronavirus infected more than 20,000 people, with no sign seen of any pause in the spread. Particularly, China including Wuhan has plunged into a serious situation that is expected to greatly affect the Chinese economy.

As China's economic growth in 2020 is well expected to slip below 6% from 6.1% in 2019, the new pneumonia epidemic is increasingly feared to reduce the growth to an even lower level. Given that any substantial fall in economic growth in China is destined to affect domestic stability, Beijing is increasingly expected to come up with a large-scale economic stimulus package. Until recently, China's energy demand expansion had been supporting oil and LNG markets. In response to the economic downside risks triggered by the new pneumonia epidemic, therefore, crude oil prices have declined rapidly. The front-month futures contract for the West Texas Intermediate crude oil declined below $50 per barrel on February 4. If oil prices decrease further, the OPEC-plus group may be prompted to further enhance joint production cuts. Chinese and global economic slowdown risks have become a focus of attention exerting great influence on the international oil market.

On the second topic of short- and medium-term outlooks on the natural gas market including the Asian LNG market, panel discussion participants discussed how long oversupply would last in the LNG market. A view given in the discussion was that oversupply would remain until the early 2020s due to ongoing LNG supply projects' entry into the production phase and last year's massive LNG project final investment decisions, despite growing demand. Important in this respect is the speed of Asia's LNG demand expansion that depends on economic growth, environmental regulations, LNG's price competitiveness and competition from other energy sources such as coal, nuclear, renewable energy, petroleum products and liquefied petroleum gas. Although Asian LNG demand is well expected to increase, the abovementioned downside risks for the Chinese economy may have to be viewed as having a great impact on the LNG market. The United States' growing presence as the driver of global expansion in LNG supply as well as oil supply also became subject to discussion. In this respect, interesting arguments were made about various factors influencing the shale revolution. As U.S. presidential election campaigns were gaining momentum, talks also covered whether U.S. President Donald Trump would be reelected and how U.S. energy and environment policies would change if a Democrat wins back the White House.

On the third topic of long-term challenges for oil and LNG, interesting arguments were made from various angles. Importantly, it was pointed out that as far as U.S. oil production continues to expand, downside pressure would structurally remain on oil prices, making it very difficult for the OPEC-plus group to control the international oil market. As indicated by history, the greater oil production cuts required to support prices are, the more difficult it is to control the market. Saudi Arabia unilaterally cut oil production by nearly 7 million bpd as a swing producer to control the oil market in the first half of the 1980s but gave up on market control in 1985 in a manner to prompt oil prices to fall sharply. Arguments at the panel discussion reminded me of such past developments. In this sense, talks in the panel discussion indicated that the key point would be how long the United States would continue expanding oil production.

Regarding long-term challenges, another focus of discussion was the fact that various uncertainties are emerging about the future of fossil fuels such as oil, gas, LNG and coal at a time when the world is in a new energy transition. As very ambitious climate change goals like a European goal of achieving "net zero" greenhouse gas emissions by 2050 are announced one after another, fossil fuels now accounting for more than 80% of global primary energy supply face foul wind and are feared to become "stranded assets" in the future. At the panel discussion, however, it was noted that a gap has emerged and is widening between aspiration about climate change goals and energy reality. An argument given in the panel discussion said that the gap is remarkable in Asia about to become the center of the global energy market, indicating how challenging it would be to balance economic growth with decarbonization in Asia. It was pointed out that progress in decarbonization would cause great challenges not only in Asia but also in resource-rich countries where fossil fuel exports now support economic growth. In this sense, it was discussed that Asia and resource-rich countries should use fossil fuels cleanly and sustainably from the viewpoint of the reality. One participant noted that innovations such as production of CO_2-free hydrogen from fossil fuels, carbon capture and storage, and carbon capture, utilization and storage would be important for sustainable use of fossil fuels and that how to realize low-cost energy transition through these innovations would be the key to the sustainable use. Even if efforts are made to reduce costs, however, costs would likely expand. Therefore, it would be important to get prepared to shoulder higher costs for the ongoing energy transition.

The future of international energy markets is filled with various uncertainties. Prospects for the future oil and energy situation will thus remain important in the future.

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