Brent fell below $50/bbl for 1st Time in 32 Months on New Coronavirus Expansion

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Crude oil prices have been plunging due to the expanding new coronavirus pandemic. On March 5, the key Brent futures contract on the London market declined by $1.14 per barrel from the previous day to $49.99/bbl, slipping below $50/bbl for the first time in 32 months, since July 24, 2017. On the same day, the key West Texas Intermediate futures contract also dropped by $0.88/bbl to $45.90/bbl.

Crude oil prices opened 2020 higher in response to the growing risk of a U.S.-Iran military clash. On January 6 when concern about the risk peaked, Brent hit the year’s high of $68.91/bbl. As the two countries were later expected to avoid any all-out military clash, however, oil prices restored stability and entered a downtrend due to an easing supply-demand balance in the international oil market.

The International Energy Agency, the Organization of the Petroleum Exporting Countries and many experts have forecast that non-OPEC oil production growth would exceed global oil demand growth in 2020. In its latest monthly oil market report, the IEA forecast that global oil demand in 2020 would increase by 0.83 million barrels per day while non-OPEC oil production expands by 2.05 million bpd due primarily to a U.S. production increase. Abundant (too abundant) oil supply is exerting downward pressure on oil prices. In a bid to support oil prices, the OPEC-plus group expanded their joint oil production cuts to 1.7 million bpd from January 2020. In such supply-demand environment, crude oil prices restored stability in the wake of the rise of geopolitical risks, with Brent falling below $60/bbl in late January.

Adding fuel to the downtrend are the expanding new coronavirus pandemic and subsequently growing global economic slowdown risks. The new coronavirus pandemic broke out in China’s Wuhan late last year and expanded mainly in the city before spreading throughout the world. The World Health Organization said the new coronavirus as of March 5 had infected 95,333 people (including 80,565 in China) and killed 3,282 people (including 3,015 in China). China and other countries have come up with various policies and measures to prevent the pandemic from expanding. At present, however, the expansion has remained unchecked.

In such circumstances, the Chinese economy was the first to be disrupted. The expanding pandemic in China known as the world’s factory has led to a general economic slowdown and stagnant private consumption in China, shaking the global economy. As Chinese economic growth and subsequent demand expansion supported the international oil market and other commodity markets in the past several years, China’s economic slowdown and demand deceleration are exerting great impacts on international markets. Market prices rapidly declined, as symbolized by Brent’s fall below $55/bbl in early February. As the OPEC-plus group’s possible enhancement of joint production cuts and an oil production decline in Libya plagued with its domestic destabilization were reported, however, oil prices’ fall seemed to stop. Since the last week of February, however, oil
prices have taken a plunge.

This is because the new coronavirus pandemic is feared to expand further to exert grave impacts on not only China but also the entire global economy. In a manner to symbolize the fear, the Dow Jones industrial average on the New York stock market continued plunging for seven trading days from February 20 after hitting a record high of 29,551 on February 12. It recorded the sharpest ever single-day decline of 1,191 points on February 27. On February 28, the index closed at 25,409, down 4,142 points or 14% from the record high. Even in the U.S. economy that has continued robust growth, concern has grown over deterioration to be caused by the new coronavirus pandemic. The Federal Reserve had no choice but to announce emergency interest rate cuts on March 3. Even after the rate cuts, however, the U.S. stock market remained unstable, repeating sharp rises and declines. On March 5, the Dow Jones average posted a steep fall of 970 points, leading Brent to slip below $50/bbl.

Forecast global economic growth rates have begun to be revised down. On March 2, the Organization for Economic Cooperation and Development released its latest outlook lowering the forecast global growth by 0.5 percentage points to 2.4% for 2020 due to the pandemic. The outlook cut China’s forecast growth by 0.8 points to 4.9%, warning that Asia linked closely to the Chinese economy would be greatly affected. Although the U.S. growth projection was lowered by only 0.1 points, the OECD outlook pointed out that the forecast global growth could be lowered further depending on future developments.

In this way, strong downward pressure on oil prices has emerged as the impact of the expanding pandemic has led to serious global economic slowdown risks. As a result, the OPEC-plus group, which consists of OPEC and some non-OPEC oil-producing countries such as Russia participating in the joint production cuts, has come under market pressure to enhance the production cuts.

On March 5, OPEC at its 178th meeting in Vienna considered the need for enhancing production cuts in view of the current supply-demand environment for the international oil market and the expanding new coronavirus pandemic’s impacts on the global economy. Based on its latest forecast that global oil demand growth in 2020 would be halved to 0.48 million barrels per day from 1.1 million bpd as projected last December, OPEC agreed to “recommend” OPEC-plus participants (1) to maintain earlier agreed production cuts totaling 1.7 million bpd until the end of 2020 and (2) to implement additional cuts totaling 1.5 million bpd (1 million bpd for OPEC and 0.5 million bpd for non-OPEC oil-producing countries) until the end of 2020.

As shown by a press release after the OPEC meeting, the agreement featured the “recommendation” of enhanced production cuts including the additional cuts totaling 1.5 million bpd. The agreement was strongly affected by Russia’s attitude of refusing to support the enhancement. Russia, which has been increasing oil production while nominally participating in the joint production cuts, is concerned that the enhanced production cuts to support oil prices would eventually benefit U.S. shale oil and lead Russia to see its market share shrinking. Although weak oil prices are unfavorable for its economy, Russia has remained negative about the additional production cuts under various strategic considerations. The OPEC-plus group has thus failed to agree on all participants’ commitment to the additional production cuts. Seemingly, however, the group has avoided any decisive breakup by refraining from announcing an agreement that clearly excludes Russia. The press release may be interpreted as indicating that OPEC including Saudi Arabia would take leadership in cutting production while retaining the spirit of the joint production cuts.
We must pay attention to future market developments indicating how the market would interpret or judge the OPEC-group meeting results. The status of the new coronavirus pandemic and its impacts on the global economy is changing. Depending on the pandemic’s future expansion and impacts, the oil market will be greatly shaken.