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Brent Closed above $70/bbl for the 1st Time in 2 Years

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On June 1, the front-month Brent crude oil futures contract rose by $0.93 per barrel to close at $70.25/bbl. The benchmark crude oil price rose above $70/bbl on an intraday basis in March, but closed above the level for the first time in two years since it finished at $70.11/bbl on May 28, 2019. As crude oil prices got back on a recovery track after their free fall under the COVID-19 pandemic in 2020, Brent rose back above $60/bbl in February. It later surpassed $69/bbl, approaching the $70/bbl level several times while falling short of closing above the level until the end of May. It topped the landmark level at last. The front-month futures contract on West Texas Intermediate also gained $1.40/bbl from the previous day to close at $67.72/bbl on June 1. WTI finished above $67/bbl for the first time in 31 months since it closed at $67.04/bbl on October 29, 2018.

There have been various factors behind the recent crude oil price recovery including Brent's rise above $70/bbl. The most important factors may be a global economic recovery and an oil demand increase. After plunging into the worst situation since the Great Depression due to the pandemic, the global economy got on a recovery path in the second half of 2020 thanks to unprecedentedly large economic stimulus packages implemented in major countries. Particularly, the United States and China have driven the global economic recovery. The International Monetary Fund projected global economic growth in 2021 at 5.5% in its World Economic Outlook in January but revised the projection upward to 6.0% in view of the latest economic recovery conditions. The Organization for Economic Cooperation and Development raised its global economic growth projection for 2021 from 4.2% announced in December 2020 to 5.6% in March and further to 5.8% on May 31. The two international organizations' upward revision of global economic growth projections for 2021 reflected growing hopes on an end to the COVID-19 pandemic through progress in vaccination and the emerging effects of major countries' economic stimulus packages.

As the global economy solidifies its recovery, global oil demand follows a steady uptrend after overcoming the worst phase under the COVID-19 pandemic. In its latest monthly oil market report (published in May), the International Energy Agency forecasts that global oil demand in 2021 would increase by 5.42 million barrels per day or 6.0% from 91.01 million bpd in the previous year to 96.43 million bpd. The forecast rise would fall short of offsetting an unprecedented decline of 8.72 million bpd or 8.7% in 2020. As the global oil demand recovery is gradually gaining momentum, however, global oil demand is increasingly expected to restore the pre-pandemic level in 2022. In the United States that leads the global economic recovery, gasoline demand is steadily growing ahead of the summer driving season, making oil market sentiment bullish. The global economic recovery and the subsequent steady increase in oil demand have turned around the supply-demand balance in the international oil market and led the market to go in the direction of equilibrium, pushing up crude oil prices.

As reiterated in this "A Japanese Perspective on the International Energy Landscape" report, we must pay attention to the fact that massive money provided to the market under powerful fiscal spending and monetary easing to stimulate economic activities has flowed into crude oil futures positioned as risk assets, supporting crude oil price hikes.

As global oil demand shows a steady recovery, we see attention-attracting oil supply developments. Excluding the substantial oil demand decline under the pandemic, factors that have exerted downside pressure on crude oil prices over the past several years included an increase in non-OPEC oil production supported by a substantial U.S. oil production expansion. However, the IEA forecasts that oil production by oil-producing countries outside the Organization of the Petroleum Exporting Countries in 2021 would increase by only 0.81 million bpd from 63.06 million bpd in 2020 to 63.87 million bpd. Russia and some other non-OPEC oil-producing countries have cooperated with OPEC in cutting production, exerting a great impact on non-OPEC oil production. Another important point is that the IEA forecasts U.S. oil production in 2021 to continue stagnation. It estimates U.S. production in 2021 to fall by 0.16 million bpd to 16.41 million bpd. High-cost U.S. shale oil production had been expected to restore its profitability and resume expansion if crude oil prices rise back above $60/bbl. However, we see no such sign at present. Analysts say that U.S. shale oil producers depending on external financing have switched their priority from quantity (production expansion) to quality (profitability). The recent absence of U.S. oil production expansion has weakened downward pressure on oil prices, leading to the price hikes.

Further important is the effect of the OPEC-plus group's production reduction policy that has led to the rebalancing of supply and demand by continuing supply and demand adjustment while watching demand growth and stagnant U.S. oil production. Since launching record production cuts in May 2020, the OPEC-plus group has micro-managed the supply-demand balance under the initiative of its leader Saudi Arabia. This has helped global crude oil inventories to restore a normal level. The OPEC-plus group has entered a process to phase out production cuts but is expected to adjust production in consideration of the oil supply-demand environment.

At its June 1 meeting that attracted global attention, the OPEC-plus group decided to narrow production cuts in July as earlier expected. OPEC-plus decisions tended to become surprises reversing earlier expectations, but the latest one met dominant forecasts. However, the decision falling within an expected range apparently indicates that the OPEC-plus group refrained from surprising the market and took a wait-and-see attitude in consideration of various potential turbulent factors in the future international oil market.

Some turbulent or attention-attracting factors would bring about crude oil price hikes, but others would trigger price drops. Depending on these factors and their impacts, future oil price developments will vary. In consideration of various possibilities, the OPEC-plus group might have taken a wait-and-see attitude for the immediate future. Attention-attracting factors to push up crude oil prices include the potential acceleration of the global economic recovery and relevant money factors. In addition, we must pay attention to potential events causing oil supply disruptions, like the recent U.S. Colonial Pipeline shutdown. Attention-attracting factors regarding the Middle East include a conservative hardliner's potential victory in Iran's presidential election in June, subsequent regional geopolitical tensions and relevant concerns over oil supply disruptions.

Important factors to push down crude oil prices would be a successful U.S.-Iran nuclear deal and Iran's subsequent comeback to the international oil market in the second half of this year. In addition, I would like to pay attention to a rise in U.S. production that could come as crude oil price hikes take hold. If concerns arise about the global economic recovery depending on some developments regarding the COVID-19 pandemic, the oil market could become turbulent under the influence of money factors.

While Brent has risen back above $70/bbl, crude oil prices can be expected to rise further or drop sharply. The OPEC-plus group will continue to micro-manage the supply-demand balance while responding to situational changes. It will then have to consider not only fiscal problems of oil-producing countries but also its actions' impacts on the global economy, the U.S. administration's reluctance to see gasoline price hikes and other factors politically and strategically.

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