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[Oil prices]

US shale oil has been a factor in limiting upward pressure on oil prices

YURI ISE
ECONOMIC RESEARCH OFFICE

MUFG Bank, Ltd.
A member of MUFG, a global financial group

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Oil prices (WTI front month) fell briefly to just above USD 50 per barrel on the back of a rise in uncertainty about the future of the global economy brought about by the conflict between the US and China. However, oil prices rose again to just below USD 59.5 per barrel as tension increased in the Middle East, namely the heightened conflict between the US and Iran (Chart 1).

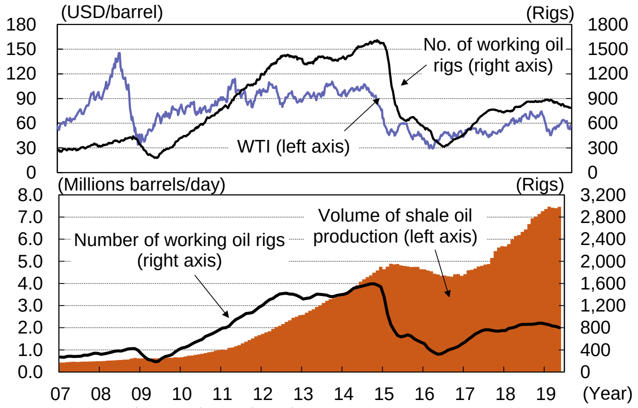
That being said, looking at supply and demand alone indicates it is unlikely that prices will only continue to increase from now; there are persistent concerns about a decline in demand, owing to the aforementioned uncertainty about the future of the global economy, and US shale oil production is rising on the supply side. Due to improvements in the efficiency of working shale oil rigs and a recovery in oil prices, US shale oil output has continued to rise since the end of 2016 and accounted for around 60% of the increase in global oil production in 2018. Currently, the volume of US shale oil production is starting to peak, mainly due to the decrease in the number of working rigs, yet an important thing to keep an eye on is the number of DUC wells[1] (the process of drilling the borehole with a rig is complete, but the processes carried out before oil production, such as hydraulic fracturing, are uncomplete) (Chart 2). In general, drilling rig companies provide shale oil producers with drilling rigs for a fixed amount over a set period of time, so there is a strong incentive for shale oil producers to drill more boreholes. On the other hand, starting production at times of sluggish oil prices is not rational economically and is said to lead to a situation where the number of DUC wells can easily rise. Even when the number of working oil rigs isn't rising, like it is now, there is a strong possibility that the volume of production will rise sharply due to a rise in oil prices, as it is no longer necessary to have operating rigs in order to produce oil from DUC wells.

The military conflict between the US and Iran is intensifying at present, and it is important to bear in mind that oil prices may easily increase, depending on the situation in the Middle East. However, it is also important to recognise that there are factors which are suppressing a rise in prices on both the demand and supply sides.

[1] Mining rights in the US belong to landowners, not the government, and are purchased by shale oil producers as leases. Since landowners receive part of the revenue from oil production as royalties, it is desirable to have shale oil producers to drill on their land. As a result, there is a stipulation in the lease agreement to drill more than a certain number of wells. In addition,

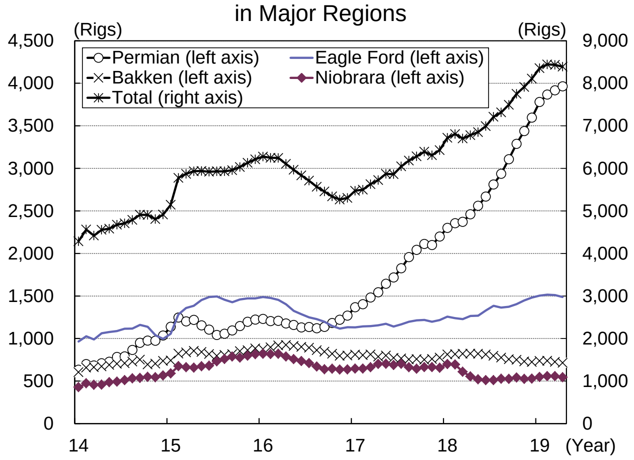
drilling rig companies provide shale oil producers with rigs for a fixed amount over a set period of time.

Chart 1: Oil Prices, the Number of US Working Oil Rigs and the Volume of US Shale Oil Production



Source: EIA, Baker Hughes, Bloomberg, MUFG Bank Economic Research Office

Chart 2: Number of Drilled but Uncompleted Wells (DUC) in Major Regions



Source: EIA, MUFG Bank Economic Research Office

For further details, please contact the Economic Research Office, MUFG Bank

Managing Director, Rei Tsuruta Tel: +81-(0)3-3240-3204

Written by Yuri Ise <yuri_ise@mufg.jp>

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