Oil prices at the USD 60 per barrel mark as oil supply and demand returns to equilibrium

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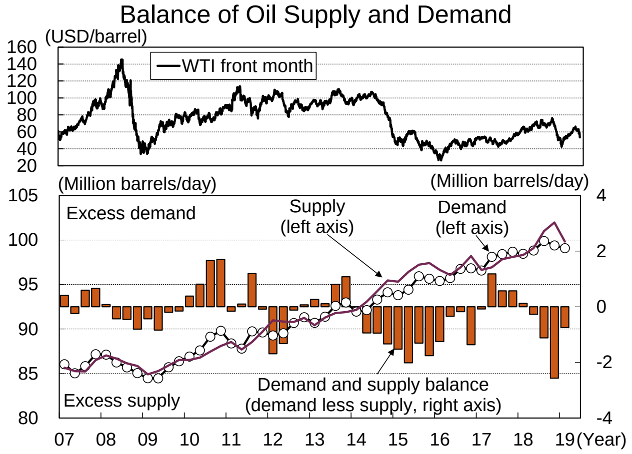
1. Overview of the Current Situation

Oil prices (WTI front month) rose to just above USD 66 per barrel at the end of April on the back of oil production cuts by OPEC+, a decrease in output by Iran and Venezuela and the growing tension between Iran on one side and the US and Saudi Arabia on the other (Chart 1). However, an escalation in the US-China conflict and a statement by the US about imposing tariffs on Mexico caused oil prices to fall and they are now around USD 55 per barrel.

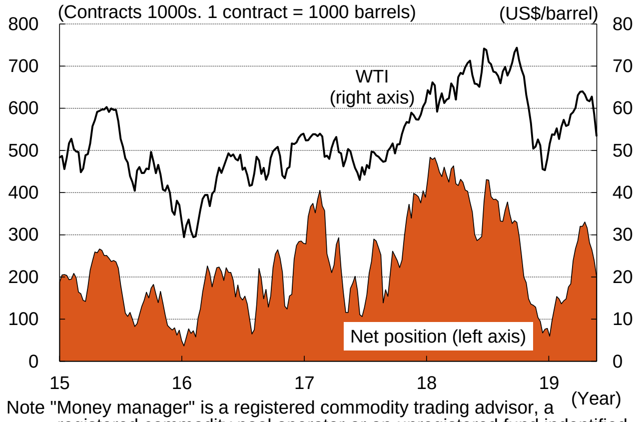
In the oil futures market, the net buying position of speculators fell owing to a sharp increase in risk aversion at the end of last year, but it subsequently returned to a high position up until the end of April. Currently, investors are once again withdrawing investment (Chart 2).

Chart 1: Oil Prices (Front Month) and the Balance of Oil Supply and Demand



Source: IEA, Bloomberg, MUFG Bank Economic Research Office

Chart 2: Money Managers' Net Position and Oil Prices



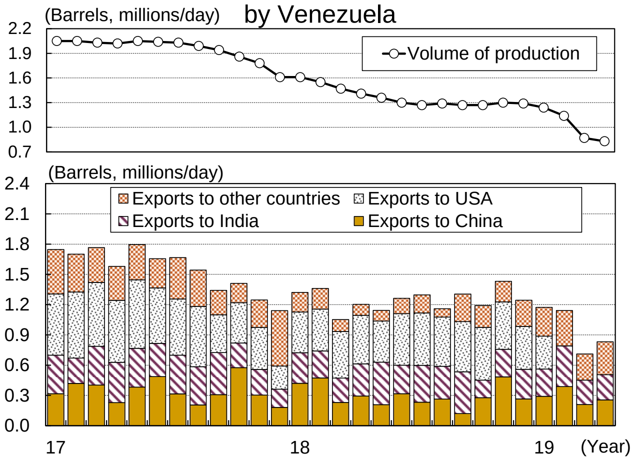
Note "Money manager" is a registered commodity trading advisor, a registered commodity pool operator or an unregistered fund indentified by the CFTC.
Source: US CFTC, Bloomberg, MUFG Bank Economic Research Office

2. Outlook

The oil market is facing disruption on both the supply and demand fronts. In terms of demand, it is thought that the growth of demand will fall sharply due to the cyclical slowdown of the global economy in addition to downward pressure from the US-China conflict. Since the US and China are the two largest consumers of oil worldwide, constituting 21% and 13% respectively of all global oil consumption (as of 2018), if there is a slowing of their economies due to an escalation in the conflict, this will have a huge impact on demand. However, while there is some speculation at present that this situation may arise, it seems the actual impact will be dependent on negotiations between the two countries (the same can be said for the statement by the US about imposing tariffs on Mexico).

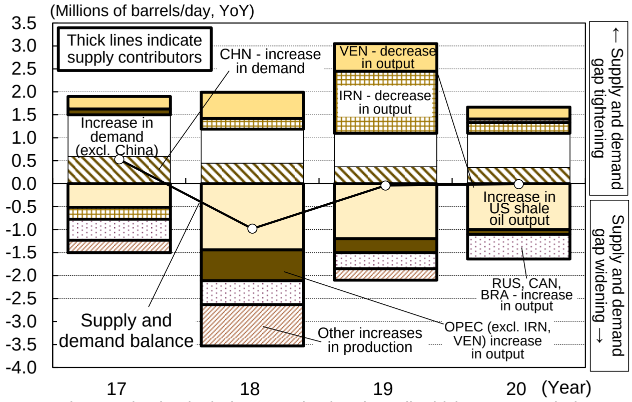
Meanwhile, what is already clear on the supply side is that there will be a further decrease in oil production by Iran and Venezuela due to US sanctions. The waiver for the US ban on imports of Iranian-produced oil by eight countries and regions, including China and Japan, expired on 2nd May. As both the Chinese and Turkish governments criticised the ban, it is unlikely that Iran will immediately stop all exports of oil (exports totalled approximately 900,000 barrels per day in April), but there will probably be a decrease to some extent. In addition, since 29th April, trading between US companies and Venezuelan state-controlled oil companies has been prohibited and even non-US companies have been banned from trading with Venezuelan state-controlled oil companies through the US financial system. As a result, Venezuela's exports of oil to the US are at zero at the moment (approximately 500,000 barrels per day were exported to the US in 2018) (Chart 3). China and India are importing oil from Venezuela as of April and are expected to continue to do so as part of their oil-for-debt swaps with Venezuela; however, a decrease in oil output will be unavoidable for the most part as large-scale power outages interrupt production.

Chart 3: Volume of Oil Production and Exports by Venezuela



Source: IEA, Bloomberg, MUFG Bank Economic Research Office

Chart 4: Balance of Oil Supply and Demand

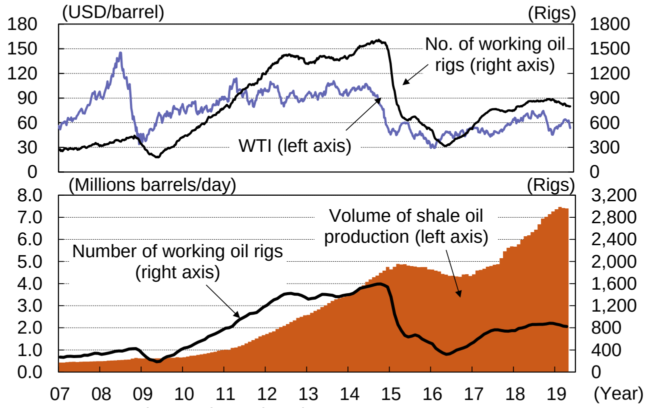


Note: Other production includes NGL (national gas liquids). OPEC excludes Iran and Venezuela. Based on members as of April 2019
Data from 2019 is a forecast by IEA and the Economic Research Office
Souce: IEA, MUFG Bank Economic Research Office

In terms of demand, there are some concerns about a large-scale slowdown of growth; meanwhile, on the supply side, oil production is forecast to decrease. Nevertheless, on the whole, the supply and demand of oil is expected to eventually find equilibrium for the most part (Chart 4). The reason for this appears to be an artificial adjustment of supply and demand by both OPEC and US shale oil. At the OPEC and non-OPEC Joint Ministerial Monitoring Committee in May, OPEC renewed its commitment to market stabilisation. Furthermore, Saudi Arabia's Minister of Energy, Industry and Mineral Resources, Khalid Al-Falih, mentioned maintaining the agreement to cut oil production past July, when it was scheduled to end but also added that "no refinery, no customer is left without their requirement of crude oil" in light of the possibility of supply shocks. OPEC is able to sufficiently cover a decrease in oil output by Iran and Venezuela, judging by its spare supply capacity of 3.19 million barrels as of April. Furthermore, individual producers of US shale oil are small in size and there is little consensus, but it appears they are adjusting their output according to their WTI benchmark of around USD

60 per barrel (Chart 5). With these two factors acting as balancers of supply and demand, oil prices are forecast to average USD 58 per barrel in 2019 and USD 60 in 2020 (Table 1). However, it is important to bear in mind that oil prices can easily fluctuate on a temporary basis, depending on the outcome of the US-China conflict and the US' tariffs against Mexico, as well as the situation in the Middle East, such as tension in the Strait of Hormuz.

Chart 5: 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

Table 1: Outlook for Oil Prices

	WTI Futures front month ($ per barrel)	YoY (%)	Brent Futures front month ($ per barrel)	YoY (%)
2018/Q1	62.9	21.5%	67.2	23.1%
2018/Q2	67.9	41.0%	75.0	47.6%
2018/Q3	69.4	44.0%	75.8	45.4%
2018/Q4	59.3	7.3%	68.6	11.6%
2019/Q1	54.9	-12.7%	63.8	-5.1%
2019/Q2	60.0	-11.6%	68.0	-9.3%
2019/Q3	58.0	-16.5%	66.0	-13.0%
2019/Q4	60.0	1.1%	68.0	-0.9%
2020/Q1	60.0	9.3%	68.0	6.5%
2020/Q2	60.0	0.0%	68.0	0.0%
2020/Q3	60.0	3.4%	68.0	3.0%
2020/Q4	60.0	0.0%	68.0	0.0%
2018	64.9	27.5%	71.7	30.9%
2019	58.2	-10.3%	66.5	-7.3%
2020	60.0	3.0%	68.0	2.3%

Forecast

Note: Average price shown for each period
Source: Bloomberg, MUFG Bank Economic Research Office

(Translated by Elizabeth Foster)

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