The Outlook for Oil Prices

A factoring in of concerns about demand results in limited upward pressure on oil prices

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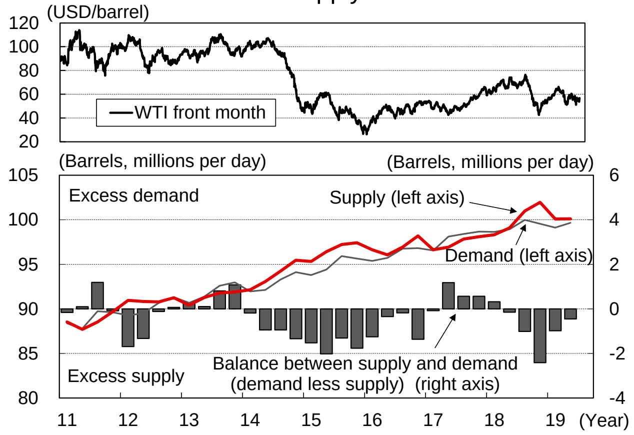
1. Overview of the Current Situation

Oil prices (WTI front month) rose to around USD 61 per barrel at the start of July owing to an extension of the agreement by OPEC+ to reduce their oil production and the growing tension in the Middle East surrounding Iran (Chart 1). However, tension between the US and China over trade subsequently rose and China's growth of industrial production was low in July. This led to concerns about reduced demand which were factored in by oil markets, resulting in a fall in oil prices to their current level of around USD 56 per barrel. The oil market is unable to settle due to reports of exchanges between the US and China and the US and Iran, as well as the economic situation in various countries.

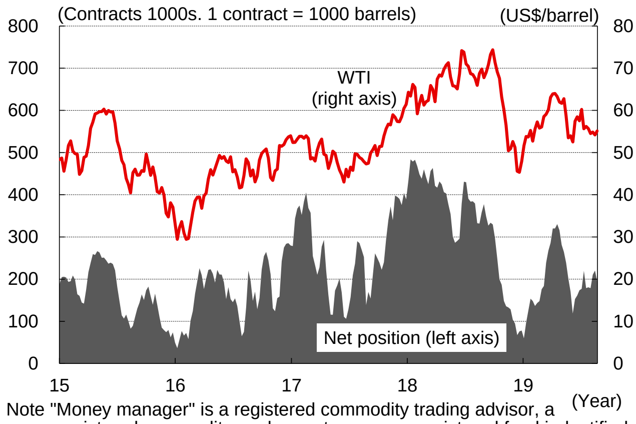
In the oil futures market, the net buying position of speculators is lower now than it was at the end of April when oil prices were around USD 65 per barrel, and it appears the oil markets are becoming increasingly bearish about the future (Chart 2).

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



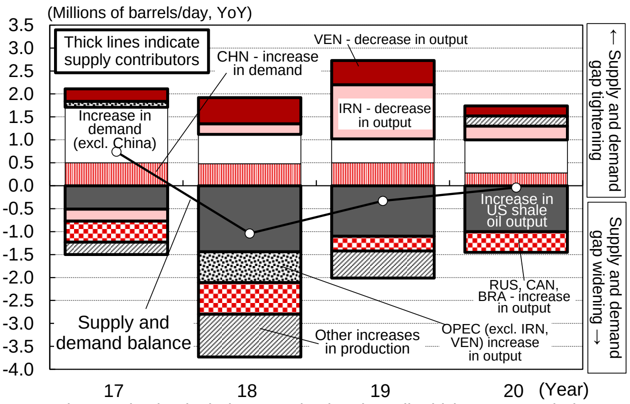
Note "Money manager" is a registered commodity trading advisor, a registered commodity pool operator or an unregistered fund indentified by the CFTC.
Source: US CFTC, Bloomberg, MUFG Bank Economic Research Office

2. Outlook

Upward pressure on oil prices is expected to be limited for the time being as the slowing of the global economy and increased tension between the US and China continue to cause concern about reduced demand for oil. Since the US and China are both major oil consuming countries, accounting for 21% and 13% respectively of global oil demand (as of 2018), it is likely that oil markets will over compensate for any decline in demand for oil caused by an escalation of the conflict between the two countries, resulting in significant downward pressure on oil prices.

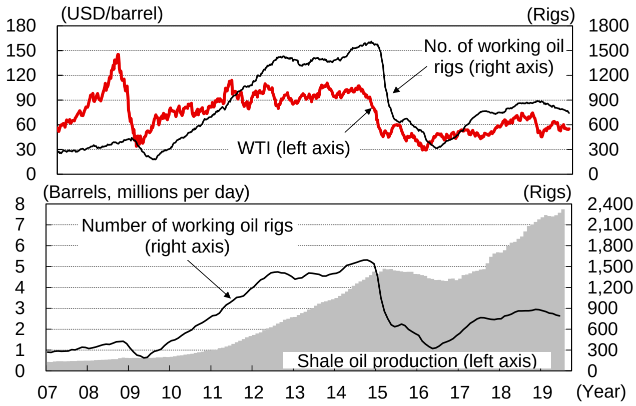
The actual balance of oil demand and supply in the April-June quarter was an excess supply of 450,000 barrels per day as the amount of excess supply continues to decrease. While demand for oil is forecast to slow further in the future owing to the deceleration of the global economy, the balance of oil supply and demand is expected to gradually draw closer to equilibrium due to an adjustment of production on the supply side owing to reactionary increases and decreases in production of US shale oil and OPEC+ cooperation in adjusting their oil outputs (Chart 3).

Chart 3: Balance of Oil Supply and Demand



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

Chart 4: Oil Prices, the Number of US Working Oil Rigs and the Volume of US Shale Oil Production



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

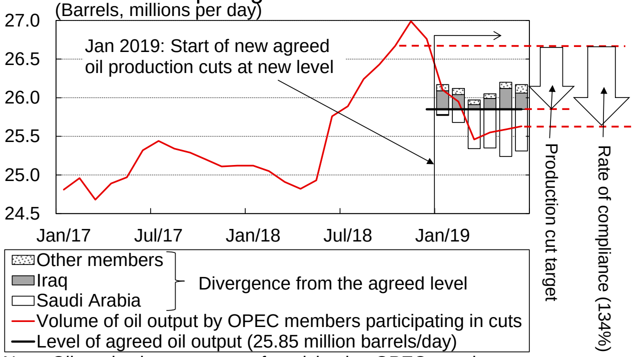
Individual producers of US shale oil are small in size and they do not take unified action, yet a WTI oil price of around USD 60 can be regarded as the benchmark for a flexible increase or decrease in oil production by US shale oil producers. With WTI oil prices of less than USD 60, the number of working oil rigs (an indicator for future oil production) has continued to fall since the end of last year, and there is a strong possibility that this will lead to a deceleration of oil production in the future (Chart 4). In addition, OPEC+ agreed to extend oil supply cuts at the new level set in January this year until the end of March next year at a meeting on 1st and 2nd July. OPEC+ has its sights set on demand-supply equilibrium and its current oil output is at a lower level than their production target, particularly that of Saudi Arabia (Chart 5). Furthermore, OPEC+ also approved the draft text of their Charter of Cooperation at the meeting, which sets forth an aim of permanent collaboration, and once again suggests the Organization will continue to pursue oil demand-supply equilibrium in the future[1]. Taking this into account, oil prices are forecast to average approximately USD 57 per barrel from 2019 to 2020 (Table 1).

In terms of risks, it is important to remain cautious about sources of large upward and downward pressures on oil prices, such as the conflict between the US and China and the situation in the Middle East. If the US-China conflict puts more downward pressure on demand for oil than expected via a slowdown of the global economy, oil markets' perception of the equilibrium oil price is expected to drop to a lower level. Nevertheless, there is still the risk that the tension in the Strait of Hormuz will cause a sharp rise in oil prices. In response, Saudi

Arabia plans to expand its East-West pipeline that runs through the country to increase its alternative routes for oil exports. In addition, the International Energy Agency (IEA) has said it will release oil stocks that members are obliged to hold as required. Nevertheless, it is important to remember that the pipeline expansion will take around two years to complete, and the IEA's measure is only temporary.

[1]Currently, OPEC+ is carrying out agreed oil production cuts to address the excess oil supply, but if the gap between the supply and demand of oil tightens due to supply disruptions in individual countries, it appears OPEC+ has an excess supply capacity (3.22 million barrels as of July) to deal with this.

Chart 5: Volume of Oil Output by OPEC Members Participating in Oil Production cuts



Note: Oil production cut target of participating OPEC members
= volume of oil output in October 2018 less 800,000 barrels per day
Oil production target of participating OPEC and non-OPEC members
= decrease of 1.2 million barrels per day
Source: IEA, 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	59.9	-11.8%	68.5	-8.7%
2019/Q3	56.0	-19.3%	61.0	-19.6%
2019/Q4	56.0	-5.6%	61.0	-11.1%
2020/Q1	56.5	2.9%	61.5	-3.7%
2020/Q2	56.5	-5.7%	61.5	-10.2%
2020/Q3	57.0	1.8%	62.0	1.6%
2020/Q4	57.0	1.8%	62.0	1.6%
2018	64.9	27.5%	71.7	30.9%
2019	56.7	-12.6%	63.6	-11.3%
2020	56.8	0.1%	61.8	-2.9%

Forecast

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

(Translated by Elizabeth Foster)

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