The Outlook for Oil Prices

Oil prices will rise gradually as supply and demand moves in equilibrium for the most part

AYUMI HIRONAKA
ECONOMIC RESEARCH OFFICE

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

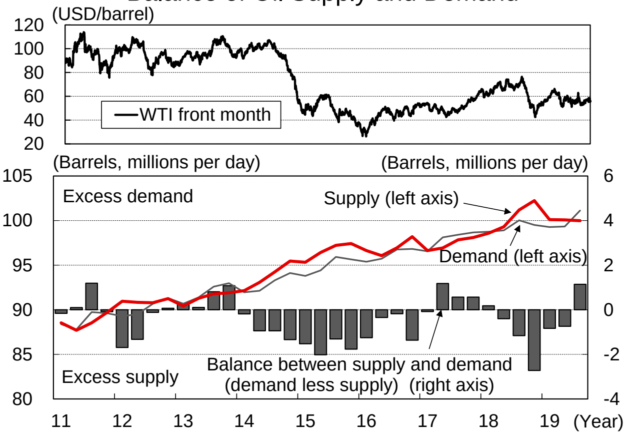
12 DECEMBER 2019
(ORIGINAL JAPANESE VERSION RELEASED ON 29 NOVEMBER 2019)

1. Overview of the Current Situation

On the whole, oil supply and demand is balanced. Demand slowed owing to the deceleration of the global economy and, on the supply front, OPEC+ is carrying out their agreed production cuts as they aim for supply-demand equilibrium, and growth of US shale oil production is slowing (there was a temporary excess of demand in the July-September quarter due to a decrease in supply brought about by the attacks on Saudi Arabia's oil-related facilities mentioned below).

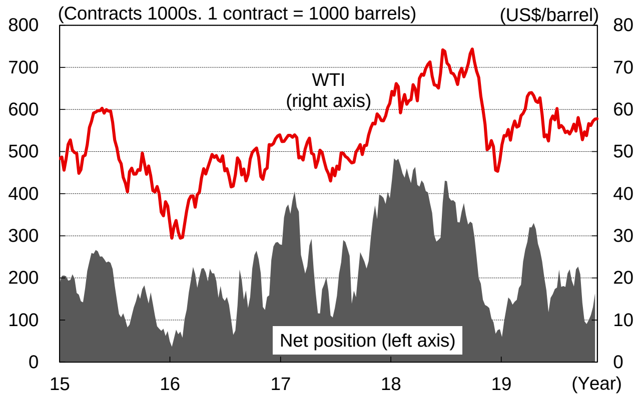
Oil prices (WTI front month) rose sharply from USD54 per barrel to just below USD 63 per barrel for a short while because of an increase in concerns about oil supply following the attack on Saudi Arabia's oil-related facilities in mid-September. Oil prices then dropped temporarily to between USD 52 and USD 53 per barrel at the start of October as worries about a decline in oil demand took hold on the back of soft US and Chinese economic indicators. Oil prices rose and fell in reaction to such news, but regressed to a mean of between USD 55 and USD 59 per barrel owing to the aforementioned equilibrium between oil supply and demand on the whole. Currently, oil prices are around USD 58 per barrel (Chart 1).

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

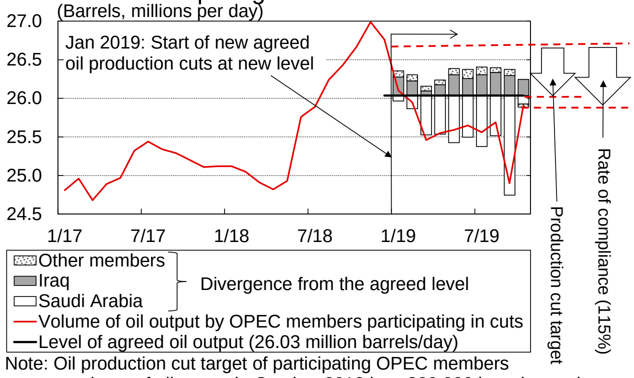
The net buying position of speculators in the US futures commodities market is low compared to mid-April, when the amount of investment rose to its highest point since the start of the year, yet the net position started to rise again from the start of October, and it appears oil markets are becoming less bearish about the future along with stock markets, where there is clear increase in risk appetite (Chart 2).

2. Outlook

Next year, the global economy is forecast to grow at the same, gradual pace it has done this year. Furthermore, judging by the current trajectory of the semiconductor and automobile sectors, the manufacturing industry – which had been soft – is starting to rebound from an adjustment. As a result, demand for oil is expected to grow at the same pace as this year.

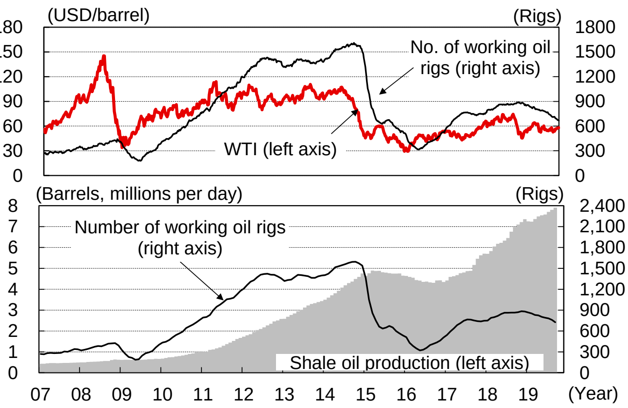
On the other hand, the question of whether or not the increase in supply can keep in pace with the rise in demand depends on the success of OPEC and non-OPEC member countries' continued oil production cuts and the deceleration of growth in US shale oil output. The volume of oil output by OPEC members participating in the agreed cuts was 25.91 million barrels per day in October, lower than their target of 26.03 barrels per day (115% rate of compliance with oil cuts, Chart 3). In the same month, Saudi Arabia – leader of OPEC – and Russia – representative of non-OPEC members – agreed to permanent cooperation over oil production increases and cuts. Taking this into consideration, OPEC+ will aim for equilibrium between oil supply and demand going forwards, and is expected to adjust their oil output in line with demand. There is also a strong possibility that the current agreement to reduce oil production will be extended to the end of March next year at the Meeting of the OPEC Conference on 5th December and the OPEC and non-OPEC Ministerial Meeting on 6th December. Furthermore, WTI prices are below USD 60 at present, which is roughly the break-even price of US shale oil production, and there is a continued fall in the number of working rigs. Taking this into consideration, the pace of shale oil production is expected to slow in the future and it appears the increase in oil supply in 2020 will fall below this year's by quite some way (Chart 4).

Chart 3: 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

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

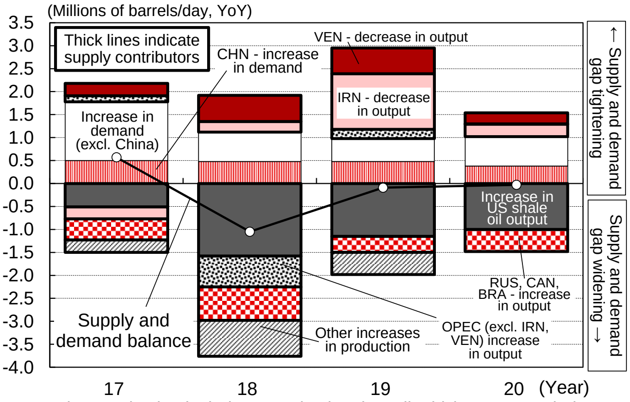


Source: U.S. EIA, Baker Hughes, Bloomberg, MUFG Bank Economic Research Office

Based on the above, oil supply and demand will continue to move in equilibrium on the whole (Chart 5). Looking ahead, oil prices are forecast to average USD 57 per barrel in 2019 and USD 58 per barrels in 2020: remaining within the USD55 to USD59 per barrel range (Table 1).

That being said, it is necessary to keep an eye on large movements in the fluctuation of oil prices caused by political and geopolitical risks via speculation about the future of demand and supply. Risks include the direction of US-China trade negotiations, which have become more uncertain as they have started to overlap with the issue of Hong Kong, and sudden disruptions to supply due to a deterioration of the situation in the Middle East.

Chart 5: Balance of Oil Supply and Demand



Note: Other production includes NGL (national gas liquids). OPEC excludes Iran and Venezuela. Based on members as of October 2019
Data from 2019 is a forecast by IEA and the Economic Research Office
Souce: 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	56.4	-18.8%	61.9	-18.4%
2019/Q4	56.0	-5.6%	61.5	-10.3%
2020/Q1	57.0	3.8%	62.5	-2.1%
2020/Q2	57.5	-4.0%	63.0	-8.0%
2020/Q3	58.0	2.8%	63.5	2.6%
2020/Q4	58.5	4.5%	64.0	4.1%
2018	64.9	27.5%	71.7	30.9%
2019	56.8	-12.5%	63.9	-10.8%
2020	57.8	1.7%	63.3	-1.1%

Forecast

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

(Translated by Elizabeth Foster)

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

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

Written by Ayumi Hironaka <ayumi_hironaka@mufg.jp>