The situation surrounding oil prices (February)

AYUMI HIRONAKA
ECONOMIC RESEARCH OFFICE

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

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1. Oil Prices

At the start of February, oil prices (WTI front month) fell momentarily to USD 49 per barrel as the number of people infected with Covid 19 – which started in China – has risen by thousands each day since the last week of January, sparking a rise in concerns about a decrease in Chinese demand for oil. Subsequently, oil prices rose to around USD53 per barrel around the middle of the month owing to reports that OPEC+ was considering further oil production cuts. However, the number of people infected with Covid 19 rose sharply outside China too and with the spread of infection now a global problem, there was an increase in concerns on a global scale about a decline in demand for oil worldwide. As a result, oil prices fell again and are now around USD 47 per barrel.

2. Oil Supply and Demand

Demand for oil in the October-December 2019 quarter was revised downwards in February from the estimate released in January by 270,000 barrels per day to 101.18 million (1.7% YoY). Demand is starting to grow, particularly that of China and India. On the other hand, supply during this period was revised upwards by 360,000 barrels per day to 101.55 million (0.7% YoY) as of February. The decrease in supply is due to co-operative oil production cuts by OPEC+.

In terms of the balance of supply and demand in the October-December 2019 quarter, there was an excess of demand for two consecutive quarters according to preliminary results, but this was amended to an excess supply of 370,000 barrels per day owing to the aforementioned revisions.

3. Main Points from February

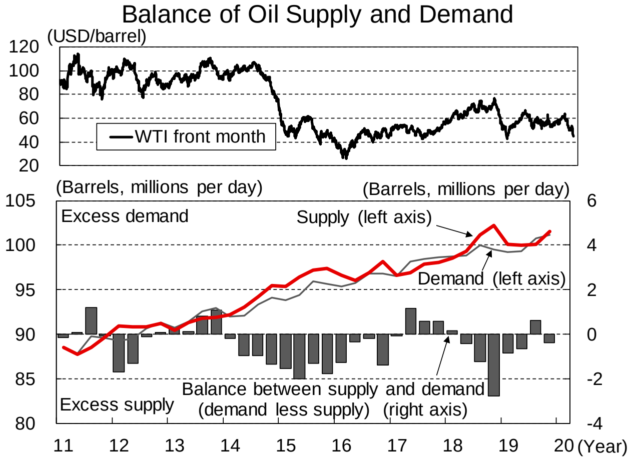
From late January, China took several emergency measures that significantly restrict the movement of goods and people to prevent the spread of Covid 19. This led to a large year-on-year decrease in coal consumption and the number of travellers, and it is thought China's demand for oil is also decreasing somewhat. In addition, there was a sharp rise in the number of infected in Italy and South Korea at the end of February and there are signs the infection will spread globally, such as the confirmed cases of infection of unknown origin in the US – a large consumer of oil. This has led to a rise in the pessimistic view that demand for oil will decline further. While it is difficult to forecast when the infection will start to slow, it appears Covid 19 will have a negative impact on the sentiment of market participants and will put strong, downward pressure on oil prices.

On the supply side, there was a rise in expectations amongst market participants that OPEC+, who works to balance the supply and demand of oil, would embark on further oil production cuts to stop the fall of oil prices and oil prices did rebound somewhat. However, the current futures curve shows that the price of 5-year contracts is lower than it was on 21st February, suggesting the market's prevailing view is that an equilibrium between oil supply and demand will be difficult to attain due to supply adjustments.

Additional cuts to oil production are key to adjusting the balance of supply and demand for oil, yet it is difficult to predict to what extend demand for oil will decrease in the future. In light of this and Russia's[1] apparent reluctance to participate in future oil production cuts, it seems it will become very difficult to adjust the balance of oil supply and demand at the OPEC+ ministerial meeting on 5th and 6th of March.

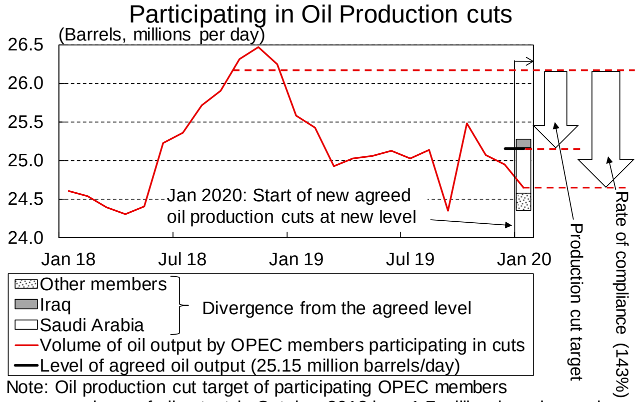
[1] It is difficult for the Russian government to adjust its volume of oil production compared with those in the Middle East because its major oil companies are parastatal and must provide their shareholders with returns on profit and adequate public information. As a result, its volume of oil production increase in January from the previous month and its rate of compliance with the oil production cuts was just 78%.

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



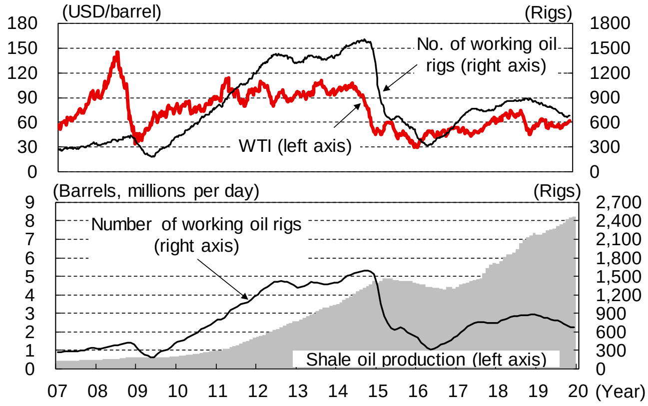
Source: IEA, Bloomberg, MUFG Bank Economic Research Office

Volume of Oil Output by OPEC Members Participating in Oil Production cuts



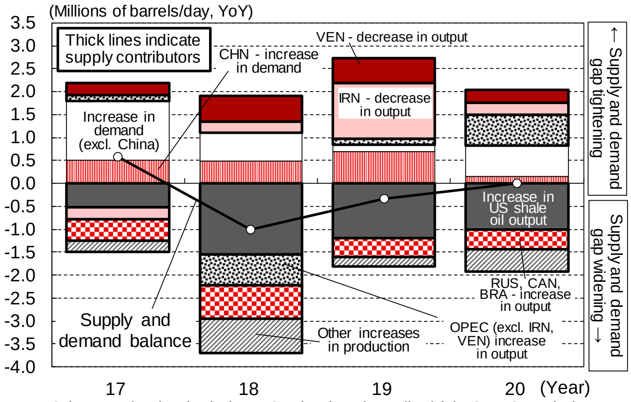
Note: Oil production cut target of participating OPEC members
= volume of oil output in October 2018 less 1.7 million barrels per day
Oil production target of participating OPEC and non-OPEC members
= decrease of 1.2 million barrels per day
Source: IEA, MUFG Bank Economic Research Office

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



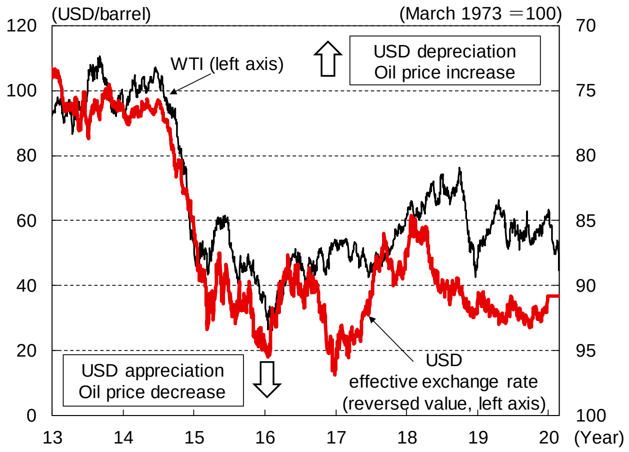
Source: U.S. EIA, Baker Hughes, Bloomberg, MUFG Bank Economic Research Office

Balance of Oil Supply and Demand



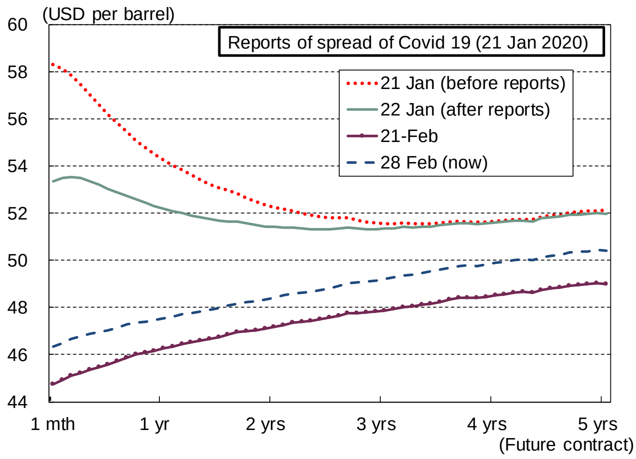
Note: Other production includes NGL (national gas liquids). OPEC excludes Iran and Venezuela. Based on members as of January 2020
Data from 2020 is a forecast by IEA and the Economic Research Office
Souce: IEA, MUFG Bank Economic Research Office

Oil Prices and the USD Effective Exchange Rate



Source: Bloomberg, MUFG Bank Economic Research

Oil Futures Curve (WTI)



Source: Bloomberg, 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 Ayumi Hironaka <ayumi_hironaka@mufg.jp>