Oil market suffers double whammy of the Covid 19 pandemic and a breakdown in collaborative oil cuts

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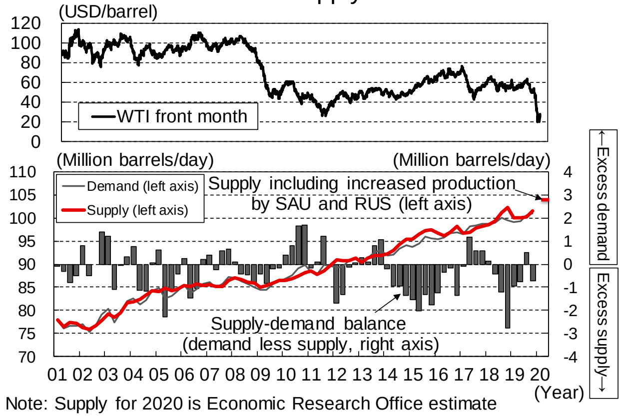
Oil prices (WTI front month) dropped below USD 20 per barrel momentarily on 20th March: the lowest level since February 2002 approximately 18 years ago (Chart 1. Around the start of 2002, a slowing of the global economy coincided with cooperative oil production cuts by oil-producing nations). The reason for this fall in oil prices is an extremely high level of concern about a deterioration of the oil supply-demand balance on both the supply and demand sides caused by coinciding factors: concerns about a deceleration of the global economy and lower demand for oil as the Covid 19 pandemic spreads to Europe and the US, on top of a breakdown of the agreement between OPEC+ to cut oil production. Russia rejected the large-scale additional oil production cuts suggested by Saudi Arabia at the OPEC+ ministerial meeting on 6th March, which was followed quickly by a shift in policy by Saudi Arabia to increase production more than expected. The nervousness about oil producers' intentions continues. On 2nd April, US President Trump announced the possibility of a large oil output cut by Russia and Saudi Arabia, which appears to have boosted oil prices to end a little above USD 25 per barrel.

Considering the decrease in economic activities around the world due to the Covid 19 pandemic, demand for oil is predicted to slump by a large amount for the time being – greater than its slump during the global financial crisis. However, it seems markets are already factoring this in to some extent. In terms of oil supply, on the other hand, the likeliest scenario is a continuation of the large increase in production caused by the shift to higher oil output in both Russia, who wants to apply the brakes to US oil output (globally the largest oil-producing country), and Saudi Arabia, who wants Russia to commit to cooperative oil production cuts. Production is forecast to increase overall, even taking into account the decrease in production of US shale oil brought about by sluggish prices. Therefore, it is probable oil prices will hover at their current low level of between USD 20 and USD 25 for the next two months or so. However, in the latter half of the year, oil prices are expected to rise gradually, assuming OPEC+ will agree to some sort of collaborative oil production cuts by their next ministerial meeting on 9th and 10th June. Such an agreement would follow a peak in the spread of Covid 19, the slowing of US shale production and concerns about the impact of low oil prices on oil-producing countries' fiscal health. As a result, oil prices are forecast to average just over USD 30 per barrel in 2020 (Table 1). However, there is still a risk that oil prices may swing upwards or downwards as demand is largely dependent on developments in the Covid 19 pandemic and supply is affected by whether or not a decrease in production is achieved. In the case of a downward swing, it will be important to keep an eye on concerns of a further decrease in energy-related investment.

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



Note: Supply for 2020 is Economic Research Office estimate
Source: IEA, Bloomberg, news reports,
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%	62.0	-18.2%	
2019/Q4	56.9	-4.1%	62.5	-8.9%	
2020/Q1	46.3	-15.7%	51.1	-19.9%	Forecast
2020/Q2	24.5	-59.1%	27.5	-59.8%	
2020/Q3	30.0	-46.8%	33.0	-46.8%	
2020/Q4	30.5	-46.4%	33.5	-46.4%	
2021/Q1	31.0	-33.0%	34.0	-33.5%	
2018	64.9	27.5%	71.7	30.9%	
2019	57.0	-12.1%	64.2	-10.4%	
2020	32.8	-42.4%	36.3	-43.5%	

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

(Translated by Elizabeth Foster)

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