

The situation surrounding oil prices (July)

NAOKI FUSE, RINA TAKASU
ECONOMIC RESEARCH OFFICE

MUFG Bank, Ltd.
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1. Oil Prices

Oil prices (WTI front month, price per barrel) followed an upward trend for the first half of July on the back of robust demand. They then fell to around USD 65 for a short while on the back of a fall in US stock prices and the decision by OPEC+ to increase its oil production. However, oil prices rose a little after that as US stock prices recovered and investors started buying oil futures. Oil is currently trading at between USD 70 and USD 75 (Chart 1 upper).

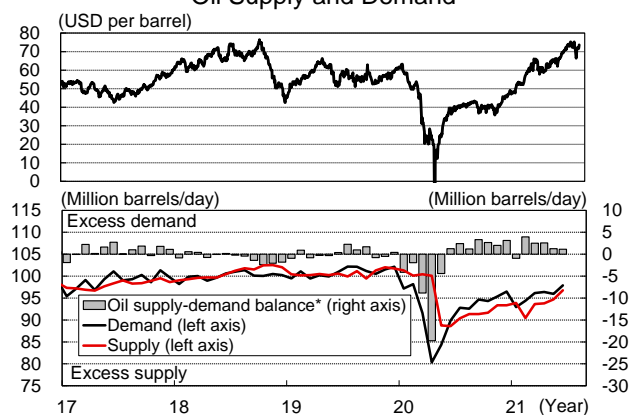
2. Oil Supply and Demand

Since January 2019, the volume of oil production in October 2018 was set as a baseline for the cooperative oil production cuts by OPEC+ which it started in January 2017. However, since May last year, OPEC+ significantly increased the scale of its cuts owing to the COVID-19 pandemic. It then reduced the scale of production cuts in stages (increased supply), but the cautious attitude with which it kept an eye on the unstable demand for oil along with sluggish US shale oil production meant oil supply was squeezed. As a result, the balance of global oil supply and demand has remained tipped towards demand since June last year, with the exception of January this year (Chart 1 lower).

At the OPEC and non-OPEC Ministerial Meeting in July, there was a disagreement about the framework for oil production cuts (the UAE opposed extending the agreement to reduce oil production). However, in the end, members showed solidarity and agreed to extend the deadline for the production cuts (from April 2022 to end December 2022), to raise the baseline for the volume of oil supply from May 2022 (an additional 1.63 million barrels per day for OPEC+ as a whole) and to increase oil production from August 2021 to December 2021 (400,000 barrels per day each month). Although the volume of oil production increases from January 2022 is undecided, given the decision to extend the period of production increases and to raise the baseline, it is likely that the volume of oil supply will recover somewhat, even despite the ongoing cooperative oil production cuts (Chart 2). Looking ahead, OPEC+ will adjust its volume of supply every month in response to the market and may end its production cuts by bringing forward the deadline to September 2022, thereby increasing its available options.

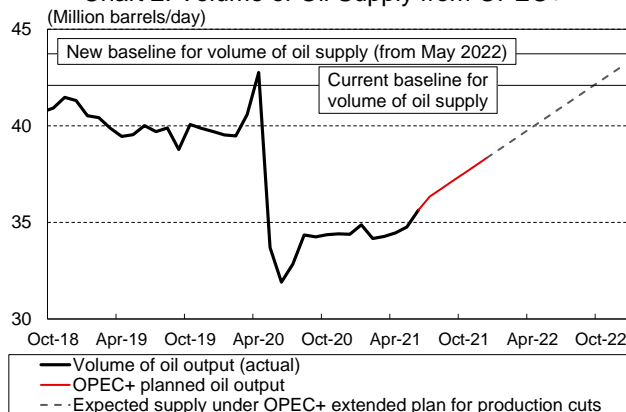
That being said, with the ongoing uncertainty about the COVID-19 pandemic and the situation in Iran, it appears that OPEC+ will continue to be flexible when it comes to adjusting the duration and scale of its oil production cuts. Taking into account its actual volume of oil supply, which it has controlled in accordance with the volume of demand since the start of the COVID-19 pandemic, it is likely OPEC+ will keep the scale of its oil production cuts to a level where excess demand is maintained. As a result, downward pressure on oil prices from the increase in output will be limited.

Chart 1: Oil Prices and the Global Balance of Oil Supply and Demand



Note: *Demand less supply
Source: EIA, Bloomberg, MUFG Bank Economic Research Office

Chart 2: Volume of Oil Supply from OPEC+



Note: Does not include Iran, Libya, Venezuela and Mexico who are not participating in oil production cuts
Source: OPEC, Bloomberg, MUFG Bank Economic Research Office

Translation 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 Naoki Fuse <naoki_fuse@mufg.jp>

Rina Takasu <rina_takasu@mufg.jp>

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