Outlook for Oil Prices

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

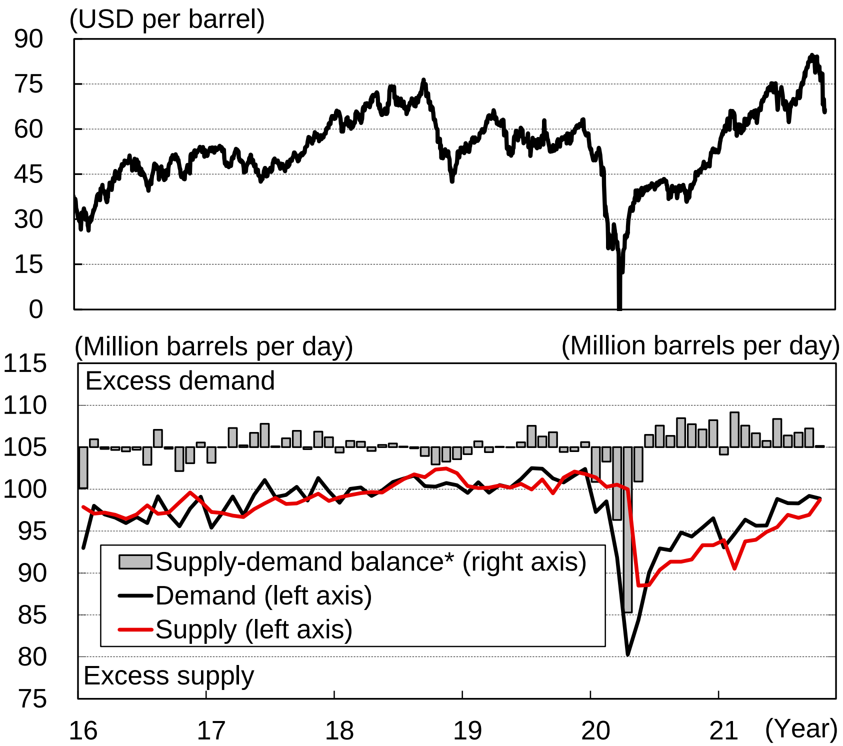
December Outlook: Current Situation

- Oil prices (WTI front month) rose to around USD 75 at the end of September as oil production fell in the US due to hurricanes hitting the country. In October, OPEC+ agreed to maintain its plan to reduce the scale of oil production cuts which it initially decided at its Ministerial Meeting in July. In addition, there was a rise in demand for oil as an alternative for coal and natural gas, which were soaring in price. As a result of these factors, oil prices hit just over USD 85 per barrel – their highest point in around seven years. Subsequently, another rise of new COVID-19 cases in Europe and signs that the US will release oil from its Strategic Petroleum Reserve caused oil prices to fall to around USD 75. The actual volume of oil reserves released from Japan, the US and others was announced to be over 60 million barrels, which equates to just under one day of the total volume of global oil consumption. Therefore, the impact of the oil release was limited. At the end of November, oil prices fell sharply due to concerns about the spread of the omicron variant, and are now around USD 65 per barrel.

- Globally, demand continues to pick up, whereas the increase in supply remains gradual owing to OPEC+ oil production cuts and a slow recovery in US shale oil output. As a result, excess demand has continued almost unbroken since June last year. However, the amount of excess demand in October was small owing to a recovery in supply.

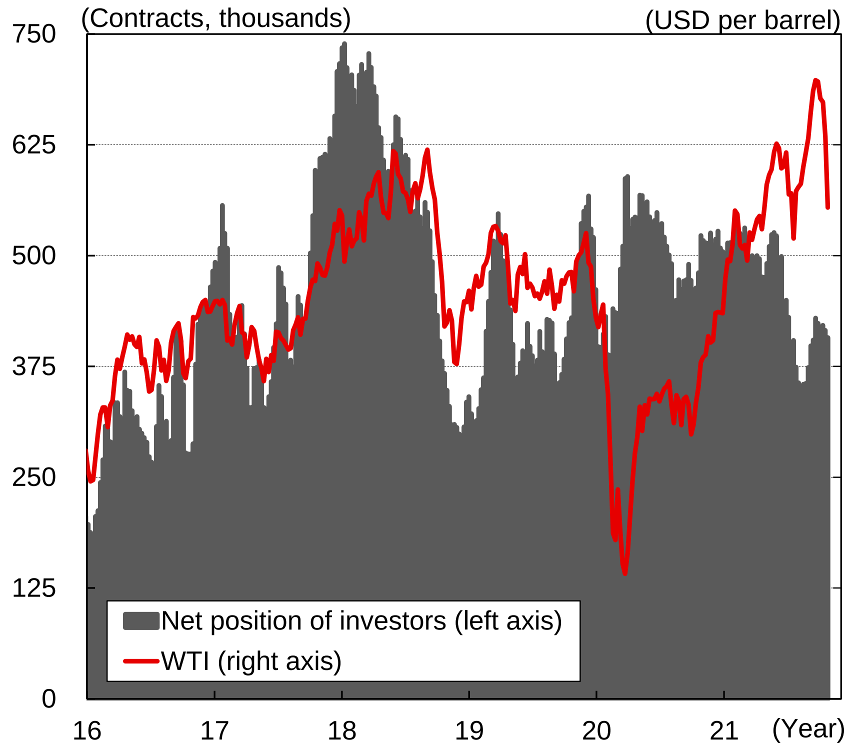
- Although oil prices rose from September, the increase in investors' net position is limited and has started to fall at present.

Oil Prices (WTI Front Month) and the Global Supply & Demand Balance



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

Net Position of Oil Future Investors and Oil Prices



Note: "Net position of investors" reflects data as of 23 November
Source: Bloomberg, MUFG Bank Economic Research Office

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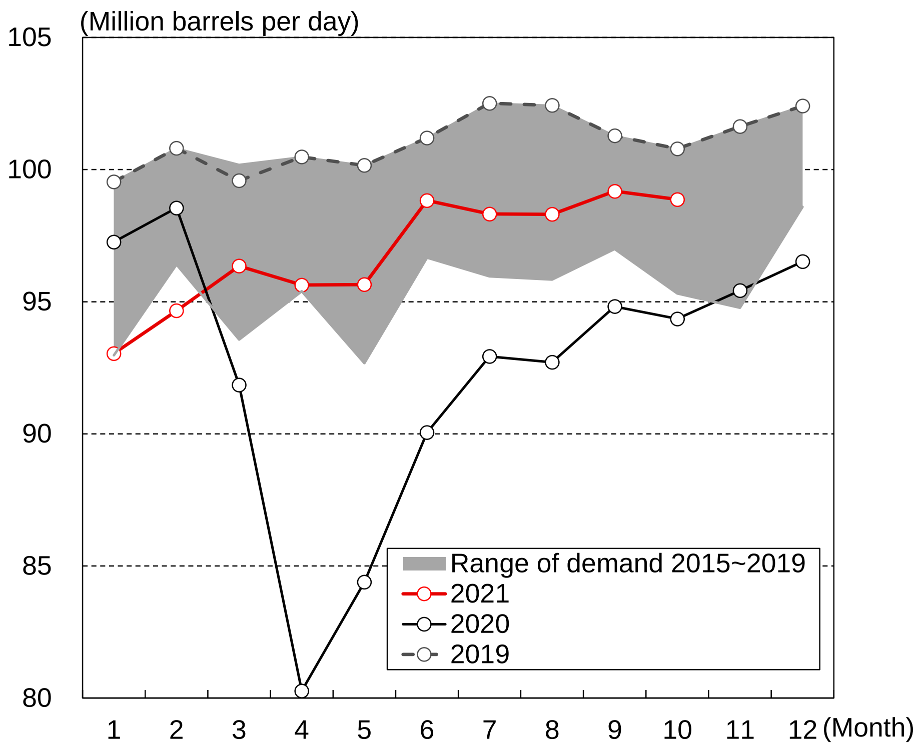
December Outlook: Demand

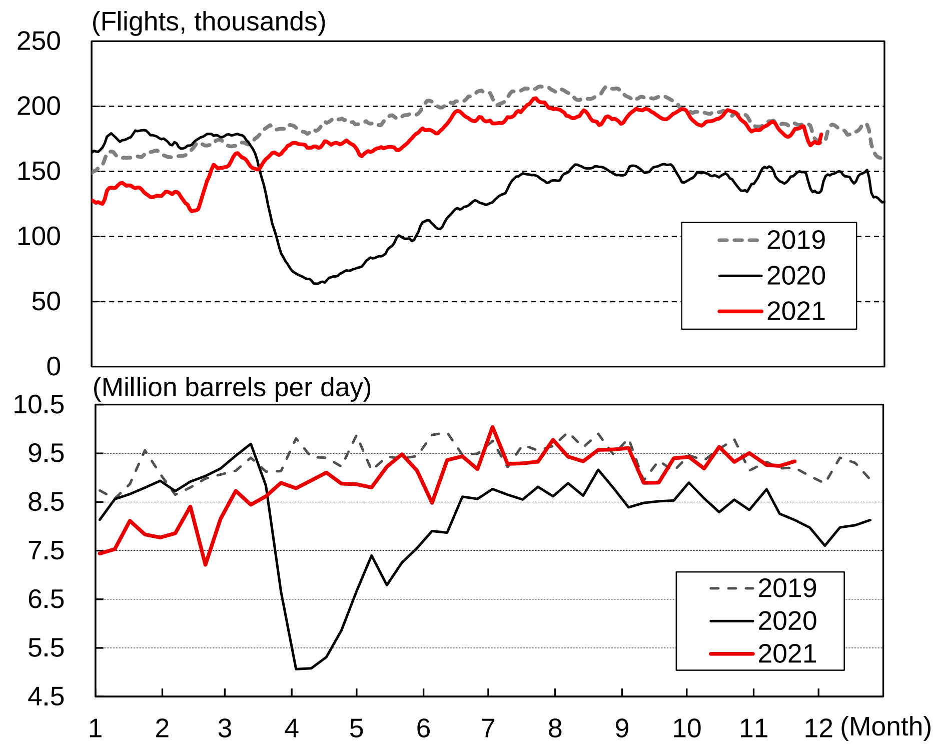
- Demand for oil fell significantly due to the pandemic last year and it remained towards the lower limit of the range recorded before the pandemic (2015 to 2019) until the start of this year as demand for transport failed to recover completely. However, demand for oil then recovered close the median of its pre-pandemic range between May and June. In October, demand for oil rose owing to a recovery in transport demand as vaccines were administered and oil became an alternative to other fossil fuels, which were experiencing a sharp rise in prices. As a result, oil demand rose from the middle towards the upper bound of its pre-pandemic range.
- The number of flights globally and the volume of US gasoline consumption both appear to have recovered to the levels they were at in 2019. In the future, demand for oil is forecast to gradually increase as the global economy recovers, yet it will be important to keep an eye on downside risks from the spread of the omicron variant.

Global Oil Demand



Source: EIA, Bloomberg, MUFG Bank Economic Research Office

Number of Global Aeroplane Flights and US Gasoline Consumption

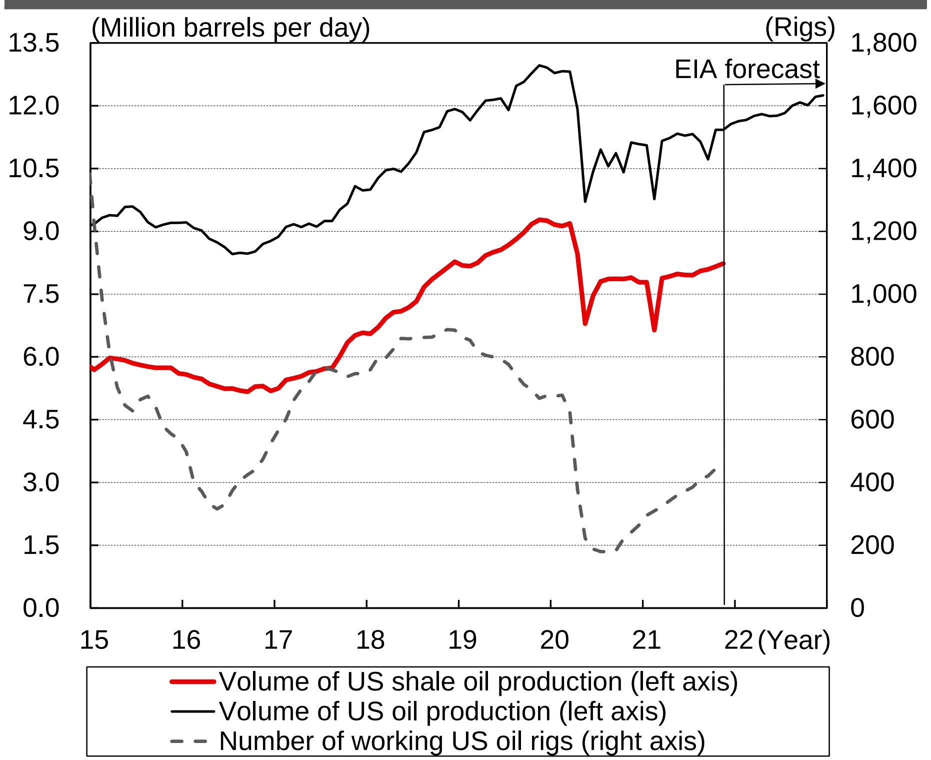


Source:flightradar24, EIA, MUFG Bank Economic Research Office

December Outlook: Supply

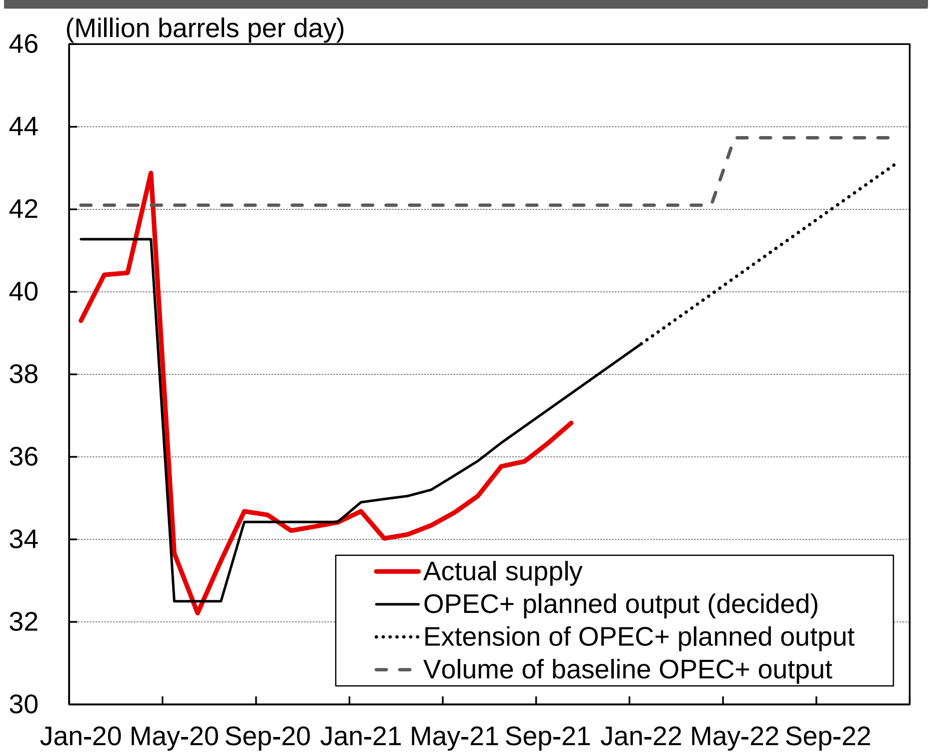
- Currently, oil prices are higher than USD 58, which marks the upper limit of the average cost of development of new shale oil fields (according to a survey published in March this year by the Federal Reserve Bank of Dallas). In addition, the number of working oil rigs has slowly recovered to around 70% of its pre-COVID-19 level. Taking this into account, the volume of US shale oil production is forecast to gradually increase from now. That being said, it is thought that attitudes about new investment in shale oil companies will remain cautious for the time being given the labour shortage and the global shift towards decarbonisation. Therefore, it is important to keep eye an on the risk that production will not recover as much as expected.
- OPEC+ has increased its output by 400,000 barrels per day each month since August based on the agreement it reached at its Ministerial Meeting in July. Although oil production in some countries has fallen below planned levels owing to operational issues at oil-related facilities, Saudi Arabia – which has a large oil production capacity – is carrying out its primary role of coordinator, and interesting is mounting as to what it will do. OPEC+ agreed to maintain its planned production cuts at its Ministerial Meeting in December, which had attracted attention in light of the sharp fall in oil prices brought about by the spread of the omicron variant, and observers will look to see if OPEC+ agrees to stick with its former plan to increase production in January next year as well. After the meeting, OPEC+ said it will "continue to monitor the market closely and make immediate adjustments (to the volume of production) if required". It is highly likely that OPEC+ will continue with its cooperative oil production cuts in order to underpin oil prices.

Volume of US Oil and Shale Oil Output and No. of US Working Oil Rigs



Source: EIA, Bloomberg, MUFG Bank Economic Research Office

Volume of OPEC+ Oil Supply



Note: 1. Excludes countries not participating in cooperative production cuts – Iran, Libya, Venezuela, Mexico
2. "Extension of OPEC+ planned output" shows the extended oil production cuts from August 2021 until January 2022
Source: IEA, MUFG Bank Economic Research Office

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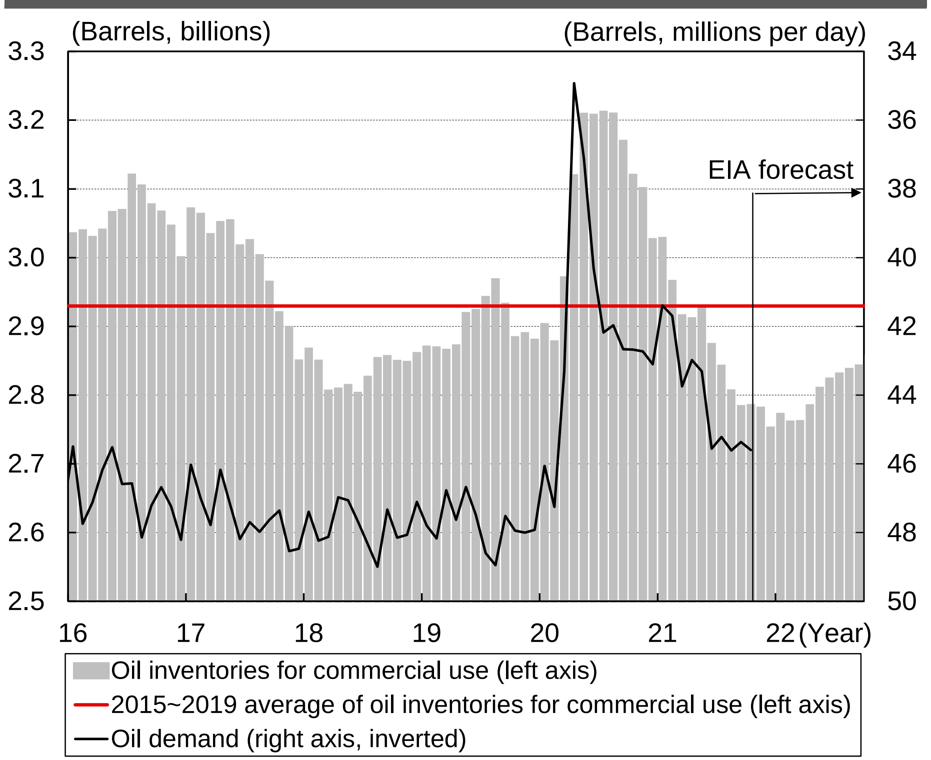
December Outlook: Oil Inventories and the Supply-Demand Balance

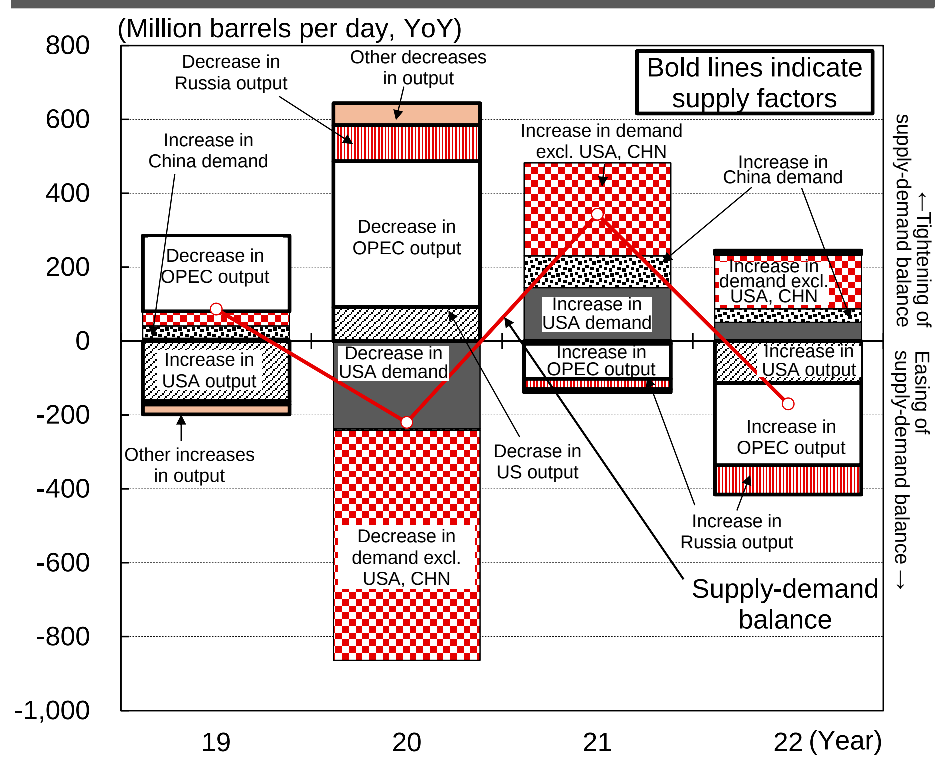
- While demand for oil is recovering at a robust pace as the global economy picks up, the increase in US shale oil and OPEC+ oil output remains gradual. As a result, the current level of OECD commercial oil inventories is currently much lower than the average it recorded before the pandemic (2015 to 2019).
- The balance of oil supply and demand is forecast to record an excess of demand in 2021 owing to the increase in global oil demand as economies recover, despite the decision by OPEC+ to increase its oil output. In 2022, although demand will continue to increase as the global economy recovers, the global balance of supply and demand is expected to shift to an excess of supply due to an increase in OPEC+ oil production and a gradual increase in US shale oil output.

OECD Commercial Oil Inventories and OECD Oil Demand



Source: EIA, MUFG Bank Economic Research Office

Forecast of Future Supply and Demand of Oil



Note: Figures from 2021 onwards are forecasts by Economic Research Office
Source: EIA, MUFG Bank Economic Research Office

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Outlook

- Oil prices (WTI front month) fell sharply owing to concerns about downward pressure on demand from the spread of the omicron variant and are currently around USD 65 per barrel. In the future, the supply and demand balance is forecast to shift from excess demand to excess supply. As a result, oil prices are expected to remain around the USD 60-per-barrel mark until the end of 2022. However, oil prices may fall or rise depending on developments in the COVID-19 situation, an unexpected increase or decrease in oil production by OPEC+, a change in policies by many countries related to decarbonisation and the outcome of negotiations over the Iran nuclear agreement.
- The futures curve for WTI oil prices (1 month to 5 years) shows 2-year futures are around USD 60~65, whereas 5-year futures are around USD 55~59, which means the market has factored in a fall in prices.

Oil Price Forecast

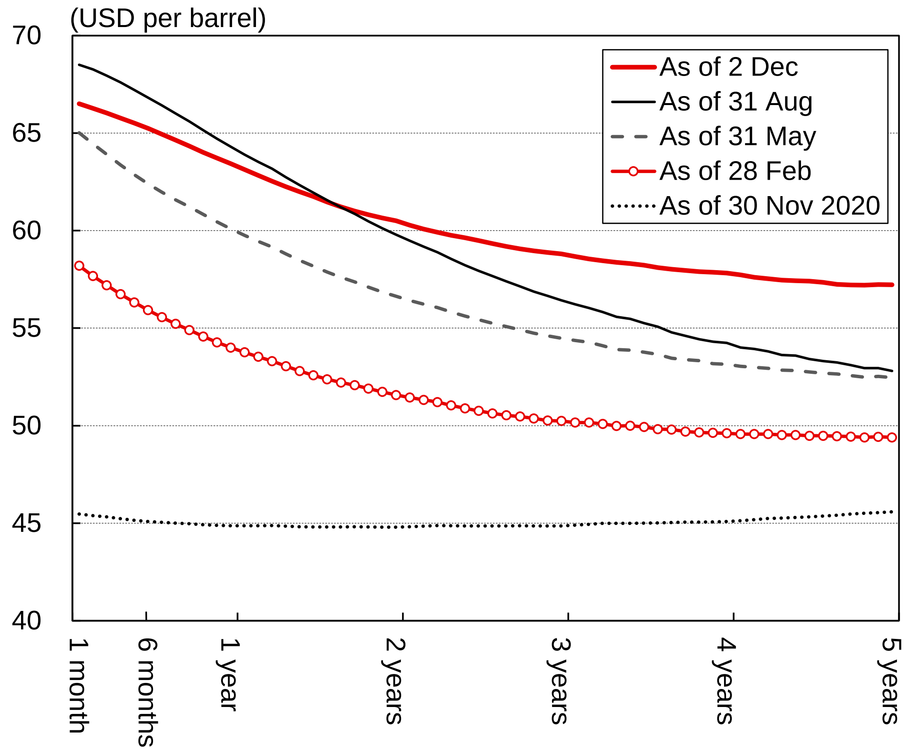
	WTI future (USD/barrel)	YoY (%)	Brent future (USD/barrel)	YoY (%)
2020 Q1	45.8	-16.6%	50.8	-20.4%
Q2	28.0	-53.3%	33.4	-51.2%
Q3	40.9	-27.5%	43.3	-30.1%
Q4	42.7	-24.9%	45.3	-27.5%
2021 Q1	58.1	27.0%	61.3	20.7%
Q2	66.1	136.1%	69.1	106.9%
Q3	70.6	72.5%	73.2	69.0%
Q4	74.0	73.3%	77.0	70.1%
2022 Q1	66.0	13.5%	69.0	12.5%
Q2	64.0	-3.2%	67.0	-3.0%
Q3	62.0	-12.1%	65.0	-11.2%
Q4	60.0	-18.9%	63.0	-18.2%

Forecast

2020	39.3	-31.0%	42.3	-34.0%
2021	67.2	70.8%	70.2	65.7%
2022	63.0	-6.3%	66.0	-5.9%

Note: Prices shown are average for period
Source: Bloomberg, MUFG Bank Economic Research Office

Oil Price Forecast



Source: Bloomberg, MUFG Bank Economic Research Office

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