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Anticipating Future Crude Oil Prices Following Current Uptrend

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Crude oil prices are creeping up. The front-month futures contract for the benchmark West Texas Intermediate crude oil on the New York Mercantile Exchange closed at $84.40 per barrel on August 9, up $1.48/bbl from the previous day. The closing price above $84/bbl was the highest in nine months since last November. From just below $70/bbl at the beginning of July, the price rose by nearly $15/bbl in one month, accelerating the rise. The front-month futures contract for the Brent crude, another benchmark, rose by $1.38/bbl from the previous day to $87.55/bbl on August 9. If the uptrend continues, the $90/bbl level will come into sight.

The first factor supporting the recent rises in crude oil prices is a decline in anxiety about the future global economy, which brings about expectations for a steady increase in global oil demand. According to the International Monetary Fund’s latest World Economic Outlook released in July 2023, the global economic growth rate this year is predicted to be 3.0%, indicating by no means high growth. The rate represents not low growth but moderate growth. Specifically, the sense of anxiety among market participants has faded away generally as the U.S. economy is on a growth path, with European and U.S. financial insecurity calming down after shaking markets temporarily. As a matter of course, however, there are some anxiety factors including a Chinese economic slump that is severer than earlier expected. Nevertheless, market participants look more positive about the future global economy than they were in July when the IMF outlook was released (after being worked out).

Under such circumstances, global oil demand is expected to increase steadily in 2023. Although it cannot be ruled out that oil demand growth will slow down due to the sluggishness or deceleration of the Chinese economy, global oil demand is expected to increase by more than 2 million barrels per day year on year in 2023 for the second consecutive year. When demand growth is steady in any commodity market, market prices tend to be firmly supported. Conversely, when demand growth is weak, prices tend to weaken.

In addition, developments on the supply side are important. In particular, oil production adjustments by the OPEC-plus group of oil-producing countries are supporting crude oil price hikes. During this year's oil price stagnation and downtrend period, the OPEC-plus group decided to enhance coordinated production cuts, signaling its emphasis on an oil supply-demand equilibrium and support for oil prices. OPEC-plus leader Saudi Arabia and Russia, another key OPEC-plus member, have implemented voluntary production cuts in addition to coordinated production cuts. The impact of the voluntary production cuts cannot be ignored. Recently, there have been reports that Saudi Arabia may further extend or even enhance its voluntary production cut of 1 million bpd that has been implemented since July, attracting attention from oil market participants.

Given the current outlook for global oil demand and overall oil supply factors including the OPEC-plus production cuts, the international oil market might have reached a supply-demand equilibrium in the second quarter of this year after a supply excess in the first quarter and may see a demand excess in the third quarter. Market participants have begun to expect an average demand excess of 1 million bpd for the second half of this year. If so, global oil inventories will decline, exerting upside pressure on crude oil prices. Potential factors that would change such a situation may be slower oil demand growth amid the potential deterioration of China's economic stagnation and the OPEC-plus group's modification of its production reduction policy.

In such a situation, crude oil prices are currently rising gradually. In addition to the abovementioned factors, various factors will impact future crude oil prices, including U.S. shale oil production, developments in Russia and Ukraine, relevant changes in Russian oil supply, unexpected supply disruptions, and geopolitical risks in the Middle East. Nevertheless, moves by Saudi Arabia and other major oil-producing countries attract attention toward the next OPEC-plus meeting scheduled for November 26.

If crude oil prices continue to rise in the future, the international oil market's stability restored this year may be affected again. Crude oil prices represent basic energy prices, so their changes, especially a significant increase, can have significant implications for the world as a whole and for oil-consuming or -importing countries. As noted in "A Japanese Perspective on the International Energy Landscape" (648), rising gasoline prices have become a focus of attention in Japan. This week, the nationwide average gasoline price topped 180 yen per liter. The problem is that the main factor behind the gasoline price increase is the gradual reduction of gasoline subsidies towards their termination at the end of September. It is expected that this factor alone will accelerate gasoline price hikes. If this factor is combined with a rise in crude oil prices, the gasoline price hikes will be further inflated. We cannot deny the possibility that gasoline prices will rise close to or above 200 yen per liter. There is concern that such price hikes may have significant social and economic impacts.

October 6 marks the 50th anniversary of the outbreak of the Fourth Middle East War, which triggered the first oil crisis. If gasoline price increases attributed to the termination of gasoline subsidies at the end of September are coupled with those stemming from the crude oil price hikes, gasoline price spikes may attract attention on the 50th anniversary of the oil crisis. Japan's rate of dependence on Middle Eastern crude oil fell from 80% during the oil crisis to less than 70% in the mid-1980s due to subsequent efforts to diversify oil supply sources, but rose to 90% recently. As a result of efforts to phase out oil imports from Russia due to the outbreak of the Ukraine crisis, the rate has risen to 94% and even exceeded the level on a monthly basis. Securing a stable oil supply from the Middle East and the stability of the region has become important for the stable supply of oil and energy security in Japan. Japanese Prime Minister Fumio Kishida's recent visit to the Middle East can be seen as designed to meet this situation. Future policy trends in major Middle Eastern oil-producing countries are extremely important for Japan and the world.

Crude oil prices are important to Japan because of their impacts on prices of not only gasoline and other petroleum products but also liquefied natural gas imports. Under long-term contracts that cover most of Japan's LNG imports, prices are indexed to crude oil prices. Although there is a certain time lag, crude oil price hikes will inevitably bring about LNG import price increases. Given that LNG-fired power plants are the main power source in Japan, LNG price hikes will lead to increases in electricity prices. For Japan, crude oil price hikes are an important problem that pushes up not only gasoline prices but energy prices as a whole. The problem, of course, is not limited to Japan. Rising crude oil prices affect the balance of power between oil-producing and -consuming countries through the transfer of wealth. Even in countries like the United States, which is almost self-sufficient in oil supply, crude oil price hikes lead to higher domestic gasoline prices that affect domestic politics. For lower-income countries in the Global South, energy price hikes are a problem that brings about more serious consequences. We should pay attention to future developments regarding crude oil prices and the international oil market.

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