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Is US$50 just a check point for WTI crude oil futures?

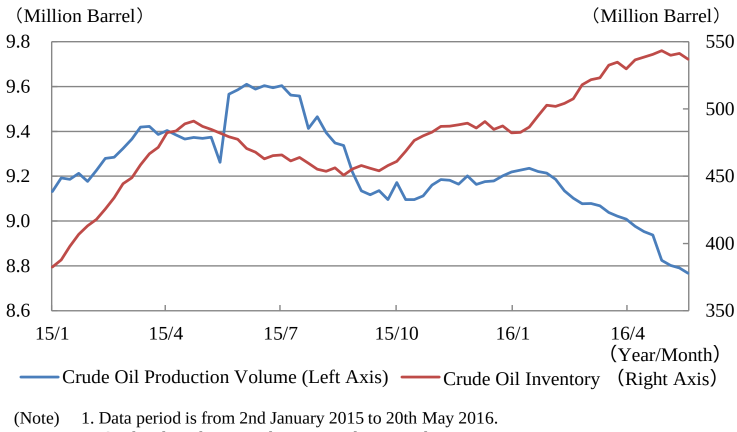
- Improving supply and demand balance and declining short positions of speculators are backdrops of solid crude oil price.
- Milestone of US$50 could be a temporal peak, however, it will not lead to a full-blown deterioration of market conditions.
- Although, we should keep an eye on Chinese economic indicators and possible US interest rate hike, crude oil market seems to become much more resilient to various shocks.

Improving supply and demand balance and declining short positions of speculators are backdrops of solid crude oil price.

WTI crude oil futures started to rise after touching bottom of USD26.05/barrel on 11th February 2016 and reached temporal high of USD50.21/barrel on 26th May 2016. Gain of crude oil futures prices was supported by i) decrease of both crude oil production and inventory in US (Chart 1) and ii) upward revision of April-June 2016 demand forecast by May Oil Market Report issued by International Energy Agency (IEA). Also, market sees arrival of driving season in US will be a positive factor to improve supply and demand balance.

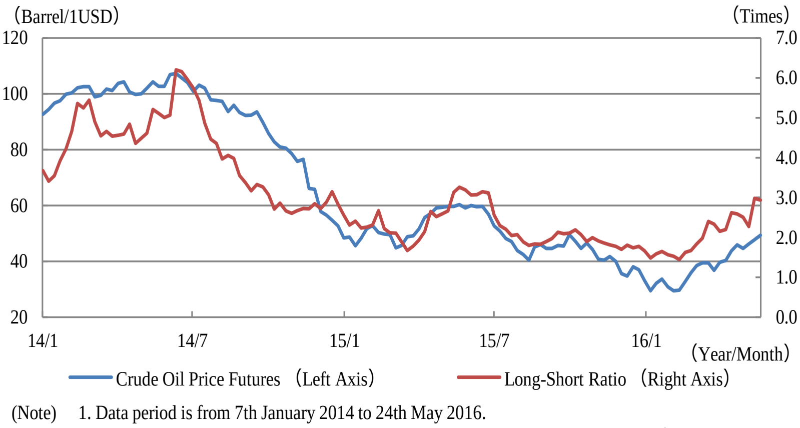
According to WTI crude oil futures positions published by US Commodity Futures Trading Commission (CFTC), Non-commercial Long-Short Ratio (ratio of long position to short position) which was low as 1.4 times in February 2016 has increased to 2.9 times on 24th May 2016. Crude oil price hike appears to be attributed to reduction of speculators' short positions, as rise of the ratio was due to significant decrease of short positions.

"Chart 1: Crude Oil Production Volume & Inventory of US"



(Note) 1. Data period is from 2nd January 2015 to 20th May 2016.
2. Crude oil production volume is a volume per day.
(Source) SMAM, based on Bloomberg L. P. data.

"Chart 2: WTI Crude Oil Futures & Long-Short Ratio"



(Note) 1. Data period is from 7th January 2014 to 24th May 2016.
2. Long-Short Ratio is ratio calculated by deviding long position by short position of Non-commercial.
(Source) SMAM, based on Bloomberg L. P. data.

Milestone of US$50 could be a temporal peak, however, it will not lead to a full-blown deterioration of market conditions.

Major oil producers met at Doha, capital city of Qatar, on 17th April to discuss over production volume to be maintained or not, in response to oil price fall in the beginning of this year. However, the meeting was adjourned without making any final agreement as Iran did not take part in. Although OPEC meeting is scheduled at Vienna, capital city of Austria, on 2nd June, maintenance of oil production volume is no more an urgent issue to discuss as currently the oil price stability is restored.

Therefore, it is not likely that the forthcoming OPEC meeting will set production target to resolve over supply. However, market participants might consider oil price has somewhat reached its peak as WTI crude oil futures had touched milestone of USD50. If that is the case, crude oil market might see weakness incidental to sell-off caused by winding up long positions, however, we believe that impact to Japanese stocks is limited as it will not lead to a full-blown deterioration of crude oil market conditions.

Although, we should keep an eye on Chinese economic indicators and possible US interest rate hike, crude oil market seemed to have become much more resilient to various shocks.

According to the latest report published by OPEC, supply and demand condition of crude oil will be balanced from July to December this year. It is likely that expectation on improving supply and demand balance will underpin the crude oil market for sometime. However, we need to be cautious of financial market reaction on i) Chinese economic indicators and ii) rising expectation on US interest rate hike. If market confirms trend of deteriorating Chinese economy, crude oil price will turn weak in expectation of decreasing crude oil demand in China.

Also, if expectation of interest rate hike were to rise sharply, financial market might experience significant volatility due to the fall of currencies and stock prices of emerging markets. In this case, it can be expected that risk-off sentiment will lead to fall in crude oil price, followed by JPY appreciation and end in Japanese equity price fall. However, crude oil market seems to become much more resilient as it had went through both negative reactions of i) and ii), from late last year to early this year.

*** Please note that this report is a translation of Japanese report written on 31st May, 2016.**

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