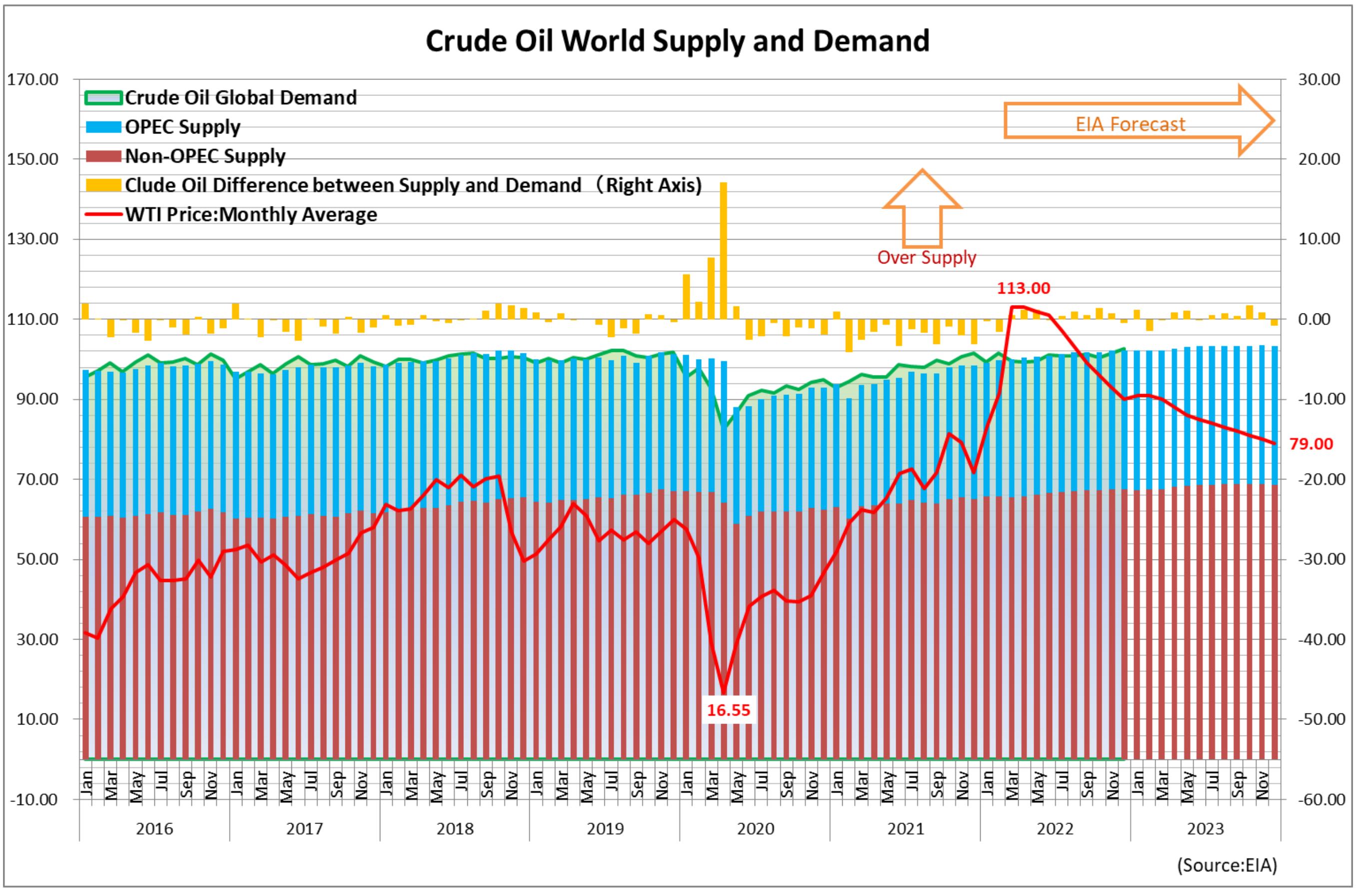
Chick Kawakami's Eye #13 :　High Oil Prices will not last so long

13th March 2022

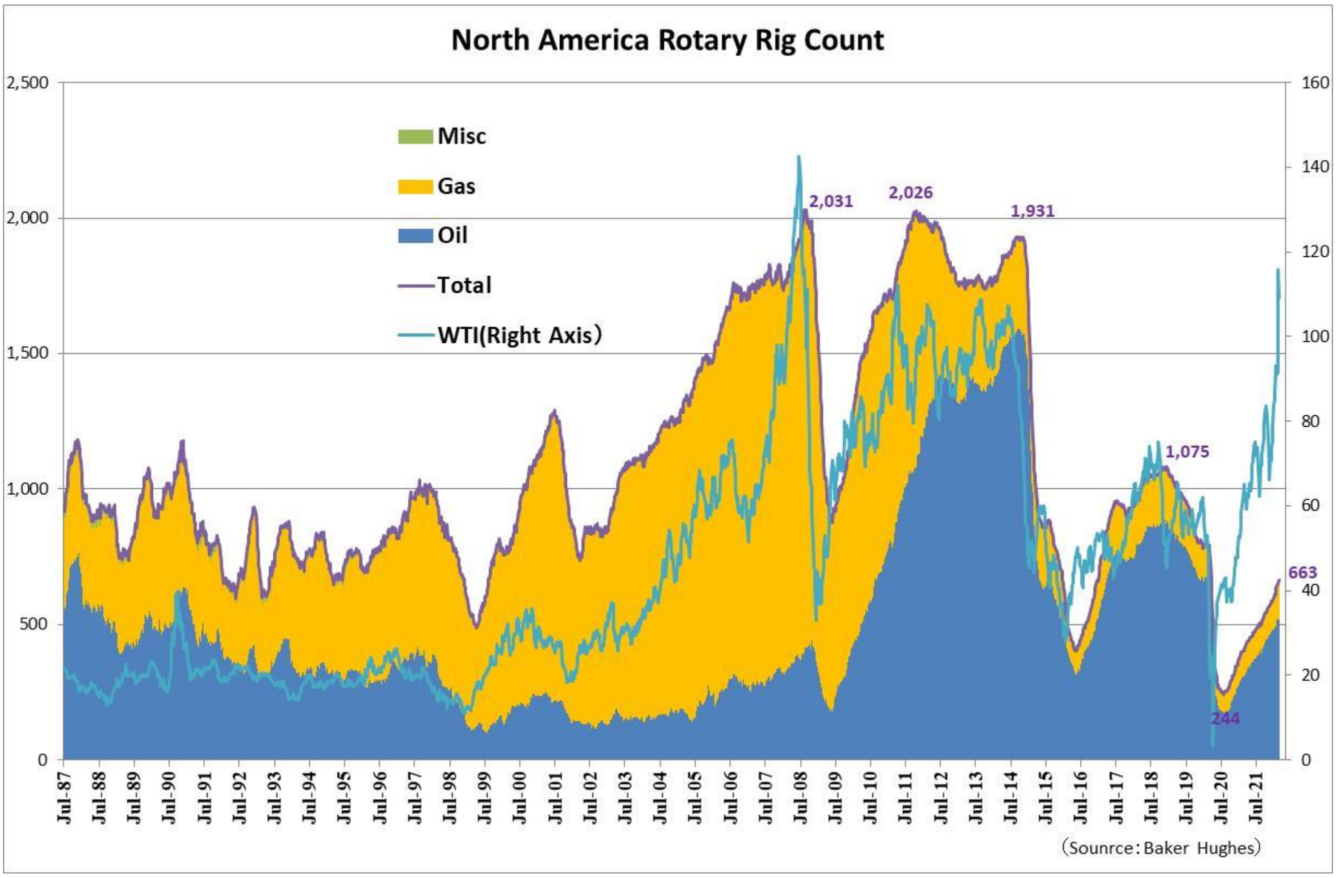
It is very heartbreaking that the fighting in Ukraine is escalating. We are praying for a quick cease fire.

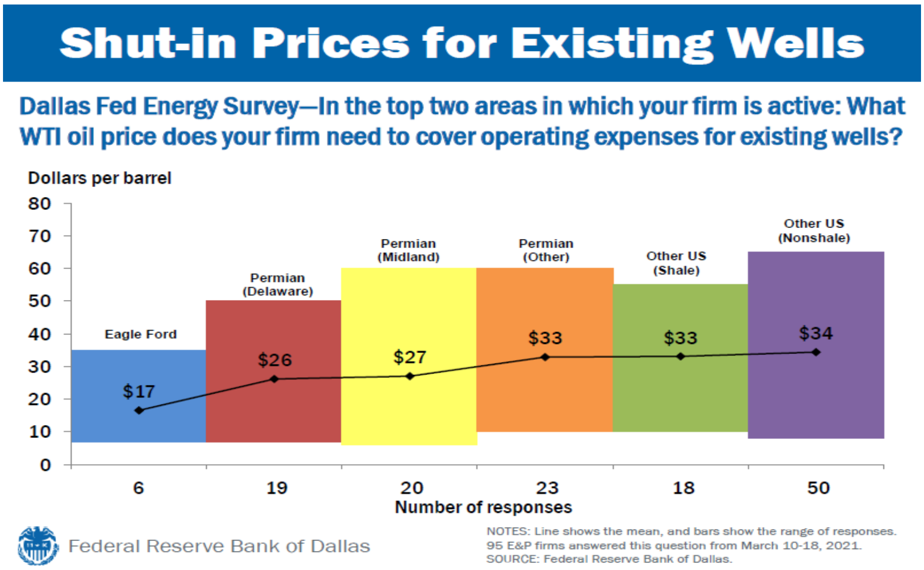
The price of crude oil continues to soar due to this state of fighting. On a West Texas Intermediate (WTI) basis, the futures price hit $130/bbl on March 7, and closed at $106/bbl on March 11.

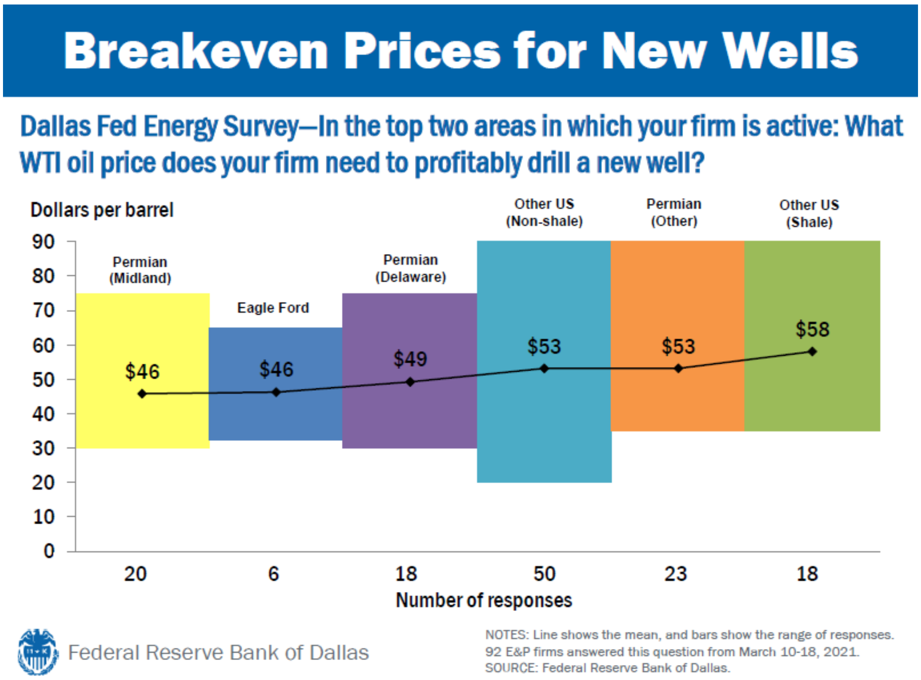
The U.S. Energy Information Administration (EIA) updated its forecast through 2023 on March 8, adding the effects of war to the factors. According to this forecast, a small surplus in crude oil supply and demand will continue from April, when the Northern Hemisphere enters a period of lower demand, and will fall to the $90/bbl WTI level in September. From a price-mechanism, higher crude oil prices restrain demand and increase supply through improved profitability of crude oil producers.



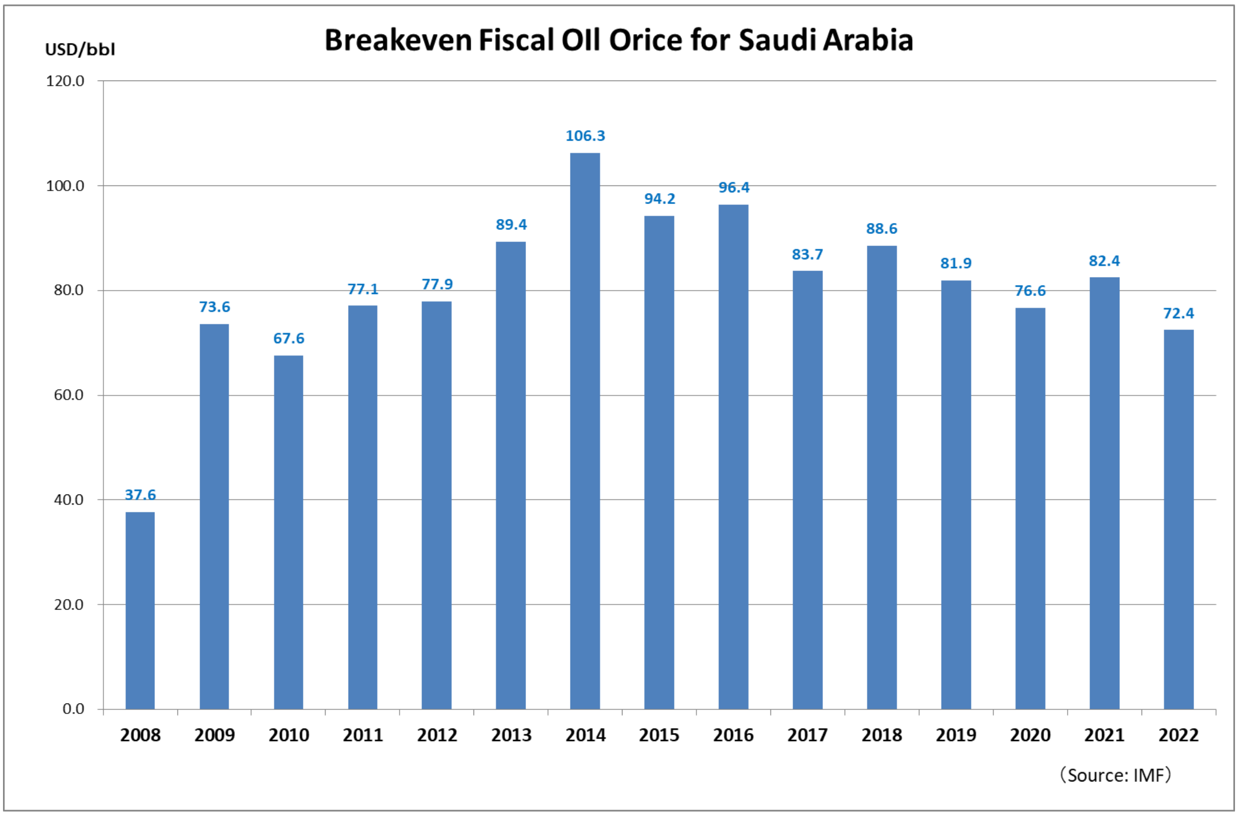
The number of shale oil operating rigs has decreased significantly since the sharp drop in oil prices in 2020, but currently, existing operating rigs are breakeven at $34 per barrel (WTI basis), even at the higher end of the range. The highest price for a new drilling rig is $58 per barrel. At the current price level, this means a considerable improvement in profitability. So it is easy to forecast that the number of rigs in operation and shale oil production will increase. Incidentally, during the week of March 5-11, the number of rigs in operation in North America increased by 8 crude oil rigs and 5 gas rigs, for a total net increase of 13 rigs. The average increase in rigs in operation from July 2021 to January 2022 was 4.5 rigs, indicating that the price increase has begun to accelerate certain extent.







Additionally the IMF estimates that the oil price at which Saudi Arabia will achieve fiscal balance is $72.4 per barrel this year, which means also a large fiscal surplus at present. The improvement in profitability, even in OPEC-plus terms, is obvious, and it is likely that the thinking of oil-producing countries will possibly change regarding the choice between continuing with the cartel to curb output or increasing production to increase revenues.



In any case, if the price mechanism works normally, an improvement in supply and demand due to increased production will become evident over time. It is necessary to watch the situation without getting too carried away by sensationalism.

Chick Kawakami
13th March 2022

Contact:
info@yamasawa.biz
kawaat@da.mbn.or.jp