SUPPLY SHOCK SEIZES OIL PRICES

The initial decline in oil prices started seven weeks ago as a result of demand destruction from the COVID-19 crisis, leading to surplus supply from the Organization of the Petroleum Exporting Countries (OPEC) and other major oil producers like Russia. As you may recall, OPEC and Russia made headlines at the beginning of March over their refusal to renew and increase production cuts, effectively launching an energy price war. Eventually, as the COVID-19 crisis deepened and demand declines became even more dire, they relented, and agreed to a historic cut of almost 10 million barrels per day, a tenth of global supply, beginning May 1st until the end of June to help control downward pressure on prices.

Saudi Arabia and other OPEC members are now reportedly considering cutting their oil production as soon as possible, rather than waiting until May 1st. Meanwhile, the Trump administration is considering a halt to Saudi crude imports and may add 75 million barrels to the Strategic Petroleum Reserve. Also being contemplated is an offer of federal stimulus to oil-and-gas producers in exchange for government ownership stakes in the companies or their crude reserves.

Also at issue is market sentiment toward oil futures contracts that are settled with the physical delivery of oil. According to reports, traders are struggling to find enough ships, railcars, caverns, and pipelines to store fuel as conventional storage facilities fill up. In fact, dozens of oil tankers have been booked in recent days to store at least 30 million barrels, adding to the roughly 130 million barrels of crude already in floating storage. As a result, the market is currently in contango, as oil contracts for future delivery are more expensive than the current spot. For now, June oil contracts are significantly higher in the $20s, showing that the market still expects demand to eventually return and storage supply of oil to be consumed. That may be a pipe dream.

It is clear that it is time for crude producing nations to come to their senses and take drastic measures to ease this massive supply glut that threatens to bankrupt drillers, fill nearly all land and sea-bound storage, and suppress prices at unsustainable, multi-decade lows. Ending the battle for market share would reduce the surplus flowing into the market, take some pressure off storage, and have a positive impact on market psychology, which is one of the factors that shapes prices. It would address only part of the problem of oversupply, but even that would be significant.

Leadership to achieve stabilization is necessary. Saudi Arabia has a unique platform for facilitating a resolution, since it is chair of this year’s G-20, the forum for the world’s major economies to address and remedy international economic problems. For example, during the 2008–2009 financial crisis, the G-20 functioned as a de facto board of directors of the world economy. But, of course, that was a more collaborative era.

So we will watch and wait to see what lies in store for energy prices in the months to come, and hope that in the midst of this health crisis and global recession that the energy producing nations of the world avoid exacerbating the challenges ahead.

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