Oil price plunge continues

By Nick Beams
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Oil prices and oil futures continued to fall sharply yesterday following Monday’s chaos, which saw contracts on West Texas Intermediate (WTI) crude fall to as low as -$40 a barrel, meaning that sellers were willing to pay buyers to take them off their hands.

The price of Brent crude, the international benchmark, fell to below $20 a barrel for the first time in 18 years as the slide in futures contracts for WTI continued. Even as WTI futures contracts for May plunged into negative territory on Monday, June futures contracts remained above $20.

Yesterday they fell to as low as $6.50 at one point, before rising to $11.57 at the end of the day—a drop of 43 percent.

A further decline seems almost certain. According to Louise Dickson, an analyst at Rystad Energy: “The contagion has spilled over to WTI June 2020 deliveries, which could also be well on their way into the red as we move towards physical delivery dates.”

The head of commodities trading at the financial firm ING, Warren Patterson, told the Financial Times that storage next month “will be even more of an issue.” In the “absence of a meaningful demand recovery, negative prices could return for June.”

Analysts at Citi have said if the global storage worsens, the price of Brent “could chase WTI down to the bottom.”

The spot price for Brent crude dropped to as low as $17.51 per barrel yesterday before recovering to $19.33—a fall of 24 percent for the day.

Some commentators have dismissed Monday’s plunge as a “technical” glitch, a kind of “flash crash,” resulting from the rapid exhaustion of storage capacity at the main US facility in Cushing, Oklahoma. But as one writer in the Financial Times noted, “this looks like the financial market equivalent of arguing that coronavirus is ‘just like the flu’.”

There are increasing calls for some form of government bailout for the industry.

The co-head of oil trading at Tarfigura, a large exporter of American crude, told the New York Times: “We are worried that the currently disorderly market has adversely damaged the industry. In the short term some form of government assistance is likely needed because the price levels we are currently transacting at are unsustainable for US producers.”

US President Trump’s attempt to halt the price slide by having Russia and Saudi Arabia cut production by 9.7 million barrels a day is now rendered a dead letter. As a result, he has indicated that government bailout measures may be forthcoming.

Yesterday Trump tweeted that he had “instructed the Secretary of Energy and Secretary of the Treasury to formulate a plan which will make funds available so that these very important companies and jobs will be secured long into the future.”

Tens of thousands of jobs have already gone. The oil and gas industry axed 51,000 jobs in March, a reduction of 9 percent. A further 15,000 workers lost their jobs in ancillary services such as construction and the manufacture of oil drilling equipment.

This is just the beginning. The chief executive of an oil-field services company, Dan Eberhart, told Bloomberg that “a tidal wave of bankruptcies is about to hit the sector.”

Even before the pandemic hit, many oil-producing companies were facing growing problems because of the fall in oil prices due to the slowdown in the global economy in 2019 after a brief upturn the previous year.

Many smaller oil companies are expected to file for bankruptcy in the coming period, adding to instability in financial markets. According to a report in the New York Times, citing data from Moody’s, production companies have $86 billion in debt falling due between 2020 and 2024. Pipeline companies have debts of $123 billion they have to repay or service over the same
The so-called shale oil revolution, which has transformed America into the largest oil producer in the world, leading Trump to hail “American energy dominance” last year, was based on ultra-low interest rates and the expectation that prices would remain elevated.

This led to the issuing by oil producers of high-yield junk bonds to fund production. As a result, according to analysis from JP Morgan Chase, energy companies were the largest single issuers of junk bonds in 10 of the last 11 years. But since the fall in oil prices, starting in 2016, some 208 producers have filed for bankruptcy involving $121.7 billion in total debt.

The pandemic and the associated lockdowns have functioned as an accelerant to a process that was already underway.

Small companies are not the only ones affected. This week S&P Global Ratings cut the credit rating of Exxon Mobil, citing the impact on its cash flow caused by the plunge in oil prices. Earlier Moody’s had downgraded its rating of Occidental Petroleum, which took on $40 billion of debt as a result of a takeover battle for Anadarko last year.

Job cuts are taking place across the board, not least in so-called clean energy production. Last week BW Research issued a report that this sector—involving solar panel manufacturing and electric cars—had lost more than 106,000 jobs last month, with employment in energy-related industries falling by more than 303,000.

An article by Neil Irwin in the New York Times yesterday warned the COVID-19 crisis went far beyond the shortages of some consumer goods. It had delivered a “deflationary shock” to the economy that would “almost surely persist beyond the period of widespread lockdowns.”

The economic effects so far—the rise in jobless claims by 22 million in the past month, with more to come, the contraction in the airline industry, restaurants and auto production, and now the plunge in oil prices—had longer term implications.

They pointed to a “deflationary collapse—a glut of goods and services and consequently falling prices—that surpasses anything seen in most people’s lifetimes,” Irwin concluded.