

# Oil price contracts take historic plunge into negative territory

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In a day of chaos in the international oil market yesterday, futures contracts expiring today on US-produced West Texas Intermediate crude dropped to as low as -\$40.32 per barrel, meaning that producers were paying buyers to take them off their hands.

The price at the close of trading was -\$37.63 compared with \$18.36 a barrel on Friday. It is the first time in history that oil prices have gone into negative territory.

The reason for the collapse is the lack of storage capacity in the US because of the collapse in demand due to the impact of the COVID-19 pandemic and the associated lockdown measures.

The main US storage facility is at Cushing, Oklahoma, a town of 10,000 people. The storage hub was at 70 percent capacity last week with traders saying it would be filled within two weeks. This prompted the futures selloff because the holder has to deliver 1000 barrels for every contract they hold to Cushing.

Traders in the futures market described the chaos.

Phil Flynn, senior market analyst at Price Futures Group, told the *New York Times*: “We saw a total collapse in the market. There was everybody selling it into the hole with no buyers. They’re going to have to drive down to a price where someone wants to buy it, and no one wants to buy it.”

The director of energy futures at Mizuho in New York told the *Times*: “I’m 55 years old, and I worked on the trading floor in college. I’ve been through the first Gulf War, second Gulf War, World Trade Center, dot-com crisis, and nothing came close to this. It could get worse. This situation we are in is that bad.”

In an interview with Bloomberg, Michael Lynch, the president of Strategic Energy and Research, said: “The background psychology right now is just massively bearish. People are concerned that we are going to see

so much build-up of inventory that it’s going to be very difficult to fix in the near term and there is going to be a lot of distressed cargoes on the market. People are trying to get rid of the oil and there are no buyers.”

Some futures traders are still betting on a revival and so contracts for June remain positive. But an even bigger crash could be in the making when they become due.

Stephen Schork, the editor of an oil-market newsletter, told the *Financial Times*: “It just gets uglier from here.”

The rapid rise in US unemployment—22 million workers have applied for jobless benefits in the past month—means that fewer and fewer Americans will be driving in the coming months, pushing down summer demand for petrol, usually the peak period.

“This summer is dead on arrival,” he said. “The biggest demand months are not going to happen.”

Global oil demand, which was 100 million barrels a day in 2019, has now fallen by 30 million barrels due to the pandemic.

Prices for oil deliveries in June remain positive but the most actively traded futures contracts fell by 18 percent yesterday to close at just over \$20 per barrel. Back in January they were trading at \$65 per barrel.

The price of contracts for Brent crude remains positive because it is stored on tankers which still have a capacity to take additional supplies but it is only a matter of time before this runs out. At the end of March there were 109 million barrels of oil stored on tankers at sea. Last Friday it has risen to 141 million.

The oil price crash has shattered the agreement orchestrated by US president Donald Trump for Russia and Saudi Arabia to cut oil production by 9.7 million barrels a day. Trump claimed the deal would save “thousands of jobs” in the US oil industry. But like so

many of the other assertions by the blowhard in the White House this pronouncement has been torn to shreds within a matter of days.

Speaking at a press briefing yesterday, Trump said the administration was looking at increasing the holdings of the Strategic Petroleum Reserve. “This is a great time to buy oil,” he said.

The idea was first floated several weeks ago but Congress refused to supply the funds for purchases. Trump said the administration was looking to fill up national petroleum reserves by as much as 75 million barrels and “one way or the other it will be full.”

But such is the extent of the contraction it is doubtful this will halt the slide, any more than the agreement with Russia and Saudi Arabia did.

The crash in the futures market will accelerate the already rapid decline in the physical market where prices are already down by more than 60 percent from the start of the year.

Even before yesterday’s historic events, Bloomberg reported that some buyers in Texas were offering as little as \$2 a barrel for some oil streams. “In Asia,” it noted, “bankers are increasingly reluctant to give commodity traders the credit to survive as lenders grow ever more fearful about the risk of a catastrophic default.”

The crash is ripping through the US oil industry. Last week producers shut down 13 percent of oil drilling operations but this has not been sufficient to counter the oversupply.

The shale industry, which produces around 10 million barrels a day, providing what Trump has hailed as “US energy dominance,” now faces a rapid decline, if not a collapse.

And it could have ramifications that reach into financial markets. Much of shale oil production has been financed by high-yield junk bonds and risky leveraged loans, predicated on oil prices of at least \$60 per barrel. If major defaults occur this could have large knock-on effects in financial markets and eventually reach the banks.

In the middle of last month, the *Financial Times* reported that most oil companies, with the exception of Exxon [Mobil] and Chevron were on “life support” and that even with oil prices at \$57 a barrel “the US shale industry was already struggling to generate cash and retain investor support in 2019” and 42 companies,

with \$26 billion in debt, had filed for bankruptcy.

In the month since that report, the situation has become dramatically worse at a speed never seen before in history.



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