April

From Peak To Negative Oil

If somebody had told you 15 years ago when oil prices were rising above $150 a barrel that oil producers would be paying storage companies good money to take oil off their hands, what would you have said? For that matter, what would you have said if somebody had told you these things a month ago?

The chart here shows the real, inflation-adjusted price of oil from 1870 to today, and what you see on the right side is a price collapse of unprecedented proportions. As pandemic-related lockdowns force factories to close and people to stop auto and air travel, global demand for oil has fallen by a shocking 29 million barrels a day. Oil exporters have reduced production, but not by nearly this degree, which means that, until Monday (April 20), they were selling the excess at below-extraction prices to anybody with the storage capacity to accept it. Storage capacity filled up rapidly, so that for a brief time, producers had to pay those who still had room in their storage facilities (via paying people to take their crude oil contracts) up to $40 a barrel to take the oil off their hands. Other producers are leasing tankers at high costs and storing oil at sea—reportedly paying $100,000 per day for each tanker.

Of course, oil does not actually have a negative worth, and the negative price concerned only contracts for delivery of barrels in May that are traded on the futures markets. Month-out futures contracts are selling at roughly $20 a barrel—suggesting that oil traders believe production will come back in line with demand. Crude exporters shut down 13% of the American drilling fleet, while Russia and the OPEC countries have agreed to reduce output by 9.7 million barrels a day. The White House has proposed paying U.S. frackers to keep their oil in the ground, but it can be costly to restart operations, and a shut oil facility may be damaged permanently. About all the government can do, currently, is lease space for an additional 47 million barrels in the Strategic Petroleum Reserve.

This is obviously uncharted territory for the global economy and investment markets. Nobody seems to know what will happen except, perhaps, a tsunami of bankruptcies among oil drilling companies. The average price for a gallon of regular gasoline in the U.S. has fallen to $1.49, down a dollar from a year ago, but who today is filling up their tanks? Name brand companies like Exxon and Chevron are likely to see earnings declines, but in total, the oil and gas industry only makes up about eight percent of the U.S. gross domestic product—compared with 14 percent in the 1980s. The shock value of watching energy producers paying others to take oil off their hands could cause a temporary spike in stock market volatility among the startled herd of Wall Street traders, but for the rest of us, it’s back to social distancing, not driving much or flying, and watching with a bit of amazement as peak oil becomes negative oil: one more strange thing about this strange period in our lives.

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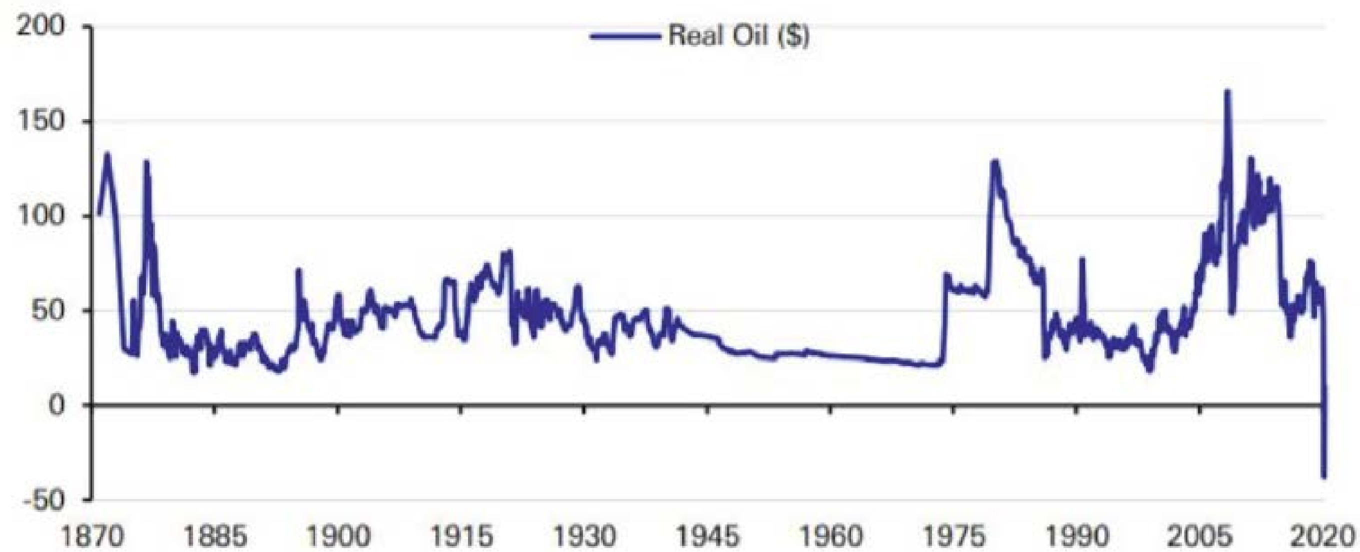
Figure 2: The cost of a barrel of oil in real USD terms



Source :Deutsche Bank, Global Financial Data

Phased-In Normalcy

By now, you've heard reports that the White House has announced federal guidelines for the easing of social distancing orders that have been put in place to slow the spread of the coronavirus. The leadership of different states will have the final say, of course, but the guidelines offer some indication of when we can expect to start congregating again without gloves and masks.

There are three phases in the proposed guidelines. (We are apparently in Phase 0 currently.)

Phase 1

Communities would enter Phase 1 when the statistics show a downward trajectory of reported illnesses within a 14-day period, and when hospitals were able to treat all patients without resort to crisis care.

In addition, before we can enter Phase 1, there would need to be a "robust testing program" in place for all at-risk healthcare workers.

If those criteria are met, the guidelines would still require vulnerable individuals—the elderly and those with pre-existing health conditions—to continue to shelter in place. Schools would remain closed and visits to senior living facilities and hospitals would still be prohibited.

What would change? People who are not at risk would go back to work, provided that they maintain appropriate social distancing. Large venues (the guidelines mention sit-down dining, movie theaters, sporting venues and places of worship) would be allowed to open under unspecified "strict physical distancing protocols." Elective surgeries could also resume, and gyms could open. But bars would remain closed.

Phase 2

Phase 2 kicks in if the states and regions enter Phase 1 and show no evidence of a rebound in cases. Vulnerable individuals would continue to shelter in place, but schools and organized youth activities would be allowed to reopen. Bars would also be allowed to open, although the protocols specify "diminished standing-room occupancy."

Phase 3

If there is no evidence of a rebound, then the state or region could enter Phase 3, which would not actually be a full return to normalcy. There would still be physical distancing protocols in workplaces, large venues, gyms and bars. But employers would resume unrestricted staffing of worksites.

The guidelines prominently make no mention of increased testing other than for healthcare workers. It's possible that, even if the state and local leaders give us the "all clear" signal, that people will still want to know whether the people in the adjacent cubicles are contagious.

-Bob Veres

Source:

https://www.whitehouse.gov/openingamerica/#criteria

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