Why Has the Price of Crude Oil Skydived?

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On the back of the unprecedented supply glut, sapped demand and filled storage amid the coronavirus pandemic – for the first time in history, the prices of the US crude oil futures tanked to a negative territory, indicating the producers would pay traders for taking the oil off their hands.

Prices on the May contract expiring Tuesday for the US-benchmark, West Texas Intermediate (WTI), dipped 321% to -40.32/barrel while the global standard, Brent crude futures pared brief gains and edged about 9.5% lower at $25.41/barrel.

The June and July WTI contracts also dropped roughly 18% to $20.43/barrel and 11% to $26.18/barrel.

As the spread between May and June contracts, known as front and second month – is now the widest in the history, the downward trend for June and July contracts insinuated the mounting uncertainty and dying investors' hopes about reopening of the US economy in near future.

Initially, it was disagreement between Russia and Saudi Arabia on production cuts at the OPEC+ forum that exacerbated tensions in the oil industry and stoked price and share war between them. By the time, the two energy rivals downplayed differences and signed an agreement; the Covid-19 went on the rampage to trigger abysmal anxieties in the US crude markets.

The ecstatic US President Donald Trump, claimed to have brokered the deal, popped up on twitter to thank Russian President Vladimir Putin and Saudi King Salman bin Abdul Aziz – terming the agreement "big" and "Great deal for all!" that "will save hundreds of thousands of energy jobs in the United States."

But with the pandemic doling out a severe blow to major driver of the US economy, the settlement between Riyadh and Moscow looks antediluvian as the price setback coupled with shelved energy demand poses a significant threat to the jobs of more than 10 million workers associated with the oil industry. Many of whom are already being terminated or furloughed.

So even the historic deal – to steeply cut the oil production by 9.7 million barrels per day (mb/d) and backstop the value decline – did little to stabilize the markets and cannot prevent the WTI from a free fall. That's because the reduction was not as per the expectations of the president himself and global analyst firms that believed it to be at least 20 mb/d to resuscitate the industry.

How Washington drove Saudi Arabia into the deal is controversial too. Trump's push for a production cut was backed by a coalition of US Congressmen that in a threatening letter on April 8, sought the Kingdom "to do its part to bring stability – not further volatility – to global crude oil markets."

The frictional tone citing threats of suspending the US-Saudi economic and military collaboration and recalling American support to counter "Iran's malign activity" – emphasized the traditional pattern of Washington's bulling behavior toward its allies to achieve its interests.

Additionally, the price at which the oil should be sold is vital for the US shale sellers. For the American oil companies, anything less than $40/barrel is perilous for their operations sustainability. If the price of the crude drops below that mark, some producers may decide to stop pumping and the firms may head for bankruptcy. That's what is happening right now.

Head of shale research Artem Abramov at Rystad Energy says "$30 is already quite bad, but once you get to $20 or even $10, it's a complete nightmare." The comments pronounces how crucial it is for the US companies that oil remains at least around $40/barrel otherwise they won't be able to survive and many of them could go bankrupt.

OPEC in its most recent monthly statement on April 16 said "The term structure of all three crude benchmarks – ICE Brent, NYMEX WTI and DME Oman – moved to a super contango in March." Contago describes a situation that refers to oversupply and encourages traders to store oil to sell later on, hoping the crudes price to rally.

But with the wiping out US storage capacity, the traders won't be any more able to buy more oil or even sell existing stocks in sharply condensing domestic oil market. The buyers of front month contracts would hence be forced to take physical delivery of the oil at the end of May that they can't so they have to sell it now at any price.

Chief commodities analyst at leading Swedish SEB Group Bjarne Schieldrop confirmed the US storage issue referring "very front-loaded" contango, stating "The curves are saying we have a big problem with the storage of oil right now."

Michael Lynch, President of Strategic Energy & Economic Research also doubts the US storage capacity to endure the flooding oil and believes that could be full to brim. "The implication is that storage might be more full than thought, or that buyers expect it to be very soon."

All the US key oil facilities, including its main storage hub and delivery point Cushing, Oklahoma, are weighed down with the excess barrels. Since the end of February, the stockpiles at the largest oil-storage tank farm in the world have increased by nearly 50% to 55 million barrels against its working storage capacity of 76 million barrels. If the critical facility is full, a trader said it would be a "disaster."

The US needs the consumption to rebound in short term. If it doesn't and the airlines keep on grounded, cars remain garaged and refineries stay idle for a longer period – there would be tremendous selling pressure on all the traders holding the contracts, adding more weight on the Trump administration to provide support and reopen economy amid pandemic.

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