PORTLAND MARKET REPORT

MAY IN VIEW

IN A WORLD ON ITS KNEES, THERE IS NO OUTLET FOR CHEAP OIL, BECAUSE THERE IS NO ECONOMIC GROWTH TO ABSORB IT.

Under normal circumstances, May 2020 would be classified as a very volatile month when it comes to oil markets. Prices swung wildly on most days – often moving by over 1 pence per litre (ppl) in the morning, only to end the day 1ppl down by close of play! However, such was the market craziness experienced in both March and April of this year, May – by comparison – would have to be considered as a pretty steady month!

The headline was that oil prices fell no further than the lows of April and actually slightly recovered to around the $30 per barrel mark. Would a period of pricing serenity provide vital breathing space for the industry to evaluate the situation? Urm…that's not really how oil markets work! You move hard, and fast…and the slow movers normally die. So the oil majors such as Shell and Exxon, immediately cancelled a quarter of their capital projects. The oil service giants, such as Halliburton, Baker Hughes and Schlumberger – always at the forefront of price downturns – halved their spending in North America and massively cut investor dividends (by 75% in Schlumberger's case). The shale industry, which had already seen a 50% increase in the number of bankruptcies in 2019 (ie, when prices were high) just went into total freefall, laying off thousands of workers and taking hundreds of drilling rigs "off-hire".

Private business is just that though – private. As painful as shutdowns may be for employees and shareholders, the travails of the private oil business rarely affect the whole population. The same cannot be said for those countries that are totally and utterly reliant on their oil production. For all of Saudi's chutzpah back in February (when they declared they could survive and even prosper in a world of low oil prices), the fact remains that the country requires $80 per barrel oil to balance ballooning national budgets. Furthermore, the recent OPEC deal has meant the kingdom had had to cut production by 25% (less revenue), whilst massively discounting their oil, in order to fight Russian encroachment of Asian markets.

The situation is even worse with fellow OPEC members Iran and Venezuela. Already hammered by US sanctions and reliant almost entirely on oil exports to prop up their respective economies, a sub $30 per barrel oil price inevitably means increased social unrest. In Africa, the oil industry has been one of the few economic bright spots over the last 10 years – providing jobs, economic stability and a focus for international inward investment. But now the flow of money has rapidly dried up and countries such as Nigeria and Angola are facing up to spiralling debts coupled with precipitous cuts to foreign investment, as oil revenues dry up. In a continent where the financial muscle and infrastructure capacity of the oil industry could play a very real role in alleviating the effects of Covid-19, this sudden decimation of the industry is disastrous.

ONE DEVASTATING QUESTION REMAINS: WHAT HAPPENS WHEN OIL STORAGE CAPACITY RUNS OUT?

Even in the developing world, the price shake-out will irretrievably change economies. North Sea oil as we know it will not survive at these low prices, because mature oil fields require complex and costly engineering processes to bring the stuff out of the ground. Those players that have diversified into offshore wind power, look to have made a fairly prescient choice. In Canada though, little diversification has taken place and as a result, Alberta's oil sands look doomed. Oil production in this part of the world has the quintuple misfortune of being landlocked, costly to produce, low quality, hard to ship and a general public (outside of Alberta at least) that doesn't care for it (memories are short of course – it was Albertan oil sands that spared Canada from the ravages of the 2008-09 financial crisis). With prices for tar sand oil consistently sitting below $10 per barrel, the inevitable likelihood is that this product will stay underground, as wells are capped and "shut-ins" of production take place.

In the midst of this industry blood-bath, there is still one further devastating question that remains and haunts the whole industry. What happens when oil storage capacity runs out? In April, such was the extent of US supply outstripping demand, that storage space actually ran out. With nowhere to put their oil, producers were forced to pay to have their oil taken away (in the same way that a restaurant would have to pay to have their waste collected). This nightmare scenario remains a global possibility and would be utterly catastrophic for the oil industry. There is no reliable data on the total number of oil storage tanks in the world (and their associated capacity), but it is estimated that global tanks are filling at a rate of 600m barrels per month and will be full (at current rates) by the end of June…

Something has to give and give it must, because oil is worthless if it can't be put anywhere. Portland's customers have frequently been asking when the oil price will rebound or have even sometimes insisted that the "price must recover soon". But the question remains why? Back in 2014 (the last price crash), low prices stimulated increases in demand, because a booming economy saw the opportunity to buy cheap oil to fuel further economic growth. But in a world on its knees, there is no outlet for cheap oil, because there is no economic growth to absorb it. Yes, it is true that demand may now be tentatively recovering (as countries gently creep out of lockdown), but as long as supply outstrips demands so spectacularly, then prices will remain in the doldrums. Which means that oil producers – on some kind of kamikaze "joyride" – are heading to the wall. The leanest, the meanest and the cheapest will survive. But the damage elsewhere will be very, very messy.

For more pricing information, see page 22

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