Oil Market Report: May 2020

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, May - by comparison - would have to be considered as a pretty steady month!

The headline was that oil prices fell no further in May than the lows seen in April and actually slightly recovered to around the $30 per barrel mark. So would a period of tranquillity allow some vital breathing space for this now hard-pressed industry? Urm...that's not really how oil markets work! You move hard, and fast...and the slow movers normally die! No surprise then that the likes of Shell and Exxon have already cancelled over a quarter of their capital projects. Likewise, oil service giants such as Halliburton, Baker Hughes and Schlumberger - always at the forefront of price downturns – have halved their spending in North America and massively cut investor dividends (sometimes for the first time in their history and in Schlumberger's case, by 75%). The shale industry, which suffered a 50% increase in the number of bankruptcies in 2019 (ie, when prices were high), has just gone into total meltdown, laying off thousands of workers and taking hundreds of drilling rigs "off-hire".

As painful as these shutdowns are for employees and shareholders, the travails of private oil businesses rarely affect a whole population. The same cannot be said however for those countries that are totally reliant on oil production to support government expenditure. For all of Saudi Arabia'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 oil at $80 per barrel to balance ballooning national budgets. The recent OPEC+ deal (see last month's report) has meant the kingdom had had to cut production by 25%, whilst also massively discounting their oil (ie, even lower than the published price), in order to fight Russian encroachment of Asian markets.

The situation is even worse for fellow OPEC members, Iran and Venezuela. Already hammered by US sanctions and totally reliant on oil exports to prop up their respective economies, a $30 per barrel oil price means cataclysmic economic disintegration and an inevitable increased level of 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 target for inward investment. Sadly that 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. This downturn, in a continent where the financial and infrastructure muscle of the oil industry could make a real difference in alleviating the worst effects of Covid-19, is seriously worrying.

Even in the developed world, the price shake-out will irretrievably change national and regional economies. North Sea oil as we know it will not survive at these low prices and that will greatly affect Scotland's economic outlook. In Canada, 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 having a general public that doesn't care for it (memories are short of course, for it was Albertan oil that spared Canada from the worst of the 2008-09 financial crisis). With prices for oil sands consistently sitting below $15 per barrel, the inevitable likelihood is that product here will stay underground, as wells are capped and "shut-ins" of production take place.

Something soon surely has to give? Many Portland customers seem to think so and have been asking frequently when the oil price will rebound. Back in 2014 (the last price crash), low prices stimulated increases in oil consumption, 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 is now tentatively recovering (as countries creep out of lockdown), but as long as supply outstrips demands so significantly, then prices will remain in the doldrums. Which means that many oil producers are heading to the wall. The leanest, the meanest and the cheapest will survive. But in this industry blood bath, the damage elsewhere will be very messy indeed.