Special Bulletin

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WTI Sank below $20/bbl on Forecast Worst Contraction since Great Depression

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On April 15, the front-month West Texas Intermediate crude oil futures contract closed $0.24 per barrel lower than on the previous day at $19.87/bbl, slipping below $20/bbl on a daily closing basis for the first time in 18 years, since February 2002. On the same day, the front-month Brent contract lost $1.91/bbl to $27.69/bbl.

WTI fell to $20.09/bbl on March 30, coming to the brink of sinking below $20/bbl. In the face of the crude oil price crash, oil-producing countries tried to reconstruct their joint production cut initiative broken up in early March and enhance production cuts. After U.S. President Donald Trump, who was hard hit by the oil price crash, mediated between Russia and Saudi Arabia amid an oil price war, the Organization of the Petroleum Exporting Countries and non-OPEC oil-producing countries agreed to cut their production by 9.7 million barrels per day. In addition to the largest ever production cut by the OPEC-plus group, other oil-producing countries could come up with their own production reduction. Total production cuts are expected by some analysts to exceed 10 million bpd to around 15 million bpd.

On news that oil-producing countries would reconstruct the joint production cut initiative and enhance production cuts, crude oil prices rebounded once, with WTI rising back above $28/bbl on April 3. After the production cut agreement was announced, however, crude oil prices crept down again, with WTI falling below $20.

This is because a massive oil demand decline that would accompany a steep global economic contraction to be caused by the Coronavirus Disease 2019 pandemic is widely expected to overwhelm the production cuts.

On April 14, the International Monetary Fund released its latest World Economic Outlook forecasting that the global economy would contract by 3.0% in 2020. Even before the release, the IMF had been warning of a substantial contraction in the 2020 global economy. However, the specific forecast of the 3% contraction surprised market participants, impressing them with the devastating COVID-19 impact.

The IMF WEO in January forecast the global economic growth rate at 3.3% for 2020. In only three months, the forecast was revised down by 6.3 percentage points. Particularly serious contractions are forecast for Western countries devastated by the pandemic. The U.S. economy is predicted to post a 5.9% contraction (against a 2.0% rise forecast in January) and the eurozone economy a 7.5% contraction (against a 1.3% rise). Non-OECD economies, which have driven global economic growth, are forecast to contract by 1.0%, instead of growing by 4.4% as predicted in January. The forecast global economic contraction of 3.0% far exceeds a 0.1% contraction in 2009 amid the global financial crisis and is the steepest since the Great Depression that started in 1929.

As human and goods traffic is strictly restricted to prevent expansion of COVID-19, economic and business activities stagnate. The serious deterioration of the real economy has shaken financial markets and systems, exerting further adverse effects on the real economy. The world has thus plunged into a vicious cycle. Depending on the future status of the pandemic, the global economy could deteriorate further. No optimism can be warranted. In a scenario where the pandemic would be more serious and prolonged, the IMF indicates that the global economy could contract by an additional 3% in 2020.

In response to the forecast contraction in the global economy, the International Energy Agency on April 14 released a report leading energy market stakeholders to reaffirm the massiveness of the demand shock. The latest IEA Oil Market Report states that global oil demand in 2020 would decline by 9.3 million bpd or 9.3% from 99.85 million bpd in 2019 to 90.55 million bpd. The steep demand decline of 9.3 million bpd amounts to a demand destruction. A demand drop through an economic contraction amid the pandemic would be combined with a plunge in international passenger and goods traffic demand amid the lockdown to bring about a massive demand shock. The traffic demand plunge is destined to seriously affect demand for oil as a key energy source for transportation.

All quarters of 2020 are forecast to see steep year-on-year oil demand plunges. In the second quarter, particularly, oil demand is projected to post the sharpest year-on-year decline among the quarters of 23.15 million bpd or 23.3% to 76.06 million bpd, reflecting the steepest macroeconomic plunge and the most serious lockdown assumed for the quarter. The world has never experienced such enormous oil demand decline.

The massive demand destruction almost nullifies the effect of even the largest ever joint oil production cuts totaling 9.7 million bpd, exerting the abovementioned downward pressure on crude oil prices. If without the reconstruction of the joint production cut initiative, oversupply would expand dramatically to bring about a further oil price fall. It was inevitable for oil-producing countries to manage to restore joint production cuts to avoid the worst scenario.

The abovementioned IEA report points out that the crude oil supply-demand balance in the second quarter of 2020 indicates a crude oil supply excess of 11.9 million bpd, leading to substantial inventory build. Based on onshore crude oil inventory storage capacity (covering both government and private sectors) and various operational assumptions, total crude oil inventories are estimated to exceed operational inventory storage capacity in sometime in May or June. In addition to onshore inventory storage capacity, large tankers and other means may have to be used to absorb crude oil inventories. The international oil industry and oil supply system will be required to prevent the oil market from being overfilled. As far as such tense situation is sustained, downward pressure may remain on crude oil prices.

Excessive crude oil price falls would impoverish oil-producing economies, disrupt necessary energy investment, and shake the stock market in a manner to destabilize the international financial system. To avoid such negative effects, all the relevant countries should consider all possible measures and cooperate to stabilize oil-producing and -consuming countries and the entire world, as discussed at meetings of the Group of 20 major countries.

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