PMA Financial Markets Update

Falling Oil Prices Reignite Concerns

The most heavily traded U.S. crude-oil futures contract fell 43% on Tuesday, April 21st to $11.57 a barrel, its lowest close in 21 years. Tuesday's drop came a day after one contract for U.S. crude fell below zero for the first time in history. Negative futures prices mean May contract holders were willing to pay someone to get out of their long positions before expiration to avoid being delivered physical crude oil next month. The plunging oil prices can be summarized as a matter of supply and demand and storage capacity.

The tremendous drop in oil demand related to a near stop in the economy has resulted in huge increases in oil stockpiles. While some U.S. shale producers are already being forced to shut wells and OPEC is considering bringing forward the start date for planned production cuts from May 1, the expected supply drops are dwarfed by lost demand. Analysts estimate that oil demand has declined by up to 30 million barrels per day while the agreed upon cut by OPEC is only about 10 million barrels per day. Quite simply, the world is running out of space to store oil. Royal Vopak NV, the world's largest independent storage company, said almost all of its space is sold.

Following two weeks of recovery in stock prices, the drop in oil price has reignited concerns about the coronavirus' impact on the economy and markets. Declining stock prices on April 20th and 21st were not limited to energy firms. Part of the reason is that analysts expect a big drop in energy industry spending, including layoffs, to magnify the economic fallout from the coronavirus. The Trump Administration is considering several possible options to support the U.S. oil industry. Providing assistance to the oil industry will likely face opposition from congressional Democrats. An alternative is to work through the emergency-loan programs the Treasury Department has launched with the Federal Reserve. Falling oil prices as well as support programs initiated by the U.S. Government and the Federal Reserve present both inflationary and deflationary risks to the economy.

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