Oil Prices Below Zero

Why in News

Recently, the prices of **West Texas Intermediate (WTI),** the **best quality of crude oil** in the world, **fell to minus $40.32 a barrel** in interlay trade in **New York (the USA).**

- It means that the seller of crude oil would be paying the buyer $40 for each barrel that is bought.
- It is the **lowest crude oil price ever recorded** below the zero mark while the **previous lowest** was recorded **immediately after World War II (WWII).**

Oil Pricing

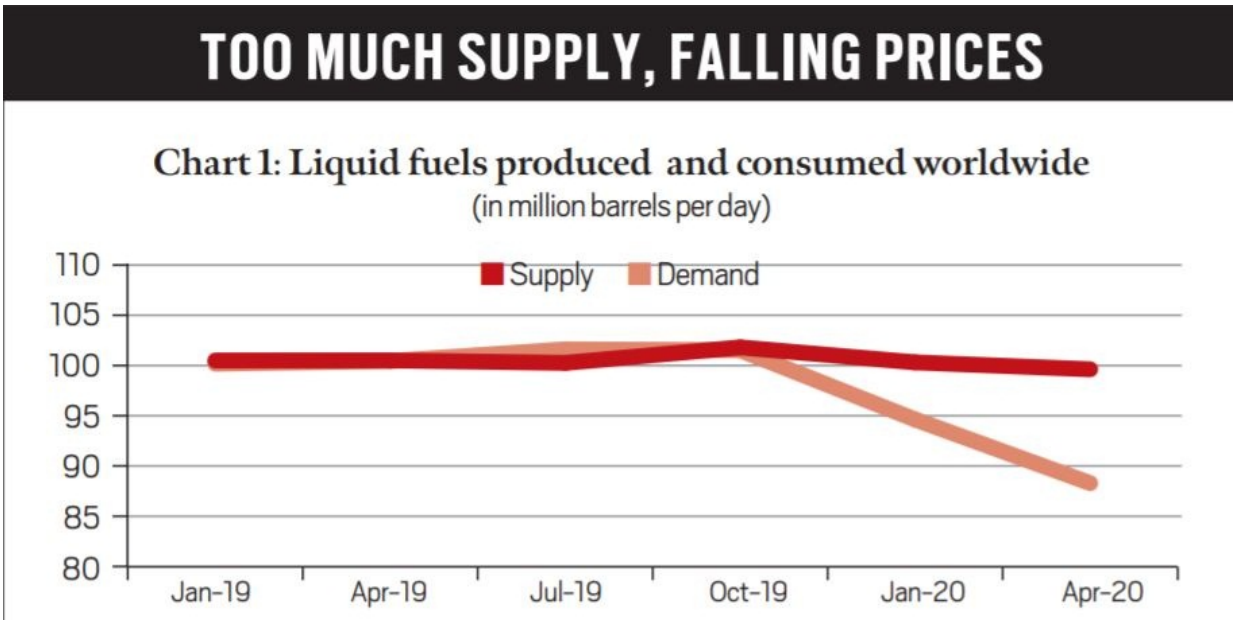
- Generally the **Organization of the Petroleum Exporting Countries (OPEC)** used to **work as a cartel and fix prices** in a favourable band.
    - OPEC is **led by Saudi Arabia,** which is the **largest exporter of crude oil in the world (single-handedly exporting 10% of the global demand).**
    - It could bring down prices by increasing oil production and raise prices by cutting production.
- The global oil pricing mainly **depends upon the partnership between the global oil exporters** instead of well-functioning competition.
- **Cutting oil production** or **completely shutting down** an oil well is a difficult decision, because **restarting** it is immensely **costly and complicated.**

    Moreover, if a country cuts production, it **risks losing market share** if other countries do not follow the suit.
- Recently, OPEC has been working with **Russia, as OPEC+** to fix the global prices and supply.

Reasons for Price Fall

Crude oil prices were **already falling before the global lockdown** due to the **higher supply and lower demand.**

They were close to $60 a barrel at the start of 2020 and, by March-end, they were closer to $20 a barrel.



- Problems arose when **Saudi Arabia and Russia disagreed over the production cuts,** required to keep prices stable.
    - Consequently, Saudi Arabia led oil-exporting countries started **undercutting each other on price** while **producing the same quantities of oil.**
    - This strategy was **unsustainable** on its own and the global spread of **Covid-19 made it even worse** as it sharply **reduced the economic activity** and the **oil-demand.**
- Oil-exporting countries decided to **cut production by 10 million barrels a day** (the **highest production cuts)** and yet the demand for oil was reducing even further.

    This **supply demand mismatch** resulted in **exhausted storage capacities.**
- It is important to highlight that the **US** became the **largest producer of crude oil in 2018** and the current US President has been pushing for **higher oil prices** instead of making efforts for lower prices like the previous US Presidents.

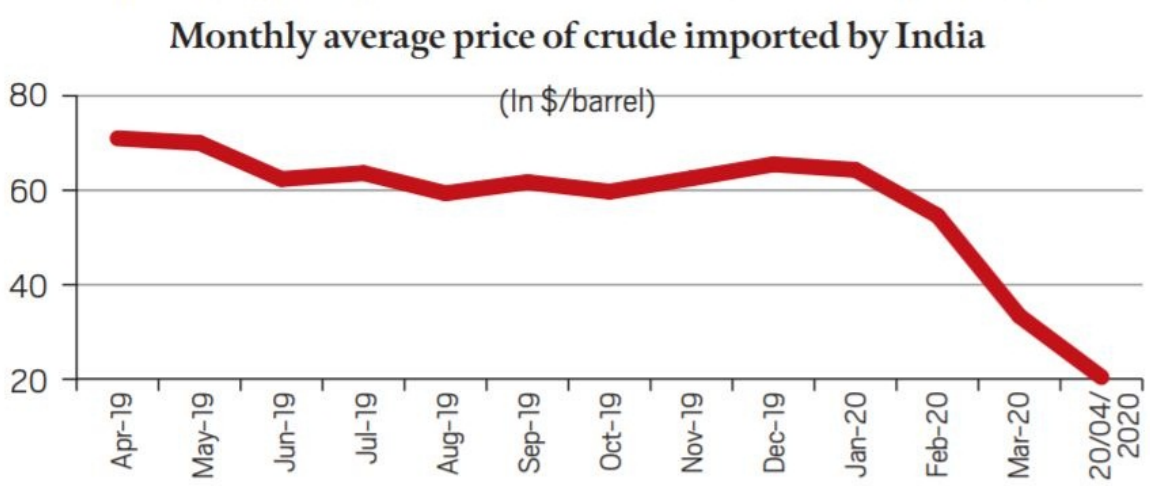
- The oil prices started falling steeply because the **May contracts for WTI were due to expire on 21st April, 2020** which posed **huge challenges** for both the **oil producers** and the **consumers (contractors/buyers).**
    - **Producers:** They started selling the oil at unbelievably low prices because **shutting production would have been costlier to restart when compared to the marginal loss on May sales.**
    - **Consumers:** They were facing the **problem of storage.** There is no space to store the oil even if they decided to buy and take the delivery.
        Accepting the oil delivery, paying for the transportation and storage would have been costlier than the hit on contract price.
    - In the short term, for both the holders of the delivery contract and the oil producers, it was less costly to pay $40 a barrel and get rid of the oil instead of storing it (consumers/buyers) or stopping production (producers). So this led to the **negative WTI oil contract prices.**

Future of Oil Prices

- It was the **WTI price for May in the US markets** that went **so low.** Crude oil prices at **other places fell but not too much.**
- Prices for **June and the coming months** are pegged **between $20 and $35 a barrel.**
- **Investment budgets of exploration and production companies** are **expected to drop** because of the **low shale oil prices.**
- Normally, this should force oil exporting countries to **cut back production and negate the excess supply, restoring balance** in the oil markets but the possibility of recent events from happening again cannot be ruled out.
- Eventually, it would be the **demand-supply mismatch** (adjusted for how much can be stored away) that will **decide the fate of oil prices.**

Impact on India

- There is **no direct impact** on India because Indian crude oil basket does not comprise WTI and it **only has Brent and oil from some of the Gulf countries.**
    However, the **weakness in WTI reflects on the falling prices** of Indian basket as well because **oil is traded globally** and has **indirect impacts.**
- The lower price can be **beneficial for India in two ways:**
    - **For Individuals:** If the government passes on the **lower prices to consumers,** then **individual consumption will be boosted** whenever the **economic recovery** starts in India.
    - **For Governments:** If both, central and the state, governments decide to **levy higher taxes** on oil, it can **boost government revenues.**

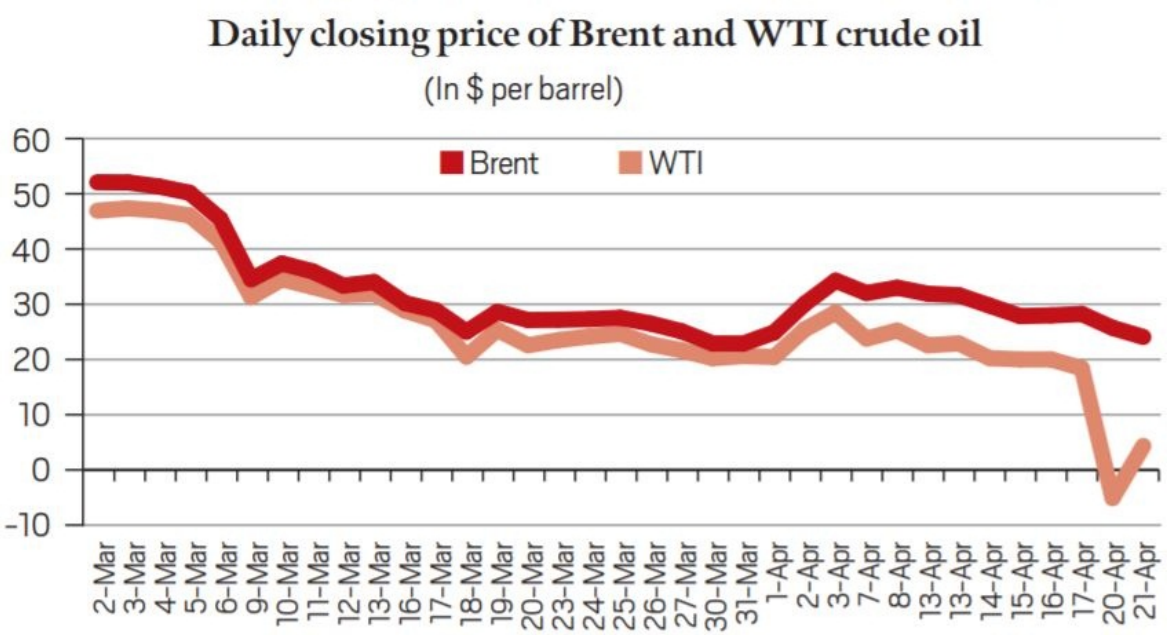


Difference between Brent and WTI

- **Brent crude oil** originates from oil fields in the **North Sea** between the Shetland Islands and Norway, while **West Texas Intermediate** (WTI) is sourced from **US oil fields,** primarily in Texas, Louisiana, and North Dakota.
- **WTI with a lower sulphur content (0.24%)** than **Brent (0.37%),** is considered **"sweeter".**
- Both oils are **relatively light,** but Brent has a slightly higher API gravity, making WTI the lighter of the two.

  American Petroleum Institute (API) gravity is an indicator of the density of crude oil or refined products.
- **Brent crude price** is the international benchmark price used by the **OPEC** while **WTI crude price** is a benchmark for **US oil prices.**

  Since **India imports primarily from OPEC** countries, Brent is the benchmark for oil prices in India.
- **Cost of shipping for Brent** crude is typically **lower,** since it is **produced near the sea** and it can be put on ships immediately. Shipping of WTI is priced higher since it is produced in landlocked areas like Cushing, Oklahoma where the storage facilities are limited.


Daily closing price of Brent and WTI crude oil
(In $ per barrel)
Brent
WTI
60
50
40
30
20
10
0
-10
2-Mar
3-Mar
4-Mar
5-Mar
6-Mar
9-Mar
10-Mar
11-Mar
12-Mar
13-Mar
16-Mar
17-Mar
18-Mar
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Source: IE