3. Oil Price Fell Below Zero

Prelims Syllabus: Industries – Textile, E-Commerce, Pharma, Service

Mains Syllabus: GS-III Infrastructure: Energy, Ports, Roads, Airports, Railways, etc.

Context:

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

- The Organization of the Petroleum Exporting Countries (OPEC) used to work as a cartel and fix prices in a favourable band. It 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 is a difficult decision, because restarting it is immensely costly and complicated. If a country cuts production, it risks losing market share if other countries do not follow the suit.

Causes for the Oil Price Fall:

- The Crude oil prices were already falling before the global lockdown due to the higher supply and lower demand.
- The price was close to $60 a barrel at the start of 2020 and, by March-end, they were closer to $20 a barrel. The Problems arose when Saudi Arabia and Russia disagreed over the production cuts, required to keep prices stable.
- Likewise, Saudi Arabia led oil-exporting countries started undercutting each other on price while producing the same quantities of oil.
- The global spread of Covid-19 made it even worse as it sharply reduced the economic activity and the oil-demand, which made the Oil-exporting countries to cut production by 10 million barrels a day (the highest production cuts) and yet the demand for oil was reducing even further.
- The supply demand mismatch resulted in exhausted storage capacities. 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).

- The Producers 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. The Consumers 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.
- 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.

Impact of Oil pricing in India:

- It does not have any 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.
- But, the weakness in WTI reflects on the falling prices of Indian basket as well because oil is traded globally and has indirect impacts.
- **The fall of oil pricing will benefit India in two ways:**
  1. If the government passes on the lower prices to consumers, then individual consumption will be boosted whenever the economic recovery starts in India.
  2. If both, central and the state, governments decide to levy higher taxes on oil, it can boost Government Revenues.

Way Ahead:

- 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. The prices for June and the coming months are pegged between $20 and $35 a barrel. The 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.