

IEF **INSIGHT** **BRIEF**



April 2020

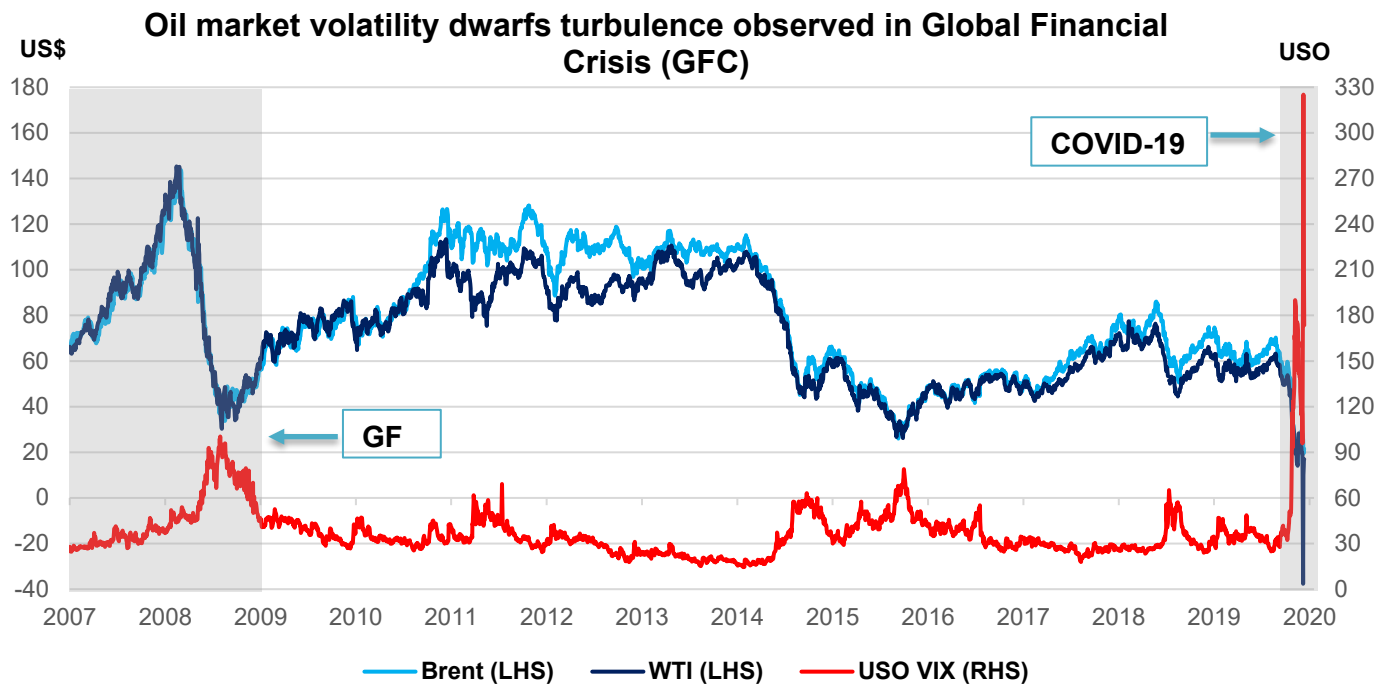
The Impact of COVID-19 on Energy Market Stability

KEY POINTS:

- The impact of COVID-19 has led to excessive volatility on physical and financial energy markets and will contract world economic growth by 3 percent in 2020 according to IMF assessments.
- Global oil demand in 2020 will fall by 7-9 mb/d according to current IEA and OPEC assessments creating a substantial oversupply that will affect storage capacity, shut in production, defer investment, and disrupt price signals.
- Three key meetings were held in April to address the impact of COVID-19 on energy market stability including the 10th OPEC and non-OPEC Ministerial Meeting. OPEC and associated countries adjusted production downwards by 9.7 mb/d for May and June, by 7.7 mb/d from July through December, and by 5.8 mb/d from January 2021 through April 2022.
- The adjustment will not offset the demand destruction brought on by the impact of the COVID-19 pandemic on the world economy but will assist in rebalancing markets over time.
- Producers and consumers remain exposed to market volatility as project cancellations and investment deferrals take place in a market environment that is still recovering from the 2014 downturn.
- This includes the possibility of a sudden upswing in energy markets when energy balances tighten as energy demand and the world economy recovers.
- The next major opportunities for producer and consumer countries to take this dialogue forward include:
 - The IEF17 International Energy Forum Ministerial Meetings scheduled to take place on 25-26 September 2020 prior to the G20 Energy Ministers Meeting, scheduled on 27-28 September 2020, and
 - The 7th Joint IEA-IEF-OPEC Workshop on the Interactions between Physical and Financial Energy Markets scheduled for late 2020

CONTEXT:

As of April 29, close to 3 million people are infected with almost 205,000 deaths in 213 countries, areas or territories according to most recent WHO data. Social distancing measures and lockdowns put in place by governments have brought the global economy to a standstill resulting in unprecedented demand destruction. The continued suppression of economic activity has reduced demand by about 30 million barrels per day (mb/d) year-on-year, and with demand forecasts falling by around 7-9 mb/d in 2020 according to assessments by the IEA and OPEC. Consequently, the oil market is witnessing excessive energy market volatility well beyond recent episodes of market turbulence.



KEY MEETINGS:

Three key meetings were held in April to address the impact of COVID-19 on energy markets:

G20 Extraordinary Virtual Energy Ministers Meeting – The G20 Extraordinary Energy Ministers Meeting with the participation of the IEA, IEF and OPEC on 10 April 2020 agreed among others to:

- Work together to develop collaborative policy responses that will ensure market stability across all energy sources taking into account each country's circumstances.
- Take all the necessary measures to ensure the balance of interests between producers and consumers, the security of our energy systems, and the uninterrupted flow of energy.
- Establish a short-term Focus Group with the task of monitoring response measures.

The 10th (Extraordinary) OPEC and non-OPEC Ministerial Meeting – OPEC and associated countries (OPEC+) agreed to a historic production adjustment on 12 April as follows:

- Starting on 1 May 2020, an overall adjustment by 9.7 mb/d will be made for an initial period of two months that concludes on 30 June 2020.
- From 1 July 2020 to 31 December 2020, the total adjustment agreed will be 7.7 mb/d.
- From 1 January 2021 to 30 April 2022 a 5.8 mb/d adjustment will be made for a period of 16 months.
- The baseline for the calculation of the adjustments is the oil production of October 2018, except for the Kingdom of Saudi Arabia and The Russian Federation, both with the same baseline level of 11.0 mb/d.
- The agreement will be valid until 30 April 2022, however, the extension of this agreement will be reviewed during December 2021.

Railroad Commission of Texas (RRC) – The Railroad Commission of Texas held an open consultation meeting on 14 April to consider whether to reinstate prorationing production, a measure last used in 1973 to limit wasteful production in excess of reasonable demand projections. On 21 April, the decision to prorate production was postponed until May 5, 2020, and a Blue Ribbon Task Force for Oil Economic Recovery, a task force led by the state's major trade associations to assist the oil and gas industry, was also announced. Key points of discussion included but were not limited to:

- Historical precedent for RRC intervention already exists as the RRC imposed market-demand prorationing intermittently in Texas between 1932 and 1973.
- Imposing a market-demand based proration of production could level the playing field and help producers and service companies remain viable during a period of excessive market volatility, save jobs, and protect reservoirs in the interest of rational resource management.
- An RRC decision to prorate production may run counter to the principles and practices established in the US energy sector after almost five decades of non-intervention.
- Regulatory uncertainties and legal challenges could arise should the RRC decide to prorate production. This will affect regulatory stability and may result in future investment being directed to other markets.
- Prorationing production would likely require the state of Texas to coordinate nationally to prevent any supply adjustment from being undercut by production in other US states not taking similar action.

GLOBAL IMPACTS:

With the production adjustment agreed by OPEC + in place, the market still faces several known and unknown challenges from both a supply and demand perspective that center on the availability of storage capacity, and the pace of demand recovery. Although this is a rapidly developing and fluid situation in which exact assessments remain elusive, the following key points reflect an emerging consensus view.

Demand:

1. **Social distancing measures and movement restrictions put in place by several governments due to COVID-19 has resulted in excessive energy market volatility.** – COVID-19 has created a shock to energy market balances that has demand falling by 7-9 mb/d in 2020 according to current IEA and OPEC assessments. Brent crude's six-month contango deepened even after the OPEC+ adjustment, and WTI entered negative territory which reflects the dislocation in supply and demand balances COVID-19 has created. Since oil markets are directly affected by a global and sudden disruption in demand, volatility is at levels much higher than during the Global Financial Crisis or any earlier episode in recent history.
2. **The possibility of a deep economic recession post-pandemic may impact future demand as the global economy recovers.** – The uncertainty plaguing the COVID-19 pandemic will cause global growth in 2020 to fall 3 percent according to the IMF. This makes the Great Lockdown the worst recession since the Great Depression, and far worse than the Global Financial Crisis according to recent IMF assessments. Oil demand may still be hampered long-term as the world economy recovers in a post-pandemic world. Government actions to stimulate the economy will depend on to what degree economic activity can safely return to pre-pandemic levels.

Supply:

1. **Rising over-supply due to lower demand has resulted in growing inventories that is putting severe pressure on global storage capacity.** – A lack of global storage capacity to accommodate excess supply will result in companies reducing or shutting in production entirely given volatile price signals. Even with a swift recovery it will take considerable time to reverse current trends and for markets to find new balances by reducing stock levels in the post-pandemic energy environment. Although OECD commercial inventories are a key indicator of market fundamentals, the lack of comprehensive data on non-OECD storage makes estimating global strategic and commercial inventories especially challenging.
2. **Independents and service companies are most exposed to pressure to shut in production and at risk of bankruptcies. IOC's and NOC's will slash investment and a new wave of mergers and acquisitions will follow.** – High- and medium-cost producers along with those with vulnerable solvability or cash-flow positions will bear the brunt of the economic turmoil caused by the pandemic. This will include but not be limited to layoffs, bankruptcies, restructuring, and new mergers and acquisitions. The steep reduction in investment due to the COVID-19 pandemic follows a period in which investment had only modestly recovered from the 2014 downturn. This implies market volatility will endure and affect both producer and consumer economies in the future, including the possibility of a sudden market upswing when energy markets tighten, and the world economy recovers.

RECOMMENDATIONS:

1. **Engage in inclusive energy dialogue on energy market stability, shared goals, and the road to recovery at the IEF17 International Energy Forum Ministerial Meeting scheduled to take place on 25-26 September.**

Excessive oil market volatility is detrimental to both producer and consumer economies. Such volatility makes future planning unclear, creates investment uncertainty, and may require expensive reallocation of resources. Planning national budgets becomes more difficult as importing countries face uncertainty regarding import costs and fuel subsidies levels, and exporters face budget shortfalls and volatile revenues. Continued producer and consumer energy dialogue among government and industry decision makers and heads of international organisations will help to stabilise energy markets, work to cushion the impact of a global recession in the wake of the COVID-19 pandemic, and reignite world economic growth. In addition to the IEF17 International Energy Forum Ministerial Meeting, the 7th IEA-IEF-OPEC Workshop on Physical and Financial Energy Market Interactions scheduled to take place later in 2020 will offer a next important opportunity to take stock of developments in physical and financial energy markets.

2. **Improve global energy data transparency, especially on storage in the non-OECD region through the Joint Organisations Data Initiative (JODI).**

To restore energy market stability and meet globally shared goals, energy data requirements will demand greater transparency to facilitate comparability and deepen market insight across countries and organisations. JODI is the only database and repository with government provided oil and gas data. JODI could improve upon existing datasets through increased participation and provision of timely, accurate, and consistent energy data on all energy sources. This includes, above all, comprehensive data on stock levels and changes for non-OECD countries. The exceptional energy market circumstances created by the COVID-19 pandemic may enable governments to make progress in enhancing strategic stock and commercial inventory data transparency for which government support remains essential. Given the unprecedented situation in the energy market, JODI has compiled a dedicated [chart book](#)

to provide the current status of available oil inventory data.

3. Evaluate and improve crisis prevention and emergency response mechanisms as a response to a more dynamic and new risk environment.

It is imperative for producer and consumer countries to discuss the new realities of the energy market and how the risk environment is constantly evolving. This can be accomplished by achieving a set of standards for energy market stability that fairly reflect both producer and consumer interests, the inclusion of new stakeholders in the dialogue who can make a meaningful contribution, and by discussing mechanisms required to prevent shocks to the market through early warning systems, sharing of burdens and benefits in maintaining spare capacity and strategic stocks, as well as building greater strategic reserve capacity. Continued dialogue will help energy market stakeholders in both consuming and producing countries to gain deeper market insight in a new and rapidly developing risk environment and help to prepare, organise, and respond to energy market developments in a mutually reinforcing manner.