

Explainer: What Happened to Oil Prices and What Does it Mean for Russia?

Oil prices in the U.S. went negative for the first time in history. Should Russia be worried?

By [Jake Cordell](#)

April 21, 2020



Russia, Saudi Arabia and others recently agreed a deal to cut oil production by 9.7 million barrels a day. Negative oil prices in the U.S. are the latest sign it will not be enough. **Michael Nagle / Xinhua / TASS**

What happened?

The headline price for a barrel of West Texas Intermediate (WTI) oil fell into negative territory for the first time in history Monday evening. Prices set a new record low of minus \$40.32 during U.S. trading hours. That means sellers were paying buyers to take oil off their hands.

Why did it happen?

The price refers to futures contracts on WTI oil — the American benchmark — due for

delivery in May. A combination of three factors pushed the headline price deep into the red, market watchers say.

First, global demand for oil has tanked since the start of the coronavirus crisis, while rigs are still pumping out more than the world needs. Second, Monday was the final day when traders, buyers and sellers could get their orders in for oil which would be delivered in May, or sell oil they had bought weeks and months ago and now realize they don't need. Third, storage facilities for unused oil are filling up fast.

1. Demand destruction. Analysts estimate that global demand for oil is down by as much as 30 million barrels per day (bpd) from its usual levels of around 100 million bpd as a result of the unprecedented lockdowns and mobility restrictions which countries around the world have introduced in response to the coronavirus crisis.

At the same time, oil producers have not cut back their production by levels to match. Russia, Saudi Arabia and other major producers struck a deal to take 9.7 million bpd out of the market starting May, while the Organization of Petroleum Exporting Countries (OPEC) claims cuts from other producers such as the U.S. mean around 20 million bpd could be taken out of the market. But analysts at Energy Aspects say that is an optimistically high estimate, relying on double counting. Either way, simple supply-and-demand dynamics dictate that if there is more oil being produced and less energy being used, prices will fall.

Related article: [OPEC+ Deal Will Help Russia Avoid 'Market Chaos,' But Provides Little Support to Embattled Economy](#)

2. Futures contracts. The headline price for oil is usually quoted as the going rate on the next-available futures contract. That means the amount for a barrel of oil to be delivered at the start of the next contract period, which runs monthly. Monday was the final day of market trading for WTI to be delivered in May. For buyers who had locked into contracts weeks and months ago, it was the last chance to ditch unwanted oil before being forced to take physical delivery of the oil in Cushing, Oklahoma — an oil hub in the U.S. where all WTI oil is physically delivered to buyers, before they pipe it or store it somewhere else.

3. Storage bottleneck. With supply outrunning demand, attention has rapidly turned to storage capacity — where to put unwanted oil. Storage facilities at Cushing have been rapidly filled over the past few weeks. Rystad Energy estimates there are only 21 million barrels of spare storage left — enough to cover just two days of U.S. oil production. That means buyers have few options to physically take delivery of the oil they bought if they don't plan to immediately use it.

This potent cocktail pushed market players into a desperate frenzy Monday as they scrambled for storage space or tried to ditch contracts to avoid being stuck having to take delivery of unwanted oil in just a few days.

What about Russia?

Monday's historic price crash was largely an American story. It affected just one kind of crude oil — WTI, with the technical aspects of storage limitations, oil being physically delivered to

Cushing, and markets trading on the contract expiry date combining to send prices into a historic slide.

For Russia, the frantic scenes of traders paying buyers \$40 a barrel to take American oil off their hands mean little on their own. Russian producers sell a different kind of oil — Urals — with the price determined by the benchmark Brent crude oil, not WTI.

However, the spillovers have rippled through the rest of the market Tuesday, with Brent and Urals coming under pressure. The sign of prices going negative in the U.S. triggered a fresh assessment of the extent of the crash in demand for global energy. Brent crude is not trading in negative territory, but crucial June futures contracts for Brent plunged by more than 20% Tuesday to below \$20 a barrel.

The immediate effect has been pressure on the ruble, which lost more than 3% against the U.S. dollar and is trading at 77 — its lowest level in three weeks.

Related article: [Coronavirus Hits Russian Markets | April 21](#)

Prices for Urals oil are a little more complicated to gauge, with a multitude of different prices quoted depending on where and in what form the oil is bought and sold. Data is also not freely available, being held by Russia's Finance Ministry and commercial firms such as Refintiv, S&P Platts and Argus Media tracking the latest prices at different locations.

Vedomosti [reported](#) Refintiv data Tuesday which showed Urals being delivered to the Mediterranean was sold at \$8.48 a barrel, the lowest price since 1998.

When Urals falls below \$25 a barrel, Russia's Central Bank accelerates its sales of foreign currencies held in Russia's reserves — the idea being that buying up rubles will counteract the negative impact which low oil prices can have on Russia's economy and which pushed the Russian economy into recession in 2015-16 as a result of the oil price crash. Last week, sales were running at around \$200 million a day. The Russian government has said it has enough in its \$125 billion sovereign wealth fund to cover six years of low oil prices, although some analysts point to larger headaches and structural weaknesses in Russia's oil industry and the wider economy should oil remain at its current levels for an extended period of time.

What next?

“A key question is whether we could see a repeat of this with the June expiry next month,” said Warren Patterson, Head of Commodities Strategy at ING. He is not optimistic that Monday could prove to be a one off. “It is likely that storage this time next month will be even more of an issue, given the surplus environment, and so in the absence of a meaningful demand recovery, negative prices could return for June.”

For Russia, Monday's wild price ride in the U.S. changes little in terms of the big picture. The fall in Brent, renewed pressure on the ruble and collapse in Urals prices to their lowest since Boris Yeltsin was Russia's President is, however, important.

Lower oil prices are bad news for the Russian economy, hitting not only the Russian

government's day-to-day budget, but also the country's mammoth rainy day funds which were built up over years of stable oil prices.

Analysts say Russia is better protected from lower oil prices than in the past — for instance, the Central Bank has not been forced to hike interest rates to protect the ruble, and is even likely to slash rates to stimulate the economy — but Russia is still a petro-heavy economy and the combination of lower oil prices and lower oil production as a result of the OPEC+ deal is likely to knock around 3% off Russia's GDP growth this year.

While the fundamentals haven't changed, prices falling to minus \$40 a barrel is a stark visualization of just how severe the fall in global demand is, and the weaknesses in the structure of oil markets.

Original url:

<https://www.themoscowtimes.com/2020/04/21/explainer-what-happened-to-wti-oil-prices-and-what-does-it-mean-for-russia-a70055>