Historic Surplus of Oil Will Push Prices Lower

U.S. production to bear the largest impacts in 2020-2021, could fall by 2-4 million barrels per day over next 18 months

- Current situation points to the possible buildup of the most extreme global oil supply surplus ever recorded
- IHS Markit estimates that—if the price war continues amidst a global recession and coronavirus crisis—the surplus could range 800 million to 1.3 billion barrels in the first six months of 2020
- Up until now, the largest six-month global surplus since 2000 was from late 2015 to early 2016, when it was a cumulative 360 MMbbl
- The largest 2020–21 impact on production volumes will be in the United States due to the fast reactivity of U.S. oil producers and the high decline rates of tight oil wells
- U.S. crude oil production could fall by 2-4 MMb/d over next 18 months

Extraordinary conditions can lead to startling outcomes. That is where the oil market now finds itself—in a truly extraordinary situation in what has been a transformative week for the global industry. There has been a dizzying drop in world oil demand and a dramatic pivot in Saudi oil production policy. This situation points to the possible buildup of the most extreme global oil supply surplus ever recorded. Counting barrels is challenging enough under normal circumstances, but the looming imbalance on current trajectory between demand and supply is so large now that it is well beyond any typical margin of error or uncertainty about data.

“There has been a dizzying drop in world oil demand and a dramatic pivot in Saudi oil production policy. If this situation persists amidst a recession, it points to the possible buildup of the most extreme global oil supply surplus ever recorded.” – Jim Burkhard, vice president and head of oil markets, IHS Markit

IHS Markit estimates that the global oil supply surplus on a monthly basis—the amount of global oil production in excess of demand—could range from 4 MMb/d to 10 MMb/d from February to May 2020. Indeed, demand in March and April could be down as much as 10 MMb/d. This estimated surplus translates into an inventory build of approximately 800 MMbbl–1.3 billion bbl in the first six months of 2020. The higher end of this range foreshadows the impact of increasing travel restrictions, reduced commuting and the likelihood of a severe global economic slowdown continuing in the second quarter. For context, up until now, the largest half-year global surplus since 2000 was in first half 2015, when it was a cumulative 352 MMbbl.
The primary cause of this surplus is the sharp, severe drop in world oil (liquids) demand, which in the first quarter will be at least 4MMb/d below the year earlier level. Oil price weakness is exacerbated by the recent decision by Saudi Arabia to substantially increase oil supply by 2.6 MMb/d relative to February levels. Russia has said that it can increase production by 300,000–500,000 b/d.

The fast reactivity of U.S. oil producers and the high decline rates of tight oil wells mean that the largest 2020–21 impact on production volumes at low prices will be in the United States. U.S. crude oil production, if and when new tight oil drilling stops, could fall by 2-4 MMb/d over 18 months. The spread of the coronavirus disease 2019 (COVID-19) and related movement restrictions raise the question as to whether oil production and supply chains be impacted owing to lack of workers in key producing areas around the world.

“The last time that there was a global surplus of this magnitude was never. Prior to this the largest six-month global surplus this century was 360 million barrels. What is coming will be twice that or more.” – Jim Burkhard, vice president and head of oil markets, IHS Markit

Three potential oil market scenarios going forward:

- **Truce and eventual demand recovery**: A “supply truce” emerges involving Saudi Arabia and Russia that leads to some production restraint, but output remains above early 2020 levels. World oil demand growth returns by the third quarter with prices in the $40-$50 range.

- **Prolonged demand decline, no supply restraint**: An unprecedented billion-barrel supply surplus emerges as global demand falls by 5 MMB/d for the year. Prices fall to the lowest levels in a generation when the surplus is at its peak. U.S. production begins a steep decline.

- **Rapid recovery and reconciliation**: The world economy and oil demand are in recovery mode by mid-year. Oil prices are buoyed by the restoration of Vienna Alliance (OPEC plus Russia) production restraint.

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