Greetings,

Key conclusions from the latest assessment of oil markets by the IHS Markit Energy Advisory Service follows. Please feel free to quote from below.

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The Days the Earth Stood Still: Global Oil Markets Face Reckoning

By Roger Diwan, vice president, financial services, IHS Markit

- IHS Markit estimates for global liquid demand point to a year-on-year contraction of more than 14.0 MMb/d in the second quarter.
- Current supply trajectory sets up implied global liquids builds of more than 12.0 MMb/d in 2Q2020
- Expect fundamental pressure concentrated over March and April, an eight-week blitz period over which stocks currently stand to build north of 1.0 billion barrels cumulatively. Such an unprecedented build would overwhelm available storage capacity globally by the middle of the second quarter
- Markets will digest and price the reality that supply will need to resolve this balance. They can do so through shut-ins or through management.
- Some sort of management or partial management is likely to emerge as paralysis spreads across the sector, but lower prices and shut-ins are likely to occur first.
- Markets are now left to grapple with where and how shut-ins will unfold. Lower prices do not mean that shut-ins will occur overnight. Shut-ins can be complex and vary by geography. Time is required to properly plan and execute them.

Light-speed oil surplus: blink and you'll miss it. Last week marked the decisive inflection point for markets in terms of recognizing the scale of the looming surplus as major countries across Europe and North America shut down. Our latest estimates for global liquids demand point to a year-on-year contraction in the second quarter of 2020 of more than 14.0 MMb/d. With supply on its current trajectory, this sets up implied global liquids builds of more than 12.0 MMb/d in the second quarter. Markets have started to translate this dire outlook into prices, with Brent and WTI trading near $27/bbl and $22/bbl, respectively Tuesday. More worrisome still, such prices still appear unlikely to garner the type of immediate supply response physical markets will require in the short term, pointing to further downside in the short term.

The crux of the challenge for oil markets is twofold, the immense size of surplus and the compressed timeline of prospective builds, severely limiting the runway of the price war. In particular, we see fundamental pressure concentrated over March and April, an eight-week blitz period over which stocks currently stand to build north of 1.0 billion barrels cumulatively. Such an unprecedented build would overwhelm available storage capacity globally by the middle of the second quarter. Given the trajectory of the outbreak, **the next few weeks are unlikely to provide material relief to bearish momentum as markets digest and price the reality that supply will need to resolve this balance**. It can do so through shut-ins or through management. We are yet to see a workable path to coordinated supply action on the scale required to mitigate the physical challenge ahead. Some sort of management or partial management is likely to emerge as paralysis spreads across the sector, but lower prices and shut-ins are likely to occur first.

Markets are now left to grapple with where and how these shut-ins will unfold, with urgency adding complexity. There are two paths that lead producers to shut-in production: negative variable cost economics (particularly where losses exceed shutdown costs), and lack of physical takeaway capacity (be it pipeline, rail, truck or tanker) forcing producers into filling limited wellhead storage and eventual shut-ins. If Brent prices near the $15-20/bbl range, a significant share of global production would likely fall below opex costs. But this does not mean those projects will shutter operations overnight. Such activities can be complex, they vary by geography and company, and time is required to properly plan and execute a shut-in.

"The crux of the challenge for oil markets is twofold, the immense size of surplus and the collapsed timeline of prospective builds, severely limiting the runway of the price war.... The next few weeks are unlikely to provide material relief to bearish momentum as markets digest and price the reality that supply will need to resolve this balance." **– Roger Diwan, vice president financial services, IHS Markit**

As demand disappears, spot barrels forced to shelter in place. Up to now, the sharp market imbalances have mostly existed as a spreadsheet exercise as we and others chart the coming course through the crisis. In the next two to three weeks we will see those physical imbalances manifest in physical markets. We are already seeing clear indications of that unfolding across the global supply chain. This includes intentional floating storage plays by global IOCs and physical traders, skipped, canceled or extended spot tenders in Latin America, and unsold cargoes in West Africa. This will soon be followed by inventory builds across onshore tanks in the U.S., with refinery margins collapsing and refinery runs soon to follow. So far, the supply chain is absorbing the weakness, but soon the pain will have to back into the wellhead, and as it does, prices will have to follow lower.

The oil market's physical challenge: flatten the curve(s). In addition to crude forward curves bending ever deeper into contango, pressure points are emerging across the supply chain. Forward curves for jet, diesel, and gasoline in key hubs have all moved into contangos over the past two weeks. The velocity of the collapse in end-user demand is upending refined product markets. Steep contangos ultimately reflect systemic imbalances that need to be temporarily digested (through inventories) or corrected, either through stimulated demand (unlikely given the broad economic slowdown) or supply reductions. As a result, steep contangos are typically relatively short-lived. For refined products, the path is relatively clear, as refiners will curtail throughputs sufficiently to rebalance their respective product markets. This is the transmission mechanism that crude markets are likely to be facing in the short term, as declining crude demand exacerbates crude imbalances. Storage can help sustain contangos for a period, but given the scale of the challenge ahead, a sharp supply response will likely be needed to flatten these curves.

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