

North America – Awash in Oil.

North America is awash in oil and this was never more evident than yesterday when the monthly contract rollover for WTI caused traders to pay rather than take physical delivery of the May contract.

Unprecedented is how some industry executives have described it. And while it makes for shocking headlines, oil producing companies will typically price their sales of the monthly average price and few if any sell oil on a spot/uncontracted basis.

At issue is North American crude oil storage. At a time of the year when US refiners would be getting ready to make and distribute gasoline for the upcoming (and probably now non-existent “driving season” that normally kicks off Memorial Day weekend), expect that US stockpiles at Cushing (WTI home) could hit 60 million barrels this week, leaving a scant ~16 million barrels of remaining excess storage capacity. Yes, that is still 20%, but most if not all of that capacity is already spoken for and it could be filled in weeks. Even before driving season, US gasoline demand was down by more than 30% this month, compared to a year ago according to the US-based Energy Information Administration (EIA).

Global oil tanker rental rates have skyrocketed in the past month as producers look for any possible storage space. Media reports have cited the use of any possible old tanks in the US as the industry struggles to find available storage. Everything that is capable of holding oil is being sought out and used. At some point in time, the costs to store the oil will become prohibitive and producers will be forced to shut-in production. This is already happening in both the US and Canada, but arguably not quickly enough to offset the precipitous fall in demand

With US consumption way down, yesterday's contract expiry and negative WTI crude oil price foreshadows continued weak crude oil prices in North America until the supply-demand balance comes back in line. Expect one or two more contract expiration's in the months ahead to again display negative pricing.

Notwithstanding North American pricing woes, Brent crude oil, which much of the world outside of North America uses as a pricing benchmark, is also under pressure, trading the low US\$20s/bbl. While unsustainable as a long term price for producers, even out of the Middle East, volatility will remain until global supply/demand is balanced. Expect OPEC+ to have to cut production again – it can't be soon enough!

Oil Price Tumble – The Action of Cunning Devils

Over the last month oil prices have been in a serious swoon and this then was projected onto equity markets as some sort of evidence that global economies are in a serious slowdown, after what has been a rather anaemic recovery from the 2008 slump. This rationale shows a disturbing intellectual flaccidity on the part of this concept's propagators and shows that analysis for some commentators rarely goes much beyond the end of the nose on their face.

For a start the global economy has been laboring under high oil prices since pre-2008, and in some ways we might interpret that the events of 2008 were in slight part caused by and certainly exacerbated by high oil prices. The recovery has certainly struggled under this burden with a massive transfer

of resources from the Western economies (and developing nations) to oil producers. One only needs to see the jewel-bedazzled cell-phones of the *burqa*-clad ladies gliding through London's Selfridges to realize who are the haves and have-nots during this period of high oil prices.

Ulterior Motives

Therefore why should oil prices take a tumble if not from global economic exhaustion? Well, while there was a *live-and-let-live* attitude by the US during this long period of high prices, it saw that the high prices, instead of being a burden, were empowering. They fed the fracking boom and led to the almost unimaginable dream that the US might be within reach of energy independence. Finally the US was in reach of kicking the very expensive millions of barrels a day habit that had bled the US economy since the 1970s and led to entanglement in the many miseries of the fractious Middle East.

However, high oil prices have also empowered a bevy of international miscreants that have created intractable problems that either require military intervention or prompt a hands-off stance that can spiral into contagion. Over the longer span there has been Venezuela and Iran as relatively low-level threats but still troublesome and trouble-causing which have both been able to get away with their actions with more latitude than usual due to the relatively strong export incomes they have gleaned from oil sales. More sinister though has been the actions of the Russians in the Ukraine and the eruption of the ISIS phenomenon.

The Devil Makes Work for Idle Cash

ISIS didn't start out enormously well-padded with cash, but what it had is widely regarded as having come from generous donors in the Gulf States and, dare we say it, Saudi Arabia. That all changed when it managed to bag itself a swathe of

Iraqi and Syrian oil-producing assets and turn them into revenue generators for its military efforts and to fund its "administration". Meanwhile over in the Ukraine, Putin's advance had proven impervious to Western pressure or opprobrium, despite selective economic sanctions, due largely to the export revenues from oil and gas. Moreover the Europeans had eschewed against really effective action because spurning Russian gas exports would have been like cutting off the nose to spite the face.

Thinking Smart (For Once)

Eisenhower in his parting words as President warned against the Military-Industrial Complex which was particularly poignant coming from a general (and a Republican). Since that time the tool of first employment has tended to be military with a string of adventures that rarely seemed to achieve the stated goal and always ended up costing fortunes in *materiel* and lives. More recently, the globalized economy has meant that the economic sanctions have become the stick of choice when a *hard to get at* donkey on the international stage has proven to be recalcitrant. However, in recent times, the obvious targets have proven to be impervious to the long-reach of the US Treasury or the Fed.

The point of vulnerability for the Russians, ISIS and its sponsors is one and the same, the oil price. While the mouthpieces of the financial media (much less discriminating in swallowing a story hook, line and sinker than even the White House Press Corps) started spouting that the oil price decline was due to "global slowdown" we looked around us and wondered "where?". China is still bubbling along, and is not using less oil.. The US economy is not exactly ebullient but was doing quite nicely.. the UK is very healthy and the European economies are a mixed bag with the major ones, excepting France and Italy doing fairly well. This is scarcely fertile ground for an Apocalypse Now scenario in oil demand.

There is however another version. This version has it that the action to sink the oil price was a concert party between the US and Saudi Arabia with the goal being the destabilizing of the various "baddies" that have not been responding to the usual reverse stimuli. The means to do this are obviously in the hands of these two parties.

The goal is to financially destabilize the already weakened Russian financial structure and frankly it seems to have worked with the Rouble in freefall and a recent front page of the Financial Times trumpeting an imminent meltdown in the domestic financial system. The US is not wrong in divining that the best way to a Russian oligarch's heart is through his pocketbook and so that is where the oil price squeeze has its most poignant effect.

With ISIS you have a situation where the largely besieged Caliphate sells its oil into the murkier corners of the global energy trade at a significant discount to reigning prices. Some reports we have heard say they are receiving as low as \$30 per bbl. A tumbling global oil price has the potential to push this price received even lower and even might make production loss-making. The last thing a putative pseudo state needs is its largest industry to be a loss-leader.

As for sponsors of ISIS, whether they be states in the Gulf or wealthy donors from the same area, declining oil prices mean less disposable income and what is the more worthy cause, a rocket-launcher for the cause or another shopping trip to Harrods? That is no contest...

The Squeeze is On

A whole bunch of nations are junkies hooked on oil export revenues. Frankly the collection does not look like the most worthy recipients of the charity of Western oil users. The following chart from The Economist was brought to our attention and it says it all about who is nearest to the edge

when oil prices go into decline. We don't feel our lachrymal ducts overflowing as we go through the names.



It would seem that quite a lot of countries have been living beyond their means and that the chickens are now coming home to roost. Most of them are now acutely vulnerable to a fall in the oil price. If these numbers can be believed then some of the more ornery ones (at least by State Department thinking) are now well under water. To keep things on a relatively even keel at home they will need to cut back on foreign adventures (state-sponsored terrorism amongst them) and put the squeeze on some of their high-rollers (which will in turn choke some of the private sponsors of the likes of ISIS, or fellow-travellers amongst the oligarchs in the Ukrainian "venture").

If the US was looking for a moment to apply the electric cattle-prod to the private parts of trouble-causers, that moment is now and the oil price is the cattle-prod of choice.

Conclusion

When cash flow is taken away from one group (oil producers) that have had a surplus and churned it into markets, then they withdraw from those markets in whole or part, particularly if they find themselves in kind of budgetary stress shown by The Economist's chart. The result therefore is a tumble in the markets which, lo and behold, we have seen. That is until the beneficiaries of the redistribution (i.e. Western and emerging market end-users) start to accumulate benefits in the form of surplus income in their own savings and that starts to make its way into the markets. In this we find nothing disturbing, in fact it is rather comforting. Perversely it's the Marxist dictum of "From those according to their abilities, to those according to their needs". Maybe the irony of that might be lost on Russians (ironically) and ISIS probably wouldn't understand it anyway. Let the redistribution to long and

fruitful!