

Effects of Coronavirus (Covid-19) on the Oil Market

REZKA Sidi Amor ¹, RAHMANE Amal ²

¹ University of Kasdi Merbah, Ouargla, sidiomar.rezka@gmail.com

² University of Mohamed Khider, Biskra, amal.rahmane@univ-biskra.dz

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Abstract:

This research paper aims to shed light on the effects of the COVID-19 pandemic on the oil market by using three Basic indicators: global oil demand, oil stock and oil price. This research aims to know global oil market conditions in the shadow of coronavirus (COVID-19), by relying on the descriptive analytical approach. It was found that this virus has reduced the demand for crude oil, which in turn caused the deterioration of prices to record levels.

Keywords: Oil markets; Oil prices; Supply and demand; COVID-19.

JEL Classification Codes : D40, P42, E23

Corresponding author: Sidi Amor Rezka, sidiomar.rezka@gmail.com

1. INTRODUCTION

The world, during this time, is going through an exceptional situation. In light of the spread of the Corona virus, the global economy was affected and global supply chains and international trade movement were disrupted, both of which cause a state of uncertainty. This virus has become an economic shock that propagated mainly through global demand and supply channels in addition to oil markets and the impact of the collapse of oil prices.

From that, we can ask the following question: What is the impact of the Corona virus on global oil markets and global companies?

Historically, the global oil prices have been subject to a great deal of volatility from any financial crisis (1929 and 2006) until massive pandemics

(1920 and 2020). Different historical events depict the trend of global oil prices from the last two centuries. We can observe that the COVID-19 crisis caused a global oil prices disruption, from US\$17 in 19 April 2020 to -US\$35 in 20 April 2020 (Estrada, 2020).

2. Literature review on the oil market

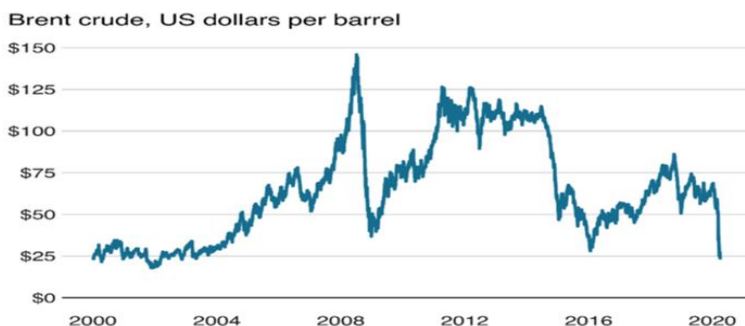
The global oil market is the most important of the world energy markets because of oil's dominant role as an energy source. Understanding how it works will also shed light on the functioning of energy markets more generally. What does it mean to say that there is a global market in energy? Fundamentally, oil is a commodity, and contracts for its supply are usually traded through commodity exchanges such as the New York Mercantile Exchange and the Intercontinental Exchange (mouawad & Timmons, 2006)

The Pandemic (COVID-19) eruption has brought fear and uncertainties for culture, societies, and businesses all over the world and the oil industry is not exceptional. The Pandemic has exhausted the oil industry, what it has done which was never seen in recessions, financial crashes, and wars had failed to do yet. The disruption caused by coronavirus has brought significant decline in demand and supply and prices in the energy sector around the world (Shaikh, Manzoor, Fida , Altaf , Arman , & Javed , 2020)

2.1 Global oil market conditions before the emerging of corona virus pandemic

Before the emergence of the Coronavirus, the global oil market witnessed an increase in the level of demand and supply.

Fig.1. Changes in oil prices over 20 years

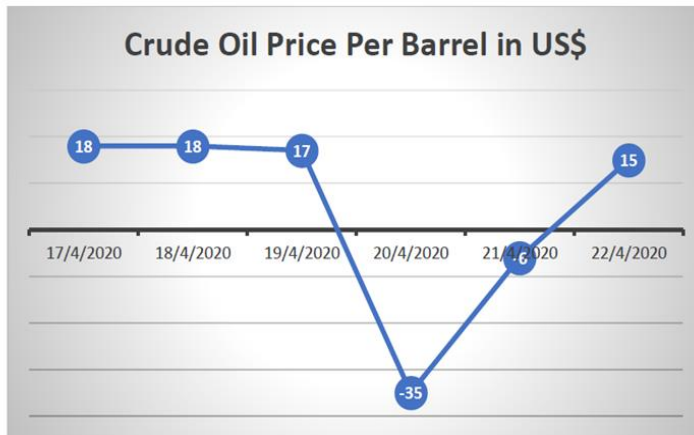


Source: (Tidjani & Sediki, 2020)

For 20 years, oil prices experienced several shocks; however, the price drop at this time occurred in response to the halt in global oil demand, which is due to the impact of this Corona virus on the global economy.

2.2 Global oil market conditions under the emerging corona virus pandemic

Fig .2. trends in the world oil price in covid-19



Source: (opec, 2020)

We are witnessing an unprecedented collapse in the oil market. In 20 April 2020, oil price falls due to the uncontrolled COVID-19 crisis worldwide. The subsequent 22 April 2020, OPEC led to a contraction of the oil production to pull up again the world oil price to US\$15. The decline of oil demand worldwide, partly due to a world massive quarantines and a huge reduction in the massive consumption of products and services, pushed down the world oil prices until red numbers (negative). The main reason why world oil price drops too much in 20 April 2020 was the massive increment of COVID-19 cases, especially in the United States (800,000 infected cases and 40,000 deaths), Europe (600,000 infected cases and 80,000 deaths), Asia (300,000 infected cases and 50,000 deaths) according to WHO (2020). Between 20 April 2020 and 21 April 2020, the prices of oil drop to negative prices rapidly due to labor mobility like lockdown –quarantines–systematically, the industrial plants were closed (U.S., China, Asia, Europe), the massive tourism contraction, less demand of massive transportation services (airways, cruisers, and railways), and the stagnation of a large

number of construction projects. Until now, the global oil demand cannot show some recovered in line until the vaccination and quarantine stops in the large economies around the world simultaneously.

In April 2020, the global oil prices hit negative values two times in the same month between -US\$35 (20/4/2020) and -US\$6 (21/4/2020) according to OPEC for the first time since the great recession of year 1929. (Estrada, 2020, p. 2)

The unprecedented drop in crude oil to \$ 0 does not mean the end of black gold, but presents a significant risk according to OCBC Bank Research. For some researchers, the negative price does not reflect the full state of the world market. June futures will rebound slightly despite the storage problem and weak demand. Moreover, the situation was provoked by uninitiated oil market speculators, who were forced to liquidate their positions at all costs.

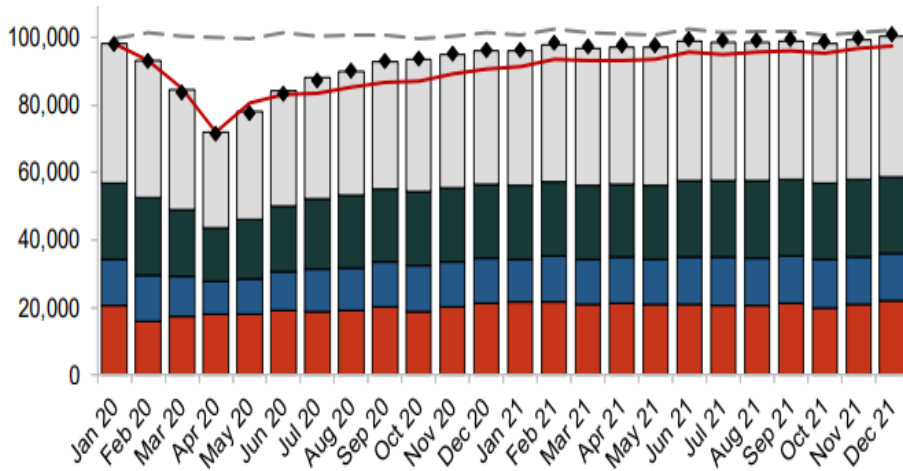
Thus, the risk of contagion to other markets will be limited. Negative prices only occurred on the May contract and are only for very thin trading volumes. As we write these lines, the oil price curve has reversed slightly as the WTI contract that traded at the market open at 0.56\$ rebounded 103% to return to \$ 1.38. However, this episode will have important repercussions, both psychological and on the functioning of the market, in the short and medium term. (Youcef, 2020)

3. The economic impact of Coronavirus on oil Industry

3.1 Global oil demand

Following this sharp drop in demand due to the health crisis, the 13 members of OPEC, which represent nearly 80% of the world's oil reserves, agreed to reduce production to ensure some price stability. (Belaid, 2020) The Corona crisis has caused an unprecedented global shutdown in human history, according to which all sources of energy consumption have been disrupted. Here we are talking about the disruption of air navigation and transportation due to the embargo, especially since the transportation sector accounts for about 60 percent of this global oil consumption. The expectations of oil demand have become more pessimistic because of the glut in the oil markets.

Fig .3. Global oil demand impact analysis COVID-19

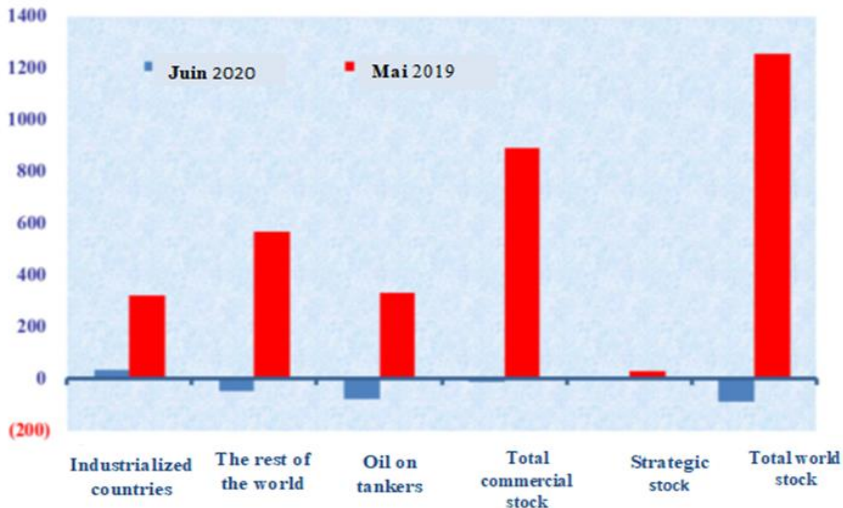


Source: (Shaikh, Manzoor, Fida , Altaf , Arman , & Javed , 2020, p. 5)

We notice from the figure 3 that global demand has seen a decline due to Coronavirus by 25 million barrels in April 2020. The decrease by 25% is because of the shutdown of the global economy, to return the demand to the levels of 90 million barrels.

3.2 Global oil stock:

Fig .4. Global oil stock 2019-2020



Source: (Oapec, 2020)

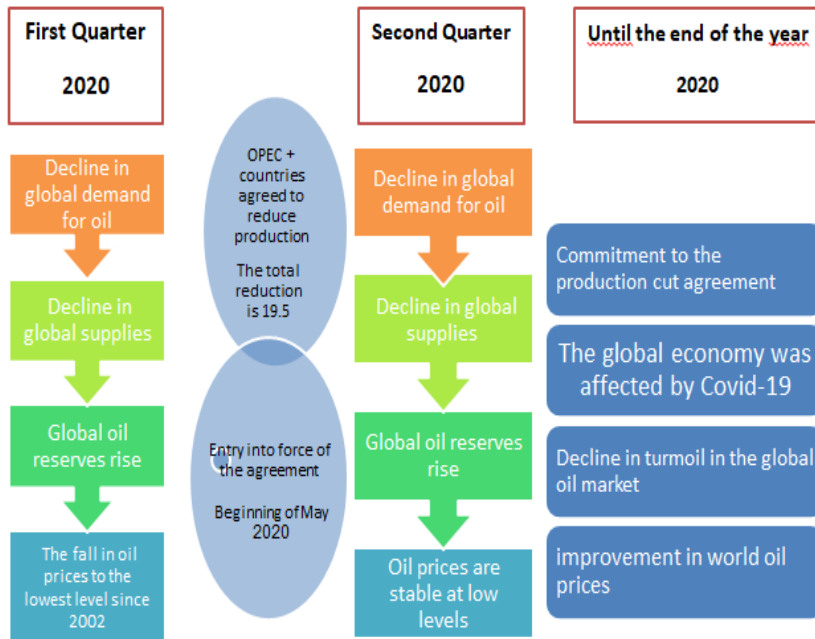
Commercial stocks for the month of June 2020 increased significantly to 34 m/b, which led to the collapse of the oil market due to the closure of the global economy and the disruption of the supply chain. All of which was caused by the outbreak of the Corona virus. The figure shows that commercial stocks are the most affected due to its direct impact on oil prices.

4. The impact of the Corona virus on oil companies

Covid-19 illness has halted global travel and has reduced manufacturing production, which shows less demand for fossil fuels; consequently, prices collapsed. It is very common today to hear a reality that there is insufficient storage capacity for oil right now. Drillers are putting down gears and shut-in the oil wells at anxious speed in connection to a well drop in oil price due to the current pandemic of coronavirus, so oil reserves may never recover again at the same pace and intensity. (Messler, 2020).

Oil companies incurred huge losses in light of the decline in oil prices as these companies reduced their investment spending, which was done to reduce costs resulting from the effects of the Coronavirus.

Fig. 5. Recent developments in the global oil market



Source: (Gaid, 2020)

The global economic environment and the repercussions resulting from the spread of the Corona virus developments in the international oil markets affected countries' economic activity. The global oil market witnessed several fluctuations due to the outbreak of Covid-19, which led to an imbalance between demand and supply. It necessitated forcing oil-producing countries to find immediate solutions to stop the deterioration of oil prices. As a result, OPEC agreement aimed at reducing oil production in order to stabilize oil markets and price improvement.

5. CONCLUSION

The global oil market is going through a three-dimensional problem: Excess in the exhibition, reduction of demand and the piling of stocks, which led to the existence of uncertainty in the oil market

- Low oil prices lead to reduced investments in the oil industry;
- Oil markets are recovering in the form of the letter W, meaning that it is very volatile;
- Coronavirus has had a major impact on oil demand, which resulted in a surplus situation in the oil market;
- Oil investments should be encouraged in order to maintain the stability of the oil market;

We offer two main recommendations:

- Maintaining stability in oil markets By encouraging investment in the oil sector;
- Intensifying efforts of all oil producers to stabilize oil prices.

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