Commodities Corner

The oil market is running out of storage space and production cuts loom

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By Myra P. Saefong

Oil storage in the U.S. may fill up by May, globally by June: analysts

U.S. crude-oil storage capacity is filling up fast as demand sinks Getty Images

ENB +1.63% TNK +0.24% TRN +1.95% CLM20 7.44%

The world is rapidly running out of space to store crude oil, and producers may finally have to admit defeat and cut output, after prices fell below zero this week with supply overwhelming demand as economies slump in the wake of the coronavirus pandemic.

"The worldwide economic shutdown has diminished demand so significantly that we are running out of room to store crude oil," said Gregory Leo, chief investment officer and head of global wealth management at IDB Bank. "The math is pretty simple. Current oil production is about 90 million barrels per day, but demand is only 75 million barrels per day."

“While futures contracts expiring later this year are still trading as high as $30, if this supply/demand imbalance is not corrected their fate will be the same,” he said in emailed commentary. “And with the price of oil so goes the fate of some energy companies,”

The Energy Information Administration pegged total U.S. working storage capacity is at 653.4 million barrels. Net stocks held at refineries and tank farms was at about 323.5 million barrels as of the week ended April 10, taking up 57% of storage capacity.

“At the current rate of increase, storage in the U.S. would fill in 7 to 8 weeks,” said Robert Yawger, director of energy futures at Mizuho Securities USA, in a note dated Tuesday.

The EIA also said stocks at the New York Mercantile Exchange delivery site at Cushing, Okla. was at about 55 million barrels for the week ended April 10, up 5.7 million barrels from a week earlier. The Cushing Complex is one of the world’s largest crude oil storage facilities.

Tom Kloza, global head of energy analysis at IHS Markit’s Oil Price Information Service, estimates that Cushing oil storage capacity is approaching 80% or so, and that “almost all of the oil storage is spoken for...booked by smart and generally well-heeled companies that saw this coming.”

At the rate of increase, storage at Cushing will break the all-time record of 69.5 million barrels in two to three weeks, said Yawger, adding that maximum storage at Cushing is around 76 million barrels.

Enbridge Inc. **ENB,** **+1.63%**, which is one of the largest operators at Cushing, has about 20 million barrels of total storage capacity at the Cushing crude-oil storage facility. Spokesman Michael Barnes declined to discuss current storage levels due to customer privacy concerns, but said while the current oil-pricing situation is historically unprecedented, Enbridge believes it is “temporary” and that “balance will be restored to the market in the long term.”

Globally, the International Energy Agency reported earlier this month that worldwide crude stocks could rise by as much as 11.9 million barrels per day in the second quarter of this year.

“With such high stock builds, the highest in history, the availability of storage is a key issue and the subject of much current debate,” the IEA said. Data suggest that “at the end of January, the 6.7 billion [barrels] of global crude oil storage capacity was holding 4.2 billion bbls, representing a utilisation rate of 63%.”

“We assume that 80% of this nameplate capacity is the maximum operational level; this means that there was about 1.2 billion bbls of spare capacity at [the end of] January” and “stocks could approach this operational capacity limit by mid-year,” it said.

Indeed, most analysts are expecting the U.S. to reach full oil storage by late April or early May, with global storage reaching full capacity by early June," said David Grumhaus, co-chief investment officer at Duff & Phelps Investment Management.

Tanker storage may offer an alternative to land storage, but it is "very pricey" and there are not enough tankers available to solve the problem, he told MarketWatch, adding that rates for very large crude carriers, or VLCCs, have skyrocketed above $100,000 a day for a three-month charter.

At its high Tuesday, shares of Teekay Tankers Ltd. **TNK,** +0.24%, the largest operator of mid-sized tankers, traded at the highest level since June 2016, according to Dow Jones Market Data.

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Railroad tank cars, "theoretically" may also "come to the rescue," said analysts at Cowen, in a note dated Tuesday. Cowen estimates that there are at least 30,000 Class 3 flammable liquid tank cars, with a capacity of over 30,000 gallons each in North America that can be deployed to hold oil. Use of tank cars for storage is unlikely at this point, but Cowen suggests that Trinity Industries Inc. **TRN,** +1.95% would be among the equipment supplies positioned to benefit.

Read Using railroad tank cars to store excess oil: It's 'possible but improbable' for now

Meanwhile, the negative oil prices for the May West Texas Intermediate crude contract on Monday offered a clue to the ultimate solution for the industry's excess oil.

Prices for May WTI crude US:CLK20 lost 306% to settle at a negative $37.63 a barrel Monday, which implied that investors needed to pay buyers to take delivery of crude oil amid an excess of crude oil and lack of storage space. It expired Tuesday at $10.01 a barrel. The new front-month June contract **CLM20,** 7.44% ended Tuesday at $11.57, down 43.3% for the session.

Read: U.S. oil's June contract drops over 43% to 21-year low as May contract expires at $10 a barrel

"There is one answer, and it is the one that no wants to hear: shut-in production," said Grumhaus. "And shut-ins are going to happen because the price will fall low enough to make it happen."

Analysts have said that an agreement reached earlier this month between the Organization of the Petroleum Exporting Countries and its allies including Russia, to cut 9.7 million barrels of oil from the world market starting May 1 through June, wasn't enough to offset demand losses.

“It seems as if things are moving too fast to stop the tidal wave that is coming,” said Grumhaus.

It is estimated that 20 million to 30 million barrels a day of oil demand have been curtailed by COVID-19, and there is just no place to put all that extra oil, he said. “U.S. production is going to have to fall by 2-3 [million barrels a day] over the coming months.”

For now, Texas, the largest oil-producing U.S. state, has refused to take action.

The Railroad Commission of Texas, which regulates the state’s oil-and-gas industry, formed a task force with an aim to research what can be done to “aid the industry” in these difficult times for oil, TRRC Chairman Wayne Christian said during a commission meeting Tuesday.

However, the commission decided not to vote on oil output cuts. Commissioner Ryan Sitton had proposed a cut of 20% in Texas oil production starting June 1, or roughly 1 million barrels per day, with the proration tied to market demand and contingent on other U.S., Canadian and OPEC+ producers cutting another 4 million barrels per day of oil.

Christian said that the commission needs to make sure that any motion they make for proration fits legal requirements and doesn’t get stuck in court.

Myra P. Saefong

Myra P. Saefong, assistant global markets editor, has covered the commodities sector for MarketWatch for 20 years. She has spent the bulk of her years at the company writing the daily Futures Movers and Metals Stocks columns and has been writing the weekly Commodities Corner column since 2005.