Our View: The Markets' Disobedience
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Oil markets continue to confound the projections of forecasters and the wishes of oil ministers. Reporters on Reuters complain that falling prices have bucked the wisdom of major analysts, while OPEC oil officials whine about "erroneous signals" sending prices down.[1]

Markets apparently know something that escapes the forecasters and ministers: oil traders and consumers have no money to purchase it. Banks are not lending. Such capital constraints can lead to a divergence of expectations between producers and buyers. In the current situation, it appears that the lack of bank lending combined with central bank tightening (and worries over government intervention) is sending prices down, much to the displeasure of OPEC and oil market analysts.

Months ago, I noted that the arbitrage relationship between products and crude had been broken when consuming countries decided to release large volumes from their strategic petroleum reserves.[2] Product prices kept rising, but crude prices were constrained. The unavailability of credit to buy crude is the likely explanation for the lack of price movement. This is not what oil ministers or OPEC would call fundamentals. Rather it is a credit constraint. Central banks are much more powerful than OPEC or the analysts that follow oil.

Oil markets, then, reflect the financial reality of today. *Financial Times*' Wilson quotes OPEC's monthly report as saying the oil price decline "had been driven by 'heavy sell-offs in futures markets, elevating market volatility.'" The OPEC authors would have been closer to the truth if they said, "The decline in oil prices has been driven by the withdrawal of financial support of buyers by banks and institutions that traditionally finance the buying and selling of oil."

In addition to their credit concerns, buyers have no incentive to purchase physical crude oil or product volumes in a backwardated market. Why should Shell buy more crude if each purchase racks up an instantaneous 15% loss?

The incentive to acquire oil or products is further undermined by regulatory risk. Governments in Europe have imposed regulations on deregulated markets, seized assets of firms supplying natural gas and electricity, and slapped taxes on private energy companies. The United States government threatens to block exports if US firms do not keep prices at home low. Firms today would be better off using sponges to suck out the last drops from tanks while keeping their money in their pockets.

Potential buyers must also worry that independent producers who want to sell their oil will soon begin to hedge 2023 production. These sales will go into a diminished, volatile futures market.

[1] See Noah Browning, Stephanie Kelly, and Laura Sanicola, " Analysis: Lower oil prices defy robust forecast for global demand," Reuters, September 16, 2022 [https://tinyurl.com/5257pd9y], and Tom Wilson, "Opec says oil sell-off driven by 'erroneous signals' in markets," *Financial Times*, September 13, 2022 [https://tinyurl.com/58dxmuct].

[2] See "Broken Arbitrage," *Notes at the Margin*, May 2, 2022 [https://tinyurl.com/dfm249zt].

Markets will continue to trend down until the institutions that finance oil purchases become more generous. In today's global situation, such generosity is months, if not years, away. The message of all this is simple: **Markets are smarter than forecasters or OPEC ministers.**