Our View: Energy's Eleanor Rigby Moment

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Three notable events took place between March 6 to March 10. The first and most important was Jerome Powell's report to Congress. After it, the LIBOR interest rate rose sharply. Then on March 10, Silicon Valley Bank failed, largely because of the interest rate hike. Finally, in Houston, the annual CERAWeek energy conference was in progress, following the Institute of Energy's gathering the week before.

Of the conference, *Financial Times* wrote, "After years of getting beaten up as climate villains, the global oil and gas industry celebrated a more friendly shift in 'vibes' as thousands of executives, policymakers and ministers descended on Houston, Texas, this week for the annual CERAWeek energy jamboree."[1]

Such was the view of *FT*'s energy reporters. A neutral observer might have a different opinion, one that recalls the Lennon-McCartney song "Eleanor Rigby"[2]:

> Father McKenzie
> Writing the words of a sermon that no one will hear
> No one comes near
> Look at him working
> Darning his socks in the night when there's nobody there
> What does he care?
> All the lonely people
> Where do they all come from?
> All the lonely people
> Where do they all belong?

The disturbing fact for the global economy is that no one outside the energy sector paid attention to the conference presentations.

We attribute the world's indifference to these talks primarily to the generally arrogant, self-centered, egotistical attitudes of senior oil and gas executives. Bloomberg's Will Kennedy captured the gist of their current thinking on March 13 with this statement: "On oil prices, almost everyone in Houston this week was pointing the same way: up."[3]

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[1] Justin Jacobs and Myles McCormick, "Oil Industry struts Texas stage with its old swagger at energy jamboree," *Financial Times*, March 11, 2023 [https://tinyurl.com/mrvwp4z5].

[2] ©1966 Sony/ATV Music Publishing LLC. Written by John Lennon and Paul McCartney for The Beatles' Revolver album.

[3] Will Kennedy, "Oil's Bullish Price Consensus Faces Strong Headwinds," Bloomberg, March 10, 2023 [https://tinyurl.com/yck6xvdb].

Few outside the oil industry listened. Further, Kennedy ignored the possibility of many oil companies finding it difficult to get loans to hold stocks and those with funds choosing to invest in secure financial assets such as government bonds and notes rather than petroleum inventories.

Bank failures inevitably lead to other banks tightening their loan standards. The oil industry will find banks cutting lending.

Petroleum inventories fall after interest rates rise and banks tighten lending standards. The stock decrease often lags the rate increase because the customers of oil suppliers, e.g., refiners, cut purchases after an interest rate hike. Refiners reduce runs in response, which leaves them temporarily with more oil than they would otherwise have. This domino effect pertains to today.

The figure below shows excess returns to storage for the second Brent contract for 2021, 2022, and 2023. Excess returns are now in the middle of the normal range. Tightness in the market is nowhere to be seen despite the views of those in the oil industry.

Still, the oil market is under growing strain as bankers raise the cost of holding stocks. The impetus to liquidate will rise as backwardation increases. Oil prices will come under downward pressure until inventories fall to minimum operating levels. This process will take months, perhaps even more than a year.