

Energy Market Report: October 2021

You wait ages for an energy story to come along and then three come at once! This month, we've had a category 4 hurricane that hit US oil heartlands, UK gas companies going under and a tanker driver shortage. On the basis that both the latter situations are "still in play" (and the hurricane came first!), this month we'll look at the impact of Hurricane Ida, whilst in future reports, we will investigate the gas and driver crises.

Atlantic Hurricane Ida hit the US Gulf Coast almost 16 years to the day that Hurricane Katrina struck the same parts of Louisiana and New Orleans in 2005. Because of the similarities in timing, there were immediate comparisons between the 2 hurricanes and certainly both caused loss of life and enormous structural damage. In oil terms, huge swathes of offshore and onshore production were taken out of action. Yet when it came to oil prices, there were no similarities, with oil markets in September 2005 behaving in an entirely different way to September 2021.

In 2005, Hurricane Katrina brought the US oil industry to its knees, with 30 oil platforms and 9 refineries impaired, destroyed or shut-down. A full 25% of total US production was "shut-in", along with 20% of gas production and numerous other related breakdowns in the commodity supply chain (petro-chemicals, shipping, agricultural commodities etc). Sadly, there was also considerable environmental damage, with some refinery tanks actually floating off their foundations due to flooding. In total, over 25m litres of oil was spilt in the immediate aftermath of Katrina.

The impact on fuel prices in September 2005 was absolutely electric. The wholesale price of gasoline went up by almost 30% overnight, from \$625 per tonne to \$850 (an increase of around 70 cents per gallon or 10 pence per litre in UK terms). On US forecourts, the increases were much more severe with rises of up to \$4 per gallon (55ppl!), leading to many accusations of profiteering. These rapid and unprecedented price rises stimulated a very rare event indeed, with the US Government and International Energy Agency combining for only the 2nd time in history (the first coincided with the First Gulf War) to make a release of both the global emergency oil reserve and the US Strategic Petroleum Reserve. Around 60m barrels of crude and refined oil (which equated to 5 days of US consumption) were allowed to "flood" the markets (apologies!) and this had the desired effect, with fuel prices very soon equalising back down to pre-Katrina levels.

This month's Hurricane Ida initially looked like it might cause a similar amount of chaos. 150mph winds battered the Gulf Coast and nearly all production facilities were shut-down, along with the same 9 refineries of 2005. Power cuts across the region meant not only did over a million people have no electricity, but industrial output also ground to a halt. Even those refiners outside of the "hurricane alley" were affected, as without electricity they had to rely on emergency power supplies, which led to very minimal capacity throughputs. Despite all this, oil prices in September were almost boring in comparison to September 2005. There were no great price movements in either direction and the restrained response of the US Petroleum Reserve was to make a "mini-release" of 2m barrels (whilst the IEA remained completely on the side-lines). Those market observers who had predicted the worst when Hurricane Ida hit, were soon scratching their heads and asking why the impact on oil prices had been so muted?

The first obvious answer is that many Gulf Coast refineries found themselves just outside the hurricane's path, meaning that only a precautionary shut-down was required followed by a reasonably quick restart of operations. Equally many oil platforms and refineries shut down in advance of the hurricane (rather than being hit mid-production) and all of them had worked on engineering and operational resilience in the years between Katrina and Ida. This beefing up and structural reinforcing of engineering apparatus was also evident when it came to much of Louisiana's state infrastructure. For example, none of the state's flood levees were breached (unlike in 2005), meaning that no production facilities were meaningfully flooded. As a result, oil spillages were negligible.

Nonetheless, to remove so much oil production from US markets and see barely a ripple of subsequent price movement is surprising and says much about the increasing diversity of the US supply chain. The proliferation of shale over the last 10 years (an industry that didn't exist in 2005) has broadened the base of US oil production, whilst refineries in Texas, New Mexico and the Mid-West have reduced the previous refining domination of the US Gulf Coast. It is also worth noting that oil-fired power stations in the US South are today a thing of the past (not the case in 2005), an element of commercial transport (including rail) is now powered by natural gas and 10% of American gasoline is now ethanol. Although difficult to quantify these factors, they do nonetheless highlight that production pressures on neat crude and refined products have shifted since 2005.

Oil prices could of course still head northwards for the rest of the year, particularly if the long-term effects of the hurricane start to hamper production recovery. Even as we write this report, almost half of US Gulf capacity remains offline and analysts are predicting a total reduction in production of around 500,000 barrels per day for September. That coincidentally (ha-ha!) is the exact same amount that OPEC announced they would release into global markets in the aftermath of Ida. This was done under the guise of protecting the market from price spikes, but of course we all know that it was a swift and opportunist move to steal market share from crippled US operators!