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BLOG

Impact of COVID-19 on the energy sector

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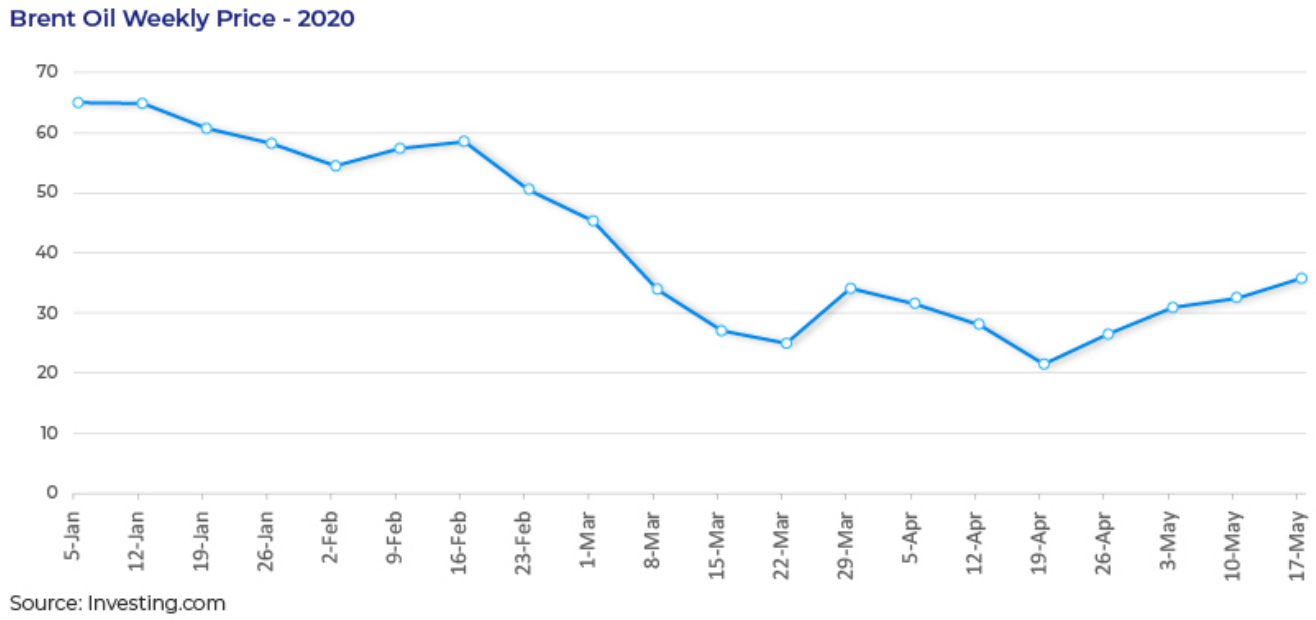
Over the past few months, the world has been grappling with a cataclysm that has brought about a socioeconomic transformation. The pandemic has adversely impacted a myriad sectors, with the energy sector being among the worst hit.

The current situation has largely contributed to the sharp collapse in demand for oil, resulting in declining production and falling prices, exacerbated by the OPEC-Russia petroleum price war in March 2020. In the days that followed the breakdown of the alliance, oil prices plummeted significantly, with further repercussions for the global economy. The sector, therefore, is facing a number of headwinds due to the need to:

- Manage the health emergency
- Cope with low oil prices (low prices and demand)
- Manage debt obligations

Failing oil prices have had a domino effect on gas prices, employment and the economic and political stability of oil-dependent countries. Volatile oil and gas prices, therefore, can be seen as an added complication as policymakers and regulators try to shield their economies from the impact of the pandemic.



The graph above depicts how demand for Brent crude fluctuated, reaching an 18-year low, and seeing daily price swings of over 10% for around two weeks in March. However, prices started recovering by mid-May, rising steadily to reach USD 35 per barrel, suggesting a slowdown in the significant contraction in oil demand.

The electricity sub-sector is also witnessing shrinking demand, coupled with power price cuts. For instance, Europe is seeing a record crash in power prices, with prices having turned negative in most countries in the region. Negative power prices are usually seen only in the wholesale electricity market when electricity prices fall below zero. Generally, this happens when electricity supply is ample and demand is low. During such periods, electricity producers pay their wholesale customers to buy electricity. In April, power prices in European countries dropped to negative territory for a sixth consecutive week, with Germany hitting a low of -EUR44.3/MWh amid high renewable energy production and reduced demand. Furthermore, overall electricity demand in April fell by around 17% y/y, according to Spanish grid operator REE.

Another factor at play is the impact of reduced power requirements on the cash flow of power companies and its ramifications for the overall energy sector, given the decline in the energy consumption of commercial and industrial consumers.

Enhanced emphasis on cost reduction

The rapid unfolding of this global pandemic has forced the regulatory authorities of developed and emerging economies to take stringent measures to contain the disease. In response, oil and gas companies would need to focus on immediate safety measures for their employees, deciding which functions can be managed remotely. However, one of the potential issues is layoffs (staff reductions), as companies could be focusing on reducing existing capacities and costs owing to the decline in activity levels. For instance, Halliburton, one of the major companies in the oil-field services sub-sector, has laid off over 600 employees at its Oklahoma location and furloughed around 3,500 employees in Houston since March.

Supply-chain disruptions may further hinder industry growth in the near term

Supply-chain disruption is one of the consequences of the present scenario, and the energy sector has been severely affected by this. This could become a bottleneck in the oil and gas sub-sector owing to the

fact that some suppliers and vendors could face operational and financial difficulties, leading to delays or ramp-downs in activity, at least for a short period of time. However, companies should look for these weak links and strategically plan supply-chain switches by identifying favourably located alternative suppliers.

Reduced or zero investments in new energy facilities and infrastructure

Power companies across the globe have either ceased or limited their capital expenditure for the construction of new infrastructure projects. They are, instead, planning to limit costs to avoid liquidity crunches and to ensure stable operations. A number of distribution system operators (DSOs) and transmission system operators (TSOs) have delayed projects and investment programmes they had initiated, leading to a substantial reduction in the procurement of electrical equipment.

Equipment deliveries have also been delayed due to restrictions imposed in equipment-producing countries, including China, the largest supplier of green energy technologies. Many renewable energy companies have, therefore, not been able to comply with deadlines for equipment installation, especially with some of the major projects being located in countries facing complete lockdown. However, some European countries are taking measures to support the renewable energy sub-sector and helping industries recover. For instance, the Spanish Wind Energy Association has proposed initiatives to support the nation's economic recovery following the pandemic, focusing on short- and long-term measures, including renewable electrification, training workers to transition to clean energy and preparing strategies for offshore wind energy.

The path ahead

Given the complexity of the crisis, a protracted and potentially challenging recovery phase would require high levels of coordination across the sector. However, the recovery is expected to be quicker since OPEC and Russia have come together to lift the energy sector from the pandemic-driven collapse, pushing production down to around 8m barrels a day, with supply slashed by 23%. Shockwaves have been felt in the form of price fluctuations, decreased demand for energy resources and the non-payment of utility bills by customers. Although the oil price trend is improving, the overall sector outlook is subject to numerous risks, and heightened levels of uncertainty persist as the impact of the crisis is still difficult to assess in its entirety.

We at Acuity Knowledge Partners can help energy companies wade through these choppy waters. Our skilled professionals come with expertise in the energy sector, offering value-added services such as industry research, financial valuation, and newsletter and RFP support to global clients.

To help our clients navigate both the people and business impact of COVID-19, we have created a dedicated hub containing a variety of topics including our latest thinking, thought leadership content and action oriented guides and best practices.

Secondary Sources:

Energy Information Administration (EIA)

International Energy Agency (IEA)

Investing.com

Forbes

World Oil

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We empower our clients to drive revenues higher. We innovate using our proprietary technology and automation solutions. We enable our clients to transform their operating model and cost base.

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