

# Quick Take: Crude below zero?

April 23, 2020

## Backdrop: a historic imbalance

- WTI inventories at Cushing, Oklahoma rose during the first three weeks of April at a pace that would exhaust the facility's working storage capacity in a month.
- This storage shortage is a measure of what has become a historic supply/demand imbalance. Figure 1 captures the collapse in refiners' demand as a result of COVID-19, which was accompanied by a burst of OPEC+ exports associated with the Russia-Saudi price war.

## A localized market circumstance

- Tuesday's collapse of WTI May futures to -\$37 per barrel reflects two conditions specific to that market: 1) It has experienced substantial growth in open interest as U.S. shale companies have hedged future production with speculative longs taking the other side. (Figure 2) 2) WTI futures settle physically rather than in cash.
- The historic price drop the day prior to contract settlement reflects the weakness in demand for physical oil and long speculators' desperation to avoid delivery, which was exacerbated by the shortage of storage capacity.
- Major commodity indexes and tracking products had already rebalanced into June and July contracts, so a relatively small set of speculators racing for the exits drove the price action. The event was localized to WTI; it didn't affect Brent futures, which settle in cash and expire on a different schedule.

## Key takeaways

- The market gyrations don't impact our baseline view on oil. Our models remain bearish given the historically imbalanced state of the physical market, the macroeconomic outlook, sentiment, and other factors.
- We suspect that the event could affect roll behavior going forward, with market participants becoming more careful about holding concentrated positions in nearby front-month futures and diversifying oil exposure further out on the curve or to other instruments such as Brent and ETPs.

Figure 1: Seasonality in U.S. DOE crude oil total refinery input

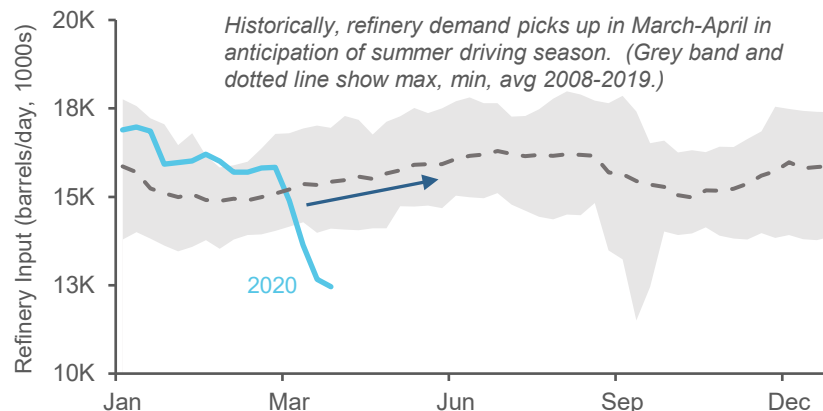
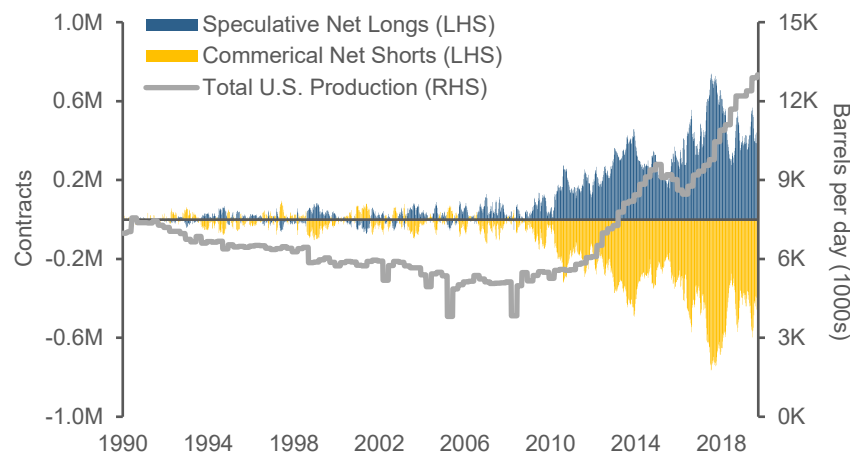


Figure 2: Futures positioning by category vs. U.S. total production



Sources: for both charts: Department of Energy, Bloomberg, Acadian Asset Management LLC. For illustrative purposes only.

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