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# *Financial Squeeze in the Oil Patch Creates Negative Oil Prices*

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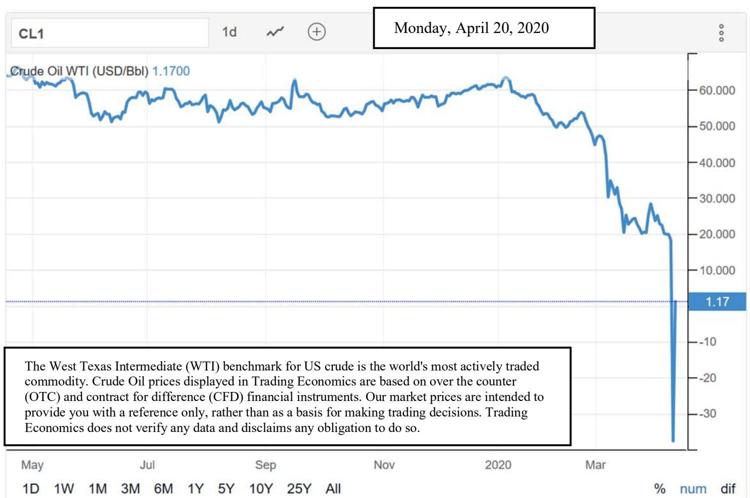
FILE PHOTO: Oil pump jacks work at sunset near Midland, Texas, U.S., August 21, 2019. REUTERS/Jessica Lutz

Stocks moved lower on an unprecedented oil market crash that spooked investors. The Dow Jones Industrial Average fell 592 points, or 2.4% to 23,650 while the S&P 500 dropped 51 points, or 1.8% to close at 2,823. The Nasdaq Composite was lower 89 points or 1.0% to 8,560.

It's not every day that you see something that has never happened before. Unprecedented seems to not really describe the event. But it is unprecedented that West Texas Intermediate crude oil dropped to a **negative $38** per barrel on the spot market for May delivery before rebounding to $1.17 in the after market. In what amounted to a financial "paper" squeeze, oil prices dropped into negative territory – something that has never been done before. The futures contracts for May delivery expire on Tuesday April 21st. Traders that had taken a long position on crude either needed to sell their position or take possession of the physical crude. Storage capacity is basically full and so traders chose not to take the actual possession of the oil so they sold – even to the point of paying others to take their crude position. A clear sign that available US storage on land was essentially gone.




Oil companies have resorted to filling empty oil tankers to hold the storage, but it is certainly difficult to get an oil tanker to Cushing Oklahoma to fill it up. So as oil storage ran out – prices collapsed. Oil prices for **<u>June</u>** delivery of West Texas Crude remained over $20 per barrel and Brent crude which is pumped out of the North Sea (and able to directly load oil tankers) closed near $26 per barrel.

While the odd development in the WTI oil market seems to be a temporary financial squeeze, it nevertheless demonstrates the extent of the collapse of demand of oil, exacerbated by a production war with Saudi Arabia and Russia on the supply side. It is hard to tell what degree the problem is over supply versus under demand. We tend to believe that it is primarily demand collapse due to the measures taken in the war against Covid-19.

The producers of oil have agreed to cut production as of May 1st. With storage space gone, the market is going to force those production cuts sooner. Also, with some countries of the world beginning to open parts of their economies, it remains to be seen if demand begins to rise. If it doesn't, we may see a similar event happen when the June delivery contracts for WTI expire on May 20th. Financial squeezes like what we experienced today don't result in immediately lower prices at the pump, however unless demand starts to rise, you will be buying gas much cheaper in the future.