April 21, 2020

Going Negative

OIL PRICES PLUNGE BELOW ZERO

- **Oil prices crashed into negative territory for the first time ever on Monday as unprecedented demand and supply shocks continued to destroy crude values.**
- **Though negative pricing is unlikely to continue, cratered crude values should persist this month with volatility, and the economic outlook for oil-producing regions in North America is dire.**

BREAKING NEW GROUND, AGAIN

In perhaps the most stunning collapse of any economic indicator since the beginning of the COVID-19 pandemic, the West Texas Intermediate (WTI) oil price benchmark closed out Monday below $0/bbl (chart 1)**.** WTI finished the day at an astonishing -37.63 USD/bbl, more than 300% below its Friday close (table, p.2). The nosedive into negative territory was anomalous and should be short-lived—it largely reflected the idiosyncrasies of pricing contracts—but nonetheless speaks to the grim conditions in global oil markets.

It was also a bad day for Canadian prices. Initial readings showed the Western Canada Select (WCS) benchmark falling more than 17% to a level slightly higher than 9 USD/bbl. However, daily WCS spot price calculations are based on the of the average of contracts signed in April. Monday's preliminary WCS value therefore likely included support from contracts for delivery in May and June, when oil prices are broadly expected to be stronger. News of negative WCS prices broke early in the day; that result apparently reflected subtraction of Friday's 14 USD/bbl WCS-WTI discount from the rapidly falling WTI price.

HOW CAN PRICES BE NEGATIVE?

Negative pricing, while uncommon, is not impossible. In general, it indicates conditions that so favour buyers that sellers are forced to pay buyers to take excess inventories off their hands. On Monday, it reflected a profoundly oversupplied market brought about by an unprecedented global economic event, and the mechanics of forward contracts.

Already depressed pricing fundamentals continue to erode. COVID-19 and efforts to contain its spread have crippled petroleum demand. The IEA estimates that Q2-2020 global crude consumption will plunge by 29 mn bpd—roughly 30%—versus year-earlier levels. In the US, gasoline consumption has nosedived during lockdowns (chart 2). On the supply side repository tanks are so full that many firms around the globe have embraced storage at sea, a trend reflected in the surge to more than 120 mn bbls in floating storage (chart 3, p.2). Meanwhile, OPEC+ output cuts of just under 10 mn bpd announced earlier this month only take effect in May and pale in comparison with the demand hit via COVID-19.

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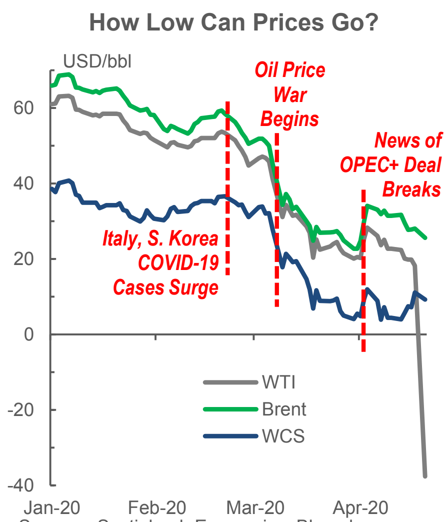
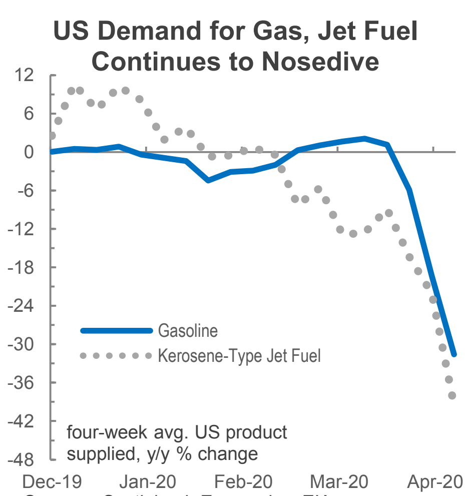
Chart 1



Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, EIA.

Rapidly deteriorating petroleum demand and heightened fears about storage capacity came just as WTI contracts for May delivery were set to expire on Tuesday. That unique coincidence of timing put additional pressure on sellers holding May contracts on Monday, driving prices even further south.

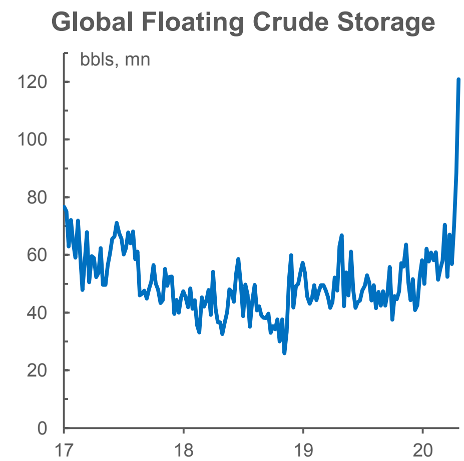
MONDAY WAS AN ANOMALY, BUT ENVIRONMENT STILL CHALLENGING

The unprecedented drop witnessed Monday should reverse. We note, for instance, that June forward contracts are trading near 20 USD/bbl, a level that is more likely near-term with the pressure of the May deadline gone.

Still, downward price pressures vis-à-vis weak fundamentals are unlikely to be alleviated before lockdowns begin to be lifted and meaningful inventory drawdowns and output reductions take place. While the Monday drop was a product of market idiosyncrasies, it reflects the severity of the current crisis and would not have taken place otherwise.

As we noted in an earlier report, the situation is particularly dire for Western Canadian producers. US Gulf Coast refineries remain the primary destination for Alberta and Saskatchewan oil, and refinery activity should remain depressed so long as COVID-19-led lockdowns and travel restrictions remain in place. Our most recent forecast calls for a gradual rise in crude values from their trough this quarter. As well, the WCS-WTI discount may narrow if production shut-ins free up some pipeline transportation capacity, and bitumen pricing may receive some support in the form of weak diluent values. But overall, depressed prices and oil and gas activity should continue to be the lay of the land.

Chart 3



Sources: Scotiabank Economics, Vortexa LTD.

Worst Single-Day WTI Price Drops Since 1983

Rank	Date	d/d % Change	Close (USD)
1	**April-20-20**	**-306**	**-37.63**
2	January-17-91	-34	21.44
3	March-09-20	-25	31.13
4	March-18-20	-24	20.37
5	October-22-90	-16	28.30

Sources: Scotiabank Economics, Bloomberg.