

OIL FUTURES AND FUNDAMENTAL OIL DEMAND



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Experienced industry hands say they've never seen anything like Monday's trading on May futures contracts for West Texas Intermediate crude oil (WTI), which closed in negative territory.

While the natural gas and oil industry certainly isn't alone in weathering the COVID-19 crisis, our impacts probably are more visible than most other sectors, underscored by **Monday's negative trading on oil futures**.

Three things to know:

1. Monday's futures trading resulted from demand decline and market technicalities

The price change in the May contract was driven by drops in oil demand and technicalities associated with traders liquidating May contracts. Oil is a commodity like gold, rice or coffee and tea. In addition to contracts of sale between oil producers and refiners, oil traders enter into contracts to buy and sell oil and manage price risk.

A negative price for a futures contract is essentially an individual oil trader offering to pay another party to take the oil off their hands. No question, futures contracts are a clear sign of continued challenges for the energy industry.

While WTI for May contracts, set to expire Tuesday, **dropped to -\$37.63**, WTI for June delivery closed at \$20.43 on Monday – significant because markets typically use the following month's contract to gauge market fundamentals during the last few days of an expiring contract. Indeed, open interest for the June contract, a signal for market liquidity, was five times greater with the futures price at more than \$20 per barrel.

2. Oil retains its fundamental value

Monday's futures trading isn't indicative of the fundamental value of oil and doesn't alter the basic global demand for oil and natural gas. The U.S. and world economies still need them for fuels, power generation and products. Yet, shelter-in-place restrictions have helped create historic drops in short-term demand, reaching an all-time low on Monday.

Apart from the world of commodity traders, crude oil remains critical to the U.S. and global economic recovery. Former Walmart CEO Bill Simon sounded an optimistic note in a Fox News interview. “I’m pretty encouraged that once we get into the crawl-walk-run-sprint (economic) start-up here, demand for oil will go back up,” Simon said.

3. Should the federal government intervene?

API continues to say government should focus instead on flattening the curve and getting a better handle on the spread of the virus so that economies can safely start back up again, and we are all looking to our nation’s public health officials for that expertise.

Certainly, leasing storage in the Strategic Petroleum Reserve under existing Energy Department authority is something a number of API’s members may consider.

API believes various proposals for government interventions – imposing tariffs on imports and quotas on domestic production and/or paying companies not to produce oil – ultimately do more harm than good.

Again, all industries are hurting now. Our industry is seeing an unprecedented storm of demand drop and a supply glut, and we knew this would be an extraordinarily challenging time.

The most important thing is to get the COVID-19 crisis behind us so we can safely rebuild the economy, with natural gas and oil there to help.