20 April 2020

Investment Event

Oil prices go negative

WTI oil prices have fallen into negative territory amid a significantly oversupplied market and limited storage capacity

Contracts for delivery beyond June have held up relatively better

Our views

The unprecedented moves in oil markets reflects the significant challenges facing the global economy.

Nevertheless, for global equities, highly attractive relative valuations and policy support measures means we remain strategically overweight in our multi-asset portfolios

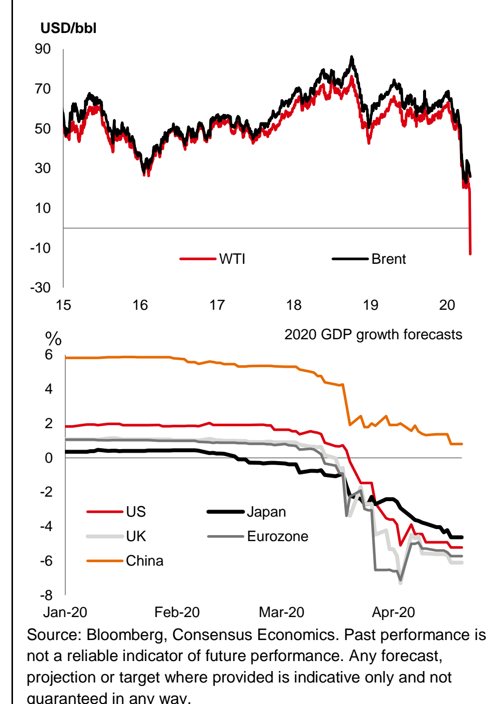
Oil prices slide further amid storage concerns

US West Texas intermediate (WTI), one of the main benchmark oil prices, dropped into single digits in trading on 20 April, and eventually into negative territory (Figure 1).

It is important to note the move into negative prices has been for the immediate front-end oil contract for May delivery that expires on 21 April. Declines in the WTI contract for June and later delivery have been significantly smaller, with prices remaining above the USD20 per barrel (bbl) level at the time of writing. Other benchmark oil prices, such as Brent, also remained above USD20/bbl on a spot and futures basis.

The collapse in the WTI oil benchmark relative to other international benchmarks reflects WTI being produced in landlocked areas, making excess production more dependent on land-based storage facilities that are close to full capacity. With limited scope to store oil, sellers are having to pay buyers to take delivery of barrels.

Figures 1 & 2: Oil prices, and consensus GDP forecasts



Source: Bloomberg, Consensus Economics. Past performance is not a reliable indicator of future performance. Any forecast, projection or target where provided is indicative only and not guaranteed in any way.

More generally, however, oil prices are exceptionally low reflecting a significant demand-supply imbalance:

- The COVID-19 pandemic and associated lockdown measures has hit oil demand extremely hard amid a worsening economic outlook (Figure 2). For example, the International Energy Agency (IEA) expects demand in April to be 29 million bbl/day lower than a year ago, down at a level last seen in 1995.
- OPEC and allied oil producers recently agreed an unprecedented cut to production of nearly 10 million bbl/day. Arguably, however, this does not go far enough to help rebalance the market in the short term, especially given the deal will apply only from 1 May onwards. There is also a major uncertainty around signatories' compliance with the agreement.

Investment implications

The collapse in oil prices may have important ramifications for the global economy. There are positives and negatives for different economies and sectors.

On the plus side, lower oil prices will help support consumers in many net-oil importing advanced and emerging economies by raising disposable incomes (less money spent on fuel) and reducing input costs into production. This will be especially important as containment measures are gradually lifted in the coming weeks.

Less positively, many economies that are major oil producers – including the US – will bear an economic hit from lower prices. Credit default rates within the US shale industry in particular are likely to pick up, weighing on the outlook for the US high-yield corporate bond sector.

Overall, the dramatic moves in the oil market reflect a very challenging economic outlook which sits alongside still-elevated levels of market volatility. There is also significant uncertainty about how the pandemic will evolve (in terms of case growth, the rollout of mass testing, and vaccination/treatment options), and thus the trajectory on any economic recovery.

Nevertheless, we think the case for a strategic, longer-term overweight in global equities in our multi-asset portfolios remains solid amid huge global policy support initiatives, and highly attractive relative valuations.

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