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On the WTI Crash

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Michael Warren and Donald Luskin

Worst squeeze ever. But even today's demand can't be supplied at twice these prices.

This will be only a brief note on WTI crude oil futures, which as of this writing have traded as low as \$10.77 per barrel. Breathless news accounts, like this one posted as the lead story on the *Financial Times* website, explain it only superficially as "a collapse in demand triggered by the coronavirus pandemic" that "leaves the world awash with crude that it is struggling to store." *This is the storage squeeze we predicted a month ago* (see "How Low Can Oil Go?" March 30, 2020). Longs in the leadmonth futures contract on the NYMEX face delivery of physical oil that they cannot store, so they must sell at any price. The second-month contract is trading at twice the price of the lead-month, and the third-month contract higher still, about where they were three weeks ago (see the chart below).

- This move is therefore a transient technical phenomenon.
- <u>To be sure, it reflects the severe supply-demand imbalance driven</u> by world-wide lockdowns to fight the spread of Covid-2019.
- <u>But demand has seen its worst</u> (see <u>"Make America Open Again"</u> April 17, 2020).
- OPEC+'s production cuts last week are imperfect, but will help.
 Just last month the cartel was in an internal price-war, now a mere memory. It remains the fact that even drastically impaired demand cannot begin to be supplied sustainably at even twice the price of the squeezed lead-month contract.

WTI crude oil futures \$35 Third Month \$30 \$25 Second month \$20 \$15 Lead month \$10 M10/2020 1212020 M12/2020 M16/2020 M17/2020 M18/2020 1,19/1000 4/5/2020 " W1015050 4/8/2020 41912020 M13/2020 414/2020 Source: Bloomberg, TrendMacro calculations

Update to strategic view

OIL: Today's crash in WTI oil is a technical phenomenon, the storagesqueeze we predicted a month ago. It is driven by the inability of longs in the expiring lead-month futures to arrange storage for physical delivery. Second- and third-month contracts are trading at twice the price. Demand is impaired to be sure, but it has seen the worst. **OPEC+** production cuts are imperfect, but will help, and they make last month's internal price war only a memory. Even severely constrained demand cannot be supplied sustainably at present prices.

[Strategy dashboard]

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