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The WTI Crude Negative Pricing

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Abstract
Crude Oil is and was the most coveted commodity in the world, as it is the engine of transport, manufacturing and other ancillary industries. Can you imagine snoozing off on April 17th 2020 and waking up on April 20th 2020, only to find that this commodity has become the seller's Crimean curse? For starters, the Corona Virus clamped all economic and social activity, halting all semblance of the industrial 21st century, during the lock down that has extended for more than two months. Its during this unprecedented phase, that all economic wisdom came screeching to a halt. Stay with me through the course of the article to understand what happened to the WTI Crude April Futures.

Keywords: WTI, Brent, Crude, Covid-19, Futures and Options

Introduction
WTI is the world’s most traded financial oil contract, a benchmark followed from Zurich to New York to Tokyo. But when each month a futures contract nears expiry and traders roll their positions into further-out contracts, the real, physical world of WTI becomes very small—centred on Cushing, an oil town in Oklahoma where a massive hub of pipelines and storage tanks serves as the actual delivery point for barrels.

Review of Literature
The article is written based on recent news and financial data that is freely available on the web. It intends to throw light on the need for macro-economic plain speak, when all other factors are rendered inane. How would economics behave in a world that has been slightly thrown out of gear? How do we realign our economic understanding to cope with Black Swan events? This is neither a critique nor an endorsement of any school of thought.

Objectives of the Paper
The Paper strives to empathise with the fall out of COVID-19 on the WTI April futures, more so with those Indian traders who were trading on MCX which mirrors the WTI contract.

Methodology
All data is considered Primary as there's no scope for deference or injunctions.

The Oil Power and Geo-Political dynamics
- “Organization of the Petroleum Exporting Countries (OPEC)” nations which include countries like Saudi Arabia, Qatar, Kuwait, UAE, etc., and
- Other oil producing countries such as – Brazil, Canada, Russia, Mexico, Norway, etc., choose not be part of the oil cartel i.e. OPEC. Hence they are just referred to as ‘Non OPEC countries”.

Between the OPEC and non OPEC countries, close to 90 million barrels of oil were pumped on a daily basis.
Different countries produce oil at different rates; this rate at which they produce mainly depends on the individual country’s finances and technology.

Events that turned the tables on crude oil prices –
American Shale Oil – The American shale oil, which comes from oil shale (sedimentary rocks containing bituminous material), which is an alternate to crude oil became

technologically viable and the cost of producing the same became relatively cheaper. The output from the American Shale oil production increased, flooding the market with cheaper oil.

Lack of co-ordinate action – Between OPEC other non OPEC oil producing countries, there was no real efforts to arrive at a production limit number, to tackle slowing demand and keep prices above break-even.

China Factor – In 2013 China surpassed The US in oil imports. The slowing Chinese economy during the last 5 years has impacted supply-demand-price equations in the Crude.

Market Dynamics – The above three points triggered a steep sell off in crude oil, adding fire to this sell off was the heavy short positions built up on Crude Oil contracts.

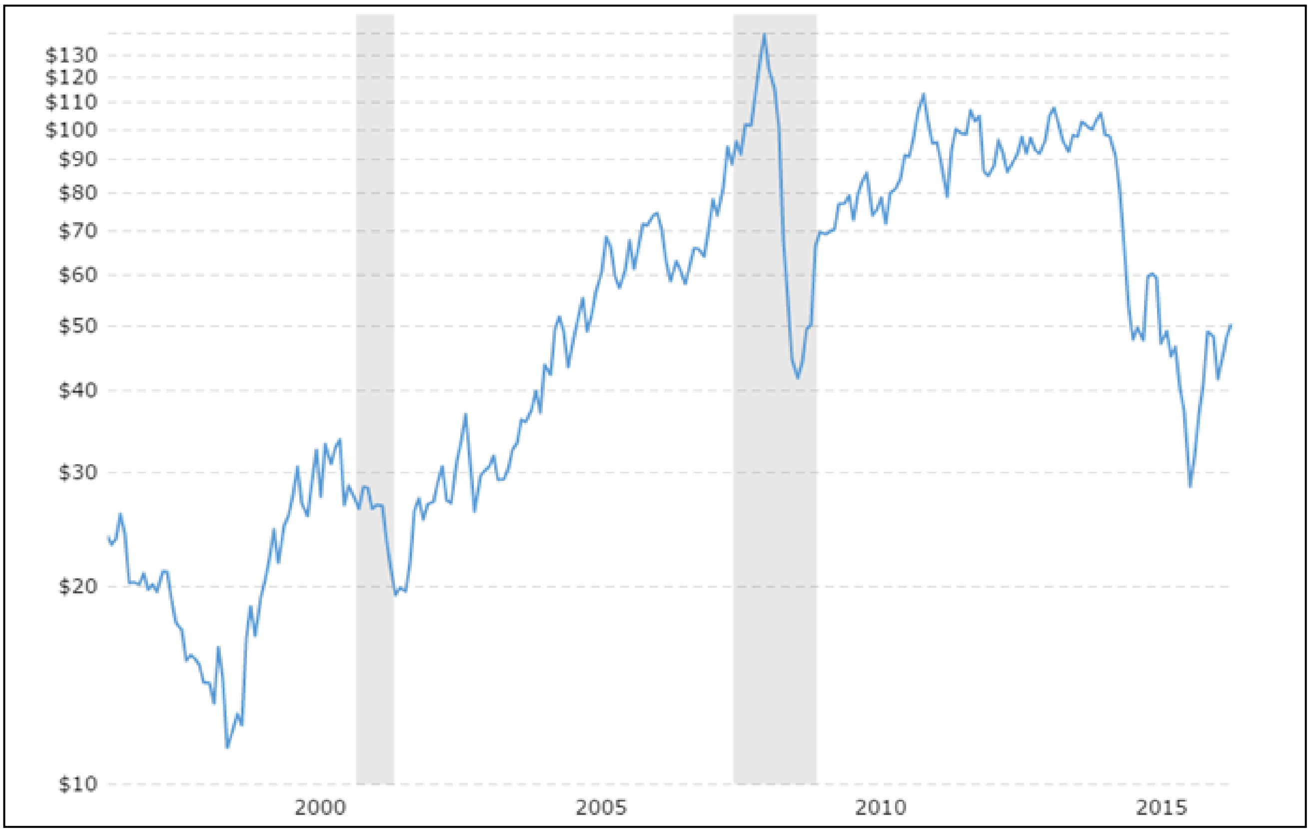


Fig 1: Oil rich countries produced several million barrels of crude oil which were exported to The US, China, India, and European countries on a daily basis. The oil producing countries are split into two baskets –

What is WTI and Brent

WTI	Brent
West Texas Intermediate, explored from oil fields off Texas, Louisiana, North Dakota	Brent is a backronym for the oil formation layers: (Broom, Rannoch, Etive, Ness and Tarbert), taken from the North Sea, off the British isles
Traded on the New York Mercantile Exchange (NYMEX)	Traded on the Intercontinental Exchange (ICE)
Has higher API, lower sulfur (Superior)	Has lower API, higher sulfur (Inferior)
Costs of production and shipping is higher	Costs of production and shipping is lower

COVID and Crude

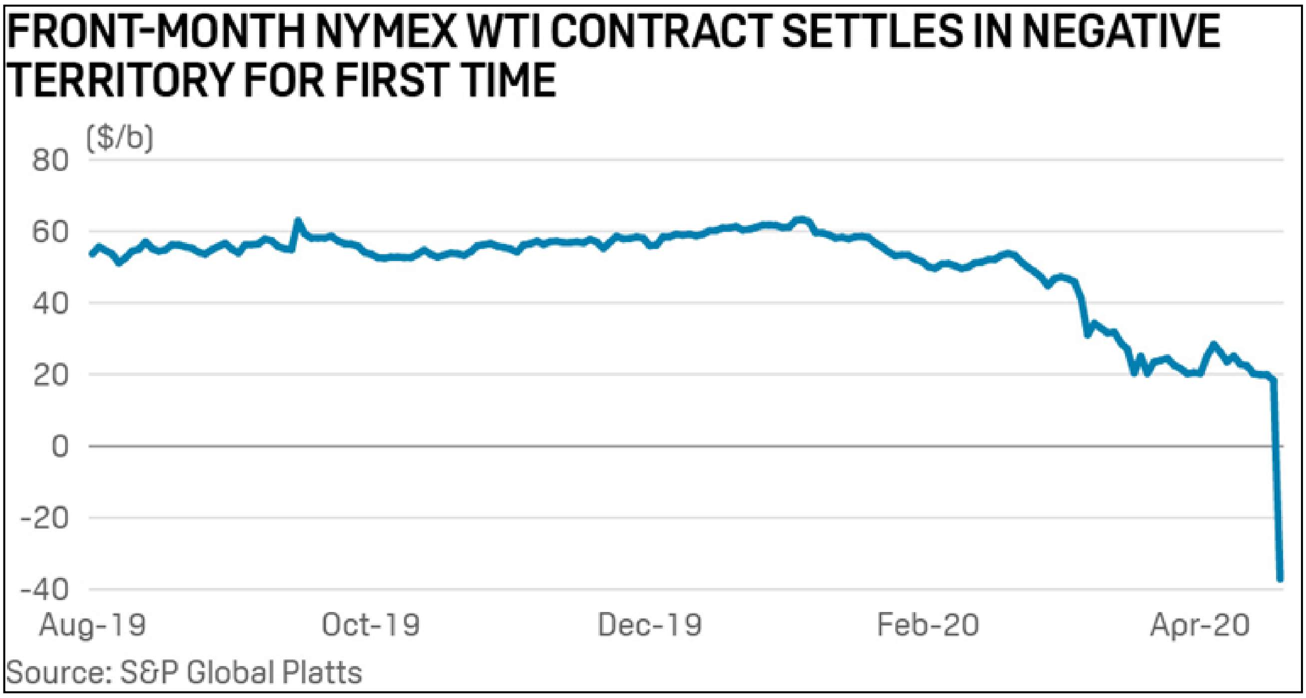
When the Corona Virus hit Wuhan, China in December 2019, little was envisaged that it would conflate with the Crude Crisis.

The ensuing lock-down was the last nail in the coffin, as it brought no respite for the plummeting oil prices. With no economic activity, physical delivery of crude for the immediate monthly contracts found no economic wisdom, and no takers, leaving the April 2020 WTI futures into a tailspin that ended close to minus 40 dollars per barrel.

Several exchanges across the world had to bear the brunt, as they closely mirrored the bigger exchanges that faced issues with delivery.

April 20 2020- WTI

On the expiry date of the April monthly futures drew to a close, desperate traders tried to roll-over their contracts to May, but the May futures was showing close to zero. This made the prices go below zero for the first time in history. As the final minutes ticked by, the abyss just got deeper with the final settlement price called out at $37.63 negative.



Impact in India

- The MCX announced a price of – Rs 2,884 (minus) as settlement of the April crude oil contract
- More than 100 brokers are estimated to have lost over Rs 450 crore.
- Few brokers have challenged the MCX settlement price decision, taking MCX and SEBI to court.
- Broker's margins lying as credit with the clearing corp were blocked until final settlement.
- Negative Pricing is being effected in the exchange software, with the vendor- 63 moons technology running trials.

Conclusion

An invisible virus opened up the fallibilities of generally accepted economic wisdom and showed the world that the humaneness is more important than the best of physical assets, be it gold, oil or land.
CME could have been more proactive in advertising the implementation of ‘negative prices’
MCX could have advised Indian traders to exit their open positions well before April 20th.
The barges and salt caverns are a flush with oil storage, but that has not translated into any relief for the common man

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