

Market Watch

Oil goes negative

Summary

- The May 2020 oil futures contract price plunged into negative territory owing to concerns about lack of storage space and technical factors. The US stock market and the 10-year government bond yield declined in tandem
- We view negative oil prices as temporary and expect oil prices to normalise as we roll into next month's futures contract and OPEC production cuts come into effect from May 1.
- US high yield bonds could see yield premiums rise in the near term as concerns about rise in defaults mount.
- **What to watch:** Response from OPEC+ (if any), speed of economies re-opening and evidence of oil demand recovering.

Background

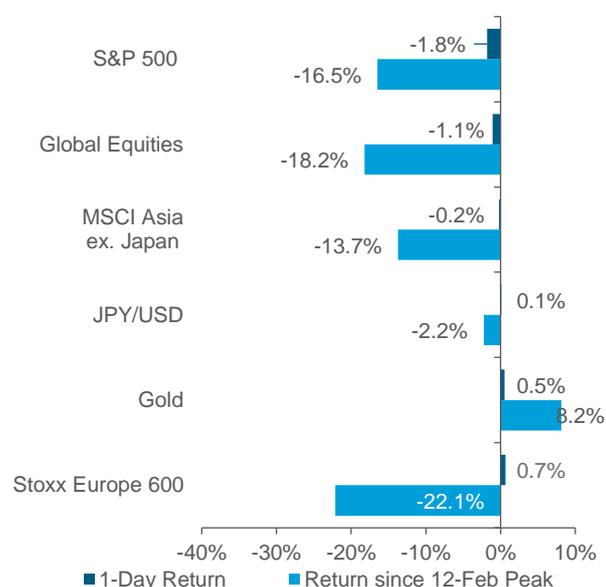
- The oil (WTI) price plunged into negative territory for the first-time ever over concerns about a lack of storage capacity, trading as low as -40.32 USD/barrel before recovering to -7 USD/barrel at the time of writing. The US S&P 500 equity market index declined 1.8%, with the energy sector hit hard by the oil price decline.
- The 10-year US government bond yield declined nearly 4bp while gold remained largely unchanged. ETF markets suggest that US HY bonds ended 1.6% lower. The USD ended 0.2% higher amid hopes of further economic stimulus measures.

What does this mean for investors?

- The sharp decline in oil prices overnight was exaggerated by technical factors. The WTI May 2020 contract (which declined below zero) are set to expire today. Anyone owning a 'long' position in that contract would need to take physical delivery of oil and store it. There is very little storage capacity left where the oil will be delivered – even if you can find somewhere to store it, the cost is prohibitive. This 'forced' long position holders to sell, driving the price into negative territory.
- The market dislocation becomes evident when we take a look for WTI June 2020 contract, which is still trading above 20 USD/barrel. Hence, it is highly likely that oil prices move back into positive territory in the coming days. OPEC+ production cuts, scheduled from May 1, should help to reduce the oversupply in the oil market. Market participants will look for further OPEC announcements or actions from OPEC.
- Low oil prices, should they persist, are a significant negative for US HY bonds, given the high exposure to relatively leveraged shale oil producers. Defaults from unhedged producers could rise, leading to an increase in yield premiums.
- **Technical watch:** The S&P 500 index's rally is showing signs of fatigue as it approaches strong resistance on the 200-day moving average (now at about 3010). Any break below the March 31 high of 2641 would confirm that the upward pressure had eased. Major support is at the March low of 2192.

Equities give up Friday's gains

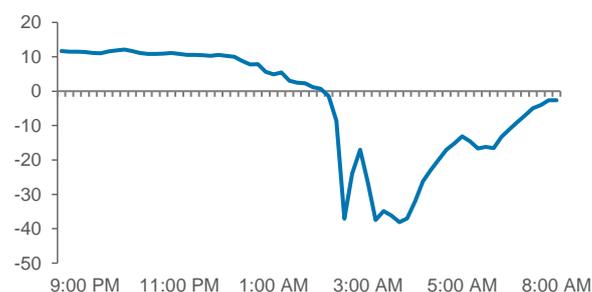
Selected market performance on 20 Apr and since 12 Feb



Source: Bloomberg, Standard Chartered

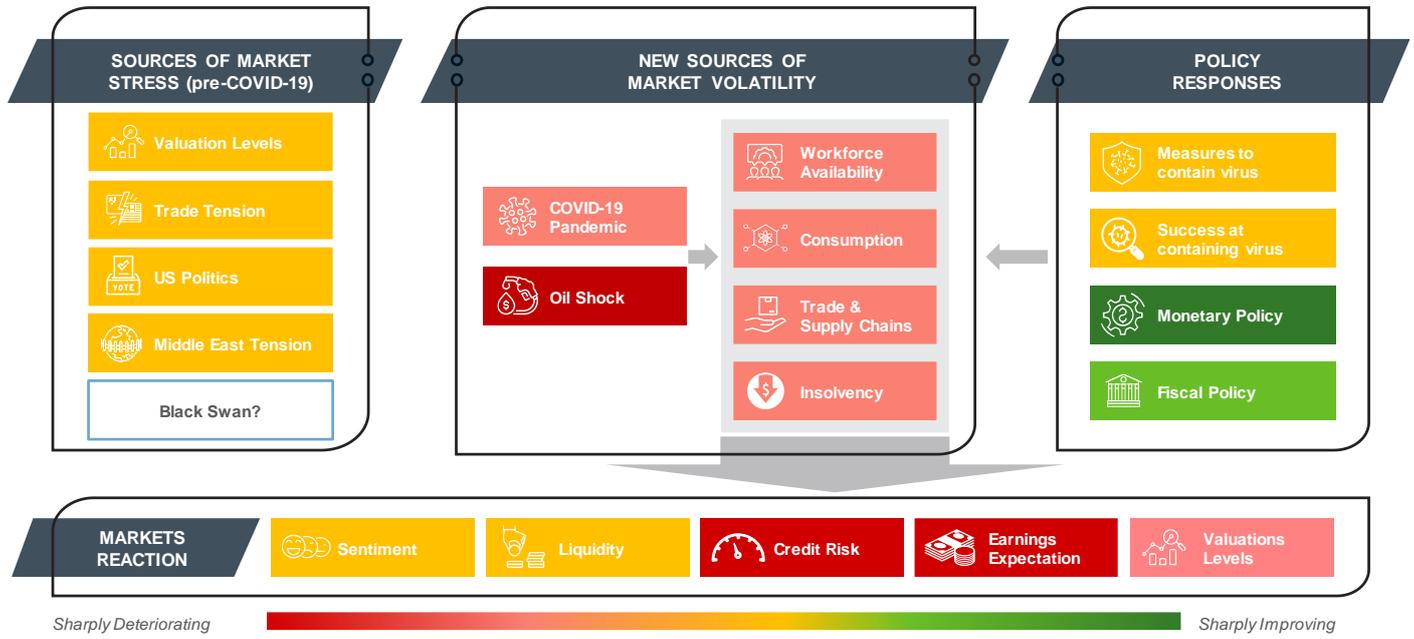
WTI oil price plunged into negative territory overnight

WTI Crude oil May contract price (USD), SGT timezone



Source: Refinitiv, Standard Chartered

Things we are watching and our assessment



Source: Standard Chartered

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