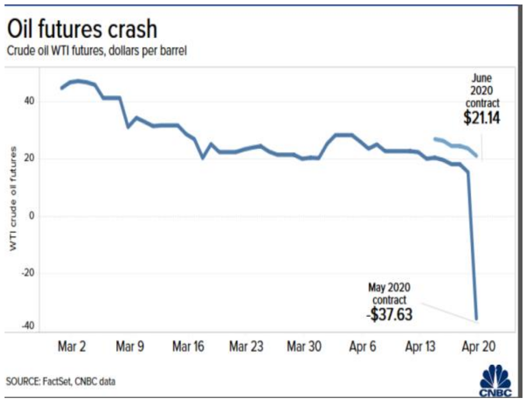
HOW ARE NEGATIVE OIL PRICES EVEN POSSIBLE?

~ *Sumat Singhal*



Back ground

On Monday price of crude oil went upto negative 40 $ that means if someone willing to sell crude oil would have to pay price along with delivering crude oil and someone buying crude oil will be receiving money along with taking crude oil. What? It's hard to believe that price of commodity can dip into negative. But that's just what happened to oil prices.

Let's understand this.

This whole matter pertains to commodity exchange of USA. As we all know demand of petrol and diesel has gone down by more than 50% due to corona virus accordingly demand of crude oil as petrol & diesel are made from crude oil where as production of crude oil has been remain less by 10-15%. And we all know demand and supply has adverse relationship so as demand for crude oil came down where as supplies are higher side, price have come down drastically. Brent crude oil is bench mark of benchmark in international market. So if any one wants to know price of crude oil, he has to see price of **brent** crude oil and is currently running at 20-25 $, which is not at Zero or negative.

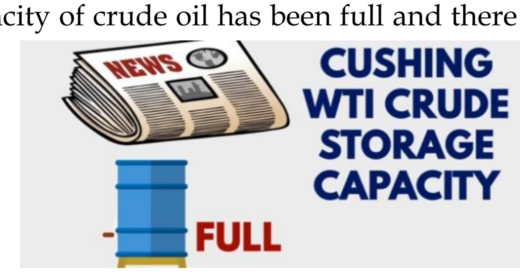
So what is issue of crude oil went negative?

That whole issues pertains to US market, as we have seen earlier bench mark of crude oil price in international market is Brent crude oil, similarly in US market benchmark of crude oil is WTI (West Texas Intermediate).

So what happened future contract of WTI trades in New York Mercantile Exchange (NYMEX) like shares are traded in stock exchange. So if you want to buy WTI for coming month i.e may, you will buy future contract in NYME for May month, lets say it is trading at $ 18 and you think that for may month price would be more than 18, you would buy it at $ 18. Each future contract has its own expiry so if you want to exit from contract you can do so before date of expiry. As far as expiry of future contract of WTI for may month is concerned, it was April 21.

That means whosoever has entered into contract of WTI future for May will have to buy the crude oil if they hold contract till date of expiry (in this case it was 21st april), and vice versa.

On 20th April, news came to market that holding capacity of crude oil has been full and there is no storage space available in the US (Cushing) for storing WTI oil further. So traders panicked and they sold their entire contract at any price.



Now let's talk about this why traders sold their contract after news of storage capacity. As we all know that whatever oil are being produced are stored at storage tank/reserve but currently oil is not being dispatched as there is no such demand of oil in the market and oil is being produced regularly.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(Photo: Bloomberg)

US benchmark WTI oil collapses to negative $40 per barrel over storage concerns

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WTI crude future contract trades every month and also have expiry and also executes smoothly. But day of Monday 20th was different, it came to mind of investors that if they buy (honour) the contract than after taking delivery where thay will storage this oil and there is also no demand of crude oil in near term, so they will have to buy storage area for this oil and has to pay storage charges/cost so they had no option but to take exit or sell the contract before expiry so they sold contract at whatever price. Initially at beginning of day it was $ 18 but soon during the day it came down to $5 , $0 and even went to negative at -$40 (negative). So trader had to pay price of $40 even after selling the crude oil. Overall reason of selling at negative was that cost of storage and other charges would be more than selling cost i.e. $50.

This was the reason of crude oil went into negative. However this was limited to market of USA.

I hope I was able to explain it!

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