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# FX Flash

# MYR: Taking Note of Oil Volatility

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### Weak Oil Prices Can Feed In to Sentiment

*Oil volatility is likely to remain and it is unlikely that we see a meaningful recovery in oil prices in the near term on oil supply-demand imbalance. Oil-led volatility in MYR could become more frequent in 2Q, as the oil market struggles to find its new balancing point. Some slight comfort though, can be found in the fact that the MYR moves could be more linked to Brent (international benchmark) rather than WTI (US benchmark). Sporadic sharp moves in spot oil prices due to immediate storage issues may also not fully translate to sharp FX moves given that FX markets tend to take into account some expectations for future oil market rebalancing as well. Nonetheless* ***we caution that negative spill over/ domino effect from soggy oil prices to other commodities and asset classes can take place if oil supply-demand dynamics do not improve****. This could weigh on sentiment and FX of net oil exporters like MYR.*

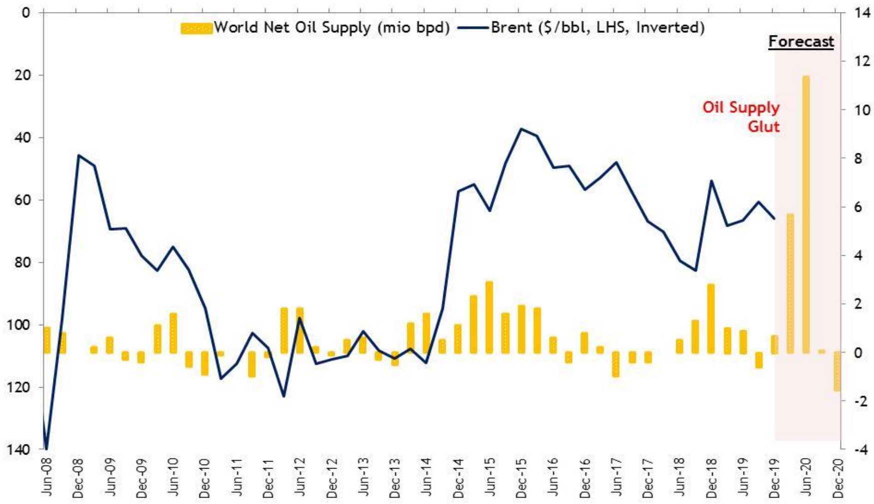
### Another Unprecedented Collapse - WTI in Negative Territories

WTI prices for May contract fell over 300% to trade a low of -$40.32/bbl at one point overnight (20 Apr) before closing at -$37.63/bbl. This is the largest one day shocking sell-off ever on history and into uncharted negative territories. As of writing, this negativity spilled over into June contracts as well, which is down to $17/bbl vs. $22/bbl this morning. Brent is also down to $22/bbl from around $26/bbl this morning.

### Demand and Supply Imbalance to Exert Downward Pressure

Demand concerns and storage constraints have been the factors weighing on oil prices broadly. On the demand side, containment measures (lockdowns, travel restrictions, border controls, etc.) to flatten COVID-19 spread nearly brought economic activities and travel mobility to a halt. On the supply side, though OPEC+ members managed to forge a historic output deal to cut production by 9.7mb/d for May and Jun, the cut came too slow (as Mexico was holding up the oil deal) and the magnitude of the cut was deemed insufficient to offset demand hit. IEA's recent report is a reminder that current oil supply-demand imbalance remains unresolved as demand loss owing to COVID-19 pandemic could result in oil inventory build of 12mbpd in 1H 2020 and global storage capacity is expected to be overwhelmed by the supply glut. Twin demand and supply shocks will continue to exert downward pressure on crude prices in the coming weeks. We do think an eventual recovery could take place sometime in 2H 2020 when demand picks up, especially if travel restrictions can be lifted alongside country lockdowns and social distancing measures. We won't rule out further supply cuts from cartels to balance supply-demand dynamics if prices continue to stay soggy.

### Oil Prices to Stay Depressed amid Oil Supply-Demand Imbalance

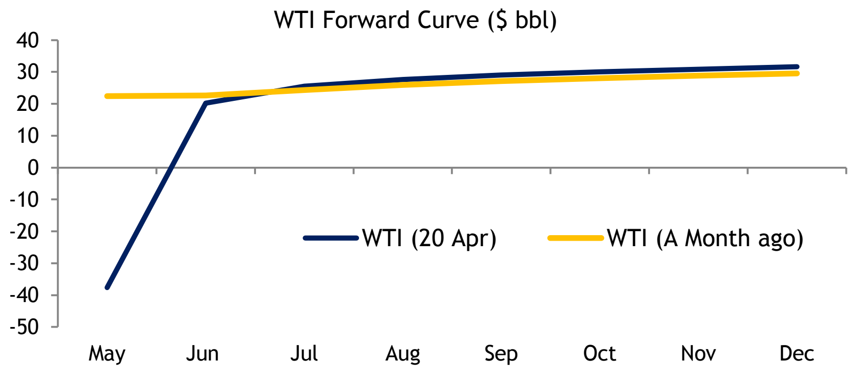



*Source: EIA, IEA, Maybank FX Research & Strategy*

### Technical Factors at Play Too – Squeeze on Long Oil Position

While WTI prices for May contract was negative overnight (last seen at $0.10/bbl). The key reason for this lies in the expiration (later tonight on 21 Apr) of the contract for May delivery and the storage constraints. As of writing, this negativity spilled over into June contracts as well, which is down to $17/bbl vs. $22/bbl this morning. Brent is also down to $22/bbl from around $26/bbl this morning.

### Anomaly (Negative Price) in May Contract Expiring Today




*Source: Bloomberg, Maybank FX Research & Strategy*

An investor with a long WTI May contract at expiry today would be obliged to take physical delivery of crude in Cushing, Oklahoma and bear all logistic expenses in May but storage hub in Cushing was reportedly full and that means the investor has to roll over their existing long position before settlement/expiry today into Jun or beyond contract (further expiry dates will be more expensive due to contango). Rolling over long position involves selling their existing long (May contract) – hence downward pressure on prices and initiating new long at a future date.

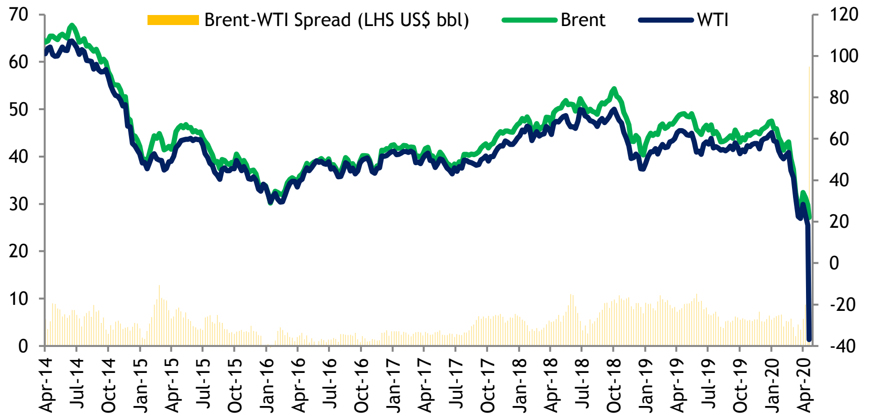
Separately and according to Bloomberg News, the USO (US Oil ETF) is the main culprit behind the plunge in WTI prices. ETFs such as USO are not created to take physical delivery of the oil contracts they hold and surge in retail interest in recent weeks created a channel to amplify the sell-off.

### WTI-Brent Divergence on US Factors

While both WTI and brent prices fell, the decline in WTI was way larger and only mirrored partly on the Brent. This is largely due to US factors on storage constraints hence limited spillover effects at this point of time. WTI contracts' main delivery point is in Cushing, Oklahoma, which had seen stockpiles rising rapidly since the start of March, and this was likely exacerbated by US lockdowns in April. Meanwhile, Brent crude involves sourcing from 15 different oil fields in the North Sea, providing easier access to sea transport/storage.

This widening of brent-WTI spread anomaly should correct when conditions normalise at some point in the future. Nonetheless **we caution that spill over effect from negative WTI to brent or other asset class could take place if oil supply-demand dynamics do not improve.**

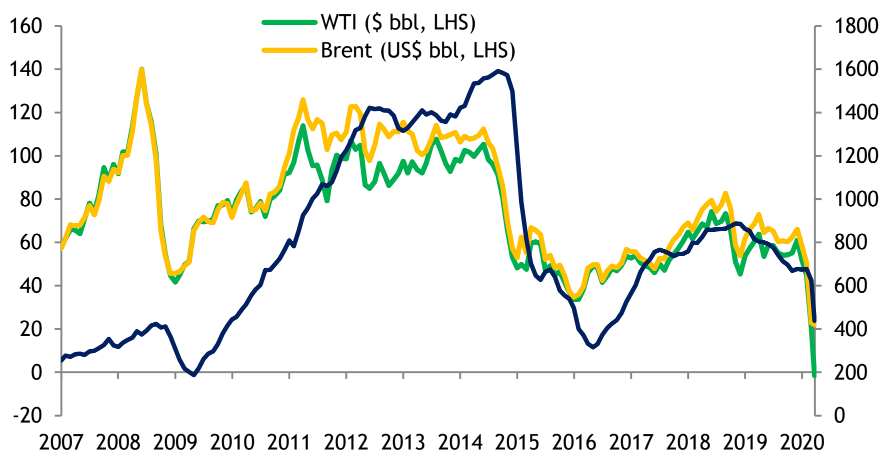
**Brent-WTI Divergence Should Correct**




*Source: Bloomberg, Maybank FX Research & Strategy*

We would continue to monitor these WTI, brent prices as well as Baker Hughes weekly drilling report on US oil rig count for indication of US shale output. Oil prices and rig counts are highly (positively) correlated. High oil prices make production profitable but the reverse is also true. Number of active US rigs drilling or oil fell by 66 to 438 last week – a 5th consecutive week of declines. Rig count reaching a bottom could signal an inflection point in oil prices.

**Rig Count Reaching a Bottom Could Signal Inflection Point for Oil**



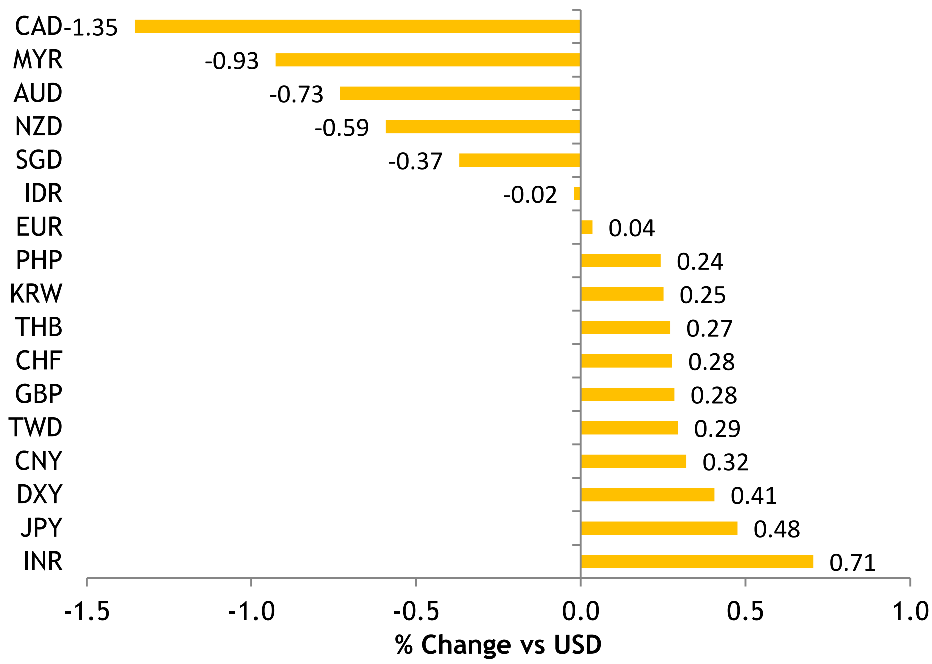

*Source: Bloomberg, Maybank FX Research & Strategy*

## FX Sensitivities to Oil Moves

In our March oil piece, we had estimated the sensitivities of various FX pairs to Brent price moves, utilizing data over the recent 5 years. The approach was to run a regression of currencies (in xxx-USD pairs) on Brent prices, controlling for equity performance (MSCI equities) and 10-year yield differentials between the country and USTs.

We reiterate the sensitivities of various FX to oil price moves below.

Estimated FX Sensitivities to -10% Decline in Oil Price




*Source: Bloomberg, CEIC, Maybank FX Research & Strategy Estimates*
Note: Values used in regression are in log-form where applicable, and data from the past 5 years are utilized.

From the analysis, most AxJ FX could see modest upsides from lower oil prices, given lower oil import burden, with INR being the prime example. We note though, that these elasticities may not hold in instances of elevated market stress. Take the overnight oil move for instance. Headlines of WTI futures entering negative territory overnight had likely exacerbated drags on global energy-linked equities, and this bout of risk aversion easily flowed through to AxJ FX trading, resulting in most AxJ FX softening vs. the USD today.

Meanwhile, historical experience suggests that net oil exporting countries could see oil revenues weakened and sentiments dampened from sharp drops in oil prices. Typical oil-linked FX proxies such as CAD is expected to be most hit, estimated to slip by around -1.4% for a -10% decline in oil prices. MYR could see softening by -0.9%. At current levels, this elasticity could imply a MYR0.02 rise in the USDMYR pair for every US$1 decline in Brent price.

The outlook for crude supply remains uncertain as demand continues to be weighed by global Covid-19 lockdowns. Even as domestic restrictions could ease into May/June, we note that international travel could also be slower to recover compared to the SARS episode, when tourism flows in Asia normalized in a matter of months. Currently, storage capacity in the US and elsewhere may continue to be a drag on the oil outlook, unless more signaling of production control from the US or OPEC+ comes into play to support sentiments.

If we take guidance from the terms of trade perspective, prices of a key exported good for net oil exporting countries are at risk of going down or staying soft, while prices of imported goods for such countries are relatively more stable. Any deterioration in the terms of trade in the current environment could mean less foreign currency revenues for oil exporting countries.

On net, oil-led volatility in MYR could become more frequent in 2Q, as the oil market struggles to find its new balancing point. Some slight comfort though, can be found in the fact that the MYR moves could be more linked to Brent (international benchmark) rather than WTI (US benchmark), with the latter seeing greater drags at this point. Sporadic sharp moves in spot oil prices due to immediate storage issues may also not fully translate to sharp FX moves given that FX markets tend to take into account some expectations for future oil market rebalancing as well. Even as **we caution that negative spill over/domino effect from oil prices to other commodities or asset classes can occur if oil supply-demand dynamics do not improve, downside risks for MYR may not be as severe at this point**. We maintain our USDMYR forecasts of 4.35 by end 2Q and 4.28 by end 2020 on the back of potentially softer USD as we head into the quarters ahead.

### USDMYR (Daily) Tech Outlook: Upside Risk for USDMYR

USDMYR was last seen at 4.3940 levels. Bearish momentum faded while RSI is rising. Immediate support at 4.40. Break above this puts next resistance at 4.4490 (2020 high). Support at 4.3550 (21 DMA, 23.6% fibo retracement of 2020 low to high).

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