Oil Market Crisis
Geopolitical Considerations Matter

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1. An unprecedented demand destruction breaks OPEC+, then brings it back together

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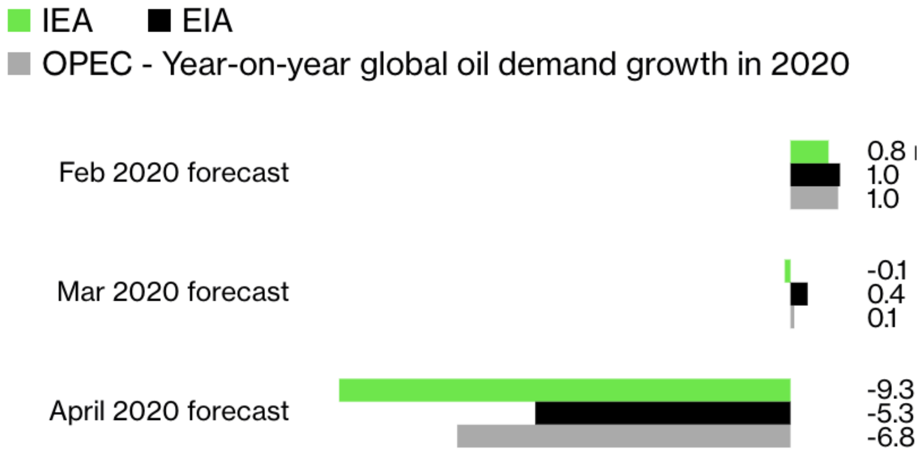
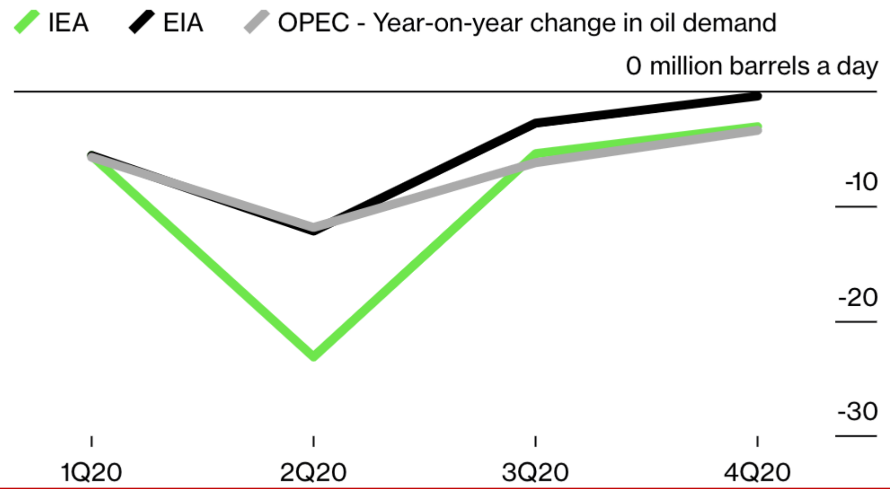
Three agencies worsening 2020 demand forecasts (Mbpd)



2020 Demand forecast per quarter: Things get better after terrible 2Q and "black April"



- **Epidemic stage:** While Covid-19 was still mostly contained within China, Rystad, IHS, predicted a 1-2 Mbpd demand downside in 2Q 2020
- **Price/Market share war:** OPEC+ production cuts negotiations failed. Russia-KSA Price/volume war could make sense with -2 Mbpd demand, and $33/b Brent forecast
- **Pandemic stage:** But we now expect 25 Mbpd demand destruction in April, averaging 9.3 Mbpd in 2020. Global storage is 60% full. $19.8/b Brent, negative prices for WTI
- **Return to "market management":** Such market conditions mean the price war can have no winner. No demand will meet higher supply volumes to make up for lower prices

Lower demand and lower prices first accelerated the breakup of the Vienna Alliance. Then much lower demand and prices brought it back together

1 Breaking up of the Vienna Alliance

2 OPEC+ new agreement

The Next Slides will put forward geopolitical and strategic rationales at the foundation of this evolution

Source: 油价迷局：其实沙特的问题不在沙特，俄罗斯的问题也不在俄罗斯，;清泉能源 Spring Energy, 陆如泉; IHS Markit; Rystad; Fitch Solutions; Bloomberg; IEA; EIA; OPEC

2. KSA price war rationale: Power continuity of the Saud family, and US security pact

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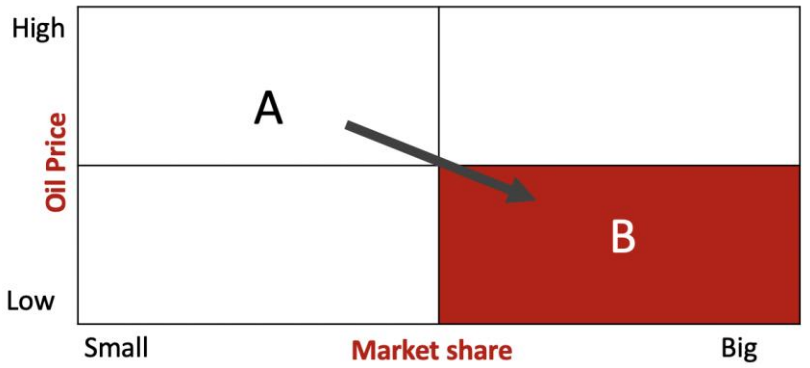
1 Market rationales

Did KSA want to grow its market share?

- Some analysts argue that KSA wanted a price war to:
- ❑ Eliminate production from higher-cost producers,
- ❑ so as to rebalance the market, bring prices up again,
- ❑ and therefore protect its oil revenues

Did KSA feel pressure to implement a "fast monetising strategy"?



- Other analysts argue that KSA wanted to create a world of low oil prices
- In such new global oil order, there would only be room for low-cost producers
- Therefore, KSA could dominate a vastly greater market, and sell much more of its huge reserves, faster, before demand peaks in 10 years, and the commodity depreciates

AND/OR

2 Geopolitical rationales

The Shia crescent, and Russia: An increasing threat to KSA

- The Saud royal family, more than ever, needs the **US security pact**:
  - ❑ Iran and the Shia crescent are a major threat to KSA
  - ❑ Russia is filling the strategic space created by the US withdrawal from Syria and Iraq to some extent
- Under this perspective, the price war could slow down Russia's rise in the region
- The price war would also accelerate the economic and political destabilisation of Shia Iran and Iraq
- Therefore, market share and oil revenue are not the only or key consideration

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3. Russian price war calculus: Balancing multiple considerations, is it worth the pain?

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1 Economic and political dimensions

A Favourable to the price war

1. **Commercially**, the price war could force shale producers out of the market

2. With more space on the market, Russian greater oil sales volumes would boos oil revenues

3. **Politically**, the price war could help Putin to consolidate his power in the context of ongoing constitutional reforms

B Unfavourable to the price war

- **Putin's 2018 National Projects program** require sustainable oil price levels to be financed

AND

2 Geopolitical dimension: favourable to price war

Nord Stream 1, and Nord Stream 2 project

- US shale hegemony, aided by sanctions against Russian energy interests (Nord Stream 2, Rosneft trading company), are a threat to Russian energy and geopolitical interests
- A price war slows down US shale oil and gas penetration in China and Europe, therefore allowing Russia to build greater influence in these two key regions, through energy dependence

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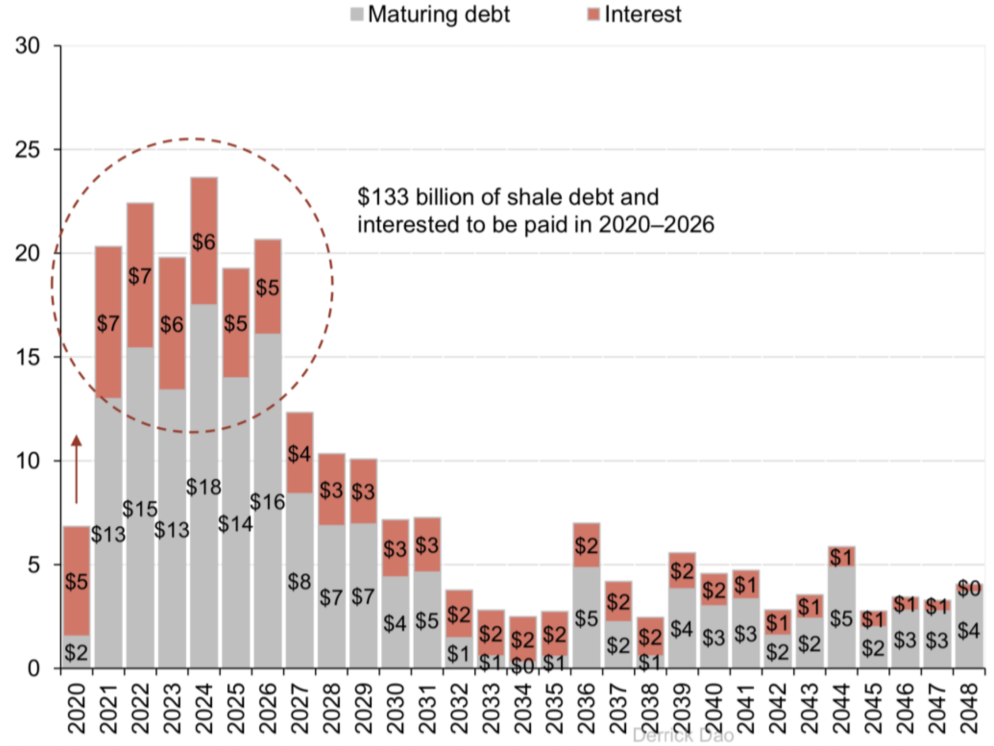
4. US intervention: Managing the managers

US E&Ps Debt & interests by maturity, Bn USD



- 29 E&Ps representing 50% of 2019 shale oil production, will have to pay back about $27.2bn in 2020-2021. Total debt: $177bn
- Although most 2020 production is hedged above their breakeven, US production is expected to fall at least 2 Mbpd in 2020
- Most 2021 production is not hedged, current WTI prices would be a catastrophe for indebted US shale industry on 2021

US intervention

- The US plays a central role in the global oil order (production, finance, technology, etc.), which allows it to enjoy exceptional "rights". It will intervene if this order is threatened
- Low demand and prices had first pushed Russia and KSA to start a price war. But when low prices became a threat to US shale dominance, and Trump's re-election, Trump managed to bring the market managers back to "rational" market management

Tools of the intervention

- US shale lobbies advocated in Washington to:
  1. Block Saudi oil from North America's biggest refinery in Port Arthur
  2. Threaten a review of the security pact between the US and KSA
  3. Impose more sanctions on Russian energy interests
- Trump put forward the idea of tariffs on Saudi oil

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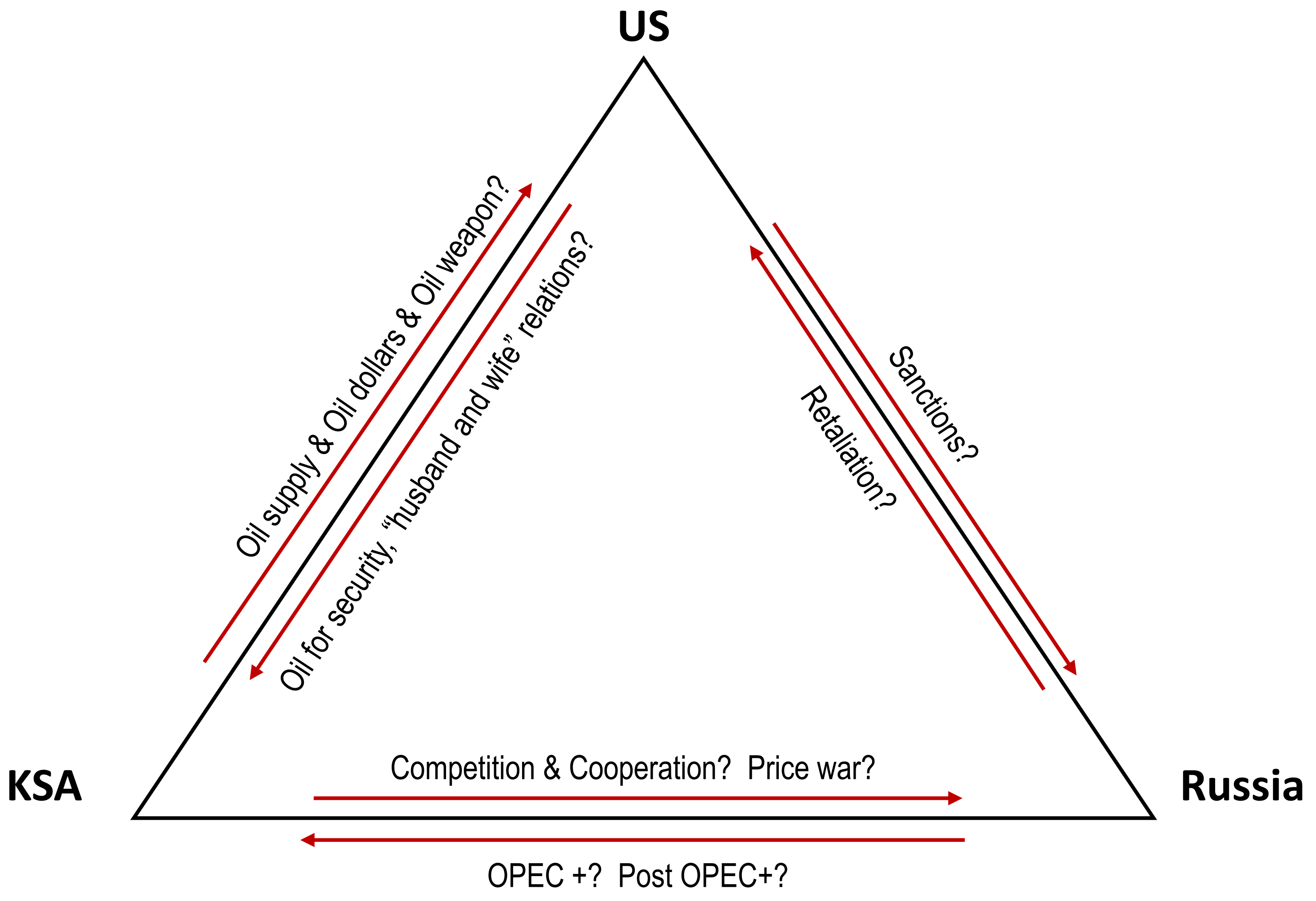
5. Conclusion: The key is competing for the “Oil Power”

The World three “10 Mbpd” producers club : Unbalanced triangle



- Novak and Abdulazin Bin Salman have made a joint statement last week pledging further supply cuts if “necessary”
- Despite this reassuring communication, soon after, WTI traded around negative $40/b
- The future?