OIL: WE MOVE FROM NEUTRAL TO POSITIVE

6 February 2020

Xavier TIMMERMANS
Investment Strategy PRB

IN A WORD:

Crude oil prices have plummeted by 20% since their January highs, while tensions between the United States and Iran have fuelled the worst fears. The coronavirus epidemic is expected to drive down global demand due to travel limitations and the slowdown in economic activity. Our belief is that this price weakness should be short-lived. Profitability problems within the shale oil industry and the fiscal position of the OPEC countries are likely to squeeze supply fairly soon.

Quarantine measures, travel restrictions and temporary business closures in China could slash global demand by nearly 400,000 barrels per day (out of a total consumption of nearly 100 million barrels per day). This may sound insignificant in percentage terms (0.4%) but in a situation of over-supply versus demand, the impact on prices is enormous.

The shale oil industry is price-sensitive

Our analysis is that a price around $50 per barrel for the West Texas Intermediate (WTI) is untenable for the shale oil industry. This industry, still dominated by small, independent producers, was already in difficulty before crude prices started to fall. Unlike conventional oil fields, the lifespan of shale oil rigs is relatively short, which means that ongoing investments are needed to drill new rigs. These small producers were already struggling to generate regular cashflows and finance themselves. The number of bankruptcies doubled in 2019 (42 in the US and Canada) and the total amount of US bonds in default exceeded $208 billion. Shareholders are now demanding more dividends and fewer investments.

In the past, every major decline in crude prices led to a decline in the number of rigs in operation, after an adaptation period of 3 to 4 months. The same will be true this time, and overproduction will thus decrease.

OPEC+ plans to cut production further

OPEC and associated countries (OPEC+) decided in early December to increase their production restrictions by an additional 0.5 million barrels per day, and Saudi Arabia reduced its own quota by 0.4 mb/d, bringing total production restrictions to 2.1 mb/d. For the past three years, OPEC+ has generally complied with its commitments, despite doubts about discipline within its organisation.

OPEC+ is currently discussing additional emergency measures to deal with the tumbling prices. This eventuality may curb downside speculation, with OPEC+ behaving like central banks whose rhetoric influences the markets even before any decision is made.

No geopolitical risk premium is abnormal

Geopolitical risks remain in the Middle East. The extremely effective attack on Saudi oil facilities in September 2019 and the intense tensions between the US and Iran at the beginning of January should remind us that the lack of risk premium in crude prices is abnormal. Any single incident could cause crude prices to soar.

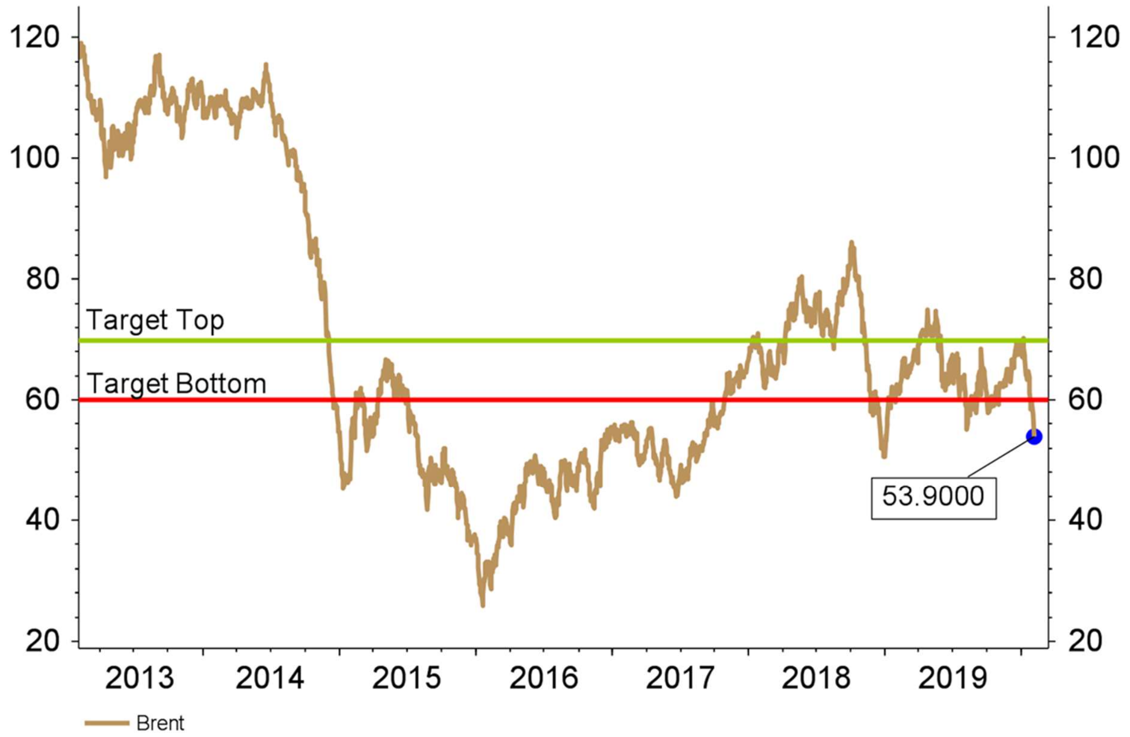
The medium-term outlook remains positive

The 2-3 year outlook remains positive due to the lack of investments in conventional oilfields in the years following the fall in prices in 2014. Without any investments, the production of conventional fields decreases by 6-7% per year on average.

The effects of the energy transition should only be felt much later.

Conclusion

We believe that the lower consumption due to the coronavirus health crisis is temporary. Demand has not disappeared, but rather postponed. Brent crude oil prices are expected to rise from ±$55/b currently to $60-70/b within the coming months. Profitability problems in the shale oil industry and the fiscal position of OPEC+ countries require a higher equilibrium price. It is in the interest of all producers to temporarily reduce their production.


BRENT
USD
120
100
80
60
40
20
Target Top
Target Bottom
53.9000
2013
2014
2015
2016
2017
2018
2019
Brent
Source: Refinitiv Datastream, 2/4/2020

THE INVESTMENT STRATEGY TEAM

France

Florent BRONES
Chief Investment Officer

Asia

Prashant BHAYANI
Chief Investment Officer, Asia

Grace TAM
Chief Investment Advisor, Asia

Belgium

Philippe GIJSELS
Chief Investment Advisor

Xavier TIMMERMANS
Senior Investment Strategy, PRB

Alain GERARD
Senior Investment Advisor, Equities

Pol TANSENS
Head of Real Estate Strategy

Luxembourg

Guy ERTZ
Chief Investment Advisor

Edouard DESBONNETS
Investment Advisor, Fixed Income

Switzerland

Roger KELLER
Chief Investment Officer

DISCLAIMER

This marketing document is provided by the Wealth Management business of BNP Paribas, a French public limited company with a capital of € 2,499,597,122, registered office 16 bd des Italiens 75009 Paris - France, registered at RCS Paris under number 662,042,449, authorised in France, under the number 662,042,449, approved in France by the Autorité des Marchés Financiers (AMF). As a marketing document, it has not been produced in accordance with regulatory constraints to ensure the independence of investment research and is not subject to the prior transaction ban. It has not been submitted to the AMF or other market authority. This document is confidential and intended solely for use by BNP Paribas SA, BNP Paribas Wealth Management SA and companies of their Group ('BNP Paribas') and the persons to whom this document is issued. It may not be distributed, published, reproduced or revealed by recipients to other persons or reference to another document without the prior consent of BNP Paribas.

This document is for informational purposes only and does not constitute an offer or solicitation in any State or jurisdiction in which such offer or solicitation is not authorised, or with persons in respect of whom such offer, solicitation or sale is unlawful. It is not, and should under no circumstances be considered as a prospectus. The information provided has been obtained from public or non-public sources that can be considered to be reliable, and although all reasonable precautions have been taken to prepare this document, and, in the event of any reasonable precautions, the accuracy or omission of the document shall not be recognised. BNP Paribas does not certify and guarantees any planned or expected success, profit, return, performance, effect, effect or profit (whether from a legal, regulatory, tax, financial, accounting or other point of view) or the product or investment. Investors should not give excessive confidence in theoretical historical information relating to theoretical historical performance. This document may refer to historical performance; Past performance is not a guide to future performance.

The information contained in this document has been drafted without taking into account your personal situation, including your financial situation, risk profile and investment objectives. Before investing in a product, the investor must fully understand the risks, including any market risk associated with the issuer, the financial merits and the suitability of such products and consult its own legal, tax, financial and accounting advisers before making an investment decision. Any investor must fully understand the characteristics of the transaction and, if not otherwise provided, be financially able to bear the loss of his investment and want to accept such risk. The investor should remember that the value of an investment as well as the income from them may fall as well as rise and that past performance is not a guide to future performance. Any investment in a product described is subject to prior reading and to an understanding of the product documentation, in particular that which describes in detail the rights and duties of the investors and the risks inherent in an investment in that product. In the absence of any written provision, BNP Paribas does not act as an investor's financial adviser for its transactions.

The information, opinions or estimates contained in this document reflect the author's judgement on the day of his drafting; they must not be considered as authority or be substituted by anyone in the exercise of his or her own judgement and subject to change without notice. Neither BNP Paribas nor any BNP Paribas Group entity will be liable for any consequences that may arise from the use of the information, opinions or estimates contained in this document.

As a distributor of the products presented in this document, BNP Paribas may receive distribution fees on which you can obtain further information on specific request. BNP Paribas, its employees or Directors may hold positions in or relationship with their issuers.

By receiving this document you agree to be bound by the above limitations. © BNP Paribas (2020). All rights reserved