March 10, 2020

Oil Could Fall Below $20, Stratas Advisors President Says

Stratas Advisors

John Paisie, president of Stratas Advisors, reviews the outlook for the oil market in a video interview with Paul Allen of the *Bloomberg Markets* report. Oil clawed back some on March 10 after its biggest drop in a generation the previous day. The battle for market share between Saudi Arabia and Russia threatens to boost supply just as the coronavirus has instilled a decline in demand, Paisie said. Hear what he has to say in the interview.

Talking Points from Stratas Advisors

Stratas Advisors President John Paisie summarizes the major factors that are weighing down oil prices and how those factors could influence future prices.

Reaction to Saudi Arabia's Production Increase and Price War

- Russia did not agree to a production deal with Saudi Arabia for several reasons:
  - The deal extended cuts through the end of the year.
  - Russia is concerned about additional production coming online in Kazakhstan.
  - Russia wants to dampen down US shale industry, which will also result in a reduction in the production of associated gas.
  - Russia has built up its sovereign wealth fund, which can be drawn on to help offset the downturn in oil prices.
- Once the deal fell through between Russia and Saudi Arabia, it left Saudi Arabia with limited options for responding.
- Back in the mid-80s, there was a similar situation of an oversupply of oil. The Saudis cut production unilaterally in an attempt to balance the market. However, other producers maintained or increased supply.
- This situation played out again after the rebound that took place in second half of 2017. US shale producers increased production in 2018 by nearly 2.0 million barrels per day (bpd) from the beginning of the year to the beginning of 2019 – and then added another 1.2 million bpd in 2019.

Oil Price Outlook

- If the Saudis move forward with production increases it will be at a time of declining oil demand. That would be much different than the dynamics of previous oil market shocks that have occurred since 1973.
- In the present situation, we can see the price of Brent dropping to $20 – and even breaking below the $20 mark before the market rebalances.
- During the 2014 downturn the price of Brent dropped below $30 for a period of time before the market started to

recover – and the bottom was not reached until the beginning of 2016

- At this point it does not look realistic to think that Saudi Arabia and Russia can reach a deal anytime soon, given the very public breakdown in negotiations – and the subsequent reaction of Saudi Arabia
- Therefore, the most likely way for the market to rebalance is for production to decline in the US and Canada – and for demand to start coming back in the second half of this year. And in time the markets will rebalance – but not until late into 2021
- The reaction in the shale sector will be dampened by hedging programs – and by the majors playing a bigger role – and having more financial wherewithal to continue to invest

Other Risks

- Geopolitical unrest impacting oil producers – Iran, Venezuela, and Mexico – and even countries like Malaysia and Brazil – is a real potential issue.
- The US oil demand will be negatively affected by lower oil prices and the downturn in shale activity – especially diesel demand – which will dampen the recovery.
- The high-yield bond market – the largest segment is made up of the energy sector – could cause issues through other parts of the financial sector.
- The impact of the coronavirus could be very extensive in the US and in Europe – and could extend past April – and return next year (although the impact in the following year will not be so severe in that there will be a more effective means to prevent and treat the virus).
- Business and consumer behavior could be modified in a structural way with travel not coming back as expected and an economy with less international trade and movement, and tighter control on spending (businesses and consumers).

