

Flash Note:
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Oil war - reasons for optimism and skepticism

Reasons for Optimism

1. Russia said it could cut by 1.6M bpd.
2. Kuwaiti oil minister al-Fadhel said the 23-country OPEC+ alliance is aiming for a global output cut of 10-15M bpd, but such a pact will need to include producers outside the group. The minister said if there had been no willingness to have an agreement, countries would not have accepted the invitation to meet.
3. Algeria's oil minister said he expected a "massive reduction" internationally **which could reach 10M bpd.**

Reasons for Skepticism

1. There remains skepticism about what form of US immediate participation in the pact. Washington has acknowledged that contended market forces will reduce US production, but not immediately (output cuts would materialize throughout Q1 2021). US officials consider federally mandated cuts as government overreach into private enterprise. In the meantime, it seems as if President Trump advocates for tariffs on imported oil as leverage to get Saudi Arabia to reduce production. Tariffs are broadly unpopular but could favor production on federal land.
2. Even if a major production cut is agreed, it may not be enough to rebalance a market grappling with demand destruction and a glut of oil already in storage.
3. Physical prices notably lagging futures are a clear sign of weak demand. The price of Dated Brent has been at least \$5/barrel lower than Brent futures since 24-Mar. The unusually wide divergence is a sign of strains in the physical market as traders scramble to find buyers or places to store crude.

If I had to bet on an outcome, I would say that there will finally be some kind of agreement that could stabilize the price of crude oil at levels of USD 30s pbl. But this agreement will not be very stable, so it is better that the sanitary restrictions are eased / lifted soon and the demand for oil recovers. Otherwise, the price of crude could temporarily go to zero. That would be problems for the HY market, banks, interbank MM, commercial paper, corporate credit, etc.