Covid-19 & OPEC+ collapse: preliminary assessment of implications for energy markets, policies and geopolitical balances

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Global situation I

- Global economic growth in 2020 was already expected to slowdown versus 2019.

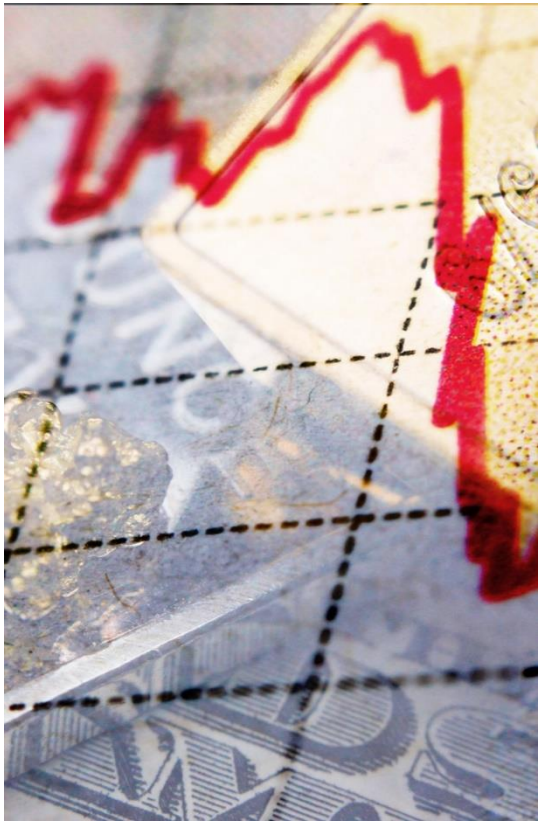
- Following the virus outbreak, an economic slowdown in January and February is already visible. Several G20 economies are already severely hit: China, Italy, South Korea, Japan notably, others will follow.

- The 2020 economic crisis could be very different from the 2009 one. This time, China is at the core of the crisis and is facing an economic and sanitary crisis.

- OECD warns that global growth could be halved to 1.5% in 2020. Several countries will enter recession.

- Global CO2 emissions are decreasing in early 2020 due to the economic slowdown in China, and to a reduction in air and maritime freight transport. With ultra low gas prices and solar deployment costs becoming always cheaper, there could be a continued push out of coal-fired power generation in 2020. With storms hitting Europe, wind power generation posted records.

Global situation II



- China's regime first prevented an appropriate reaction, which favoured the outbreak, but is now an asset to limit its expansion. China is now working to save its economy and improve its global image.
- The epidemic is expanding in Europe and could have potentially large and structural economic, social, geopolitical and geo-economic consequences on the short and long term.
- Parts of the world are now facing a sanitary and economic crises. There is an oil market crisis. There is a possible global economic crisis. There could be a financial crisis. But there could also be an economic rebound in H2 2020 if the covid-19 outbreak has peaked by April-May.
- Little can be certainly predicted at this stage in terms of duration, impacts, locations, and sectors as the situation is evolving fast and remains highly uncertain, but several facts and trends can be observed, and perspectives considered.

Oil markets facing a supply side and demand side driven storm

- **Demand**

  - **Pace of demand growth in 2020 was already seen as slower than in 2019, at around +1mbd.**

  - The Covid-19-related economic slowdown has been directly hitting the growth in oil demand, notably in China, the world's largest importer.

  - That demand reduction is now accelerating and 2020 could see an overall decline in demand.

Oil markets facing a supply side and demand side driven storm

- **Supply**

  - The 11/2016 OPEC+ alliance has suddenly collapsed after the 05-06 March meetings. Saudi Arabia overplayed its cards when seeking to twist Russia's arm in forcing it to significant additional cuts it did not want (-500 kbd for allied producers like Russia) - Russia had so far only committed to postpone the growth of its own production and Rosneft notably lobbied for starting new fields and raising its production.

  - Reaction from MBS was also unexpected - going for a price war and a battle for market share, reflecting anger as Saudis shouldered the agreements since the beginning in taking the largest cuts (Saudi production is down to 10 mbd) and OPEC offered an addition 1 mbd cut. MBS decision also reflects weaker ties with the United States.

  - As of April when the current 2,1 mbd OPEC+ cut expires, Russia could progressively start adding up to + 400 kbd, and Saudi Arabia + 2 mbd, with markets being then oversupplied in spite of the near total halt of Iranian, Venezuelan and Libyan exports.

  - Russia's readiness to jeopardize the OPEC+ alliance also reflects the limited prospects for a strategic alliance with Saudi Arabia. It also reflects a likely priority given to hit US producers, following sanctions imposed on Nord Stream 2 and Rosneft.

Oil prices now collapsing, following the collapse in gas prices in 2019

- Brent prices have collapsed from nearly 70$/barrel in early January to 36$/barrel, but have bottomed out so far
- WTI gas prices reached 1.7$/Mbtu, versus 2.5$/Mbtu in past months. TTF gas prices in Europe are at their weakest, so are Japan's JKM prices (@3$/Mbtu!) amidst a very mild winter.
- LNG prices are expected to remain depressed all through the year. New FIDs in export projects are expected to be rescheduled (Qatar…)

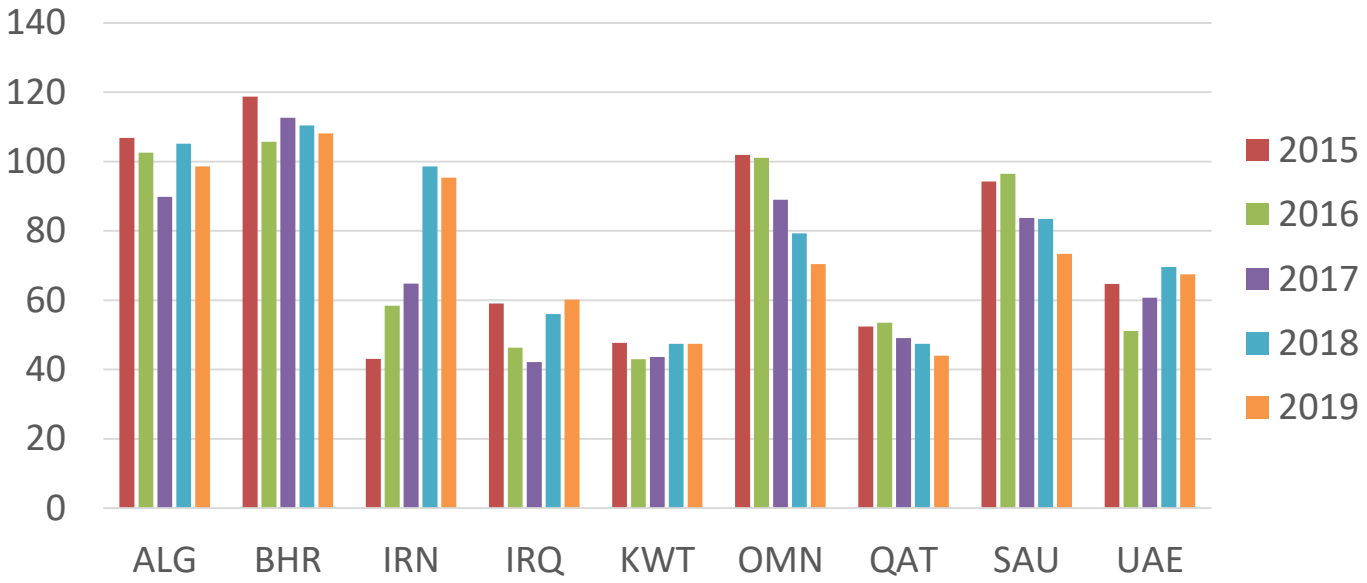
- Long term gas contracts could be revised
- With the collapse of OPEC+, there is no longer a downward limit for the oil price and the hard-won credibility of this surprising alliance is broken…
- Oil prices could fall much further.
- However, the dramatic impacts of the arms twist between Russia and Saudi Arabia might prompt them to come back to the table sooner or later.

Global implications across the oil industry

- If the situation continues, US shale (high opex costs) and deep offshore producers will feel the greatest pain.
- The restructuring of the US industry will accelerate, the growth in US liquids & exports (>3mbd recently) could be reduced, making room for Russia and Saudi Arabia.
- The US is no party to OPEC+ and its output growth depends on environmental regulation, cost reduction, efficiency gains and the oil price levels.
- Sharp demand reduction could be slightly eased by higher storage (contango operations and strategic stocks) and also by higher passenger car use to avoid public transport.
- Back in 2015, the oil price crisis was essentially supply side driven. Hence why the current situation is unprecedented.

OPEC+ oil producers need a much higher oil price to ensure their budget balances

Oil price levels needed for budgets to breakeven, selection of producers, 2015-2019 ($/barrel)

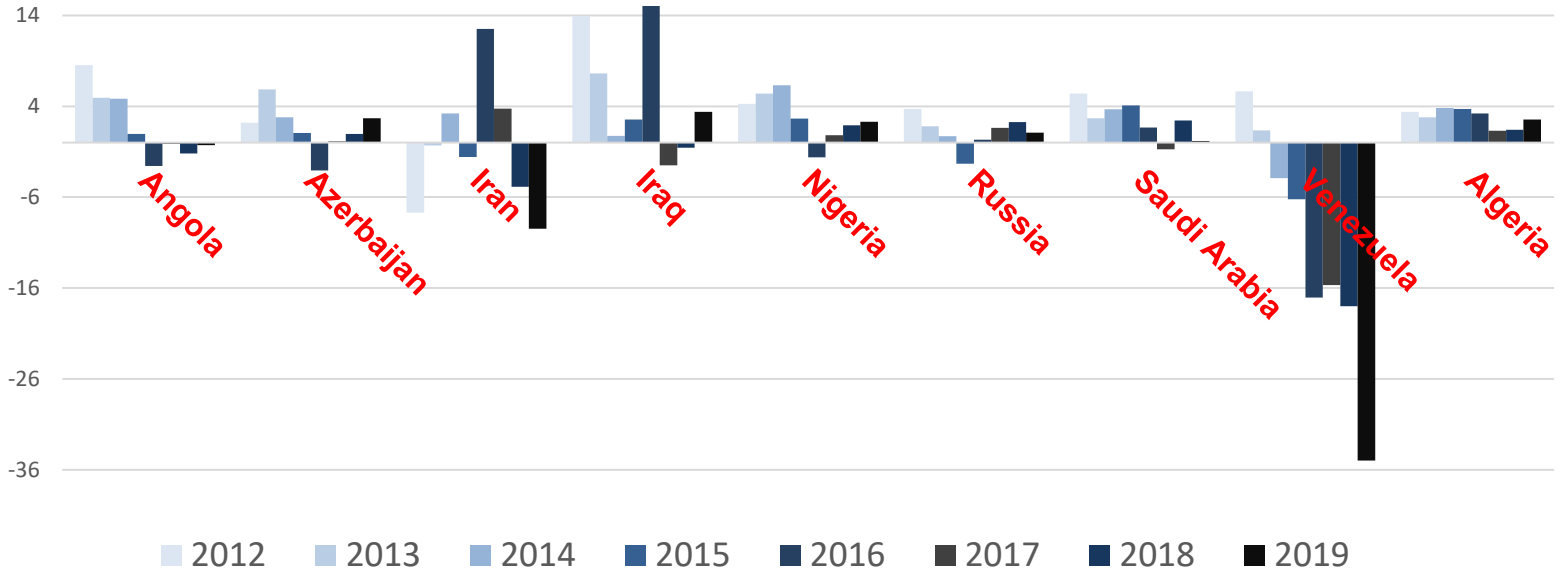


Source: IMF Regional economic report, November 2018

Most producers have insufficiently diversified their economies. Military spending often remains particularly high, notably in Saudi Arabia, the world's largest arms importer in 2015-2019 according to SIPRI. Several have financial reserves, but they are more limited than in 2014.

Algeria, Nigeria, Angola, Iraq, Iran face particularly worrisome economic prospects, the Saudi and Russian economies are also weak

GDP growth in a selection of OPEC+ members, 2012-2019 (%)

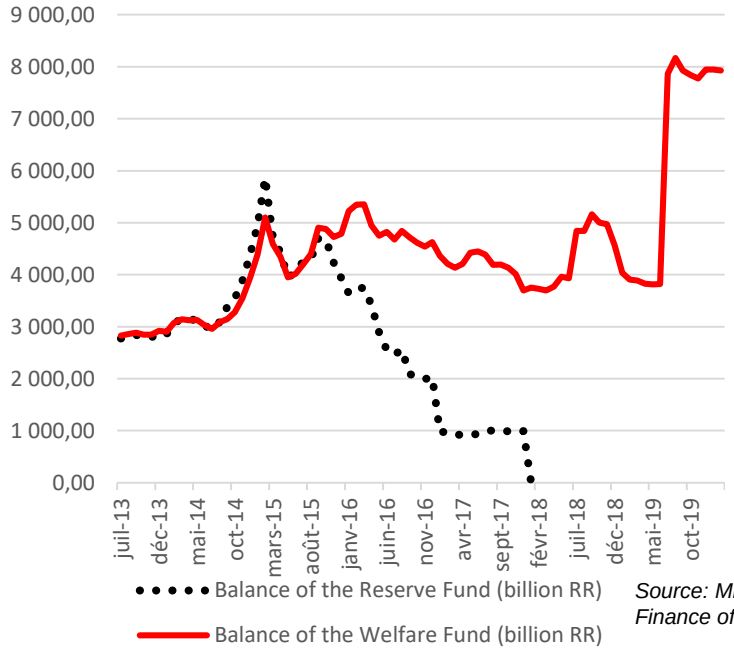


Source: IMF

The current oil price crisis comes after an already year-long gas price crisis, which has already been affecting dual oil and LNG/gas exporters like **Nigeria, Algeria, Russia** or **Angola**. Algeria and Iraq, which are facing institutional crises, are particularly exposed. Iran's prospects are dire, as it is hit by sanctions and the virus.
Following the 2015-2016 crisis, most underwent an economic recession, which could be repeated.

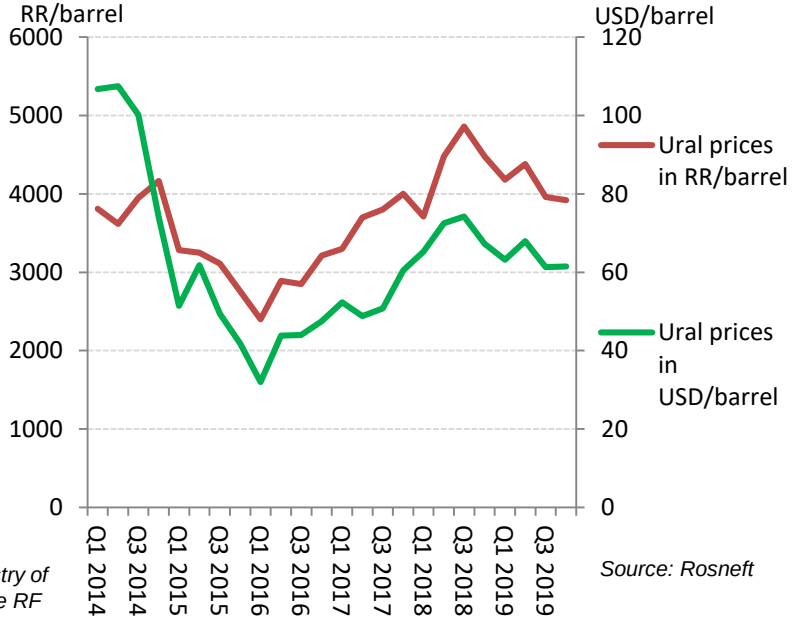
Russia's oil producers are preserved thanks to the ruble depreciation but economic growth could halt in Russia, in spite of fiscal reserves

Russia's fiscal reserves, 07/2013-02/2020, in rubles



Source: Ministry of Finance of the RF

Evolution of Ural prices in rubles (RR) and $, Q&2014-Q42019



Source: Rosneft

The Ruble depreciation is sharp, now trading at 72 RR against the $, the lowest since March 2016. Fiscal reserves and a cautious budget will help level off the price crisis, but are unlikely to prevent the threat of another recession if the situation continues until H2 2020.

Renewable deployment could slow down

- Supply chains for solar equipment from China are facing interruptions/delays.
- Several developers face challenges with meeting timetables.
- With growing economic difficulties, countries could cut back subsidies for low carbon technologies.
- The offshore wind industry should be less impacted than the solar industry.
- IOCs, many of which have recently published huge ambitions to invest into renewables, could also cut back on their “green” investments in 2020 and 2021 in order to secure returns for shareholders.
- China could unleash a price war for solar panels, driving an investment rebound.

Gas markets to remain depressed

- A slowdown in US shale oil growth could reduce associated gas production, which could have a slight upward pressure on US gas prices.
- Gas demand growth in Asia should remain very low this year, leaving markets oversupplied. Producers are expected to try to reduce their LNG output.
- Depressed LNG prices could in principles help to push LNG demand in emerging economies if they are not further hit by currency depreciation and economic slowdown.
- In the EU, the ETS prices could further decrease (-2 EUR/t already), which is an advantage for gas in power generation as gas is desperately cheap.

The execution of the European Green Deal will be challenged

- EU's ability to cope with economic, sanitary and migration crises is weaker than in 2009: many minority governments, populism, Germany is politically and economically weakened… Institutions could be increasingly paralyzed…
- Airlines will ask for carbon taxation plans to be postponed as they will suffer dramatically albeit the restructuring of the sector + lower fuel costs will help their later recovery.
- The car industry is facing an existential crisis as the roll out of EVs in the EU could occur in the midst of a demand crisis. Implementing tougher emissions standards will be further resisted, notably by Germany, which faces the sharpest risks.
- Several EU economies, notably Italy, could be in recession (tourism already collapsed, which could also be the case for Spain), with governments having to fight sanitary, social, and economic crises at the same time.
- The possibility of a paralysis of institutions and EU governance mechanisms is to be considered, which could slow down or even disrupt decision-making.

The execution of the European Green Deal will be challenged

- Several EU member countries are already pulling the break on the acceleration of the energy transition (2030 targets for example) and could be further inclined to focus on short term measures to limit the economic and social impacts of the crisis.
- The budget discussions for 2021-2027 are expected to be further complicated, so will be the discussions over raising the 2030 targets.
- Financing the Green Deal could face competition from financing the urgent additional budget support measures which are already being prepared by the European Commission.
- The ETS reform discussion will be extremely difficult as they will happen in a period of lower economic growth, possibly when the recovery will have to be organized… Aviation could seek more time.
- Carbon floor price for power generation would be even more needed now, but politically hard to implement now.
- The Eurozone 3% deficit rule will have to be reformed.
- If the possible EU stimulus packages are not driven by measures aligned with the climate neutrality goal, social movements will become more radical & credibility will be weakened.

Perspectives for 2020: uncertainties and risks ahead

- Spread of Covid-19 in the **Middle East, North Africa** and **Africa** could be highly problematic given their weak health infrastructures.

- Global governance mechanisms will be needed to protect societies and economies and organize recovery measures, but:

  - **Saudi Arabia holds the G20 presidency** and has proven highly erratic in starting an oil price war

  - **Trump presides over the G7 but is facing a potential oil sector and sanitary crises which could have large social and political impacts ahead of the November election.** If he is re-elected, can the US afford to continue combatting the multilateral trade order when it will be a powerful tool for the economic recovery?

  - Preparatory work for **COP26** to be affected, governments from emerging economies are less likely to be interested in raising their NDCs, could struggle with social and economic unrests.

- Geopolitical adjustments are already visible**: Russia-China, Russia-Saudi Arabia, Japan-South Korea**. Several OPEC producers will be extremely unstable and will lobby Russia and Saudi Arabia.

Perspectives for 2020: uncertainties and risks ahead

- The oil crisis can exacerbate structural problems in **Mexico** and **Brazil**. Maduro in Venezuela will face further challenge to stay in power.

- Instability in **Sub-Saharan Africa/Sahel** could grow (payment of salaries in producing countries); South Africa already in recession, Nigeria could follow soon.

- Over time, companies will seek to reorganize global value chains to be less dependent on specific areas in **China**, and reduce the geographical distances in value chains.

- The political transition process in **Saudi Arabia** is showing increasing signs of activation, while the country's stability is increasingly uncertain (e.g. latest high profile arrests).

- Ultimately, the low commodity prices can ease the impacts of an economic crisis and facilitate the recovery.

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