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## Oil prices caught between extremes

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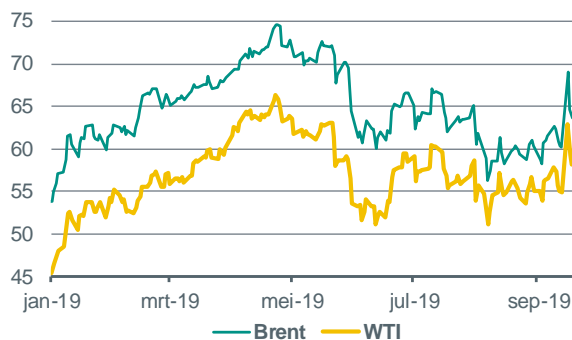
- **The attacks on Saudi oil production facilities will mean increased market vulnerability in Q4**
- **Markets seem to be ignoring geopolitical tensions as risk premium is not being priced in**
- **We maintain our oil price forecasts, but upside risks have increased**

### Attack on Saudi oil production facilities triggered only short term volatility

After the attack on key Saudi oil production facilities last week, oil prices jumped higher. However, in the aftermath, Saudi officials assured the market that the production facilities will be up-and-running before the end of the month. As a result, oil prices eased to levels only a few dollars above the Friday close. Nevertheless, despite the fact that oil prices seem to have calmed, some things have changed for sure.

### Brent and WTI crude oil prices

USD/bbl



Source: Bloomberg

### Important data:

25 Sept	EIA Monthly Energy Review
8 Oct	EIA Short-term energy outlook
10 Oct	OPEC Monthly Oil Market Report
11 Oct	IEA Oil Market Report
13 Nov	IEA World Energy Outlook
5-6 Dec	OPEC/non-OPEC meeting

### Supply related risks flipped from downside to upside price risk

If the Saudi statement is correct, oil production will be back to normal at the end of the month, and global inventories are sufficient to meet global demand. Still, the rumoured request from Saudi Arabia to Iraq for 20 million barrels of oil to supply refineries triggered fresh support for oil prices. This suggests that the market is still somewhat suspicious and highly sensitive to supply-related news. And not without good reason, as the recent attacks show the vulnerability of the Saudi oil infrastructure. The Saudi authorities need to step up the protection of oil production facilities while at the same time ensuring they meet their obligations towards consumers. Saudi Arabia is not only the third largest oil producer of the world, it is also the only swing producer of the market. In any event, when crude

production is hit, Saudi Arabia is the one country looked at to step in by increasing production. However, with the oil market's 'producer of last resort' becoming less reliable, not only the Saudi oil supply, but *global* oil supply could be at risk.

Before the attack, the market was already mainly driven by supply-related news, which suggested oversupply (US crude production, US inventories, US/Iran diplomatic talks, economic slowdown). But after the attack, the focus seems to have shifted towards risks of supply/production shortages and the impact on the Saudi's spare capacity. As long as Saudi production is not fully restored, and demand is partially met by tapping strategic reserves, the oil market is extremely vulnerable to new shocks. Should there be a new shock – this can be a new attack on global oil supply, or for instance a hurricane in the Gulf of Mexico – markets could fear that supply would drop further and inventories will quickly dissipate, resulting in possible shortages. This could again trigger a significant price jump.

### Market does not seem to be fully pricing geopolitical risk

Geopolitical tensions had already increased in recent months. And although these tensions have been lingering for some time, recent events significantly raise the risk of an escalation. We have seen earlier drone attacks on the Saudi oil infrastructure, and attacks on tankers which threaten a closure of the Strait of Hormuz. After the latest drone attacks on the Saudi oil production facilities, the US seems to be cooperating with Saudi Arabia, and a military response could still follow. Iran threatened an 'all-out war' in case of any US or Saudi military strike. Such an escalation of the situation seems in nobody's interest, but cannot be fully ruled out.

#### Brent/WTI spread

USD/bbl



Source: Bloomberg

We have seen proxy wars in the region for quite some time now. However, since these wars have taken place in regions where oil production cannot be hurt, financial markets essentially ignored them. Now that tensions between crucial oil producers Saudi Arabia and Iran are building, one could be forgiven for thinking a higher risk premium than is priced in at this moment may be justified. The fact that the market is not pricing in a significant risk premium indicates that expectations of an escalation are very low. And in the event of a temporary production disruption, expectations are that this can be met by existing inventories and spare capacity. As a result, the Brent/WTI spread – which is seen

as a good indicator of geopolitical risk premium – has barely widened. Since WTI mainly reflects oil market conditions in the US, while Brent better reflects conditions in Europe and the Middle East, any increase in the spread would reflect softer conditions in the US (not happening now) or increased supply risk in Europe and/or the Middle East.

### Forecasts unchanged; up- and downside risks become even bigger

We are not revising our forecasts for now. For the coming quarter, upside risks to our base case scenario have increased while the other drivers of the oil market haven't changed. The ongoing trade dispute between US and China, which has a negative effect on global economic growth and thus oil demand, is the biggest downside risk to our base case scenario. Increased geopolitical risks offset the downside risks. As a result, oil prices seem to be caught between extremes. As long as neither the trade war and geopolitical tensions do not escalate, oil prices will continue to trade within this delicate equilibrium up until what will be a crucial OPEC+ meeting, scheduled for 5 December. Any escalation affecting either demand or supply could potential trigger large price swings. Especially with investors being positioned rather neutral.

If Saudi production is brought back to normal and no new shocks are seen in the meantime, downside risks may return again in Q1 2020 and could even rise if other oil producers make use of the momentum to step up their own crude production. We see the Brent oil price at USD 60 at the end of Q4 and Q1 2020, while we see it rising to USD 70 by the end of next year.

**Table 1: Oil and gas price forecasts ABN AMRO**

End of period		23-sep	dec-19	mrt-20	jun-20	sep-20	dec-20	mrt-21	jun-21	sep-21	dec-21
Brent	USD/bbl	64,71	60	60	65	65	70	70	70	75	75
WTI	USD/bbl	58,59	55	55	60	60	65	65	65	70	70
Natural Gas (HH)	USD/mmBtu	2,51	3,00	2,50	2,25	2,25	2,75	2,50	2,50	2,50	2,75
TTF	EUR/MWh	12,25	20	17	18	20	23	19	21	23	25

Average		Q4 19	2019	Q1 20	Q2 20	Q3 20	Q4 20	2020	Q1 21	Q2 21	Q3 21	Q4 21	2021
Brent	USD/bbl	58	62	60	63	65	68	65	70	70	73	75	73
WTI	USD/bbl	53	56	55	58	60	63	60	65	65	68	70	68
Natural Gas (HH)	USD/mmBtu	2,75	2,50	2,75	2,50	2,25	2,50	2,50	2,75	2,50	2,50	2,75	2,50
TTF	EUR/MWh	19	17	19	18	19	22	20	21	20	22	24	22

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