WHY OIL PRICE SHOULD BE ESSENTIALLY UNPREDICTABLE INTO 2023 ?

Many investors have recently been asking us about our views on energy in general and our forecasts on the price of oil in peculiar.

That could be explained by the fact that we have been consistently more bullish than the consensus of analysts on oil – and commodities altogether – ever since the end of 2020.
⇔ Our target for Brent in December 2020 was USD 87 when it was trading in the low 50's. That target was reached in October 2021, which triggered profit-taking driving back the barrel towards the 65 marks within a few weeks.
⇔ Following such meaningful consolidation, we then **raised our target at USD 128**; indeed, our conviction was that such level would be tested, however briefly, "at some stage in 2022" – refer to accordingly to our "Market Wrap to Go".

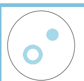
Our rationale for such a bold target back then was essentially three-fold:

- First, the **covid-induced collapse in crude prices witnessed in the spring of 2020** had quite simply been excessive, not even taking into account the negative prices reached on a WTI futures contract just before its delivery in April 2020.
  In other words, excess brings excess and, therefore, such downward climax was virtually intrinsically always meant to result in an opposite climate; textbook rubber band effect in other words... Importantly, such counterbalancing dynamics implied, ex ante, that crude "had the legs" to reach out for levels possibly beyond those justified by mere supply and demand fundamentals.

- Second, our assumption back then was that **global growth would steadily surprise on the upside** (another counterbalancing effect in a way) which would mechanically support prices of energy in general and oil in particular, a view that simply happened to be vindicated...

- Third and last, our anticipation back then was that not only would **global inflation tensions not be transitory, but they would reach levels WAY BEYOND** darkest scenarios from the consensus, which is also exactly what happened... That last point was important in the equation, based on our view that, in textbook feedback loop mode, oil usually, and quite logically in a way, catalyses upward price spirals. Put it this way, when overall prices go up, oil increasingly looks like a natural hedge, which increases inflation expectations in return, and so forth.

All in all, such trifecta, that unfolded slowly, progressively but relentlessly, meant that our aforementioned price target at USD 128 for Brent was simply meant to be tested at some stage, mutatis mutandis.
One could legitimately ask, **why price target at USD 128?** Well, simply because that was the high tested, however briefly, in 2011. Besides, the fact that it was an intimidating USD 20 below the 2008 all-time high at USD 147 (see graph below) increase the odds that it would be somehow tested, in as much as such a test would require less soul-searching and/or elaborate rationale for some kind of **new paradigm for global energy.**



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So much for the context. But what is the situation now that the USD 128 target has been reached and even largely surpassed (Brent traded up to USD 139 on March 7th), however briefly?

Well, the situation is A LOT more complicated now, as far as oil forecasts go, at the very least !

Indeed, while it remains our deep conviction that USD 128 would have been tested anyway on Brent at some stage this year, **Ukraine** was quite obviously the catalyst for such a violent spike to and through that target. And here, not only are we **dealing with an archetypal exogenous shock** (Russia being the world's third largest oil producer), but we are also, even more crucially, **entering the realm of the utterly binary…**

Concretely, from a market perspective, that means that the price of oil should be ESSENTIALLY UNPREDICTABLE henceforth and for at least three reasons:

- The first reason, in the current context mutatis mutandis, is that the **new Russian paradigm** is implying a lot of – too many actually – new unknowns.
  Concretely, the constant vagaries of the news flow around Ukraine result in very high and, more crucially, whimsical volatility on benchmark oil futures contracts, which hurts liquidity, which creates even more volatility in return and so on.
  ⇔ As an illustration of that « visibility trap », on the eve of the war (February 23rd), Brent was trading around USD 97. On the day the Russian invasion began (February 24th), it logically surged, reaching USD 106. Less logical maybe (apart from classical « buy the rumour, sell the news ») pattern possibly, is the fact that, only the following day, Brent fell back lower than pre-war levels, at USD 95.

Anyway, oil was quickly back on a fiercely bullish path, reaching the 120 mark on March 3rd; and this spike reached its climax at USD 139 on March 7th at USD 139 amid rumors of a possible European embargo on Russian oil.
Such embargo did not materialize though, triggering a very violent reversal towards USD 97, which was tested again (see above) as rapidly as March 13th. But that happened to be the root of another surge, bringing Brent to the USD 125 area as quickly as March 24t, before consolidating to USD 105 again.

Ad nauseam?... What next in a market that can concretely switch from technically bullish to technically bearish within days if not hours, depending on endlessly morphing sanction regimes (refer to below graph); nobody can know for sure, in one word: UNDECIPHERABLE.

- Second, **strategic cards are only starting to be reshuffled**.
  Indeed, beyond manic short term price volatility, key lines are moving fast and the shifts and rifts currently developing are likely to be of tectonic importance across the global energy complex in the medium to long run.

  Below, we have listed just a selection of current developments or declarations which may herald various game-changers for the oil markets:

  » What will be the strategy of China henceforward?
  The Middle Kingdom is already sourcing 15% of its oil imports in Russia (1,6 million barrels per day) and is likely to be interested for more considering current discounts (above USD 25 per barrel) on Urals blend.

- » In that regard, could sanctions from the international community reach China at some stage?
  Note, the declaration from European Council President Charles Michel in the wake of the EU-China virtual summit on April 1st: *"Any attempts to circumvent sanctions or provide aid to Russia would prolong the war. This would lead to more loss of life and greater impact". "We will also remain vigilant on any attempts to aid Russia financially or militarily. However, positive steps by China to help end the war would be welcomed by all Europeans and the global community."*

- » In that very same line of thought, India is ALREADY ramping up its purchases of Russian oil (local refiners bought at least 8 million barrels of Urals since March 1st),

- » More generally, spreads between various oil blends tend to widen (Arab Light at a record premium of USD 9 per barrel against Oman / Dubai, for instance) again, which points to an increasingly fragmented global oil market in the distance,

- » What will be the medium-term reverberations of US announcing the largest-ever drawdown for it Strategic Petroleum Reserves (1 million barrels / day for 6 months)? Besides, the price elasticity of US oil shale output remains remarkably low at this juncture,

- » *"OPEC+ will keep politics out of the room in its decision-making process in favour of the common good"* - Saudi Arabia's Energy Minister Prince Abdulaziz bin Salman bin Abdulaziz Al Saud,

- » *"Always Russia is going to be part of OPEC and we need to respect them". "Who can replace Russia today? I cannot think of a country that can in a year, two, three, four or even ten years replace ten million barrels. It's not realistic."* - UAE's Energy Minister Suhail Al Mazrouei.

Just a selection…Too many questions, too many unknowns…

- Third, while the afore-described **strategic reshuffling** is likely **to support oil prices** toward a higher new normal in the medium run, we are probably already **not that far from a tipping point as regards oil importers' resilience to price rises.**
  ⬄ If we come back to fundamentals, market consensus has it that, at this juncture and notwithstanding highly specific circumstances, both global demand and supply are healthy, which concretely means that the market is not anticipating a DURABLE mismatch from a GLOBAL perspective then again.
  ⬄ This sanguine view may well prove to be true eventually but that certainly does not rule out a significant mismatch on a local and/or temporary basis.

  In other words, while there may be enough oil for everybody on aggregate, there may well not be enough at the right place and / or the right moment amid aforementioned totally unforeseeable factors.

Based on our geopolitical assumptions, we **reckon it is highly likely that further "super spikes"** will be seen in the near future, possibly towards new all-time highs. However and crucially, we concomitantly reckon that such spikes would most likely **be short-lived** in as much as consumer resilience is ALREADY reaching critical levels in most key importing countries, including the US.

⇔ In this regard, it should be noted that 75% of working Americans say inflation has impacted their finances over the past year and one in five US workers already cannot make it from paycheck-to-paycheck.

In other words, we are getting perilously **close to cost-of-energy-induced recession in the current global macro equation.**

All in all, we shall for once draw no conclusion.
Indeed, while we **remain constructive on the price of energy overall** at this juncture and even reckon that a spike above the 150 mark on Brent is likely in the near term, such spike would probably be "a bridge too far" from a macro cyclical perspective i.e. it would quite probably trigger a global recession which would then mechanically hammer oil prices in return, like it happened in all previous "oil shocks" in the last 6 decades or so, really...
Anyway, that is, for once then again, not the key question for oil at this stage. The **key question is about the emergence of a new global energy architecture** and, here, implications, while still hazy, should or at the very least could be as deeply strategic as very long-lasting.

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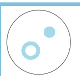

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