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MACROCOSM

Is the Oil Shock Over Already?

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Donald Luskin

Yesterday's collapse got Saudi and Russia trash-talking – but that means they're talking.

Dare we hope? Sunday night we wrote in a report to clients:

- *This schism between Saudi and Russia may very well be the end of the OPEC-Plus structure. But we think that probably MBS [Saudi Crown Prince Mohammad bin Salman] believes he can drive Russia back to the negotiating table if [oil] prices fall sufficiently, in which case it would be the salvation of the meta-cartel. It took an oil price of $26 to get their attention in the 2015-16 price war. While it's very bad news that oil has traded tonight at $30 already, that's only $4 off the level that worked last time – we could conceivably get this over with very quickly* (see "Just What We Didn't Need: An Oil Price War" March 8, 2020).

Later Sunday night WTI traded as low $27.34. The low in the prior price war was WTI $26.05 on February 11, 2016, and that proved to be a major risk-back-on turning point not just for oil, but for assets generally. *Missed it by that much!*

- But maybe it's enough. Maybe we can get this over quickly. *Bravissimo* to Mr. Market for forcing the issue.

Overnight Saudi Arabia reportedly told customers it would supply crude at the rate of 12.3 million barrels per day next month, a 27% increase month-on-month, and 11% above all-time highs. Russia couldn't quite match that, but it reportedly responded that it would increase its production by 500,000, a jump of 5%, and also a new all-time high. *Both these claims are, to put it simply, lies. These things can't physically be done, certainly not so quickly and certainly not sustainably.*

- *But this is just what we told clients yesterday to expect – that Saudi and Russia would circle each other menacingly, spouting trash-talk, telling lies, with the purpose of creating a safe-space of strength and dignity within which to re-engage in negotiations. That's because the reality is that neither oil-producing nation can survive at these prices.*
- *Indeed, after the trash talk, reportedly "Saudi-government advisers" say former Saudi energy minister Khalid al-Falih is in talks with Russian Energy Minister Alexander Novak. Novak said on Russian*

Update to strategic view

OIL, US MACRO, US STOCKS: Yesterday's oil panic, with prices as low as WTI $27, seems to have been enough for Saudi and Russia to signal that they are talking about patching things up. This diplomacy is enabled by trash-talk from both sides, absurd lies threatening levels of production neither can quickly achieve nor long sustain. But time is not on our side, with low oil prices putting stress on credit markets and courting the risk of systemic events. The Trump administration is promoting economic relief in the form of a payroll tax holiday, which we expect will get bid up by Democrats into something that looks more like "stimulus." These developments take some pressure off. US equities still haven't quite registered a 20% correction and yesterday's panic may not be enough to resolve the market's response to the newly combined Covid-2019 and oil crises. But we think a little more timid averaging in is appropriate.

[Strategy dashboard]

television this morning that "the doors are not closed" to future cooperation, and that the scheduled June OPEC-Plus meeting could be moved forward to May.

- *Oil prices will be buoyed by more such statements, and ultimately with results of cooperation. It will also help when actual production statistics fall far short of Saudi's and Russia's absurd lies.*
- *But this will take time, and time is not on our side. With every passing day, low oil prices put stress on credit markets – the spread to Treasuries in the energy sector of the US non-investment grade market hit 14.3%. As long as this lasts, we run the risk of what could start as only small credit-events, but which could ramify into serious implications.*

Running in parallel, late yesterday the Trump administration let it be known that it will work with congress to push through an economic relief program aimed at cushioning the blow of the Covid-2019 crisis. As we expected, its centerpiece is a payroll tax holiday (see "Powell Not to the Rescue" March 4, 2020). It's being framed as relief, not "stimulus" – this is a Republican initiative after all. We to continue expect Democrats to start a bidding war that will end up enlarging the program. Truth be told, by the time it grinds through the process, the Covid-2019 crisis will likely be over.

- All this certainly takes some pressure off. *It indicates that the system is working, that "reverse reflexivity" is in operation. Unlike the positive feedback loops leading to vicious cycles in George Soros' canonical theory, this is a negative feedback loop in which markets act as a brake on harmful events in the real economy.*
- At the worst yesterday, we didn't quite reach our minimum objective of a 20% correction for the S&P 500, from top tick last month to bottom. Only 19.4%. *Missed it by that much.*
- Nothing about this last month has been easy. But resolving the newly combined Covid-2019 and oil crises with just a single horrific day yesterday seems too easy. So with respect and not a little fear, it's probably time for a little more timid averaging in.

Bottom line

Yesterday's oil panic, with prices as low as WTI $27, seems to have been enough for Saudi and Russia to signal that they are talking about patching things up. This diplomacy is enabled by trash-talk from both sides, absurd lies threatening levels of production neither can quickly achieve nor long sustain. But time is not on our side, with low oil prices putting stress on credit markets and courting the risk of systemic events. The Trump administration is promoting economic relief in the form of a payroll tax holiday, which we expect will get bid up by Democrats into something that looks more like "stimulus." These developments take some pressure off. US equities still haven't quite registered a 20% correction and yesterday's panic may not be enough to resolve the market's response to the newly combined Covid-2019 and oil crises. But we think a little more timid averaging in is appropriate.

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