

## But what if...

### Imagining a world with oil at \$15 per barrel



We are expecting an average oil price of \$40/b for 2016. But what if the oil price for the rest of the year turns out to be closer to \$15/b, say?

From January's lows, it would probably not take much for oil to fall to – and break through – \$15/b. To imagine oil staying low is an entirely different matter. Steep forward curves indicate that the markets expect a fairly swift recovery, and for good reasons. Oil production currently exceeds consumption by about 1.5mb/d. Supply outside OPEC is expected to shrink by about 0.7mb/d in 2016, mainly due to falling U.S. production. Add in an expected rise in consumption of about 1.2mb/d, mainly in emerging markets, and you can see how inventories will eventually begin to fall. So, how might oil stay lower for longer? Well, you need to imagine that either supply is a lot stronger than we are expecting, demand is weaker, or a combination of the two. The four hypothetical scenarios are designed simply to illustrate the diversity of potential economic and investment implications.

## 1. Supply shocks leaving the world awash with cheap oil



Imagine that Saudi Arabia and other OPEC members increase output by another 1mb/d or more. In this scenario, OPEC announces that it is ready to see oil trading between \$10 and 20/b for "as long as it takes", to squeeze supply in the rest of the world.

#### Likelihood

Unlikely

#### Comment

We doubt OPEC would have enough spare capacity. Production in Iran and Libya might surprise, and U.S. shale might again prove more resilient than many expect, but none of this is likely to be sufficient to keep prices low for long.

For net importers, lower oil prices would probably be good news. Of course, countries also producing oil would see investment fall further. At the same time higher resulting disposable income would increase consumer spending and GDP. The sizes of both negative and positive effects are debatable, but the key message is that the effect is likely to be positive. We would expect financial markets to eventually come around to the same view. Of course, we would need to watch financial conditions very carefully, not least as asset sales by oil-exporting countries like Saudi Arabia would be even bigger than at current oil prices. Still we would expect the overall effect on the world economy and financial markets to be neutral, at worst.

## 2. Demand shocks, where cheap oil is just a symptom



Suppose supply shrinks slightly, just as we forecast, but global oil demand barely rises. As a result, supply has to shrink a lot more, which in turn causes low prices for longer. A lot would depend on where and why oil demand might fall short.

⊕ For this scenario, the overall effects on the world economy and global financial markets should tend to be positive.

⊖ For these scenarios, the overall effects on the world economy and global financial markets are likely to be negative.

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