# Is the World Just 1 Geopolitical Crisis Away From an Oil Price Spike?

## Description

With the oil industry now firmly caught in the crisis, it is hard to imagine that we may be one geopolitical crisis away from a sharp spike in global crude prices. This is despite concerns that the current supply glut of 3.1 million barrels daily will only continue to grow as U.S. output remains far higher than expected and Iran looks to significantly boost production.



**Now what?**

For much of its history after World War II, the Middle East has been a powder keg, lurching from one crisis to the next because national identity, religion and petro-politics has proved to be a volatile mix. This is even truer today, with the rise of the Islamic State, the increasing intensity of the civil war in Syria, escalating conflict in Yemen, and the failure of Libya as a state all sharply magnifying regional tensions.

Thrown into this mix is one of the Middle East's most powerful powers, Saudi Arabia. It has significantly boosted its oil output in order to keep oil prices low as part of its strategy, which is aimed at regaining market share. To date, this has had little impact on its intended target, U.S. shale oil producers, but it is hurting a number of OPEC members, and has left Saudi Arabia with a massive $140 billion hole in its 2015 budget.

This couldn't come at the worst time. Saudi Arabia is focused on flexing its political and military muscle in the region to remain a dominant power. Growing military and political demands saw the Saudi's hike their military budget in 2014 by 17% to a massive 10% of GDP, the highest in the region. Then you have the Saudi's costly incursion into Yemen to battle the Shia Houthi rebels, as well as its ongoing participation in airstrikes against the Islamic State.

It is difficult to see how the Saudi's can continue to fund their political and military ambitions for a sustained period and meet domestic budgetary requirements when they are incurring massive budget deficits.

All it could take is one more major regional geopolitical crisis that demands Saudi intervention for them to consider scaling back output and triggering a rebound in prices.

On top of this is the potential for yet another major regional crisis reducing output from other oil producers. Examples of this include the conflict in Iraq with the Islamic State, which has caused Iraqi oil output to drop sharply in recent months. There is also the civil war in Libya that has caused its oil output to fall to less than a third of what it was when the war began in 2011.

**So what?**

Any rebound in oil at this time is likely to be modest because there is still a global supply glut of over three million barrels. One of the best ways to play such a rebound is with the integrated energy majors such as **Imperial Oil Ltd.** (TSX:IMO)(NYSE:IMO) and **Suncor Energy Inc.** (TSX:SU)(NYSE:SU).

However, a company that I believe stands out is **Vermilion Energy Inc.** (TSX:VET)(NYSE:VET). It is one of the few companies in the patch to leave its dividend unchanged, and it remains profitable despite the harsh operating environment, posting a second-quarter $6.8 million net profit. Then you have its solid balance sheet and global portfolio of oil and gas assets that allows it to access higher Brent prices.



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