Will a Trade War Bring an End to Higher Oil?

Description

After dipping sharply on a larger-than-expected U.S. inventory build and Saudi Arabia's announcement that it intends to pump the most crude ever in July 2018, oil is climbing again to see West Texas Intermediate (WTI) at over US$68 a barrel. There is, however, increasing speculation that the price of crude will fall in coming months. The Russian Ministry of Energy recently claimed that oil is overpriced and due to collapse.

Then there are the threats to global economic growth posed by Trump's approach to trade, higher oil, rising interest rates, and a cooling Chinese economy. That would have a significant impact on oil because greater-than-expected demand growth sparked by the ongoing global economic upswing has been among the primary drivers of higher-than-anticipated oil.

Now what?

If a major trade war occurs, according to economists, it could shave up to a full percentage point off global domestic product (GDP) with China being the worst affected. This is because the East Asian nation is Trump's primary target, and he has threatened to slap tariffs on up to US$500 billion of Chinese imports. According to data from *Bloomberg*, that is essentially the value of all imports the U.S. received from China in 2017. Beijing is threatening to reciprocate, which sharply increases the risk of a trade war, particularly now that the dialogue between the two nations is heating up.

Trump hasn't only singled out China; he has also announced tariffs for various imports from Canada and the European Union, who in turn have stated they will respond with their own on U.S. imports.

The real fear is that a trade war will not only constrain global economic growth at a crucial time when central banks are working towards normalizing monetary policy after almost a decade of quantitative easing, but it could trigger a deep recession. That would be an economic disaster, especially when it is considered that some major economies such as Italy are overleveraged and on the brink of experiencing their own crisis.

It could tip China, which is the world's single largest consumer of commodities, into a protracted slowdown. That would cause metals and other commodity prices to plummet, curbing growth among many emerging economies that are dependent on extracting raw materials to promote economic prosperity. A broad-based decline among developing economies that have only just returned to growth after the end of the last protracted commodities slump would further magnify deteriorating demand for crude.

This would sharply impact oil and could be the long-awaited catalyst that would trigger another rout, pushing WTI to US$55 per barrel or lower. That would be a disaster for Canada's energy patch, where many upstream producers need WTI to be greater than US$55 a barrel in order to be profitable.

So what?

Among the best ways for investors to bolster their exposure to crude and take advantage of the potential for higher oil while offsetting the risk of lower prices is by investing in integrated energy major **Suncor Energy Inc.** (TSX:SU)(NYSE:SU). The company has demonstrated that it is incredibly resilient to sharply weaker crude and used the prolonged slump to acquire oil assets at close to fire-sale prices, substantially bulking up its portfolio.

Suncor also has some of the lowest cash operating costs among Canadian oil sands companies, leaving it well placed to remain profitable if oil weakens. The low decline rates of its operations mean that it doesn't have to invest as much capital to sustain production compared to shale oil producers. The financial impact of lower oil is offset by its refining operations where margins expand when oil falls.

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