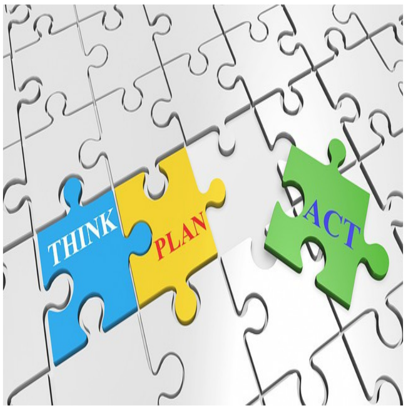

Will Trump's Trade Policies Trigger the Next Oil Price Collapse?

Description

Oil is whipsawing wildly as energy markets react to a swathe of good and bad news in recent weeks. Over the last week, West Texas Intermediate (WTI), the key North American benchmark price, pulled back sharply on news that Trump is planning to ratchet up the tariffs he plans to impose on US$200 billion of Chinese imports. After briefly breaking through the psychologically important US$70-a-barrel barrier WTI has pulled back to be trading at around US$67 per barrel, highlighting the extreme volatility currently gripping energy markets.

Such high levels of volatility typically are a portent of an impending market meltdown. While there have been claims, notably from Russia's Finance Ministry, that crude is overvalued and a price collapse is long overdue, perceived supply constraints combined with firmer-than-anticipated demand growth is buoying prices. There are signs, however, that current events are capping the upside for oil, and that it could remain range bound for longer than expected.

Now what?

Oil's latest decline can be blamed on Trump ramping up the rhetoric on tariffs sparking fears that a full-blown trade war will erupt between the world's two largest economies. The fear is that it would prevent China's massive manufacturing sector from effectively accessing vital markets, notably in its largest export partner the U.S. This would sharply curtail activity in the world's single largest national manufacturing sector, causing consumption of commodities such as copper, zinc, lead, nickel, silver, and steel-making coal to tumble.

Such a conflict would spill over into the global economy, potentially having a tremendous impact and slicing up to 1% of global gross domestic product (GDP). It could also spark an economic crisis in emerging markets.

You see, many emerging markets are already under considerable pressure because of a stronger U.S. dollar, growing capital outflows, and higher interest rates. Many of those economies are highly dependent on extracting as well as exporting metals and other commodities to drive economic growth. If commodity prices collapsed because of a sharp deterioration in Chinese manufacturing activity, it could cause those already vulnerable emerging markets to descend into crisis.

The fallout from such an event would be felt across the world and cause the consumption of oil as well as other petroleum products to shrink, leading to significantly weaker demand growth and hence prices. That would be magnified by growing supply because many of the constraints that were identified earlier in 2018 have eased considerably.

Recent data from the U.S. Energy Information Administration (EIA) shows that domestic production is at record levels and oil inventories contrary to earlier predictions are rising. Saudi Arabia, along with some other OPEC members, has also demonstrated a willingness to boost production if required. This is all working to weigh on oil prices, indicating that if a trade war eventuates, which would severely constrain global growth, oil could tumble below the US$60-a-barrel mark.

So what?

While the threat of a trade war and weaker crude is very real, it shouldn't prevent investors from bolstering their exposure to energy companies. Many Canadian oil stocks have failed to keep pace with oil's unexpected surge in value since the start of 2018.

One is **Canadian Natural Resources** (TSX:CNQ)(NYSE:CNQ), which has gained less than half a percent compared to WTI's 15% for the year to date. This has created an opportunity because the company reported some solid second-quarter 2018 financial results.

Key among them was production growth of 13% year over year, a 30% increase in netback, despite higher costs and a notable 57% rise in cash flow from operations. This saw Canadian Natural report adjusted net earnings of $1.3 billion, which was almost four times greater than the same period in 2017. There is every sign that Canadian Natural's earnings will improve over the remainder of 2018 because of growing production, which is expected to be 22% greater than 2017, and its focus on reducing costs coupled with firmer oil. Those attributes — along with higher oil — will give Canadian Natural's profitability a solid boost, causing its stock to appreciate.

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Date
2025/08/27
Date Created
2018/08/02
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