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The Inevitable Outcome Of The Oil Price War

By Simon Watkins - Mar 19, 2020, 8:00 PM CDT

One might reasonably posit that when Crown Prince Mohammed bin Salman (MbS) signalled that Saudi Arabia was once again going to produce oil to the maximum to crash oil prices in a full-scale oil price war, Russian President Vladimir Putin probably fell off the horse he was riding barechested somewhere in Siberia because he was laughing so much. There is a phrase in Russian intelligence circles for clueless people that are ruthlessly used without their knowledge in covert operations, which is 'a useful idiot', and it is hard to think of anyone more 'useful' in this context to the Russians than whoever came up with Saudi's latest 'plan'. Whichever way the oil price war pans out, Russia wins.

In purely basic oil economics terms, Russia has a budget breakeven price of US$40 per barrel of Brent this year: Saudi's is US$84. Russia can produce over 11 million barrels per day (mbpd) of oil without figuratively breaking sweat; Saudi's average from 1973 to right now is just over 8 mbpd. Russia's major oil producer, Rosneft, has been begging President Putin to allow it to produce and sell more oil since the OPEC+ arrangement was first agreed in December 2016; Saudi's major oil producer, Aramco, only suffers value-destruction in such a scenario. This includes for those people who were sufficiently trusting of MbS to buy shares in Aramco's recent IPO. Russia can cope with oil prices as low as US$25 per barrel from a budget and foreign asset reserves perspective for up to 10 years; Saudi can manage 2 years at most.

A key reason why Russia can survive for so much longer than Saudis is actually thanks to MbS himself. Underlining this – and the fact that the Russians do have a very impish sense of humour, as they do – was that Russia's Energy Minister, Alexander Novak, last week praised the co-operation of the OPEC+ grouping over the past three years, which, he added "had earned Russia 10 trillion rubles [US$140 billion]." Presumably just to highlight the irony of this further, Russia's Finance Ministry then helpfully chipped in that the accumulated funds from the previous OPEC+ agreements will help Russia to support the ruble and will also help Russia to cope with oil prices as low as US$25 per barrel for up to 10 years. The metaphorical icing on the cake, though, was Novak adding that "we may reach new agreements [with OPEC] if needed". In practical terms this means that if, in fact, it takes longer than originally thought by Russia for Saudi to go bankrupt and it starts to have any negative impact on Russia, then Moscow will just click its fingers together and Riyadh will come running to sign a new OPEC+ output cap deal.

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But surely, some may say, Saudi stands no chance of going bankrupt? In fact, as highlighted above, Saudi will absolutely go bankrupt if it continues this oil price war. As Saudi Arabia's own deputy economic minister, Mohamed Al Tuwaijri, stated unequivocally in October 2016 last time that the Saudis tried this exact same 'strategy' from 2014 to 2016: "If we [Saudi Arabia] don't take any reform measures, and if the global economy stays the same, then we're doomed to bankruptcy in three to four years." That is to say, that if Saudi kept overproducing to push oil prices down – just as it is doing right now, yet again - then it would be bankrupt within three to four years. The timeframe has halved for a variety of reasons outlined in my recent piece on this very subject here.

But what has Russia to gain from Saudi going bankrupt? Economically, it means that Saudi will default on sovereign and corporate debt, will not be able to service its key industries, and will be unable to meet the requirements for its major oil and gas contracts. Simply having less Saudi oil and gas competing in the same space as Russia and its allies – notably Iran and Iraq – would be benefit enough for Russia but there are even bigger added benefits too. One of these is the destruction of the already strained relationship between the U.S. and Saudi Arabia that has endured since 1945. At that time, as analysed in depth in my new book on the global oil markets, the deal that was struck between the then-U.S. President Franklin D. Roosevelt and the Saudi King at the time, Abdulaziz, onboard the U.S. Navy cruiser Quincy in the Great Bitter Lake segment of the Suez Canal was that the U.S. would receive all of the oil supplies it needed for as long as Saudi had oil in place, in return for which the U.S. would guarantee the security both of the country and of the ruling House of Saud.

Support in the U.S. for the continuation of this relationship has already diminished markedly in the past few years. This change in attitude began in earnest when it came to the U.S. public's attention that 15 of the 19 hijackers who flew the aeroplanes involved in the '9/11' terrorist atrocity on the U.S. were Saudi nationals. The extent of the Saudi government's involvement in funding such terrorism appeared front and centre following the overriding on 28 September 2017 by the U.S Congress of former President Barack Obama's veto of the Justice Against Sponsors of Terrorism Act. That made it possible for families of the victims of the '9/11' terrorist attack to sue the government of Saudi Arabia for damages. Within a short space of time after this reversal, there were seven major lawsuits in federal courts alleging Saudi government support and funding for the '9/11' attack, and more lawsuits are expected.

Subsequent events have not softened this negative view, with ongoing pressure from the U.S. Congress over the Saudi-led war in Yemen, the cosying up of Saudi to Russia in the OPEC+ grouping, and Lebanese President Michel Aoun's allegation in 2017 that then-Prime Minister Saad al Hariri had been kidnapped by the Saudis and forced to resign. Matters grew worse with the murder of dissident Saudi journalist, Jamal Khashoggi, on 2 October 2018 at the Saudi consulate in Istanbul, Turkey, which even the CIA concluded was personally ordered by MbS. Such was the shift in sentiment away from Saudi over these years that the U.S. Presidential Administration has come under growing pressure to finally implement the 'No Oil Producing and Exporting Cartels Act' (NOPEC). This bill – which can still be implemented, incidentally (apparently something else that MbS has not taken into consideration) - would make it illegal to artificially cap oil (and gas) production or to set prices, as OPEC and Saudi Arabia do.

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The bill would also immediately remove the sovereign immunity that presently exists in U.S. courts for OPEC as a group and for its individual member states. This would leave Saudi Arabia open to be sued under existing U.S. anti-trust legislation with its total liability being its estimated US$1 trillion of investments in the U.S. This, and all of the other aforementioned events, resulted in MbS being completely unable to find any international listing destination for the Aramco IPO. As highlighted ahead of the IPO in previous articles published in OilPrice.com, Aramco shares are now haemorrhaging value for precisely the key reason cited: that the company would be used as an instrument of government policy - however ill-considered - regardless of the considerations of shareholders.

Moreover, at the weekend, Aramco posted figures showing a 21 per cent fall in 2019 'due to a drop in oil prices' – and this is before the new price-crashing strategy was put in place by MbS! After the 'strategy' announcement, the shares were trading at 15 per cent less than the offer price. In addition, again making a lie of its previous statements, it emerged at the end of last week that, despite its proven ridiculous claims by the Kingdom to boost supplies to levels never before even vaguely attained. Aramco rejected at least three Asian refiners' (one Korean, one Taiwanese, and one Chinese) requests for additional crude for April, on top of their long-term supply deal.

So Russia, with Saudi Arabia either in the oil price war or better still bankrupt, benefits either way. The long-term goal of Russia is to control directly or indirectly all of the key players in the Shia crescent of power in the Middle East, including most immediately Lebanon, Syria, Iraq, Iran, and Yemen (via Iran). All of these countries have vast oil and gas reserves and/or useful coastlines for Russian military and commercial needs (Mediterranean access or access to the Arabian Sea). To do this, Russia's core foreign policy strategy is to create chaos and then project Russian solutions and therefore power into that chaos. In this respect, again, MbS is being very 'useful' to the Russians.

By Simon Watkins for Oilprice.com

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