Saudi Arabia's Moves in the Oil Market

The situation around the continuing fall in the price of oil continues to be the main problem of the world economy, as well as politics, because we are talking about the well-being and stability of key players such as Russia, the United States, Saudi Arabia, Iraq, Iran, etc. Now, attention is primarily focused on Saudi Arabia's stubborn reluctance to cut oil production. And we can only guess: is it directed against Russia or against the United States?

Brent oil price has been falling almost non-stop since mid-June this year, when it was a little over $115 per barrel. The decline has already exceeded 20%. For more than two years oil had been trading in the range of $100 - 115 per barrel. Several times the price briefly extended beyond the upper limit of the corridor, and once, in April 2013, fell below $100. This time, things are quite different. The price plummeted below $100 a month ago, and last week remained stable at a benchmark below $90. Moreover, on October 15 alone, it fell by $4 per barrel.

The current situation has started generating conspiracy theories. And most analysts are trying, foremost, to understand the policies of Saudi Arabia, which clearly has no intention to cut production significantly in order to maintain the price of oil. In fact, it is the one that is capable of responding first to any major change in the market situation: it has spare capacity to increase production if the price rises too high; it is able to quickly reduce production because it produces much more than other countries (9.7 million barrels per day). But on October 8, Saudi Arabia unexpectedly lowered the official price at which it sells oil to Asia, which is actually the only region where demand for imported oil is still growing. The Eurozone teeters on the brink of recession and demand there is low, and the shale oil boom in the United States has sharply reduced their dependence on foreign oil supplies. In addition, Canada has been actively purchasing light crude oil in the United States: in July, it comprised 71% of all oil imported by Canada, while the previous year - only 14%. As a result, transportation of oil to the shores of North America has declined significantly (plus Canada has increased its exports of heavy crude oil), and exporters have now launched a real struggle to attract Asian buyers.

Most likely, the Kingdom of Saudi Arabia (KSA) is trying to increase or at least maintain its market share, maintaining output and reducing the price for Asia. However, some analysts believe that Saudi Arabia's reluctance to cut production is politically motivated. After all, one cannot rule out the option that the Saudis have agreed with the United States to strike at Russia in response to its actions in the Ukrainian conflict. Falling oil prices could lead to a serious reduction in budget revenues in Russia. One half of Russia's budget income is derived from oil and gas exports, and gas price is in turn linked to oil prices (together this comprises two-thirds of the total revenue of Russian exports).

Something very similar has already happened 30 years ago. Then the Soviet Union sent troops into Afghanistan, which was one of the reasons that prompted Saudi Arabia to reconsider its relations with the United States after the Arab oil embargo of 1973. In the 1980s, Washington asked Saudi Arabia to increase oil production, in the expectation that the price reduction would help the American economy. And besides, the head of the CIA, William Casey, had developed a plan to strike at the Soviet economy by means of sharply declining oil prices. Of course, this was only an additional factor contributing to the degradation of the Soviet economy, which could no longer live without the influx of petrodollars. Moreover, the United States expanded its own oil production, increasing its
amount of $6 billion from the Central Bank in the last 10 days, the ruble fell again. During this
period. The ruble behaves like a classical oil currency. And it continues to fall. In spite of the intervention in
the dual currency basket; it was almost a mirror image of an 8-percent decline in crude oil prices over the same
summer, although the sanctions were already imposed. In early August, the ruble fell by 9% against
Western sanctions which is the cause of a sharp depreciation of the Russian ruble. The ruble remained fairly
maintained, and Russia began to withdraw its troops from the border. After all, in reality, it is low oil prices, rather
than its growth promotes the formation of an excess supply of oil on the world market. However, today in Russia, although it is also heavily dependent on oil exports, there is a market economy and a floating exchange rate, which should soften the shock of the fall in oil prices.

But another group of experts believe that Riyadh began a covert attack on the shale oil industry of the United States, which, in their view, has undermined the position of Saudi Arabia and other Gulf countries in the world oil market. A steady decline in oil prices should significantly complicate the work of a number of companies engaged in the labor-intensive extraction of oil in the United States and force them to partially curtail their activity. According to experts, if prices fall to $80, American companies will reduce drilling activity. However, there is another opinion - companies that extract shale oil in the United States today can weather much more serious drops in prices than was recently assumed. The rapid growth in efficiency will reduce the cost of production of shale oil. A drop in the cost of shale oil extraction in the United States means that manufacturers can continue to invest at prices much lower than today. This creates problems for the implementation of the strategy of "punishment" of shale oil extractors by OPEC countries.

Most likely, however, it has nothing to do with a conspiracy, but rather the system of functioning within OPEC. Saudi Arabia has always defined policy within the cartel and often used its influence. Lowering prices, Riyadh sends a signal that maintaining market share is more important than price. If the price falls too low, the Saudis can always cut back production. Now, caring about their own interests, Saudi Arabia is not too concerned about the fact that other manufacturers are suffering losses. But not everyone in the KSA shares this view. On October 14, Saudi billionaire Prince Alwaleed bin Talal sent the head of the Ministry of Oil of the kingdom, Ali al-Naimi, and other ministers, an open letter in which he expressed concern about the continuing decline in the cost of and demand for oil, the main export product of the kingdom and a source of replenishment of its budget. The prince writes that he is astonished by comments made by Ali al-Naimi, who, according to media reports, called the risks associated with the fall in oil prices below $100 a barrel - "exaggerated".

The IMF estimates that the kingdom's balanced budget is provided by the average price of oil in 2014 at a benchmark of $86.1 per barrel. Alwaleed warns that because of the continuing fall in prices the national budget in 2014 and 2015 would be short by billions of riyals. According to Prince Alwaleed, the development of shale oil projects will not allow Saudi Arabia to reach production at the level of 15 million barrels per day. It is this figure that was set as a target a few years ago. Now the kingdom produces about 12.5 million barrels of oil per day.

But, so far, experts do not see any significant risks to the Saudi economy. Since the beginning of the year, the average price of oil has reached $106 per barrel, and the country has financial reserves that could be harnessed to overcome possible difficulties (Saudi Arabia's foreign exchange reserves amount to $757 billion). Iran, after Saudi Arabia, also reduced the price of oil for buyers from Asian countries. Beginning in November, Asian buyers will buy Iranian oil for $1 cheaper. This is the biggest discount since November 2008. November deliveries from Iran will go for as low as $96.44 per barrel. Prior to this, oil from Saudi Arabia fell by $1.2 to $90.02 per barrel for Asian buyers. Oil traders expect a new round of reduction in selling prices of Saudi Arabia - in the range of $0.7-1 per barrel.

In any case, we cannot ignore the fact that cheap oil is probably the most serious threat to Russia. Crude oil prices fell by more than 23% since June, which led to a weakening of the ruble and the formation of a "hole" in the state budget. The Russian government has already warned that it will be forced to take more money from the reserves if oil prices and the exchange rate will remain at current levels. In an interview with news agency RIA-Novosti, the Deputy Finance Minister Tatyana Nesterenko, stressed that half of the reserve fund established by the state to protect against fluctuations in energy prices, may have to be used for patching holes in the state budget over the next three years.

Low oil prices almost completely overshadowed news from the southeast of Ukraine, where a fragile cease-fire is maintained, and Russia began to withdraw its troops from the border. After all, in reality, it is low oil prices, rather than Western sanctions which are the cause of a sharp depreciation of the Russian ruble. The ruble remained fairly quiet during the summer, although the sanctions were already imposed. In early August, the ruble fell by 9% against the dual currency basket; it was almost a mirror image of an 8-percent decline in crude oil prices over the same period. The ruble behaves like a classical oil currency. And it continues to fall. In spite of the intervention in the amount of $6 billion from the Central Bank in the last 10 days, the ruble fell again.
Due to Russia's excessive dependence on oil and natural gas, which account for more than two-thirds of its exports, low energy prices may well cause a recession in the Russian economy in the amount of $2 trillion. Economic growth can be expected to remain in the range of positive values only if the price of oil will remain above $92 - 93 dollars per barrel. At a price of $90 per barrel, the Russian economy will shrink by 0.4% next year, and at $80 per barrel the reduction would be 1.7%

So, today no one can say whether it is a Saudi-American conspiracy against Russia or the KSA is just trying to protect its interests in the face of shale oil production growth in the United States. According to some experts, the United States also uses Tehran, removing economic sanctions against it, thus reducing the price of oil and thereby weakening the Russian economy. In addition, by manipulating the Iranian authorities, Barack Obama intends to supplant Moscow from the oil and gas market in Europe and around the world. And there is certainly no doubt. With the introduction of sanctions against Moscow in connection with Ukraine, Obama is openly carrying out this task. Releasing Iranian oil on the market after the lifting international sanctions against Iran, in view of the fact that the United States and Saudi Arabia have already increased oil exports, could lead to a drop in oil prices down to $75 - 80 per barrel.

Russia's budget for 2015 is calculated based on the price of oil set at $90 per barrel. A drop to $75 - 80 per barrel would be a devastating blow for the Russian economy. Besides, from 2016, Iraq plans to begin exporting gas to Europe. This will be the next powerful blow, because 70% of Russian revenues come from the sale of hydrocarbons. With the help of the former Soviet republics (Azerbaijan, Turkmenistan, Uzbekistan, Kazakhstan), Iran and Iraq, Washington can certainly count on squeezing Russia's hydrocarbons out of Europe completely. After that, the construction of the "South Stream" will lose all meaning, not to mention the fact that even Ukraine will be able to get rid of gas supplies from Russia.

Also, we must bear in mind that last week Saudi officials made it clear to market participants that the Kingdom does not exclude the possibility that in the next year or two, the price of oil will be set at $80, but the country is ready for such a scenario, in order to maintain its share of the world oil market. In public statements, the majority of Saudi oil experts do not attach much importance to the so called "shale threat", but members of the May OPEC meeting discussed this issue and agreed to establish a committee for its thorough analysis. In its latest monthly report, OPEC’s forecast for the daily demand for oil produced by members of the cartel indicates a fall by 250 thousand barrels to 29.61 million barrels in 2014. The organization explained that the expected decline would be caused by the increase in oil supplies from countries outside OPEC, mostly from the United States. So, challenging times lie ahead for Russia until the country extricates itself from its addiction to oil and gas.

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