OPEC Meeting and its Consequences for Oil Producers

The results of the recent OPEC meeting were fairly predictable – with all member states announcing their reluctance to cut oil production levels, with some even planning to increase them. In the meantime, Iran wants to get back the market share it had before it was hit by international sanctions. In this situation the first country to cut oil production will lose its position and be forced to sustain a severe financial blow. Therefore, Russia is not the only one to suffer, since Saudi Arabia and the UAE are also facing economic stagnation triggered by the serious reduction in prices and subsequent profits. Moreover, all oil exporting states are facing the prospects of losing the support of their population, since they are forced to cut on the social benefits they’ve been providing to their citizens through their respective oil wealth.

Thus, the message of the meeting in Vienna has been pretty clear – every country is fighting for itself. As for the positions of the so-called Fragile Five, they will be soon occupied by other exporters. It’s clear that Venezuela, which is on the verge of bankruptcy; Nigeria, which faces unending terrorism; Libya, which has been plunged into chaos ever since the bloody overthrow of Muammar Gaddafi; Iraq – that has been torn by bloodshed since 2003; and Algeria, where oil exports dropped due to the depletion of natural resources, are no longer capable of competing in this race for survival.

Saudi Arabia is now forced to reduce its vast public spending in empty hope that low oil prices will result in the bankruptcy of American shale companies -- the very companies that may allow the US to become completely independent from the Persian Gulf in its energy needs. Riyadh is now signing contracts in Europe, it has just sealed a deal with a Polish refinery that had been seeking ways to get rid of its dependency on Russian supplies. The only upside of this story is that Saudi Arabia will be forced to cut the financial support it has been providing terrorist groups across the Middle East.

Iran is also taking advantage of the current situation in a bid to increase its influence, and, from its point of view, dropping the prices even lower is a good thing, since it can force its arch-rival – Saudi Arabia to sustain even more financial losses.

In general, each exporter is playing a game of his own under these difficult conditions, when a sharp decline in oil prices has changed the geopolitical picture of the world in less than two years.

One must admit that Russia is suffering heavy financial losses in this situation. To maintain the standard of living that people enjoyed in 2014, Moscow needs the price of 96 dollars per barrel, while Venezuela has a considerably...
higher expectation – 126 dollars per barrel. In addition, the lack of financial resources weakens Russia’s defense capabilities and compromises the arms modernization campaign that was launched in the face of the increasingly hostile posture held by the West. NATO forces have already surrounded the western part of Russia and it is now increasing its military presence right on the Russian border. As for Saudi Arabia, it has a comparatively small population, while its political system requires no elections to be held, and while the reserves of the Kingdom are more significant. Additionally, Saudi Arabia has been enjoying the lowest production costs in the world. Russia spends almost twice as much on raw material production in the oil fields of Western Siberia as Saudi Arabia does in its fields. As for Russia’s energy future, the vast majority of reserves Russia planned to use are in the Arctic covered by ice or in other remote and hard to reach areas, which may be considered a profitable investment only with a price of 120 dollars per barrel.

It is clear that the OPEC meeting in Vienna has brought Moscow no good. At the same time, members of this organization called other countries to take their own measures in a bid to stabilize the market.

As for current oil prices, the fact that a barrel is now being sold for over 50 dollars for the first time since October 2015, is little reason for optimism. It is the ceiling, not the starting point, and investors testify to this fact. Hedge funds and other so-called “non-commercial” speculators increased the number of long positions to a record high – 555,000 base oil contracts traded on the New York futures market. The previous record – 548,000 contracts – was set exactly on the eve of peak oil prices (120 dollars per barrel) in June, 2014. The return of speculative enthusiasm is usually a sure sign that prices will go down. The oil market is no longer controlled by OPEC. There are new sources of supply, and technology that has helped in lifting certain environmental constraints. Therefore, the oil market is now responding according to supply and demand, just like any other commodity market. If this new model is sustained, the price of oil will no longer be determined by the needs and desires of oil-producing nations. Saudi Arabia and Russia may want or even “need” the price of 70 or 80 dollars per barrel, but they won’t get it.

Now that all the major oil producers openly seek to maximize production, oil will be traded like any other raw material with an excess of supply on a competitive market. Pricing will go in accordance to what is written within any economic textbook: it will be determined by the marginal cost of the last provider, whose products are meeting the global demand. When the demand for oil is high enough as it is now and usually is at the beginning of summer, the price will be set at the marginal cost of production from oil shale deposits in US and Canadian oil sands. When the demand weakens, as often happens in autumn and winter, the market price will be determined by the marginal costs of the cheaper but less accessible oil producers in Asia and Africa, like Kazakhstan and Nigeria. From now on, it is the costs of the marginal producers that determine the upper and lower thresholds of oil prices. Low-cost producers in Saudi Arabia, Iraq, Iran, and Russia will continue to pump as much oil as their physical infrastructure allows them to, as long as the price is above 25 dollars per barrel or so. Unpredictable changes in supply and demand, will cause fluctuations within this price range. It is not surprising that prices doubled, starting from the lowest level of 28 dollars per barrel in mid-January. Now, however, when the ceiling of 50 dollars has been broken, one can only expect prices to go down again.

Against this backdrop, on June 5, Saudi Arabia increased the price of its oil for American and Asian buyers, while reducing it to Europeans. It is believed that this step was aimed at countering Iran’s growing exports. As of now Tehran is selling up to 400,000 barrels per day in Europe, but it plans to increase this level to 700,000 barrels per day after signing deals with Greek, French and Italian partners. Saudi Arabia has been selling 800,000 barrels per day to Europe so far. The fight for customers will be waged through low prices, special offers and discounts for individual customers. Iran is confident in its victory, since it’s less dependent on oil profits. But this battle will also affect local producers from the UK, Northern Ireland, and Norway who have been trying to attract investments in production amidst falling prices.

Russia will also suffer from falling prices since it has been relying heavily on the European market. Therefore, only deep economic reform will be able to change the difficult situation surrounding the Russian economy, an economy that has already been hit by Western sanctions and low oil prices. Hopes for high oil prices are nothing but an unnecessary illusion. It is time to admit that the US and its closest allies are committed to the displacement of Putin from power by any means possible. The bet is to achieve a coup d’état in Russia, relying on the most dissatisfied elites or upon the unrest in the country provoked by growing socioeconomic difficulties caused by the sanctions. Washington understands that it cannot conquer Russia by military means, while the use of nuclear weapons will have equally grave consequences to everyone on the planet. The plan to install an obedient government within the Kremlin – is the safest and least expensive option for dealing with Russia. At this stage there’s no means to launch a “color revolution” in Russia, even with the active support of the so-called Russian opposition – both domestic and foreign. That is why Washington has been trying to damage Russia’s economy even further by pushing it out of...
markets it has been occupying, particularly - gas and oil.

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