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Oil geopolitics webinar Round 2

Lately the US-Saudi relationship has been in flux. Uncertain.

Saudi still needs the US:

- Hard security protection (\$100b/yr)
- Diplomatic backing (Khashoggi/Yemen)
- Economic partnership (two-way investment; Bechtel-Riyadh metro)

But the US needs Saudi less and less

- US approaching self-sufficiency in oil
- Imports of Saudi crude dropping (except for price war shipments in April-May)
- Saudi spare capacity still useful, but not as crucial in an oversupplied market

Newly nationalist US foreign policy is partly a result of feelings of self-sufficiency (partly just Trump)

- We can slap sanctions on just about anyone and get away with it. Even on oil producers that might have been immune in the past
- Republican senators even suggested sanctioning Saudi (recent letter)

There is little recognition that Saudi/OPEC constraints on production were helping drive these changes in US posture

Saudi/OPEC/Russia since 2016 had been cutting production. Those cuts gave US industry the market signals it needed to ramp up by 4.4mbd

Yes constraints on production helped the Saudi budget

But they also contributed to negative effects (from the Saudi perspective)

- OPEC was “subsidizing” a competitor (allowing US producers to free-ride)
- That allowed the US to approach long-sought “energy independence.” Washington also felt strategically “independent” from KSA
 - o US EnSec Brouillette: “Maybe we don’t need as much as we used to need from you.”

These shifting circumstances brought about another important change

In the past, dominant voices in the US encouraged a “free” oil market, with lower prices

That is no longer the case

With the US becoming No. 1 oil producer, the US oil industry is now seen as a domestic champion. Increasingly important/influential in Washington

Trump shifted his stance. From cheering low prices, he began decrying them

US policymakers – who loved to beat up on OPEC – did a 180

Now they want MORE OPEC, not less

Republican senators even threatened to bring home US troops and Patriot batteries (recent letter)

Saudi oil minister Prince Abdulaziz said it seemed that the US no longer wanted a free market (after calling off price war).

The price war “was a factual exercise in what a true free market would do when you have a crisis”

He criticized the “so-called dogma of free marketeering.”

Saudi Arabia, needing to preserve US friendship amid a surprising American uproar over *low* prices, backed down.

Of course, the price war was also hurting the kingdom – and Russia and everybody else – and a new agreement that wasn’t possible in March was suddenly attainable.

Saudis led OPEC+ cuts, but did not push US producers to cut more than was happening “organically” via market effects

The US’ main contribution seemed to be the preservation of the US security umbrella

So, once again the Saudis are restraining the world’s lowest-cost production, which may help high-cost producers survive

When demand resumes we could see another shale revival like we saw in 2016

If that happens, Saudis and Russians will avoid following the same playbook that allowed shale to sweep to No. 1 on the back of OPEC’s cuts

Are there ways KSA or OPEC can persuade the US to play along, as an OPEC+ partner?

- Not impossible (TXRRC)

Are there other concessions the Saudis might seek, in exchange for restraining production?

- Hard security commitment/Nuclear umbrella?

Saudi strategic rebalancing may be inevitable

As oil demand continues to shift away from the OECD the developing world, big exporters like Saudi Arabia are going to have to rethink their old oil-for-security ties.

Developing countries may buy oil, but they can't make the same hard security commitments. They just don't have the military wherewithal

For now the price war looks like a major strategic error by KSA.

Lasted all of 5 weeks

MbS and Putin were forced to climb down – wisely took the first face-saving opportunity

Saudis misjudged the coronavirus AND the shift in US perceptions of oil

IRAN

Signs of Iran returning to life. Rouhani has not imposed tough quarantine. Iran's government can't afford to pay people to remain home.

Normal life is supposed to resume next week.

Some signs of a resumption of Iranian BAU this week

On Wednesday: 11 Iranian vessels conducted harassed a US Navy taskforce

On Tuesday: Iranian forces boarded and briefly seized a HK-flagged tanker.

No effect on oil price.

But Iran is warning that its grievances with the US remain unresolved.

This is a problem of the Trump admin's making (by renegeing on the nuclear deal and reimposing sanctions).

Trump may face a second crisis alongside coronavirus.

And since Trump declined to relax sanctions during Iran's outbreak – and may block IMF relief -- there is no reason to expect Iran to back down as the US reaches peak infection

ENDS