Commodities Corner
News & Commentary
4 things Saudi Arabia's economic reform plan says about oil; Battles for market share will continue

Myra P. Saefong, MarketWatch
1,229 words
26 April 2016
08:54
MarketWatch
MRKWC
English

Battles for market share will continue

Saudi Arabia on Monday said that it plans to make itself capable of living without oil within the next four years—a very ambitious goal for a country that exports more of the energy source than anyone else in the world.

The kingdom approved a long-term blueprint for economic reform dubbed "Saudi Vision 2030," which aims to reduce the country's dependence on oil revenues. It'll be quite a challenge for a nation that still saw about 70% of last year's revenue come from petroleum despite the steep drop in prices since mid-2014.

"By 2020, we'll be able to live without oil," Deputy Crown Prince Mohammed bin Salman, who heads the economic council, told Saudi new channel Al-Arabiya in an interview aired Monday. He also said that less than 5% of the state-owned Saudi Arabian Oil Co. will be publicly sold off in a move that would value the world's largest energy firm at as much as $2.5 trillion.

Read: Meet the 30-year-old prince emerging as the oil market's 'ultimate disrupter'

The reform plan follows a slump oil prices, which saw Brent (LCOM6, UK) and West Texas Intermediate crudes (CLM6, US) drop by roughly 70% to lows under $30 a barrel this year, from highs above $100 a barrel in mid-2014. The drop has thrown the kingdom into turmoil, prompting substantial budget cuts and other measures that observers have feared could spark social unrest.

"Saudi Arabia's new reform agenda is heavily influenced by the sustained dip in oil prices contributing to a budget deficit this year of about $90 billion," said **Usha Haley**, a professor of management at West Virginia University, who is an expert on international energy policy.

"Despite some diversification, oil still accounted for over 70% of the kingdom's revenues," she said. But the Saudis realize that the present "oil-dependent strategy cannot sustain a high quality of life in Saudi Arabia."

That said, analysts say that the plan isn't likely to result in any production cuts.

"Over the longer term, I don't think this becomes a real threat to supply," said Robbie Fraser, commodity analyst at Schneider Electric. "Saudi Arabia will continue to produce oil for years to come in order to fund its diversification effort."

Still, there are four key things that the reform plan hints at:

1) Loss of control

Saudi Arabia's influence in the oil market has diminished and the Saudis know it.

They see their ability to control oil prices slipping away, said Fraser, “and for the Saudi government, a lack of control over the long-term price of oil is virtually identical to a lack of control over the country’s long-term economic and political stability.”

But the Saudis’ influence in the market hasn’t weakened solely due to falling oil prices.

On a broader scale, there continues to be conflict between the world’s major oil producers. Members of the Organization of the Petroleum Exporting Countries, led by Saudi Arabia, and non-OPEC countries failed to reach an agreement earlier this month to cap output levels.

And if the Saudis can’t get OPEC and non-OPEC nations to work together, they’re “probably thinking the new price norm for WTI oil is $45 to $65 a barrel, said Kevin Kerr, managing editor and executive publisher of Commodities Watch.

2) More market-share battles

Major oil producing countries have been reluctant to cut back on production despite the plunge in prices because they fear losing their share of the market to rivals—and the Saudi reform plan implies that market-share battles will continue.

“The most noteworthy point is that the this plan confirms that Saudi Arabia is going to maintain its current policy in oil markets—defending market share and ignoring commercially unwise calls for an output cut,” said Omar Al-Ubaydli, a program director at the Bahrain Center for Strategic, International and Energy Studies.

“Any speculators who were hanging on to the hope that internal and external political pressure would lead the Saudis into a commercial error [output cut] should really consider moving on, and accept that the Saudis are not going to cut output for the benefit of other producers, and at a significant cost to themselves,” he said.

At the same time, the market-share battle has helped to exacerbate Saudi Arabia’s economic woes.

“The Saudis had already been selling oil at a much lower price than they could maintain to drive the U.S. shale companies out of business,” said **Haley**. “Shale puts a ceiling on how high oil prices can go.”

But the “survival of shale gas as an alternative and viable resource, and the continued development of other energy sources, has created an urgency for the kingdom, that its leaders could not write off as a blip,” she said.

The reform plan shows that Saudi Arabia are “aware of the looming landscape for energy and intends to do something about it for their country and themselves,” said **Haley**.

3) Petrodollar endangered?

Economies in the oil-rich Middle East have been taking big hits from the plunge in oil prices and that could prompt them to take further action.

When Saudi Arabia agreed back in the 1970s to price all of its future oil sales in U.S. dollars in return for military protection, that meant that any country who wanted to buy oil from the kingdom would have to buy dollars to make the transaction, Jody Chudley wrote in a recent article for The Daily Reckoning.

The petrodollar has “done wonderful things for asset prices in the United States,” said Chudley.

But the relationship between the U.S. and Saudi Arabia has deteriorated, particularly after the Western nations reached a deal with Iran over Tehran’s nuclear program.

See: This nasty oil rivalry is why a genuine output freeze is a long shot

Now, the U.S. Senate is considering a weapons export ban or limit on Saudi Arabia. “Remember it is military support that was the carrot that the U.S. dangled in front of the Saudis, which enabled the petrodollar in the first place,” Chudley said.

Read: Obama seeks to quell talk of U.S.-Saudi divorce

4) Peak demand

Lastly, the Saudi Vision 2030 plan implies that the world just doesn’t need as much oil as it used to.

The Saudi reforms “strongly point to the slow but powerful forces of peak demand—a long process where the Persian Gulf majors are most vulnerable,” said Richard Hastings, macro strategist at Seaport Global Securities.

The immigration reform component of the plan “allows for more labor to participate in the country,” helping to perpetuate the move away from oil and petroleum products, he said.

“The announcement does not change crude-oil price action immediately, because it now seems very likely that the price collapse in 2014 was triggered by the beginning of the peak demand era,” Hastings said. “Prices now seem to capture most of the process that is now under way in the global petroleum story.”

So Saudi Arabia’s reform plan may have come just in time.

Document MRKWC00020160425ec4p003uy

Search Summary

Text	usha haley
Date	In the last 3 months
Source	All Sources
Author	All Authors
Company	All Companies
Subject	All Subjects
Industry	All Industries
Region	All Regions
Language	English
Results Found	9
Timestamp	27 April 2016 14:50

