

Markets

Saudi Arabia Faces a Dramatic Choice at OPEC

- Saudi-Russia meeting at G20 likely to determine OPEC outcome
- WTI crude plunged below \$50 a barrel for first time in a year



The Three Men That Will Determine the Future of Oil Prices

By Javier Blas

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The choice facing Saudi Arabia at next week's OPEC meeting is dramatic: cut oil production and enrage Donald Trump, or keep pumping and risk ultra-low prices blowing up its economy.

For Mohammed bin Salman, the kingdom's crown prince and day-to-day ruler, the dilemma has been sharpened by the murder of Jamal Khashoggi in the Saudi consulate in Istanbul. Under pressure from angry senators and other Washington power players, he needs Trump's political protection.

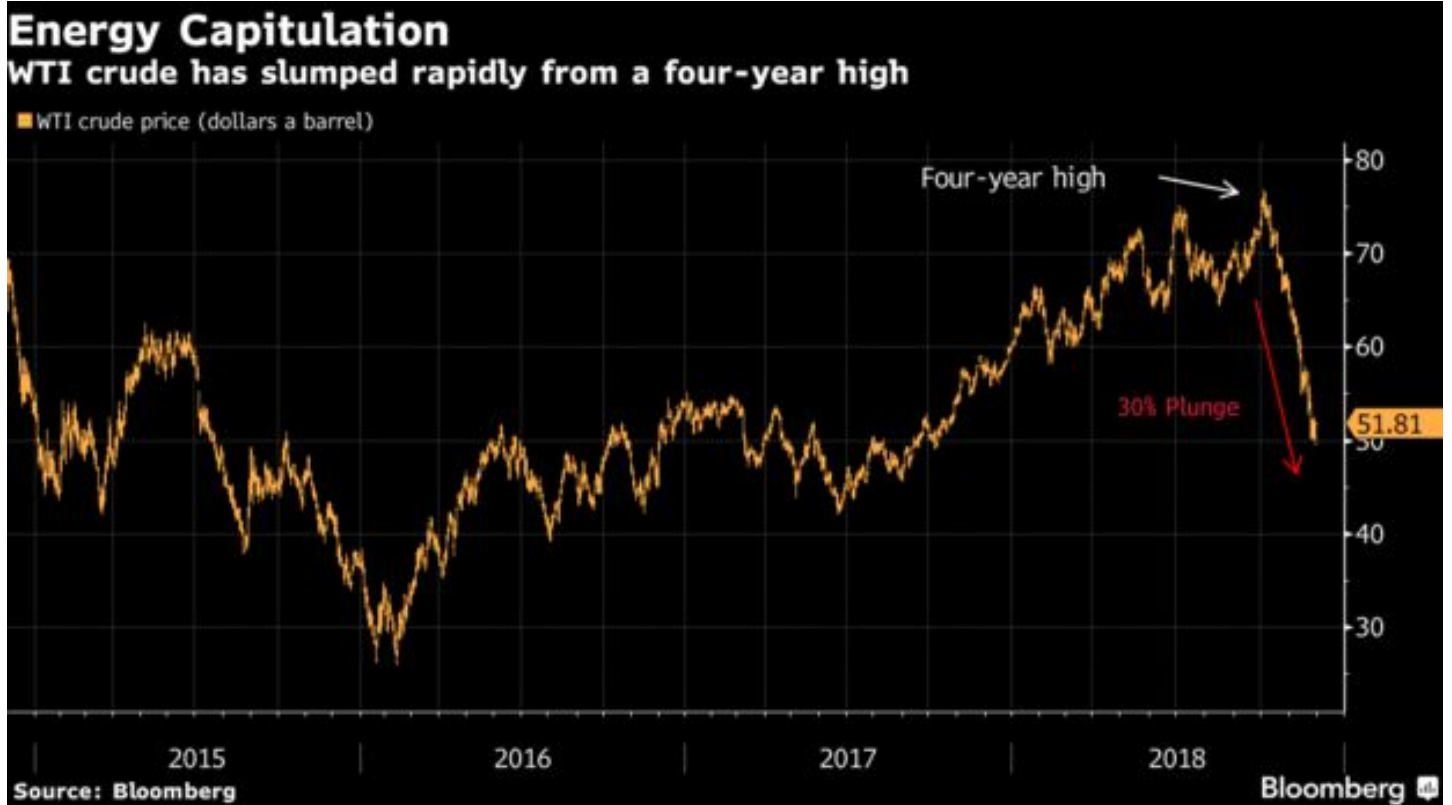


Mohammed bin Salman arrives in Buenos Aires *Source: Saudi Press Agency*

Things will come to a head this weekend at the Group of 20 summit in Buenos Aires, a meeting that could shape the oil market in 2019 and affect everything from the war in Yemen to the share price of Exxon Mobil Corp. Vladimir Putin will also play a key role -- Russia and Saudi Arabia have spent the last two years working together to manage the oil market.

"It's a long shot, but the parties are going to be there and if there's something to be worked out, it can be worked out there," said Ed Morse, a veteran OPEC-watcher at Citigroup Inc. "The question is whether there's room for agreement among the U.S., Saudi Arabia and Russia on what the right price is."

What happens at the G20 will effectively determine the outcome of the meeting of the Organization of Petroleum Exporting Countries and its allies. With just a week to go before ministers gather in Vienna, delegates from the group would normally be busy swapping proposals and counter-proposals, discussing potential output levels, and drafting communique. This time around the activity has been muted as officials say they are waiting for clarity from Buenos Aires.



If the Saudis want to halt the slump in crude prices, the first obstacle is a traditional ally: the U.S. President.

The market is abuzz with talk that MBS, as Prince Mohammed is known, may not feel able to defy Trump's desire for lower oil prices because the White House supported him in the aftermath of the Khashoggi killing. After the U.S. Senate on Wednesday voted in favor of a bill that goes against Saudi interests in Yemen, Trump will arrive in Buenos Aires with even more ammunition to show he's the kingdom's last friend in Washington.

"President Trump has effectively put a ceiling on oil prices -- arguably this ceiling is about \$70 a barrel Brent, maximum \$75," said Thibaut Remoundos, founder of London-based Commodities Trading Corporation Ltd. "It will be interesting to see if Saudi-Russia can keep the floor in place."

In public and private, the president has told the Saudis he wants cheaper crude, even disclosing that he berated MBS in a phone call in October when international benchmark Brent surged above \$80.

Prior to the collapse in oil prices, the kingdom was responsive to Trump's demands. Its November production surged to an all-time record above 11 million barrels a day, prompting a jubilant response on Twitter.

In shadow of the Khashoggi murder, the quip in the oil market is that MBS will be forced to accept a grand bargain: "Lower for longer" oil prices in exchange for staying in power for longer.

Riyadh has powerful reasons to stop this joke becoming reality. It needs crude above \$73 on average next year to balance its budget, according to the International Monetary Fund. It lacks the

financial reserves of 2014, the last time it decided against cutting output to support prices and instead chose to fight a price war against U.S. shale producers.

"The kingdom's current fiscal buffers are thinner and the prospects for its economy and private sector are weaker," said Bassam Fattouh, director of the Oxford Institute for Energy Studies. In a stark example of Saudi vulnerability, its foreign exchange reserves have fallen to about \$500 billion, down from a peak of nearly \$750 billion four years ago.

Drill Baby Drill

Saudi oil production hits an all-time high above 11 million barrels a day

Source: Bloomberg News

Data up to Oct 2018 is Bloomberg survey. November is latest figure available.

There may be limits to the pressure that Trump can put on MBS, who remains his most important ally in the Persian Gulf. The White House wants to continue pushing Iranian oil exports lower to force Tehran to negotiate a new nuclear deal, which would require a helping hand from Riyadh to keep the market under control.

That may give the kingdom a narrow path between provoking the president's wrath and preventing an even deeper oil-price slump. Privately, some OPEC delegates are discussing the idea of engineering a production cut without explicitly calling it that, perhaps by saying that output will fall because customers are asking for fewer barrels.

Khalid Al-Falih, the Saudi energy minister, already said earlier this month that the kingdom will pump less in December than November, and predicted another drop in January, as buyers seek lower volumes. Others could follow suit by emphasizing OPEC's long standing position that it will keep the market stable by matching supply to demand.

Persuading Putin

That would bring Riyadh to its second problem: Russia, a long-time foe turned ally over the last two years.

Thanks to a flexible currency and a much lower fiscal break-even price than the Saudis, Putin said this week that oil at \$60 a barrel was “absolutely fine” for his country. That doesn’t mean the Kremlin is about to give up its alliance with Saudi Arabia, which extends beyond oil, but it means could drive a hard bargain.

Russian and Saudi officials are scheduled to meet in Moscow over the weekend, signaling that an agreement on production cuts is possible if the Putin-MBS meeting in Buenos Aires goes well, said people briefed with the talks. Yet, Moscow is yet to commit to any cuts and appears reluctant to shoulder as much of the burden as it did in 2016, the people said, who asked not to be named because the negotiations are private.

On Friday, Russian Energy Minister Alexander Novak reiterated Putin’s view: \$60 a barrel is just fine for Moscow. "In my view, the current price range is comfortable for producers and consumers," Novak told the TASS news agency.

With Saudi oil production at an all-time above 11 million barrels, other OPEC and non-OPEC nations are asking Riyadh to make the first and deepest sacrifice before asking others to chip in, the people said.

The consensus is that the Saudis have few good options. Even if they can slip an implicit supply cut past Trump, then persuade Moscow to make a substantial supply reduction, few delegates and OPEC watchers believe it would deliver the kind of robust public deal that would send oil prices back to the \$75-\$85 range seen earlier this year.

"Announcing an OPEC cut will be even harder than agreeing one," said Amrita Sen, chief oil analyst at consultant Energy Aspects Ltd. in London. "Walking out of Vienna next week with no explicit cut, but a jumbled statement referring to some broad intention to prevent the market from being oversupplied will undoubtedly trigger a further sell-off."

– *With assistance by Dina Khrennikova, Grant Smith, and Elena Mazneva*

(Updates with Russian oil minister comments in 4th paragraph from bottom.)