Saudi Arabia Losing Influence in Global Oil Markets

As it continues to wrestle with declining oil prices worldwide, Saudi Arabia, the de facto head of the OPEC oil cartel, is giving up ground. It said a week ago that it would not allow any “free riders” to enjoy higher oil prices if they rose due to Saudi’s singular attempt to keep them up. A week later it was reported that the kingdom cut its production by 800,000 barrels per day, 60 percent below its agreement. So much for disclaimers against those “free riders” who continue to violate the agreement by exceeding their quotas.

Now comes news that the kingdom’s exports to the United States for the week ended March 10 fell by 425,000 barrels a day, the sharpest weekly drop since the cartel’s November agreement to limit production. The Saudis tell observers that it wants to concentrate its marketing efforts closer to home: Russia, China, France, Spain, and Italy. That cut reduces Saudi exports into the United States to just 12 percent of all American crude oil imports. In the 1990s, those exports counted for a third of all U.S. imports.

But it turns out that other OPEC cartel members are successfully undercutting the Saudis’ attempts to capture and keep more of those markets that are closer to home.

China is cutting deals with Russia, reducing the kingdom’s share. Iran and Iraq, two members of the OPEC cartel, are raiding customers in France, Spain, and Italy that used to purchase most of their crude from the kingdom.

Meanwhile American oil producers are ignoring the troubles facing Saudi Arabia and its failing cartel. They have added more than 400,000 barrels per day of new production since the November agreement, and continue to bring idled rigs back to life, with more than 750 now operational compared to just 267 a year ago.

The picture of the failure of OPEC and its leader is seen in the price chart of crude oil since the agreement was inked in November. At the time Nymex Crude was selling at $46.50 a barrel. By early January it had jumped to $56. When it became clear that the cartel’s agreement wasn’t going to hold together, thanks to exceptions given to Nigeria and Syria, and non-compliance by other members, the price started falling. Last week the price dropped through $50 a barrel, following reports that crude supplies and inventories were continuing to set records, which forced oil traders to close their long positions and move to the short side of the market. Since then, the price has continued to fall, touching mid-day lows close to $48.

In other words, for all of its efforts, OPEC birthed a gnat.

In the United States, seemingly oblivious to OPEC’s problems, the oil industry continues its renaissance. The Energy Information Administration expects Permian Basin (West Texas) production to jump by 70,000 barrels a day next month, while drillers in the Eagle Ford region (Southeast Texas) are ramping up production there as well, with estimates of new production there jumping by 28,000 barrels per day in April, twice recent estimates by the EIA.

The refrain remains in place: Saudi Arabia is caught in its own web. If the OPEC agreement to limit oil production is extended when it expires in May, it's more than likely that non-compliance will escalate as members of the cartel get tired of waiting for the day when prices rise. If the meeting on May 25 ends the agreement, it will be a free-for-all, with members of the cartel ignoring everything but their own self-interests, and ramping up production before prices drop further. It will also be a tacit agreement that the cartel has failed, leaving each member to seek its own self-interest.

This will impact Saudi Arabia the most. Its citizens, having become comfortable with the welfare state benefits funded by oil revenues, aren't likely to cotton to cuts in those benefits. Further, the kingdom is seeking to sell between five and 10 percent of its state-owned Aramco oil company. As the price of crude continues to slide, so do the Saudis' expectations of being able to raise enough money to redirect its economy away from oil and gas and into other ventures.

What the Saudis are learning, albeit belatedly, is that they no longer control the oil markets. Whatever agreement OPEC cobbles together during its May meeting is likely to be stillborn. Increasingly lower break-even points in the U.S. oil patch are spelling the end of both the cartel and Saudi Arabian influence.

Photo is of headquarters of Saudi Aramaco

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