MENA ECONOMICS UPDATE

Will Saudi shift tack on oil policy?

- **Saudi Arabia has cut oil output significantly over the past year or so but that hasn't prevented global oil prices from falling. Despite Aramco's announcement today that it is postponing plans to raise production capacity to 13mn bpd, we think looming peak oil demand will prompt a reversion to the efforts under previous Oil Minister Ali Al-Naimi during 2014-16 to ramp up oil *production* to regain market share.**
- Saudi Arabia has persuaded the rest of OPEC+ to deliver large oil output reductions over the past 18 months, which have been complemented by the Kingdom undertaking additional voluntary reductions. In total, production has been lowered from 11.0mn bpd in September 2022 to 8.9mn bpd now. But it would be fair to say that these cuts have failed to have the desired effect – oil prices are now lower than they were prior to the production cuts that were announced in September 2022.
- Of course, it's clearly difficult to know what would have happened if those production cuts hadn't been implemented. Even so, the overall result is that the Kingdom's oil export revenues are now a lot lower. We estimate that oil export revenues came in at around $250bn last year, down from $327bn in 2022.
- That has contributed to the deterioration in Saudi Arabia's current account and budget balances. The current account surplus shrunk to 5.5% of GDP in Q3 (on a four-quarter sum basis) and the budget deficit is estimated to have widened to 2.0% of GDP last year. And with the government keen to keep fiscal policy loose, the 2024 Budget showed that these shortfalls are expected to persist through to 2026.
- As we highlighted in an *Update*, there is no serious near-term threat to the dollar peg or fiscal sustainability. And Saudi officials may feel the need to keep output restrained in order to support prices to ensure that Budget plans can be fulfilled. **But there are growing question marks over the decision to push through oil output cuts given that they simply seem to be causing Saudi Arabia's share of the oil market to fall.**
- **What's more, there are escalating tensions within OPEC+ over Saudi diktats to keep oil output low when it looks increasingly likely that oil demand will peak in the coming years**. Indeed, a number of countries are clearly concerned that peak oil demand threatens to leave them with untapped natural resources. The UAE has raised its medium-term output targets and Angola has left OPEC.
- **Saudi Arabia is better positioned to contend with peak oil demand than many other oil producers**. Of course, the Kingdom's current economic model will need to be overhauled to reduce its dependence on oil – something that Crown Prince Mohammed bin Salman is aware of even if, in our view, his Vision 2030 reform plans fall short. (See here.) But the cost of oil production in Saudi Arabia is among the lowest in the world and so it will remain a key producer for decades to come. And large fiscal and external buffers provide the authorities with plenty of scope to smooth the economic adjustment.
- **That said, the backdrop of declining demand means that the Kingdom would find it increasingly difficult to manipulate supply and boost prices for any length of time**. Saudi Arabia will be able to step in to balance the market in the event of a demand shock or a supply surge. Even before today's announcement of a cut to capacity plans, Saudi Arabia had estimated spare capacity of 3mn bpd. But if prices are kept artificially high for an extended period, oil demand will fall at an even faster pace and non-OPEC supply will rise.
- **Saudi Arabia would then be forced to cut production again to keep prices high, and the cycle would continue until policymakers refuse to cede any more market share**. This is exactly what happened in the 1980s when the Kingdom and the rest of OPEC tried to keep prices high in the face of a wave of output from the North Sea, the US and Russia. Over the past four decades, Saudi Arabia's share of global oil exports has declined from close to 30% to just 12% now.
- **The upshot is that we think that Saudi Arabia will eventually scale back its efforts to prop up oil prices and revert to the oil policy adopted by previous Oil Minister Ali al-Naimi to regain market share**. Policymakers will almost certainly question the need to keep large amounts of spare capacity going forward. Indeed, in the event of a rapid deterioration in oil demand, we think that output would be ramped up significantly in order to avoid leaving substantial quantities of oil stranded.
- Such a shift in policy, particularly if it were sudden and unexpected, would put some downward pressure on oil prices. But this is unlikely to be too troubling for the Kingdom, and the government has proven its willingness to impose harsh fiscal austerity if necessary.

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