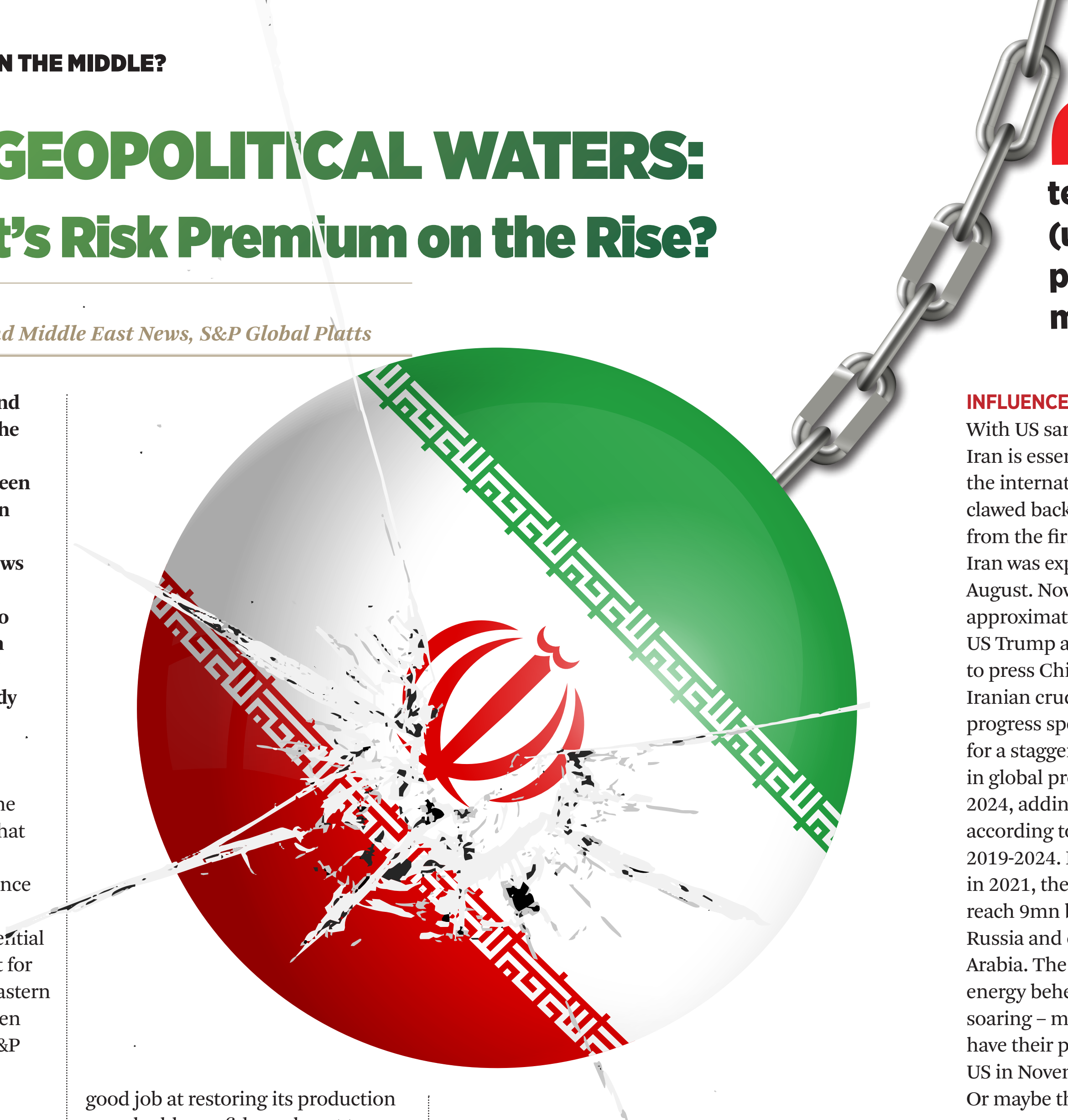
CHOPPY GEOPOLITICAL WATERS: Middle East's Risk Premium on the Rise?

BY HERMAN WANG
Managing Editor of OPEC and Middle East News, S&P Global Platts



Oil tankers ablaze and drone attacks on the world's biggest oil exporter. It's not been a dull year in the Middle Eastern energy markets, that's for sure. While events allow dramatic news headlines to write themselves, this adds more complications to commodities and trade flows in the Middle East – global hub of East-West trade flows – in already unpredictable times.

While geopolitics and energy have always been two sides of the same coin, there's no denying that the knock-on impact of recent geopolitical bust-ups will influence prices. The sudden change in geopolitical risk warrants a potential $5/bl-10/bl premium to account for now-undeniably high Middle Eastern dangers to supply and the sudden elimination of spare capacity, S&P Global Platts Analytics said.

REGIONAL JITTERS

Thanks to the biggest attack on oil infrastructure since the Gulf War, oil markets are still calculating the risk premium after drones hit Saudi Arabia's Abqaiq oil processing facility – the kingdom's largest – and the Khurais oil field, in September. The attacks took 5.7mn b/d of production offline, about half of OPEC's biggest and most influential member's capacity – equating to 5% of global supplies. In short, this attack exposed a nerve, not just in Saudi, but worldwide. Saudi Arabia has, by all counts, done a good job at restoring its production – a valuable confidence boost to an industry awakening to a new (and for many, unnerving) style of aerial attacks. The kingdom's press conference shortly after the attack was a masterpiece of positive communication. A reassuring picture was presented, dulling the more severe price moves. The US, a key ally of the Saudis, accused Iran of carrying out the attacks, which Tehran strongly denied. Yemen's Iran-backed Houthi rebels claimed responsibility for the attacks. And it goes on; the bad blood doing little to stabilize energy prices.

On October 11, oil prices jumped again after Iran's state shipping company said one of its Suezmax tankers in the Red Sea carrying 1mn b/d of crude had spilled oil after two "separate explosions, probably by missile hits" occurred. This followed a handful of tanker-related incidents in the Strait of Hormuz chokepoint – through which a fifth of the world's sea-borne oil passes daily – earlier this year. The narrative of pricing premiums for the Middle East was reinforced (again).

> **"What is certain is that worsened geopolitics typically don't bode well for deeper pockets. And there's no telling whether 2020 will be calmer on the geopolitical scene (unlikely). So, the rallying support of regional NOCs and IOCs, plus new partners worldwide, is critical to sustaining the much-needed flow of funds."**

INFLUENCERS TO WATCH

With US sanctions, OPEC member Iran is essentially knocked out of the international market. Having clawed back production efficiently from the first round of sanctions, Iran was exporting 2mn b/d a day last August. Now it's in the six figures, approximately 200,000 b/d. And the US Trump administration continues to press China to stop importing Iranian crude. Comparatively, the US' progress speeds on. It will account for a staggering 70% of the increase in global production capacity until 2024, adding a total of 4mn b/d, according to the IEA's Oil Outlook 2019-2024. Likely a net oil exporter in 2021, the US' gross exports will reach 9mn b/d near 2024, overtaking Russia and catching up on Saudi Arabia. The fortunes of these two energy behemoths – one fading, one soaring – may be edited when they have their presidential elections: the US in November 2020, Iran in 2021. Or maybe they won't.

GLOBAL ROWS

There's the US-China trade war that continues to reshape global trade flows. 61% of respondents to a GIQ Industry Survey in October believe the trade dispute is nearer the beginning than the end but the good news is that just 10% feel the Middle East is the biggest loser; Asia meanwhile was seen taking the biggest hit at 57% with other countries along the New Silk Road at 33%. If the tension is not resolved, 58% of survey respondents said energy companies in the Middle East and worldwide are not prepared for the long-term impact of the decoupling of the world's two economic heavyweights. Adding to the uncertainty is the impact on oil prices from discord within the Gulf Corporation Council (GCC) and also from Libya and Venezuela's geopolitics.

GOLDEN CHILD: OPEC+?

And not to mention the growing production from non-OPEC producers like Brazil, Canada, Norway and Guyana (while output from some OPEC producers falls). Every growth and every decline in an oil producer's influence triggers a political ripple. Watch this space. The recent OPEC meeting in Vienna in December, with the group doing a good job at reassuring the market since they joined forces with Russia and other non-OPEC allies – rare unity in any industry worldwide – in 2016. Nearly half (42%) of survey respondents said they are very confident in OPEC+'s ability to balance the oil markets this fourth quarter; 28% said somewhat confident. Let's end this long list (that only covers a slither of geopolitical-energy dynamics worldwide) on a positive note. Saudi and Kuwait may (there have been many false starts) resume oil production in jointly-operated fields in the Saudi–Kuwaiti Neutral Zone since the shutdowns of Khafji and Wafra in 2014 and 2015, respectively.

BOLSTER ACCOUNTABILITY?

There has been a relatively muted response worldwide, notably from the US, to the scale and global impact of the attacks on energy infrastructure in the Middle East this year. The road of geopolitically powered violence and hostility will be easier to tread if there's a lack of consequences, militarily speaking but this isn't necessarily good news for the energy markets, nor economic growth. There must be stronger or more predictable deterrents in place, in part, to buoy investors' confidence.

In 2018, global energy investment remained relatively stable, at over $1.8trn, following three years of decline, the IEA detailed in its World Energy Investment 2019 report. This trajectory must accelerate to ensure energy security. Investment in the Middle East was down by one-fifth over the past three years, one of the largest declines globally, the IEA added. Soon it will be revealed whether the largest Middle Eastern national oil companies (NOCs), many stating higher capital budgets for 2019, came through.

WHAT'S NEXT?

What is certain is that worsened geopolitics typically don't bode well for deeper pockets. And there's no telling whether 2020 will be calmer. So, the rallying support of regional NOCs and IOCs, plus new partners worldwide, is critical to sustaining the much-needed flow of funds. This feeds directly into the region's energy security, but also its attractiveness as a global hub – value that is impossible to put a price tag on. War of words, and worse, only hamper the region's bottom line. ▯