



بنك الإمارات دبي الوطني  
Emirates NBD

## Commodities

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# Crude oil update

## Saudi Arabia: oil change?

Saudi Arabia's king, Salman bin Abdulaziz, announced a major cabinet reshuffle in which veteran oil minister, Ali al Naimi, has been replaced by Khalid al Falih, the chairman of Saudi Aramco and formerly its CEO. Mr al Naimi had been in the post of petroleum minister since 1995, and ahead of that CEO of Aramco, and speculation surrounding his replacement was something of a cottage industry among OPEC and oil market watchers. With Mr al Falih now in place the focus will turn to whether there will be any change to Saudi Arabia's oil market policy.

Mr al Naimi had been a major proponent of OPEC's December 2014 decision to keep crude oil production steady in an attempt to maintain market share despite the sharp drop in prices. However, oil market policy is now coming under the influence of the deputy crown prince and king's son, Mohammed bin Salman. Earlier in April, the deputy crown prince appeared to be behind the apparent shift in Saudi's oil policy when he insisted that any production freeze among OPEC members must be taken on by all countries, including Iran. He has also indicated that Saudi Arabia could raise production substantially in a relatively short period by as much as 1m b/d.

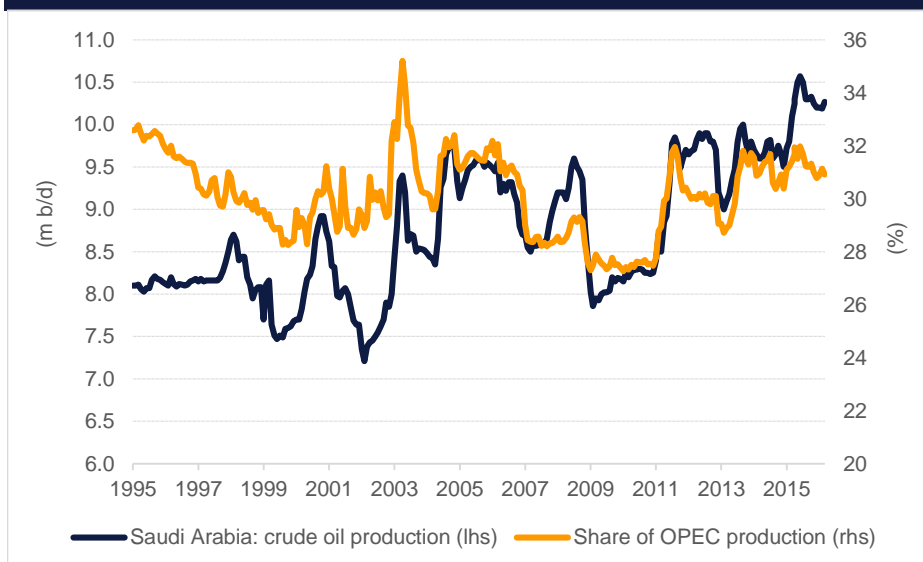
The change in oil minister introduces a new element of uncertainty to global oil markets and Mr al Falih's first appearance as minister at the June 2nd OPEC meeting will be closely scrutinised for any change in policy. In light of the change in minister, however, we consider what options are available for Saudi Arabia and assess the impact we feel they could have on markets.

## Maintain current policy

We believe this is the most likely course of action following the change in oil minister. Oil markets are in a process of rebalancing with production in the US falling persistently (down 377k b/d year to date) and inventory builds showing some signs of slowing down (although not reversing in any substantial manner yet). The massive wildfires in Canada are now threatening production there, providing another unanticipated boost to tightening markets.

Saudi Arabia's share of OPEC production has dipped in the past year but the decline has been relatively marginal. Keeping production steady would allow Saudi Arabia to benefit from a pending supply squeeze in the longer term as capital expenditure on new projects in the oil industry has plummeted. In this scenario we would expect crude oil prices over the next several months to continue their gradual grind upwards, with occasional upward and downward spikes.

## On Naimi's watch, Saudi Arabia's crude output rose while market share fluctuated

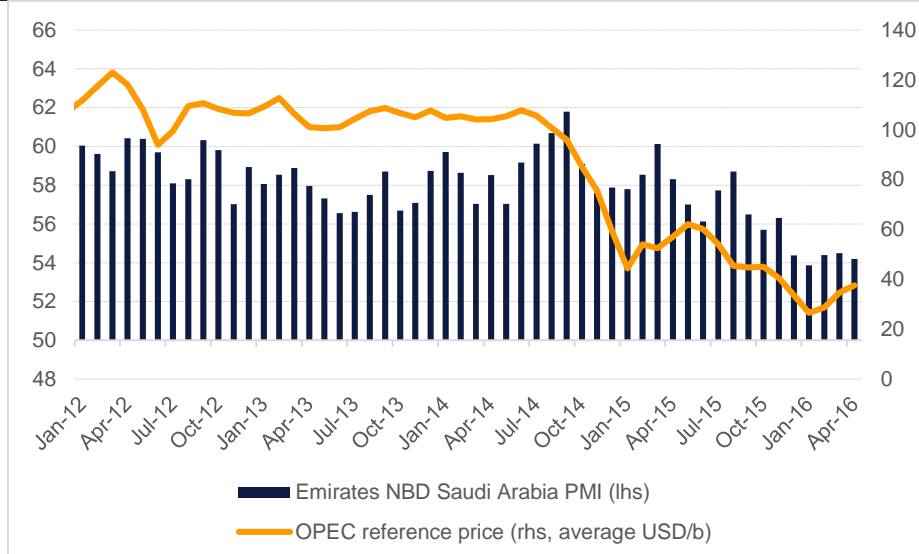


Sources: Bloomberg, Emirates NBD Research.

## Raise production

Increasing current production would mean Saudi Arabia engaging in a further market share with its fellow OPEC members and would undo some of the current rebalancing in global crude markets. In the very short-term, we expect to see a tick up in Saudi Arabia's production as the country meets higher power demand in summer by burning crude but we doubt this will affect export volumes in anything more than a transitory way. However, a push to substantially raise production and sustain it at elevated levels (which we would define as greater than a 500k b/d increase in production for more than six months) would negatively affect the psychology of the current oil market and lead to prices staying soft. Increasing production would not put an end to the market rebalancing but would lengthen the process and mean lower prices for longer.

## Saudi Arabia's non-oil economy hit by fall in prices



Source: Bloomberg, Emirates NBD Research.

## Cut output

A production cut is the least likely scenario in our view for several reasons. First, it would reverse the past year and half of working to rebalance the market by forcing out higher cost producers as higher oil prices would benefit non-OPEC producers along with Saudi Arabia and its OPEC colleagues. Secondly, the non-oil economy in Saudi Arabia is currently being squeezed by a lack of liquidity related to a drop in oil revenues. Given the changes the oil market has seen in recent years (rapid response times for shale producers, Iran and potentially Iraq poised to add more barrels), there is no guarantee a production cut would cause prices to rise to a level high enough to offset the declines in the non-oil sector. Finally, oil demand in Saudi Arabia (and indeed the whole GCC) will continue to grow, not least to feed major new refinery and petrochemical projects. Cutting production from on a volume basis alone appears untenable if current demand projections are to be met.

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