

# Why oil prices are suddenly tanking



Once red-hot, oil prices are suddenly tanking.

Rumors about emergency action from the Trump administration helped send US crude plunging 5% on Monday, sinking to as low as \$67.58 a barrel.

The reversal has wiped out 9% from oil price in less than a week. US oil closed at \$74.11 a barrel on July 10.

“It’s a great reminder of how quickly sentiment can swing – and how volatile these markets are,” said Michael Wittner, global head of oil research at Société Générale.

Analysts blamed Monday’s sell-off on reports suggesting Saudi Arabia and the United States are racing to prevent an oil shortage caused by President Donald Trump’s sanctions on Iran.

Late Friday, The Wall Street Journal reported that the Trump administration is considering a rare step: teaming up with other Western countries to simultaneously release oil

stockpiled for emergencies. Such a move isn't imminent and would only come if efforts to get OPEC to pump more fail to cool off prices, the paper reported.

The Energy Department, which released oil from the Strategic Petroleum Reserve last year after Hurricane Harvey, declined to comment on the news. The White House also declined to comment.

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Trump has repeatedly blasted OPEC for lofty oil prices and complained that prices are "too high." That's despite the fact that Trump's own tough stance on Iran, the world's fifth-largest oil producer, contributed to the price spike.

"Trump is attempting to jawbone the price of crude down. This goes back to the midterm elections," said Ben Cook, portfolio manager at BP Capital Fund Advisors.

Michael Tran, director of global energy strategy at RBC Capital Markets, doubts that tapping emergency oil stockpiles is necessary or would even work. He noted that refineries in the United States are already operating at "extremely high levels," leaving little room to turn more oil into gasoline.

"It would be relatively ineffective," said Tran.

Saudi Arabia-led OPEC and Russia agreed last month to pump more oil, but their move failed to cool off prices. In fact, oil bulls argued that unleashing more oil now will leave Saudi Arabia with little firepower to respond to future shortages.

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Another factor behind Monday's drop is a Bloomberg News report that Saudi Arabia is offering extra crude oil on top of its contractual supplies to some buyers in Asia. That suggests that Saudi Arabia is taking aggressive steps to keep oil prices from getting too high.

“They’re letting buyers know: If you want more crude from us, we have it,” said Wittner.

Meanwhile, there are signs that at least one of OPEC’s hobbled members is on the rebound. Last week, oil prices plunged after Libya’s national oil company announced it had regained control of multiple ports, enabling it to resume exports. Disruptions in Libya and Venezuela have been instrumental in lifting prices to their highest levels in nearly four years.

“We’re getting hints here that barrels are available and aren’t in the short supply that we thought,” said BP Capital’s Cook.

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## **Iran warns OPEC, Saudi on violating output-cap agreement**



Addressing Al Mazrouei, Zanganeh warned that any violation of

OPEC's oil production ceiling will hurt the effectiveness of the organization, Shana news agency reported on Monday.

Urging strict adherence to the agreed caps, the Iranian minister noted that some member countries have produced "far above" their original commitment in June and violated the agreement.

Zanganeh further stressed the role of the Joint OPEC-Non-OPEC Ministerial Monitoring Committee (JMMC), saying that JMMC should monitor and report the conformity level of the members.

### **JMMC can't interpret OPEC's decisions**

In his letter to Khalid al-Falih, Zanganeh stressed that JMMC doesn't have the right to interpret the organization's decision which was made during the 174th meeting.

He further noted that last month's OPEC supply pact does not give member countries the right to raise oil production above their targets.

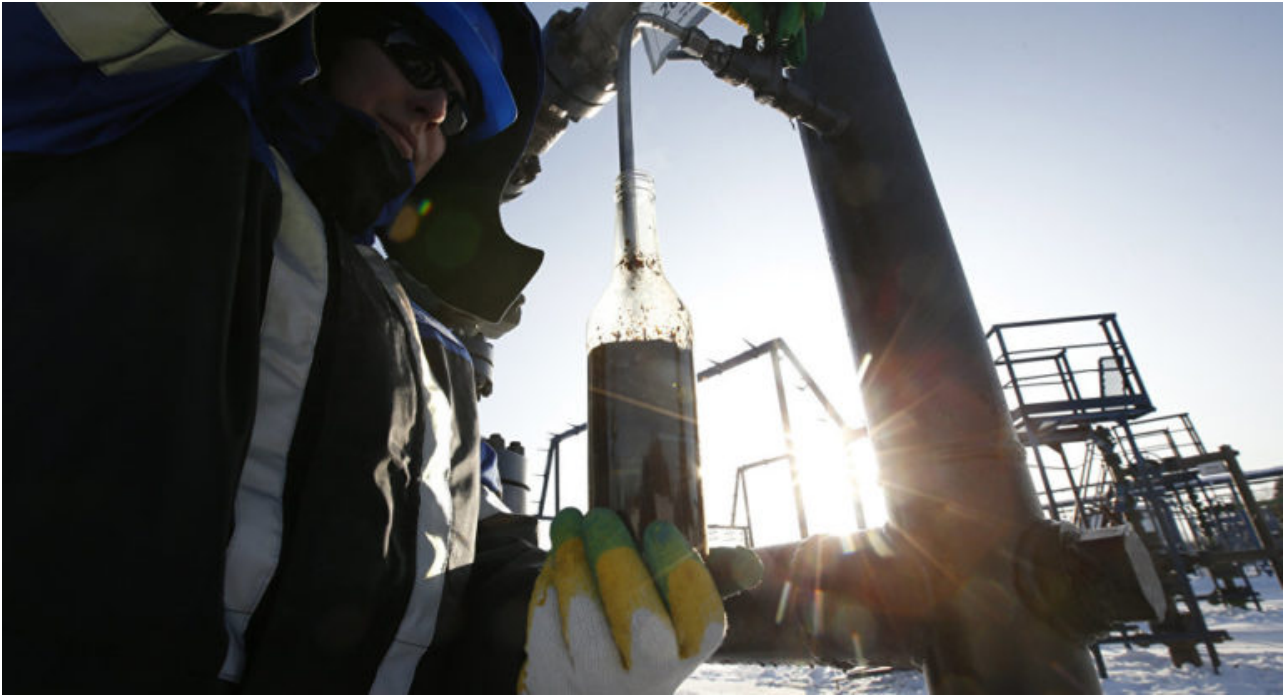
"Member countries committed themselves to reach a production adjustment conformity level of 100 percent, as of July 1, 2018," Zanganeh stated.

"This decision neither warrants member countries the right to exceed their production level above the allocated production level decided, nor the right to redistribute the unfulfilled production adjustment commitments among member countries."

EF/MA

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## **Fitch Economist Blows Lid off US' Dependence on Russian Oil**



Russia doesn't view the US as a potential key purchaser of the its oil, while Washington has expressed a keen interest in putting a damper on exorbitant oil prices by pushing OPEC to boost its output, which seems especially relevant ahead of the US midterm elections.

The US purchases approximately 8 billion dollars' worth of Russian oil, which is about 3 percent of Russia's total production, Dmitry Marinichenko, head of natural resources and raw materials group at the rating agency Fitch, told Sputnik.

"As of today, the US buys roughly 300,000 barrels of oil from Russia daily, while the amount drastically varies from month to month," he said, noting that it is currently just "a drop in the bucket," meeting just about 2-3 percent of US' need for oil imports and accounting for less than 3 percent of Russia's overall oil production," said Marinichenko.

According to the economist, the American market can't be billed as a priority for Russia, whereas the major destination of Russian oil flow has recently become China.

"So, it's hardly possible to speak about any new trends with this regard," he remarked.

On July 16, it emerged that the US is floating the possibility of a dip into its emergency oil reserves if the prospective global oil output is not sufficient to propel prices down, with the suggestion coming in the run-up to the US midterm elections slated for November 6.

Late last month, OPEC and its partners, led by Russia, agreed to ramp up oil production by about one million barrels per day, or one percent of global supply, with the US exerting pressure on them in a bid to put an end to the high oil prices. OPEC's plan, however, comes amid speculation about the future of the oil market at large, with Iran being squeezed away from it by the US. In June, Washington threatened to slap penalties on countries that fail to curb oil trade with Iran by November 4.

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## **Opec+ oil production boost to reassure market investors: EIU**

The 1mn barrels per day production boost by Opec and its allies will help to reassure market investors and prevent a spike in oil prices in the near term, Economist Intelligence Unit (EIU) has said in a report.

This would be equivalent to about 1% of global supply, EIU noted. Nonetheless, EIU said a "number of geopolitical risks remain", including the potential for further output declines from Iran and Venezuela, which will push oil prices gradually higher over the remainder of 2018.

"The fundamental problem facing Opec at its ministerial

meeting in Vienna on June 22 was that some of its members do not have the capacity to rapidly increase output even if quota caps are relaxed, given problems related to under-investment and politics," EIU said. "This means that they would suffer revenue hit from lower prices without a counterbalancing increase in volume," EIU said. Venezuela's output in May was just 1.4mn bpd, its lowest in 30 years, as domestic political and economic turmoil has undermined the oil sector.

This, EIU said was down from 2.1mn bpd in October 2016, making the reduction more than seven times greater than its obligation under the Opec deal, which is also described as more than 700% "compliance" with its cut target. Angola, meanwhile, has struggled owing to underinvestment since the collapse in oil prices in 2015, meaning that it produced just 1.5mn bpd in May, equivalent to a 290% compliance rate. "Despite the differences in production capacity, all members do fundamentally benefit from an environment in which prices are more stable and avoid another dramatic crash driven by a shale boom. As a result, they were able to achieve an agreement, firstly among the Opec countries and then on June 23 with their non-Opec partners," EIU said.

In November 2016 Opec and major non-Opec exporters, particularly Russia made a decision to cut nearly 1.8mn barrels per day (bpd) from supply. This had a dramatic impact on the oil market, particularly from mid 2017 after compliance began to improve, and the deal was twice extended, first until March 2018 and then until December. A pick-up in the global economy, boosting demand, and problems with some producers, notably Venezuela, which saw them producing below their Opec quota, added to the upward pressure on oil prices, which rallied by more than 50%, hitting a four year high of \$79/barrel in May, a level which had seemed almost inconceivable back in 2016, when prices averaged just \$44/b.

"However, the success of the deal in bolstering prices stoked

complaints from oil consumers – notably the US president, Donald Trump – and added to worries of a repeat of the previous crash, as high prices motivate investment in new capacity outside the exporter bloc, particularly in US shale. “This all led to a growing consensus that the exporters need to release more oil to put a ceiling on prices,” EIU said.

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## Turk Economy Czar Sees Curbing Inflation Top Priority



- Berat Albayrak uses first interview to highlight policy goals
- Erdogan's son-in-law says Turkish central bank is independent



Treasury and Finance Minister Berat Albayrak pledged to rein in inflation and highlighted central bank independence in his first interview since his appointment, suggesting his policies will focus on Turkey's key vulnerabilities.

Turkey's independent central bank will do what economic realities and financial market conditions dictate, state-run Anadolu news agency cited Albayrak as saying on Thursday. The appointment of Albayrak, President Recep Tayyip Erdogan's son-in-law, on Monday sparked concerns that his policies would mirror the Turkish leader's growth-at-all-costs approach.

"Our policies will take shape based on the framework of stable and sustainable growth, with priority given to budget discipline, single-digit inflation and structural reforms," Albayrak was quoted as saying. The fact that the bank's independence is subject to speculation is "unacceptable," he added. The lira gained.

Read more on Albayrak: Running Turkey's Economy Is Now a Family Business for Erdogan

Albayrak's comments were intended to signal what his policy priorities will be. The lira weakened nearly 7 percent following the announcement of Turkey's new government on Monday, with investors worried about what the new economic administration would bode for the central bank's autonomy.

Albayrak said the central bank will be more "active" than ever, and the government will assist it by coordinating fiscal and monetary policies. He vowed to eventually bring inflation to the official 5 percent target.

The lira, which had weakened to a record low of 4.9743 per dollar during Asia trading hours, strengthened after the remarks and was trading 1.3 percent higher at 4.8137 per dollar at 2:18 p.m. in Istanbul.

The minister needs to deliver on his words in order to dispel

concerns over the future of monetary-policy making, said BlueBay Asset Management strategist Timothy Ash.

“Finally he speaks, talking the talk,” Ash said by email. But Albayrak “needs to walk the walk by tightening policy in a convincing way.”

Rabobank emerging-market currency strategist Piotr Matys described the remarks as “relatively reassuring.” The bank was maintaining for now its “very cautiously optimistic view” that the new administration may “rebalance the overheated economy and focus on implementing structural reforms over the next two years,” he said in an emailed note.

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## **Time running out for Brexiteers**



By Gwynne Dyer/Washington, DC

Even with Donald Trump scheduled for a brief visit to the United Kingdom this week amid massive protests, it's still 'all Brexit, all of the time' in the sceptred isle – and the long struggle over the nature of the deal that will define Britain's relationship with the European Union post-exit allegedly reached a turning point last weekend.

"They had nothing else to offer. They had no Plan B. She faced them down," said a senior government official about the hard-line Brexiteers after Prime Minister Theresa May got them to sign up to a so-called 'soft Brexit' at a crisis cabinet meeting last Friday. But the armistice between the 'Leave' and 'Remain' factions in her fractious Conservative Party lasted less than 48 hours.

On Sunday morning hard-line Brexiteer David Davis, the ludicrously titled Secretary of State for Exiting the European Union, reneged on his short-lived support for May's negotiating goals and resigned in protest. Then Foreign Secretary Boris Johnson followed suit, claiming that May's plan meant "the (Brexit) dream is dying, suffocated by needless self-doubt."

The sheer fecklessness of the 'Brexit dream' is epitomised by Johnson, who first compared May's negotiating plans to "polishing a turd", then came round to supporting them for about 36 hours, and finally resigned, saying that they would reduce the UK to a "vassal state" with the "status of a colony" of the EU. Yet at no point in the discussion did either of them offer a coherent counter-proposal.

And what is all this Sturm und Drang about? A negotiating position, devised by May with great difficulty two years after the referendum that yielded 52% support for an undefined 'Brexit', which could never be accepted by the European Union. Its sole virtue was that it seemed possible to unite the 'Leave' and 'Remain' factions of the Conservative Party behind it. But the unity imposed by May broke down before the weekend was over.

All four of the great offices of state – prime minister, chancellor (finance minister), foreign secretary and home

secretary (interior minister) – are now held by Conservative politicians who voted Remain in the referendum. Yet they are unable to persuade their party to accept even a ‘soft Brexit’ that preserves Britain’s existing access to its biggest trading partner, the EU.

The Brexiteers’ power lies in their implicit threat to stage a revolt that overthrows May, fatally splits the Conservative Party, and precipitates an early election that brings the Labour Party to power. They may not really have the numbers to do that – it’s widely assumed that a majority of the Conservative members of parliament secretly want a very soft Brexit or no Brexit at all – but May dares not test that assumption.

So, horrified by the prospect of a Labour government led by Jeremy Corbyn (who is regularly portrayed by the right-wing media as a Lenin in waiting), the Conservatives are doomed to cling desperately to power even though they can probably never deliver a successful Brexit. And the time is running out.

The United Kingdom will be leaving the European Union on March 29 of next year whether there is a deal that maintains most of its current trade with the EU or not. In practice, the deadline for an agreement is next October, since time must be allowed for 27 other EU members to ratify the deal. If there is no deal, the UK simply ‘crashes out’, and chaos ensues.

The volume of trade in goods and services between the United Kingdom and the rest of the EU is so great, and the preparation for documenting the safety and origins of goods and collecting customs on them so scanty, that the new border would simply freeze up.

That would cause great difficulty for many European enterprises, but for Britain it would be a catastrophe. As an example, two-fifths of the components for cars built in the UK are sourced from elsewhere in the EU. Yet most of the time available for negotiating a soft Brexit has already been wasted, and Britain still does not have a realistic negotiating position.

This preposterous situation is almost entirely due to the

civil war within the Conservative Party between the Brexit faction the rest. The only reason that there was a referendum at all was because former prime minister David Cameron thought that a decisive defeat in a referendum would shut the Brexiteers up and end that war. He miscalculated.

The Brexiteers spun a fantasy of an oppressive EU that was the cause of all Britain's troubles and sold it to the nostalgic older generation, the unemployed and underemployed who were looking for somebody to blame, and sundry nationalists of all colours.

They narrowly won the referendum with the help of a rabidly nationalist right-wing press, spending well beyond the legal limits in the campaign – and, it now appears, with considerable support from Russia. (The biggest contributor to the Brexit campaign, mega-rich investor Arron Banks, met the Russian ambassador at least eleven times during the run-up to the referendum and the subsequent two months.)

There's still a chance that reason will prevail before the UK crashes out of the EU, of course. But the odds are no better than even.

\* Gwynne Dyer's new book is *Growing Pains: The Future of Democracy (and Work)*.

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## **Libya's National Oil Corporation to re-open key southern oilfield**

Libya's National Oil Corporation (NOC) said yesterday it will re-open a southern oil field and resume production within 48 hours, after announcing a resumption of exports in the eastern

oil crescent. The NOC announced “the lifting of force majeure” at the Al-Fil field, in place since February 23, in a statement on its website.

Production would resume at an initial rate of “50,000 bpd (barrels per day) within two days and (rise) to 72,000 bpd three days later”, the NOC added. Production stopped at Al-Fil due to a strike by the local branch of the Petroleum Facilities Guard, which demanded higher salaries.

The NOC said “the dispute regarding pay and benefits was brought to an end” at the field. Al-Fil is in the Marzuq basin in the southwest of the country and is managed by Mellitah Oil and Gas, a joint venture between NOC and Italian firm Eni. Separately, the NOC on Wednesday said it was resuming exports from terminals in eastern Libya’s oil crescent after shipments were stopped for more than two weeks due to a standoff between rival political administrations. Exports from all four of the eastern ports had been suspended after military strongman Khalifa Haftar’s self-styled Libyan National Army regained full control of the region from a rival militia in June.

Haftar refuses to recognise the authority of a UN-backed government based in Tripoli and supports a parallel administration in eastern Libya. Libya’s oil output will keep dropping day by day if major ports remain closed, the head of the NOC had said last week, a Bloomberg report said last week. “Today, production is 527,000 barrels a day, tomorrow it will be lower, and after tomorrow it will be even lower and every-day it will keep falling,” Mustafa Sanalla, chairman of the NOC said in a video statement posted on the company’s Facebook page. The nation was producing more than twice that amount before fighting in February forced an oil field in western Libya to shut down, he said. Haftar’s forces had given control of the ports to a separate oil authority in the eastern city of Benghazi, after recapturing them from a rival militia.

The US, the UK, France and Italy expressed concern about this transfer to an entity other than the NOC. The surprise handover led to a halt in shipments from the ports of some 850,000 barrels a day. Libya's instability in complicating Opec's effort to pump more crude as well as UN-backed efforts to hold elections this year. Haftar's forces said their army was not receiving payments for protecting oil facilities.

Sanalla said in the video statement that crude revenue is sent to the central bank and that the NOC isn't responsible for how it gets distributed. "I understand Haftar's feeling," Sanalla said. "He must be frustrated like most Libyans, but do we express this disappointment by halting exports? I don't think this is right. We all agree that the situation is not right, that national wealth is not utilised to its best."

While Libya holds Africa's largest oil reserves, years of conflict among armed groups competing for influence over its energy riches have hobbled production and exports since a 2011 revolt led to the ouster and death of former strongman Muammar al-Gaddafi. The economy's decay economy has stoked anger in eastern Libya over a perceived misuse of funds and a view that that too much wealth is concentrated in the west. Libya was pumping about 1.3mn barrels of crude a day in February before militias closed the western 80,000-barrels-a-day Elephant, or El-Feel, field in February, Sanalla said on Saturday.

Output will continue to decline if the five ports recaptured by Haftar stay closed, he said. Oil facilities in the Gulf of Sirte along the central coast are old and in poor condition, and only four of 13 storage tanks at the port of Ras Lanuf are currently operational, he said.

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# Why Saudi's Aramco IPO won't happen: It's a bad investment



Bloomberg/London

It was the moment Saudi Arabia's reforming young prince told the world he meant business. In early 2016, Mohammed bin Salman said he planned to sell shares in the kingdom's crown jewel: Saudi Aramco, the giant energy company that produces 10% of the world's oil and finances the Saudi state. The initial public offering – planned for 2018 – would be the deal to end all deals, raising more than \$100bn for a new sovereign wealth fund, creating the world's most valuable listed company, and funnelling hundreds of millions of dollars in fees to Wall Street's elite banks. MBS, as the 32-year-old crown prince is known, said the company would be worth at least \$2tn – more than double the current market valuation of Apple Inc – and perhaps as much as \$2.5tn.

Two years later, things look very different. A combination of hubris on the valuation, an overambitious timetable, and indifference – if not derision – from global investors doubtful that an IPO would benefit them, has forced Riyadh to



delay the sale until at least 2019. And many observers – including members of the company’s senior leadership – doubt whether it will happen at all. Aramco has become the zombie IPO.

Add Donald Trump to the mix. While the US president has said he’s excited about the idea of Aramco selling shares in New York, keeping the price of gasoline under control seems far more important. With Republicans facing tough midterm elections in November, he’s pressured Saudi Arabia to pump more oil, and cheaper crude means a lower valuation for the company.

For MBS, the IPO has faded in importance as he grapples with an agenda crowded with social and economic reforms at home and an assertive foreign policy. He may also not need the money as much as he did at the outset of his mission to change the country. Saudi authorities this year reached agreements to recover more than \$100bn (the same amount the Aramco IPO was supposed to provide) from a controversial corruption investigation that saw many of the kingdom’s most prominent subjects imprisoned at the five-star Riyadh Ritz-Carlton.

Already, senior officials have started to soften expectations for the IPO. “The timing isn’t critical for the government of Saudi Arabia,” Khalid al-Falih, the energy minister, told an industry conference in June. While “it would be nice if we can do it in 2019,” the minister said, “there is a lot more at stake than just ticking a box and say, ‘We got this out of the way.’ ” Aramco didn’t respond to requests for comment for this story.

Delaying the IPO beyond 2019 – or even shelving it – would be a setback to MBS’s plan to transform Saudi Arabia and leave the kingdom open to suggestions that it’s not truly serious about overhauling its economy. But it would also be a victory for environmentalist in Europe and America who say international investors should begin turning their back on oil and prepare for the switch to an electric transport system.

Aramco is a company like no other. Its profits easily outstrip those of every other company on Earth, from Apple to Exxon

Mobil Corp. The billions of petro dollars it pumps out every month underpin the kingdom's decades-old social contract: generous state handouts in return for the political loyalty that maintains stability in the country. Those dollars also finance the lavish lifestyles of hundreds of princes. For decades, diplomats have joked that Saudi Arabia is the only family business with a seat at the UN. As the world's largest petroleum producer, Aramco is key for global economic growth and international security. At one point during the Arab oil embargo in the 1970s, the US even considered the possibility of seizing the company's oil fields by force, according to declassified British intelligence papers.

The company finds itself caught in geopolitical crosswinds once again. Riyadh needs higher oil prices to fund its national budget and get the Aramco valuation closer to the \$2tn target MBS wants. But that's antagonising Trump – Saudi Arabia's most important ally – and other customers, notably China and India, the world's second- and third-largest oil consumers.

On April 20 the US president took to Twitter to lambaste the Saudis' push for higher oil prices. "Looks like Opec is at it again," Trump tweeted. "Oil prices are artificially Very High!" Since then, Trump has issued more tweets about oil, Saudi Arabia, and the Organisation of Petroleum Exporting Countries. In one, he said he'd persuaded Saudi King Salman to raise production in order to lower prices.

The problem isn't just Washington, Beijing, and New Delhi. Moscow, which for the last two years has supported the Saudis in boosting oil prices by curbing oil output, has called time on the production cuts. Vladimir Putin said at the end of May that Moscow would be happier with \$60 a barrel than the \$80-plus the Saudis are aiming for.

The Saudis duly delivered. In late June they announced that Opec and its allies will increase production by as much as 1mn barrels a day – equal to about 1% of global demand. At the St Petersburg International Economic Forum, al-Falih pledged to do "whatever is necessary to keep the market in balance,"

echoing the famous pledge made by Mario Draghi, the head of the European Central Bank, to save the single currency at the height of the euro crisis in 2012.

All of a sudden, Riyadh couldn't push for the higher oil prices it needs to achieve the Aramco valuation it wants. "This is a pivotal change from recent months," says Olivier Jakob, managing director of Swiss-based consultant PetroMatrix GmbH. "We are back to the days when Saudi Arabia had to respond to US requests for a cap on gasoline prices."

The IPO process started in January 2016, when MBS told the Economist that Riyadh was considering selling shares in Aramco, which the kingdom nationalised in 1976 when it took over the stake of its American owners. "Personally, I'm enthusiastic about this step," he said. "I believe it is in the interest of the Saudi market, and it is in the interest of Aramco." Nowhere was the surprise greater than at Aramco itself, where senior officials weren't expecting the announcement, according to people with direct knowledge of the events who asked not to be named to avoid damaging their relationships with the kingdom.

For months, Saudi officials said again and again the IPO was "on track, on time" for the second half of 2018, with a sale on both the Tawadul, the local stock market, and a foreign stock exchange, most likely New York or London. Late last year, Saudi officials poured cold water on the foreign exchange, sketching a plan for a far less ambitious IPO just in Riyadh.

Then, earlier this year, when it became obvious the process was delayed, officials shifted their narrative, saying the sale would happen "most likely" in 2019. Now the guidance has weakened again. The Saudis are adamant the IPO has simply been delayed rather than cancelled. Yet signs the deal is deep in the long grass abound.

Inside Aramco, key executives working on the project have left or moved. Abdullah bin Ibrahim al-Saadon, a 30-year veteran who as chief financial officer was the most senior executive working on the IPO's day-to-day preparations, left in June to

become the chairman of the Royal Commission for Jubail and Yanbu. Aramco has yet to announce a permanent replacement for al-Saadani; another executive is working in an acting capacity as CFO. Motassim al-Maashouq, another key executive on the IPO project, has been asked to take on new responsibilities.

Wall Street is also feeling the delay. In January, Aramco called global banks to pitch for IPO roles, joining the lenders that have so far done most of the preparatory work – JPMorgan Chase, Morgan Stanley, HSBC Bank, Moelis, and Evercore. Nearly six months later, banks hoping to win new mandates, including Goldman Sachs Group and Citigroup, are still waiting for a call from the company. “Without explanation, they’ve gone quiet,” says a banker who’d hoped to participate.

The main problem is valuation. There’s a wide gulf between MBS’s ambitious \$2tn target – which the prince says is non-negotiable – and the \$1tn to \$1.5tn that most analysts and investors see as more realistic, according to two persons directly involved in the internal discussions. The gap between what the market thinks Aramco is worth and what the Saudi royals want is so wide that, even at the narrowest end it would overshadow the combined value of America’s two largest oil companies – Exxon Mobil and Chevron Corp. In May, al-Falih said the company was ready for an IPO but investors weren’t. “We are ready,” he said. “We’re simply waiting for a market readiness for the IPO.”

The valuation problem has become more visible after Bloomberg News disclosed the first accountings of Aramco since its nationalisation almost 40 years ago. The leaked documents included the company’s tax regime, until now secret. The accounts showed that Aramco was the world’s most profitable company, churning out \$33.8bn in net income the first six months of 2017 – before taxes. Much of the cash the highly taxed company generates is channelled as royalties into the Saudi government budget. How can investors be sure the government won’t raise taxes on the company to pay for more social or military spending, especially when the government

already needs a price of about \$80 a barrel to break even? Even higher oil prices won't help the valuation as much as they might, because Riyadh has overhauled the royalty system to mean the government gets more cash as crude rises. A marginal rate of 20% of revenue is due for oil prices up to \$70 a barrel, 40% between \$70 and \$100, and 50% above \$100. The government also widened the volume of crude covered by the royalties. Previously, the royalty was applied to exports. Now, it's on production. The increase is almost a third to a fourth of the previous volume covered.

For potential investors, the Aramco conundrum goes beyond the valuation. They may also be spooked by the politics involved in the way oil is priced. Aramco's production has always been determined by the state; it must fit into what's decided by Opec, where Saudi Arabia is the leading member. That creates potential conflicts between what works for the government in Riyadh and what maximises investor returns.

Fund managers also worry that the value of oil fields could dwindle as governments ramp up their efforts to reduce fossil fuel consumption to fight climate change. The spread of electric vehicles, for example, will reduce demand growth over the next two decades. In May a group of investors including Standard Life Aberdeen, Fidelity Investments, and Legal & General Group warned oil companies about the risk of global warming. "As long-term investors, representing more than \$10.4tn in assets," they said in an open letter, they believed "the case for action on climate change is clear."

The government has options should it decide to get the IPO done quickly. It could slash tax rates on the company to juice its valuation and look to take the money back in dividends. A face-saving private placement – selling a stake in Aramco to a Chinese enterprise without the public exposure of how much money was actually raised in the transaction – is also possible. Officials have openly discussed a sale – in effect, a distribution of a few shares each to Saudi citizens – that would take place only in the country's stock market. "I'm sure there will be a form of sale of Saudi Aramco in a market, but

it's unclear which market and exactly how," says John Browne, who ran British oil giant BP Plc for more than a decade.

"I'm reluctant to use the word IPO."

The once-in-a-generation deal MBS promised in 2016 seems a long way off.

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## The global economy's uncertain future



At the start of 2018, most of the world economy was experiencing a synchronised cyclical recovery that seemed to herald a longer period of sustainable growth and an end to the decade-long hangover from the 2008 slump. Despite the shock of Brexit, storm clouds over the Middle East and Korean Peninsula, and US President Donald Trump's unpredictable behaviour, rising investment and wages, alongside falling rates of unemployment, appeared to be in the offing.

Yet, as I warned in January, "the global mood [had] shifted

from fear about political risks to obliviousness, even though many such risks still loom large.” Moreover, while my preferred global indicators were all looking up, I worried about whether that would continue after the first half of 2018, given foreseeable complications such as monetary-policy tightening across advanced economies, especially in the US.

Lo and behold, we are now halfway through 2018, and some of those same indicators are no longer looking quite so rosy. While the US Institute for Supply Management’s June Purchasing Managers’ Index (PMI) remains very strong, other comparable surveys around the world are not nearly as robust as they were six months ago. Most important, business activity has slowed in both China and Europe.

Another key indicator is South Korea’s trade data, which is published monthly and before that of any other country. On July 1, we learned that South Korean exports had fallen year-on-year in June 2018. Whereas 2017 was a record-setting year for the country’s nominal export strength, 2018 has ushered in several months of decelerating performance. Ironically, this slump coincides with improved relations with North Korea, while the strong performance last year occurred in spite of nuclear brinkmanship on the Korean Peninsula.

The weakening of South Korean exports calls for careful follow-up analysis, both of other major economies’ trade data and of South Korea’s July data, when it is published on August 1. Given the worrying escalation of Trump’s import tariffs and the retaliatory measures being pursued by China, the European Union, and others, one should not be surprised if the weakening of global trade persists.

That said, one also should not assume that falling trade numbers are a direct result of tariffs. We do not yet have a full regional breakdown of export performance. But from the data that are available for the first 20 days of June, we can see that South Korean exports to the US and China were actually rather strong; the weakness was in exports to

Association of Southeast Asian Nations countries and the Middle East. If this remains the case, there is less reason to worry that the strong global-trade performance over the past 12-18 months is being thrown into reverse.

After all, we are in a decade in which the world economy is dominated by activity in the US and China. According to my calculations, 85% of the growth of nominal GDP worldwide since 2010 is due to these two countries, with the US accounting for 35% and China accounting for 50%. So, as long as China and the US are doing fine, the global economy can be expected to sustain annual output growth of around 3.4%.

As for the rest of the world, economic indicators from this time last year through early 2018 seemed to suggest that many previously weak performers were finally on the mend. In nominal dollar terms, Brazil, the EU, Japan, and Russia all experienced slight declines since 2010, but showed signs of improvement in 2017.

For example, at this time last year, the EU looked as though it was on the cusp of a robust, widespread cyclical recovery. But that no longer seems to be the case. Key economies such as France and Germany have experienced a slowdown, perhaps owing to fears of a global trade war. And, of course, the plodding Brexit negotiations, Italy's new anti-establishment government, and an intra-EU political crisis over immigration have all created more economic uncertainty. The immigration crisis, in particular, could have severe consequences both for German Chancellor Angela Merkel's government and for EU cohesion.

To be sure, Europe's economic softening could prove temporary, and PMIs for eurozone countries did strengthen somewhat in June, following a couple of months of marked decline. But it would be foolhardy to rule out the worst.

Still, as we have seen, the sustainability of global growth depends largely on the US and China. Obviously, if these two economic giants are going to start trading blows with tit-for-tat tariffs, both will lose – and so will the world economy.



For the US, where consumption accounts for around 70% of GDP, positive international trade and a stable, friendly investment climate are essential for sustainable growth. One hopes that someone close to Trump can turn him around before his policies derail the world's long-awaited recovery. – Project Syndicate

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## The energy implications of the Gulf crisis



Even though energy production and exports are the lifeblood of all Arab states in the Gulf, the present crisis between Qatar on the one hand and Saudi Arabia, the United Arab Emirates, Bahrain, and Egypt on the other has had very little influence on the economics of oil and gas either internationally or within the region. However, the countries involved have a lot to gain from a resolution of the conflict, particularly if it leads to greater energy market integration.

Qatar is the largest producer and exporter of liquefied natural gas (LNG) in the world. It also exports a large share—about 750,000 barrels per day (bpd)—of highly valuable natural gas liquids (NGLs) such as propane and butane, as well as a small amount (600,000 bpd) of crude oil. By contrast, Saudi Arabia does not produce any LNG, but exports about 9.07 million bpd of crude oil, refined oil products, and NGLs.

Because the two countries' production and exports are so different, Qatar and Saudi Arabia do not compete in the same markets. The energy trade links of the Gulf countries have always been between the respective producer and importing countries in Asia, Europe, and the Americas. There are no oil or gas exchanges between Qatar and Saudi Arabia or Bahrain. Hence, the political tensions between these countries have had limited impact on their energy policies.

The UAE and Qatar, for their part, have long-standing energy relations. They jointly built, own, and operate a natural gas pipeline called the Dolphin Gas Project that transports about 2 billion cubic feet per day of natural gas from the North Dome field in Qatar to the UAE for distribution in the Emirates and Oman. The intra-Gulf Cooperation Council crisis has not affected these gas sales, which continue to be of importance to both the UAE and Qatar.

It appears that as far as energy production and exports are concerned, Qatar has not been impacted at all by the embargoes imposed by its Arab neighbors. Gulf exports of gas and oil are transported by ship, and the sea lanes to and from Qatar are open. Qatar can be confident that these lanes will never be closed to enforce the embargo. Indeed, should the Saudis or Emiratis decide to block the lanes out of Qatari ports, Asian and European buyers of Qatari gas and oil would strongly object and in turn could boycott Saudi products. Further, the U.S. could be relied on to maintain the right of navigation for Qatar's products, just as the U.S. Navy would keep the Straits of Hormuz open in the case of Iranian interference.

Saudi Arabia and the UAE are very unlikely to test this premise.

Though the present tensions have not influenced energy production or exports in the region, should tensions ease, both sides of the crisis could benefit. Bahrain, Kuwait, and the UAE are in dire need of natural gas. Bahrain is now building an LNG receiving terminal and Kuwait and Dubai already have one. It is quite nonsensical for these countries to import LNG—which costs a great deal to produce, transport, and re-gasify—when they could get cheap gas directly from short pipelines to Qatar.

Saudi Arabia, which needs more gas to fuel its economic expansion, is spending great amounts to increase production from tight gas formations, when it could obtain much cheaper gas a few kilometers away. The UAE could expand the Dolphin pipeline and provide low-cost gas to all of its emirates rather than invest tens of billions in new LNG plants.

Kuwait could also benefit greatly from an LNG link with Qatar. Kuwait tried to secure funding for a Qatar-Kuwait pipeline in the early 2000s, but the pipeline was vetoed by Saudi Arabia, who already feared Qatari influence on the region. Kuwait has very little gas and is not likely to get substantial amounts from either Iran or Iraq, which have gas but no ability to export it in large quantities to Kuwait. An easing of tensions could translate to a revisiting of the Qatar-Kuwait pipeline dispute with Saudi Arabia.

Egypt, at one point a net exporter of LNG, has in the past five years become a net importer. However, Italian oil and gas company Eni is now developing the Zohr gas field in Egyptian waters north of Alexandria, and Egypt is scheduled to stop all imports of natural gas, though it will be left with little to export. The Qatar crisis is not affecting Egypt's energy needs and energy policy.