

CSAM Commodities Q&A: Attack on Saudi Oil Facilities

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What happened?

Saudi Arabia's Abqaiq processing facility and its Khurais oilfield were attacked by drones on Sunday September 15. It was widely reported that the attack involved 10 drones, launched from Yemen or Iran. The location of the launch is still to be determined and may be significant in terms of what retaliatory actions may be undertaken by Saudi Arabia and/or others.

Brent crude rose to nearly \$72 at the open on Sunday, before closing at \$69.02, up from \$60.22 on Friday. WTI for the same delivery rose from \$54.80 Friday to \$62.67 after trading as high as \$63.89. Petroleum products were all sharply higher as well. All sold off somewhat on Tuesday amid announcements that the facilities may be back online by the end of September, as reported in the afternoon by the Saudi Energy Ministry.

The Khurais oilfield can produce around 1.5 million barrels per day (bpd) and is Saudi Arabia's second largest onshore oil field. It produces light crude oil, though heavier and more sulfurous than West Texas light sweet crude.

The Abqaiq processing facility is even more important to Saudi Arabian crude production and export and thus to global prices. It is the largest oil processing center in the world, with over 7 million bpd of capacity. It is something of a pipeline crossroads for the kingdom, built by Saudi Aramco to clean up heavy sour crudes and process natural gas liquids to make them more valuable and tradeable and to send them to its major ports for exports.

How much crude oil does Saudi Arabia produce?

Saudi Arabia was pumping around 9.8 million bpd before the incident. The highest level they have ever produced is a little over 11 million bpd (IEA). Saudi Arabia's oil minister today announced that they will be back to full capacity by month end, able to produce over 11 million bpd. However, this does not mean they will be producing that much oil. They have been purposefully leaving some of their production idle, since they struck a deal with OPEC and partners to restrict supply in an effort to support prices since December 2018, when they were producing around 10.55 million bpd. For context, the United States produced around 12.4 million bpd as of the latest data from the US DOE as of 09/06/2019.

How much crude oil production is expected to be offline due to the attacks?

It was reported by Saudi Aramco that 5.7 million bpd was offline due to the attacks. This is due to a combination of production losses and processing losses. Saudi Arabia represented around 10% of global oil production as of July 2019 (IEA). The losses represent around 6% of global crude production.

Which countries will be most affected by this?

China is one of the largest importers of Saudi crude, importing around 1.5 million bpd and one of the fastest growing importers. It is likely Saudi Arabia would prioritize China for these reasons, so they may remain relatively unaffected directly, though they will still be impacted if crude prices go higher due to lower supply availability (IEA). Japan, Korea, and Taiwan all also import Saudi crude and may be more impacted. They are already facing reduced export capacity due to the existing Iran sanctions.

How long is this expected to last? What can be done to alleviate the short term effects?

This is one of the biggest unknowns: how much will be out for how long. The Saudi oil ministry on September 17th said they would fully be operational by month end. Assuming this is the case, then a US Strategic Petroleum Reserve (SPR) release, or release of other IEA member nations strategic inventories may not be required. President Trump indicated this amid the press conference given by the Saudis.

OPEC spare capacity as of July 2019 was around 1 million bpd, which was almost all in Saudi Arabia. Russia, party to the OPEC production cut agreement, would be the largest source of available spare capacity outside of Saudi Arabia, with around 300 thousand bpd of idle capacity. They could probably bring this back online within a few weeks or months if the outage were to last longer.

A US SPR release could help alleviate some of the burden. The SPR contains 648 million barrels as of the latest data provided in March 2019, by the US Department of Energy. The US consumes around 20.1 million bpd. So, the SPR represents around 30 days of demand cover (DOE) or around 96 days of import cover, with the US importing around 6.7 million bpd. The US has grown exports significantly over the past several years, given the large increase in US crude oil exports, with exports reaching 3.3 million bpd as of September 6th 2019. So, the US SPR is currently around 309 days of net imports. There can be issues with quality of the barrels released and they need to be transported to refineries, pipelines, etc., but the US currently is sitting on a fairly comfortable amount of inventories, which could help alleviate price spikes at least in the short term.

What have we seen in the crude oil market since then?

Since the attack over the weekend, we have seen what seems to be significant producer hedging. Many producers have been waiting for prices to rise above \$55 to hedge. On Monday, prices rose above that level all the way out through contracts for December 2020 delivery. As a result, producers were very active sellers of deferred crude oil contracts, allowing them to lock in prices for future production. Speculative length, including CTA's had been very light with net managed money for crude and petroleum products near their lowest levels over at least the past 3 years and well below levels from fall 2018, when crude prices fell from \$75 to \$80 ahead of the OPEC production cut agreement, per CFTC data through September 9, 2019. The CFTC has not published positioning data yet that includes data for this week. The report we receive on September 20th will shed light on how much length was added on September 16th. However, it is likely that we will see an increase in long positions amid what were record levels of volume trading and also covering of short positions.

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