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Feud Between Brothers:
the GCC rift and implications for oil and gas markets

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Earlier this week, Saudi Arabia, the UAE, Bahrain and Egypt cut diplomatic and economic ties with Qatar, accusing Qatar of supporting extremism. The measures are of unprecedented severity in modern GCC diplomacy with adverse consequences for Qatar, not least for its reputation as a business and international and regional transit hub and a host for international events, including the 2022 World Cup.

While efforts at mediation are underway, it will be difficult to bridge the gap between Qatar and Saudi Arabia and its closest allies. At the root of the dispute is a fundamental difference in foreign and regional policy. For years now, Qatar has operated a pro-active foreign policy, supporting the Muslim Brotherhood and its affiliated militant groups across the region. Supporting such groups has helped Qatar punch above its weight and establish itself as a key player in the region’s affairs. Qatar has also been able to shield itself, so far, from being a target of these militant groups. In contrast, Saudi Arabia and the UAE have long-standing bans on the Muslim Brotherhood and consider the movement to be a major threat to their countries’ political stability. So it should come as no surprise that Qatar and Saudi Arabia have found themselves pitched against each other in regional power struggles in places like Egypt, Syria, Libya and Palestine. Also, Qatar has always adopted a cautious approach towards Iran, eager to promote economic and cultural links whilst being careful not to provoke the country that controls the other half of the North Field (known as South Pars in Iran). Saudi Arabia on the other hand considers Iran a threat, and a destabilizing regional force, that should be confronted by building an alliance with the US and other Muslim countries.

Although the rift between Qatar and Saudi Arabia is nothing new, some new factors have played a role in the recent escalation: President Trump’s support for Saudi Arabia on Iran and terrorism; the subsequent spat over remarks attributed to the Qatari emir critical of Saudi policy and warning against isolating Iran as a regional and Islamic power; and payments reported to have been made by Qatar for the release of hostages held in Iraq.

Further escalation is unlikely, but the dispute will not be resolved anytime soon - unless Qatar makes some very painful concessions. Therefore, oil and gas markets should prepare for a flow of headline news, which could induce erratic volatility, despite the impact of the current escalation on oil and gas market fundamentals being rather limited.

In terms of the oil market, we expect a limited impact on balances or prices. Qatar’s crude oil production has been in decline for many year and currently stands at around 0.6 mb/d, with limited upside potential. The extraction of natural gas from the North Field is associated with the production of large volumes of condensates and NGLs, exceeding the volume of crude oil production. There has been some speculation that the present dispute could derail the current OPEC-NOPEC deal, but there is no basis for such speculation. After all, many OPEC members are politically opposed (for instance Iran and Saudi Arabia) and more recently Russia and Saudi Arabia succeeded in forging an output deal despite the fact the two countries disagree on many key issue including Syria, Yemen and Iran. But even in the unlikely event that Qatar’s membership of OPEC is revoked, Qatar is one of the organization’s least significant oil producers, accounting for under 2 per cent of group oil output and its contribution to the current output cut is minimal. However, the closure of the maritime space will disrupt some traditional shipping routes, as Qatari crudes are often co-loaded into Very Large Crude Carriers (VLCCs) with other crudes from the region. Platts, the price reporting agency, has already restricted Qatari loading crude in its pricing process. On the demand side, given Qatar’s importance as a regional and international air travel hub, short-term demand, especially for jet fuel, may be affected as many flights out of Qatar have been cancelled. If the current restrictions are long lasting, then there is a serious risk to Qatar’s ambition of becoming an international and regional transit hub.

In terms of the gas market, Qatar is a global LNG player. Its LNG exports only began in December 1996, but they have risen rapidly reaching the current capacity of 78 million tons per annum (mtpa). Because it is located roughly equidistant between the major consuming centers of Asia and Europe, Qatar sells its LNG to markets in both the Atlantic and the Pacific Basins and has held a strategic role as a ‘swing supplier’ between these regions. This has given it an importance in world LNG markets even beyond that resulting from its large LNG export volumes.

Despite Qatar’s massive gas production and the potential to satisfy growing demand from its GCC neighbours, its regional pipeline exports remain limited. Plans for a GCC-wide gas grid failed over a series of political rows, tensions and pricing issues. A smaller version of the gas grid concept has translated into the Dolphin pipeline, which transports Qatari gas at relatively low cost to the gas-hungry markets of Abu Dhabi and Oman.

Will the current dispute affect Qatar’s gas exports? For now, there is no indication that Qatar’s exports of LNG, oil or NGLs will be impeded and there are reports that Qatar's leading clients in Asia have received reassurances that supplies would continue as usual. However, bunkering at Fujairah has been halted for Qatari-flagged vessels or those heading to or leaving Qatar and therefore Qatari ships may be forced to operate in the Iranian Exclusive Economic Zone (EEZ) waters if they are banned from the Emirati EEZ. According to some reports, this is already creating chaos, pushing shippers to find new points for refueling with the risk of increasing costs and delaying deliveries. Qatar shipping should retain use of the Suez Canal, which is governed by international agreements. But Egypt could reduce the canal-fee discount offered to LNG ships, making transits more expensive for Qatari LNG carriers and reducing Qatari LNG competitiveness in the European market. Pipeline gas (Dolphin pipeline) and LNG exports to the UAE are set to continue for now, as are LNG exports to Egypt, delivered through trading companies. The UAE may attempt to source some additional LNG cargoes to try and reduce its imports of Qatari gas (currently 2bn cf/d) via the Dolphin system, which would put pressure on spot prices, though such pressures are likely to be short lived as the LNG market is well supplied. In the unlikely event that Qatar completely cuts, or the UAE attempts to completely cease, pipeline gas supplies, this would probably require UAE to suspend most, and Oman some, of its LNG exports; and should this be accompanied by restrictions on Qatari exports, the global LNG market would take a big hit. Egypt could bar LNG of Qatari origin, but there is no evidence yet that Egypt will make such a move, especially given that the delivery of Qatari LNG to Egypt is made through traders who own the cargoes and don't use Qatari ships.

While the impacts of the current escalation on energy markets are likely to be limited, the same can’t be said for the stability of the Middle East. The region is already undergoing a ‘regional’ civil war, which has fragmented countries, created new geographical boundaries, weakened the authority of central governments and increased the power of non-state actors. The current rift within the GCC, if not contained, will only amplify the ‘regional’ civil war, increasing the risk of further fragmentation, more intense proxy conflicts, and higher instability, which whilst it may not have a direct impact on immediate oil and gas supplies, may well impact the long-term productive potential of the region.