THE OXFORD INSTITUTE FOR ENERGY STUDIES

Heightened Geopolitical Risks in the Middle East and Potential Impacts on Oil Markets

Bassam Fattouh
Oxford Institute for Energy Studies

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Changing Nature of Geopolitical Risks

- The nature of geopolitical risks in MENA region have changed and are becoming more complex
  - Reconfiguration of borders
  - Fragmentation of some states and rise of non-state actors and local power centers
  - Consolidation of power with domestic and regional repercussions
  - Heightened regional confrontation and proxy wars
  - Changing roles of international and regional actors
- Overall, there has been a general deterioration in the geopolitical backdrop, but the short-term impacts on oil and gas markets have been limited
  - Output losses from the region have been limited in the last few years
  - Libya output has recovered from low levels (but below its pre-2011 levels)
  - Did not preclude OPEC/NOPEC reaching an agreement on oil output cut
  - When stocks were high, the market barely reacted to geopolitical flashpoints
- However, geopolitical backdrop is having some more subtle longer-term impact
  - Higher spending requirements which require higher oil prices
  - Affecting the long-term productive capacity of many oil producers
    - Will the lowest cost producers be able to develop their reserves?
- As the overhang has been eroded and spare capacity is thin, geopolitical events will have bigger impact on markets, but the impact will remain small in the absence of large supply disruption

Divergent Dynamics: Fragmentation versus Consolidation

Fragmentation and Rise of Non-State Actors

- The eclipse of the central state and its formal institutions in many parts of MENA
  - Weakening of states' formal institutions (army, security, judiciary)
  - Legitimacy crisis (Libya, Yemen, Syria)
- This has encouraged the proliferation of armed non-state actors and rise of local power centers
  - Hizbollah (Lebanon), Houthis (Yemen), Libya Dawn (Libya), Hashd al-Shaabi (Iraq), YPG (Syria) just to mention few
  - Rise of local power centers who act strategically and can enter in alliances with or against central authority
  - Have control over large areas in a country and can target infrastructure to improve their bargaining position
- Changed the nature of risk facing oil and service companies: can no longer just negotiate with the central government; but also with local power centers and non-state actors for issues such as access and security

Consolidation of Power in Saudi Arabia

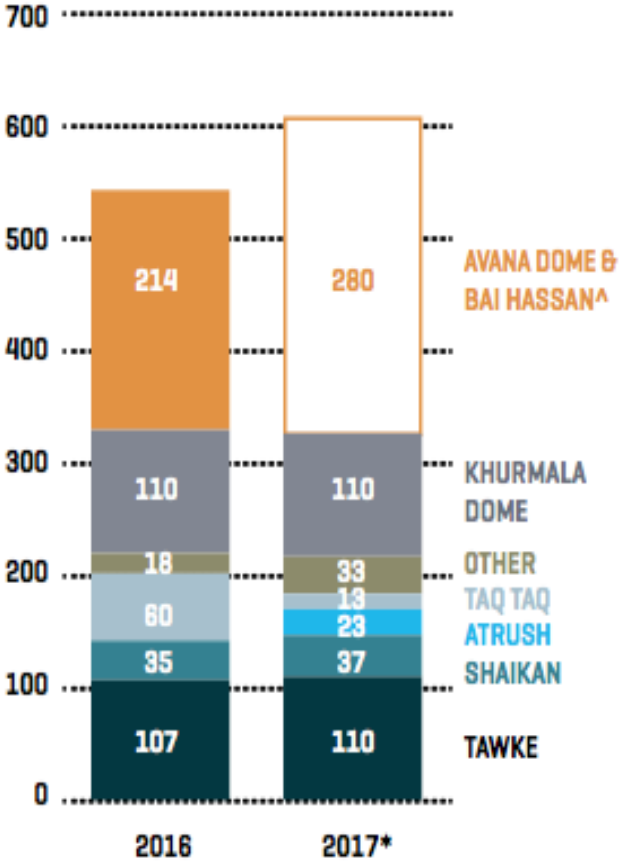
- Unprecedented consolidation of power within the hands of Crown Prince Mohammed Bin Salman (MBS)
  - Positioned himself as a reformer with a vision to transform the economy in very challenging times (Vision 2030: Means and an end)
- A decades-old system of consensus rule dismantled
- Absolute power with little checks and balances
- More assertive foreign policy
- Loss of traditional alliances
  - Key branches of royal family sidelined
  - Crack down on the religious establishment
  - Private sector in recession and corruption probe increased uncertainty
- New alliance: Young Saudis
- Is social opening enough on its own?
- MBS will be judged mainly on the performance of domestic economy (success to create jobs for his 'new' constituency)
- But then successful delivery on the reforms is key

But Output Disruptions have been Limited

KRG Loss of Oil Output

- The defeat of ISIS reopened an old dispute between Baghdad and KRG
- Baghdad retaking Kirkuk in October meant that KRG lost almost half its oil output
- Baghdad limiting flows through the Kurdish pipeline until new deal reached on export volumes and revenue sharing
  - Flows on Kurdish pipeline dropped by few hundred thousand barrels
  - Partially offset by increase in exports from the South and limited exports to Iran from North

KRG Oil Output, mb/d



Source: MEES

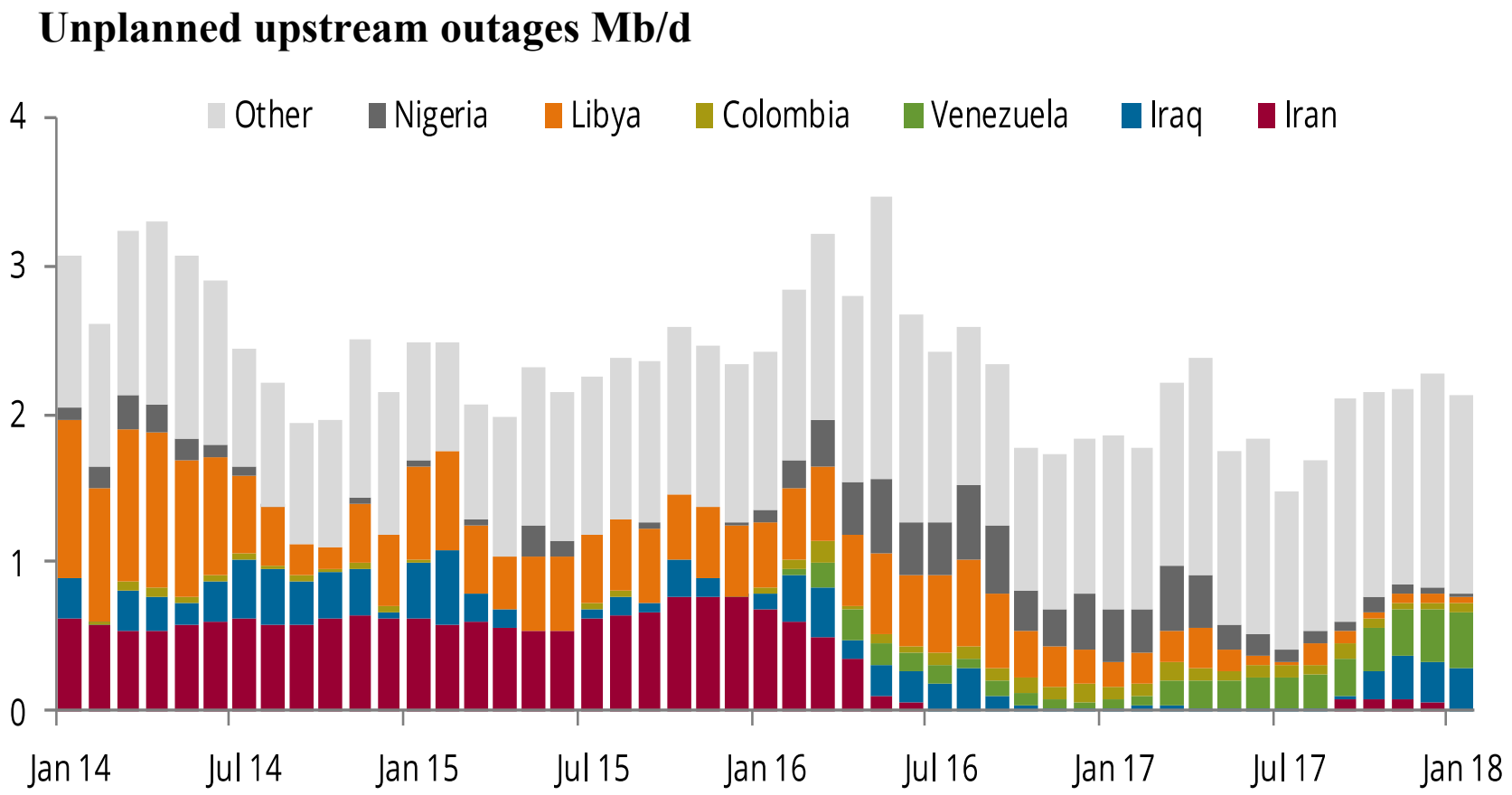
Libya's Volatile Output

- After reaching very low levels, Libyan oil output recovered reaching around 1 mb/d in recent months
- However, output has been highly volatile and the recovery remains fragile as the underlying political problems remain highly unresolved
- Output volatility affected by closure of pipelines, fields, and terminals and often by local power centers demanding jobs, better pay conditions and demanding higher share of the oil revenues

Libyan oil output, mb/d

Source: Energy Aspects

Unplanned Outages in Middle East Receded

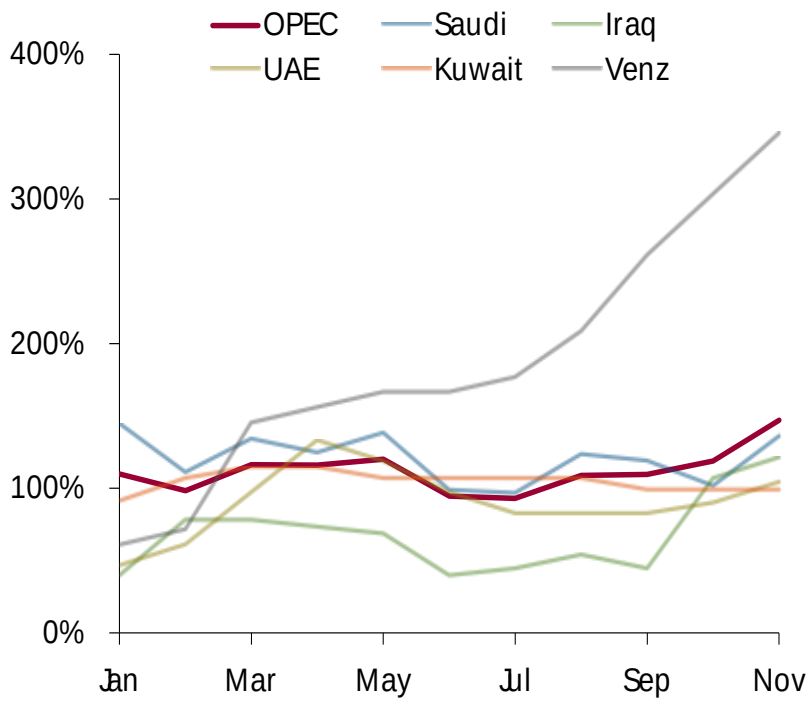


Outages from MENA have receded as Libya increased its production and Iran resumed its production after the lifting of sanctions

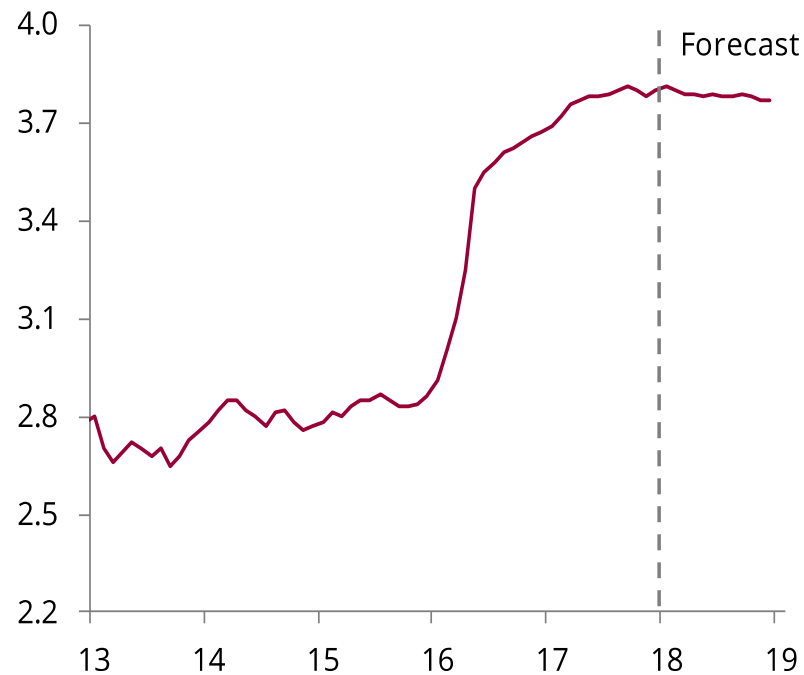
Source: Energy Aspects

No Impact on the OPEC/NOPEC Deal

OPEC Compliance Rate, %



Iran oil output, mb/d



OPEC compliance has been very high defying all expectations

Iran less complicating factor in the OPEC/NOPEC deal as country reached its maximum potential with limited upside from here without attracting foreign investment/technology

Source: Energy Aspects

Impact on Long-Term Productive Potential

The Iran Nuclear Deal: On Life Support?

- Trump refused to certify Iran is complying with the JCPOA but extended nuclear sanctions waiver in January 2018
- But warned that 'This is the last chance' putting pressure on Europeans/US Congress to 'fix the deal' + announced new targeted sanctions against Iranian entities and individuals
- In public, Iran refusing to renegotiate and it will consider any new conditions as a breach of agreement
- In case US decides to withdraw from the deal, US secondary sanctions that impact non-US companies would snap back into place
- Massive uncertainty affecting investment in Iran's energy sector

Table 1: Upstream Contracts Awarded, MOUs for Study, and Heads of Agreement (2016)

Operator	Partners	Field	Date	Type
Lukoil	None	Ab Teymour / Mansouri	24-Jan	MoU for study
Total	None	South Azadegan	24-Mar	MoU for study
Wintershall	None	Four fields in western Iran	12-Apr	MoU for study
OMV	None	Zagros area	04-May	MoU for study
Zarubezhneft	None	Aban / Paydar Gharb	13-Jul	MoU for study
Persia Oil and Gas	None	North Yaran Phase 2	04-Oct	IPC*
Persia Oil and Gas	None	Koupal EOR	04-Oct	IPC
Persia Oil and Gas	None	Maran EOR	04-Oct	IPC
Tatneft	None	Dehloran	08-Oct	MoU for study
PGNiG	None	Sumar	06-Nov	MoU for study
Total (50%)	CNPC (30%), Petropars (19.5%)	South Pars Phase 11	08-Nov	Heads of Agreement
DNO	None	Changuleh	16-Nov	MoU for study
Pergas consortium	None	Shadegan / Rag-e Sefid	23-Nov	MoU for study
Schlumberger	None	Shadegan / Rag-e Sefid / Parsi	27-Nov	MoU for study
PTTEP	None	Changuleh / Balal / Dalamperi	06-Dec	MoU for study
Shell	None	South Azedagan/Yadavaran/Kish Gas	07-Dec	MoU for study
Gazprom Neft	None	Changuleh / Cheshmeh Khosh	13-Dec	MoU for study
Petronas	None	South Azadegan / Cheshmeh Khosh	22-Dec	Mou for study

Source: Energy Aspects[7]

Citing U.S. assets, Total chief says would have to review Iran gas deal if new sanctions arose

Reuters Staff

2 MIN READ

Potential Output Growth Constrained in Other Regions

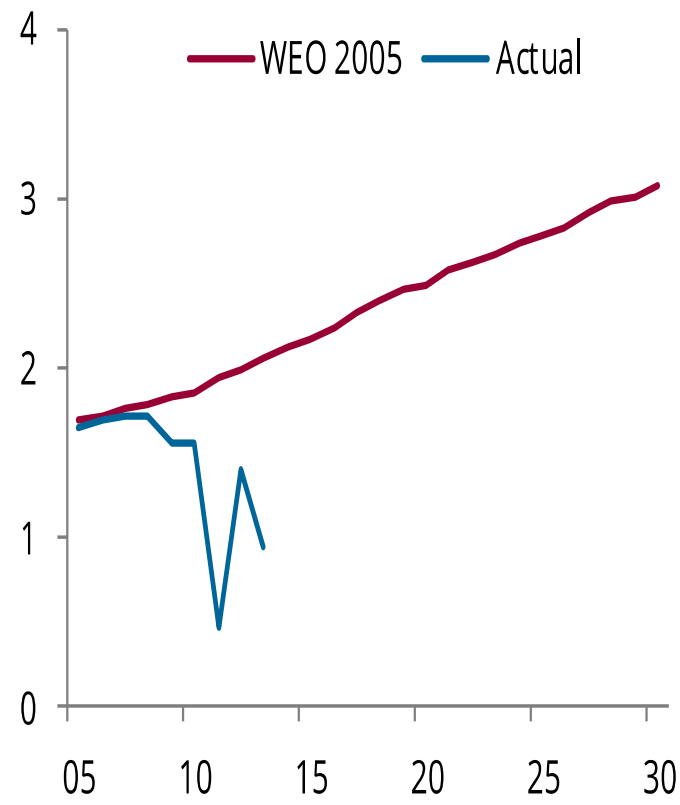
Fig 25: Kurdish field production, thousand b/d

Block (field)	Operator	End-2013 output	Current output	End-2015 target
Khurmala	KAR	70	130	250
Taq Taq	Genel	48	110	225
Tawke	DNO	53	140	150
Shaikan	Gulf Keystone	7	38	150
Garmian	WesternZagros	-	6	60
Barda Rash	Afren	1	-	50
Akri-Bijeel	MOL	-	2	50
Sarsang (Swara Tika)	HKN Energy	-	-	50
Atrush	Taqa	-	-	50
Kurdamir	WesternZagros	-	-	40
Topkhana	Repsol	-	-	30
Hawler (Demir Dagh)	Oryx Petroleum	-	-	25
Gas condensate fields				
Bina Bawi	Genel	-	-	50
Miran	Genel	-	-	50
Khor Mor	Dana	20	20	20
Total		**199**	**446**	**1,250**

Note: Targets from official KRG Ministry of Natural Resources documents published in 2013
Source: KRG MNR, Iraq Oil Report, company reports, Energy Aspects

KRG's ambitious plans to increase productive capacity unlikely to be met in the foreseeable future given the constraints on finance and unstable relationship between KRG and Baghdad

Libya output vs IEA 2005 forecast, mb/d



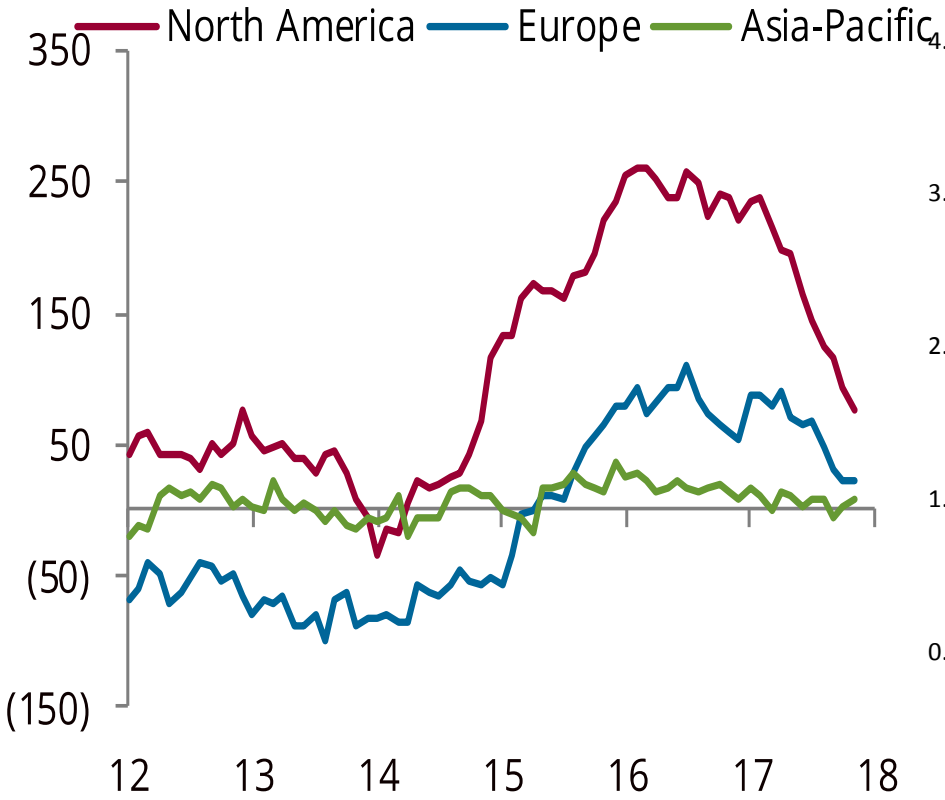
Prior projections that Libya will increase its productive capacity to 3 mb/d will not materialize due to lack of investment in an unstable environment

Source: Energy Aspects, IEA

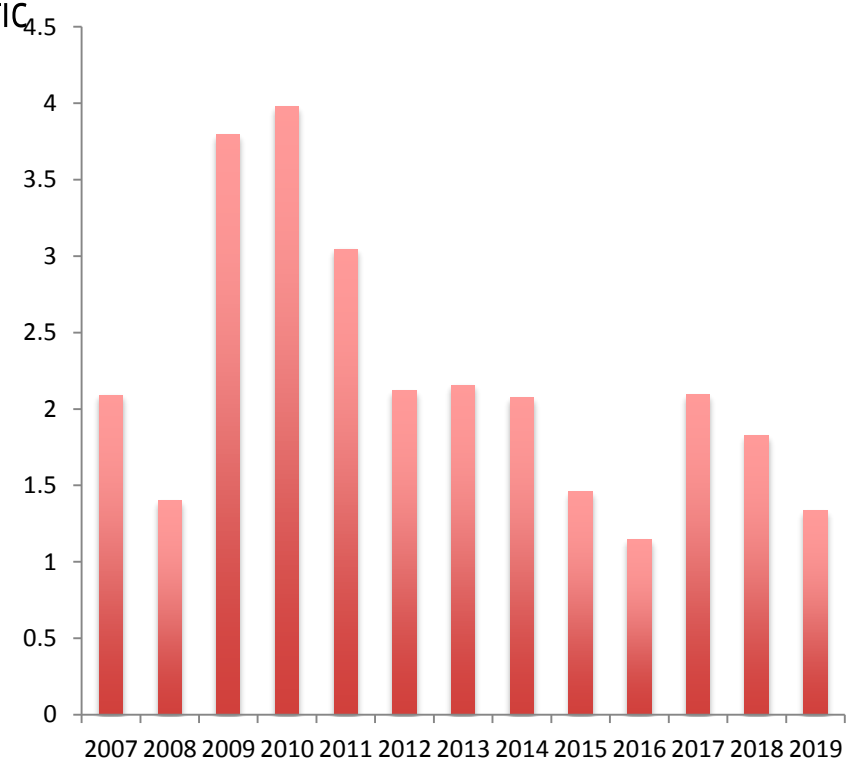
Geopolitical Risk in Tighter Markets

Geopolitical Risks More Important in Tighter Markets

OECD stocks relative to the five-year average Mb



OPEC surplus capacity, mb/d



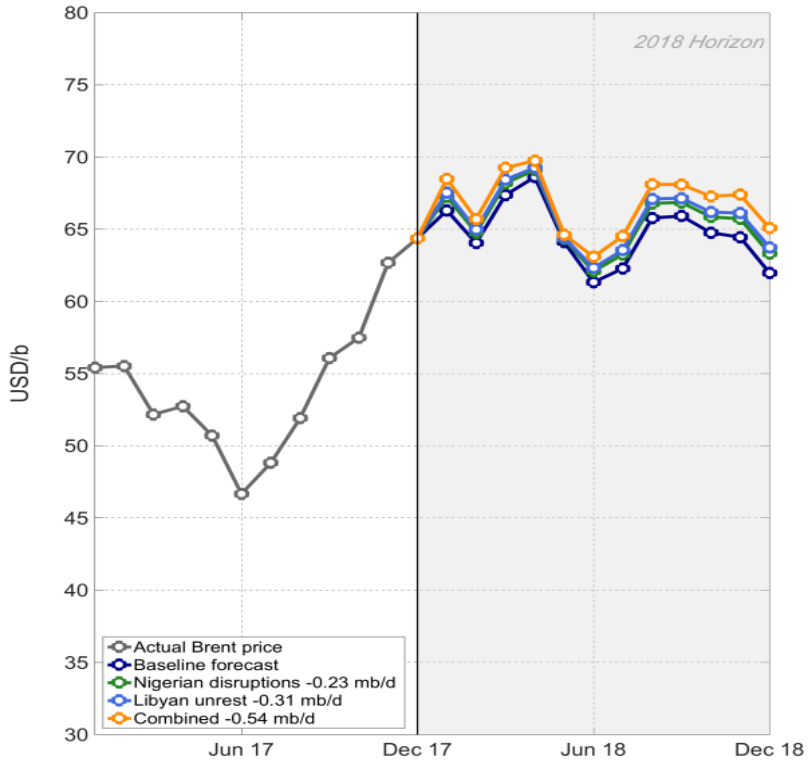
The crude overhang has been largely eroded as a result of stronger demand and OPEC/NOPEC cuts

OPEC spare capacity thinner especially when measured as a percentage of global oil consumption

Source: Energy Aspects, EIA

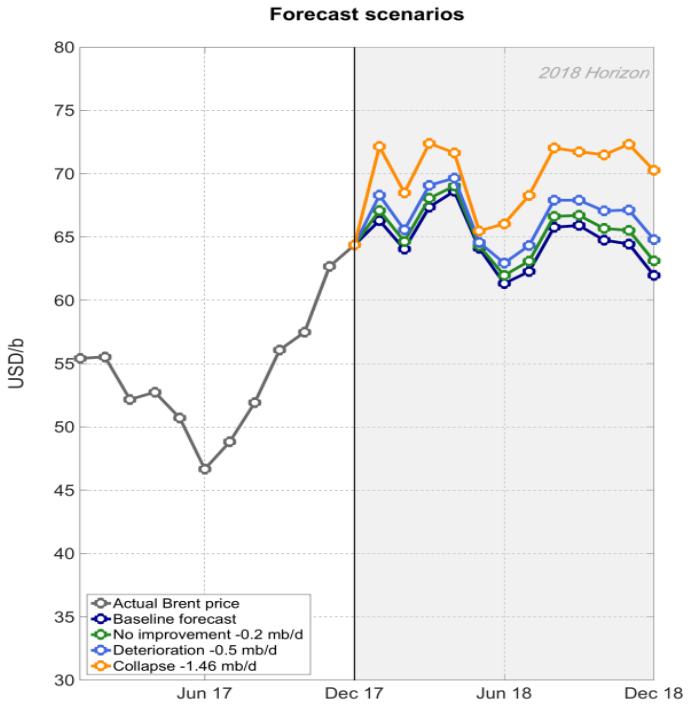
But Impact Limited in Absence of Large Disruption

Libyan and Nigerian geopolitical supply disruption scenarios, in USD/b



Losses from Libya and Nigeria to the January 2017 levels will result in marginal increases in the oil price relative to the baseline forecast

Venezuelan crisis scenarios, in USD/b



An unanticipated collapse of the Venezuelan output in 2018 constitutes the biggest geopolitical risk that could, *ceteris paribus,* push prices well above the $70/b mark

Source: OIES, Oil Price Paths 2018