# Why Saudi Arabia Will Lose The Next Oil Price War

Saudi Arabia has instigated two oil price wars in the last decade and has lost both. Given its apparent inability to learn from its mistakes it may well instigate another one but it will lose that as well. In the process, it has created a political and economic strait-jacket for itself in which the only outcome is its eventual effective bankruptcy. OilPrice.com outlines why this is so below.

The principal target for Saudi Arabia in both of its recent oil price wars has been the U.S. shale industry. In the first oil price war from 2014 to 2016, the Saudi’s objective was to halt the development of the U.S. shale sector by pushing oil prices so low through overproduction that so many of its companies went bankrupt that the sector no longer posed a threat to the then-Saudi dominance of the global oil markets. In the second oil price war which only just ended, the main Saudi objective was exactly the same, with the added target of stopping U.S. shale producers from scooping up the oil supply contracts that were being unfilled by Saudi Arabia as the Kingdom complied with the oil production cuts mandated by various OPEC and OPEC+ output cut agreements.

In the run-up to the first oil price war, the Saudis can be forgiven for thinking that they stood a chance of destroying the then-relatively nascent U.S. shale sector. It was widely assumed that the breakeven price across the U.S. shale sector was US$70 per barrel and that this figure was largely inflexible. Saudi Arabia also held record high foreign assets reserves of US$737 billion at the time of launching the first oil war. This allowed it room for manoeuvre in sustaining its economically crucial SAR-US$-currency peg and in covering any budget deficits that would be caused by the oil price fall. At a private meeting in October 2014 in New York between Saudi officials and other senior figures in the global oil industry, the Saudis were ‘extremely confident’ of securing a victory ‘within a matter of months’, a New York-based banker with close knowledge of the meeting told OilPrice.com. This, the Saudis thought, would not only permanently disable the U.S, shale industry but would also impose some supply discipline on other OPEC members.

Before this latest Saudi-instigated oil price war, the U.S. had little interest in the fact that this US$70 per barrel level was way below Saudi Arabia’s then-budget breakeven oil price. After this latest attack on its strategically vital shale sector, the U.S. has absolutely no interest whatsoever in this budget breakeven fact or indeed in whether Saudi Arabia continues to slowly haemorrhage into bankruptcy in the coming years, according to a number of Washington-based sources close to the U.S. Presidential Administration spoken to by OilPrice.com in the last few weeks. Partly this indifference is due to the perceived ‘betrayal’ of the foundation stone deal that had determined the two countries relationship since 1945. This was that the U.S. would receive all of the oil supplies it needed for as long as Saudi Arabia had oil in place, in return for which the U.S. would guarantee the security of the ruling House of Saud. This altered slightly with the advent of the U.S. shale sector to ensure that Saudi Arabia also allows the U.S. shale industry to continue to function and grow.

Partly as well, this indifference is due to the series of other blunders that senior U.S. politicians believe have been made by Saudi Crown Prince Mohammed bin Salman (MbS), which now make him a liability. This includes – but is not limited to – the Saudi-led war in Yemen, the cosying up of Saudi to Russia in the OPEC+ grouping, Lebanese President Michel Aoun’s allegation in 2017 that then-Prime Minister Saad al Hariri had been kidnapped by the Saudis and forced to resign, and the murder of dissident Saudi journalist, Jamal Khashoggi, which even the CIA concluded was personally ordered by MbS.

These factors culminated in President Trump making his earlier Tweeted implied threat about the fragile hold that the al-Sauds have on power in Saudi Arabia without U.S. assistance into a guaranteed promise during a telephone conversation on 2 April with MbS. During this call, Trump reportedly told MbS that unless OPEC started cutting oil production (with the implication being to push up prices to levels where the U.S. shale producers could start making decent profits) then he would be powerless to stop lawmakers from passing legislation to withdraw U.S. troops from Saudi Arabia. Shortly thereafter, MbS did what he was told. The change in this rhetoric from implied threat to guaranteed action means that this is now in the fabric of all future U.S. dealings with Saudi Arabia and it brings the Saudis crashing back to the basic problem. That is: economically it cannot afford to continue to crush oil prices for long enough to cause sustained damage to the U.S. shale sector, politically it is not permitted to allow prices to rise high enough to avoid eventual effective bankruptcy, and any pricing in between just allows the U.S. shale sector to make greater profits and grow even more. In this regard, the OPEC+ production cuts are perhaps the cruellest cut of all for the Saudis: the Saudis have to implement them and abide by them because they are needed to keep oil prices high enough to ensure the profitability and growth of the U.S. shale sector but the cuts cannot continue for long enough to allow the Saudis back into an ongoing budget surplus.

Already in this context, March saw Saudi Arabia’s central bank depleted its net foreign assets at the fastest rate since at least 2000, falling by just over SAR100 billion (US$27 billion). This is a full 5 per cent decrease from just the previous month, and the total reserves figure now stands at just US$464 billion, the lowest level since 2011. It leaves only US$164 billion of ‘fighting reserves’ that can be used on everything else that Saudi needs when the US$300 billion that is estimated to be needed to keep the economic cornerstone SAR/US$-peg is subtracted. At the same time, the Kingdom slipped into a US$9 billion+ budget deficit in the first quarter and a number of independent analysts are predicting that its overall gross domestic product could shrink by more than 3 per cent this year (the first outright contraction since 2017 and the biggest since 1999), whilst the budget deficit could widen to 15 per cent of economic output.