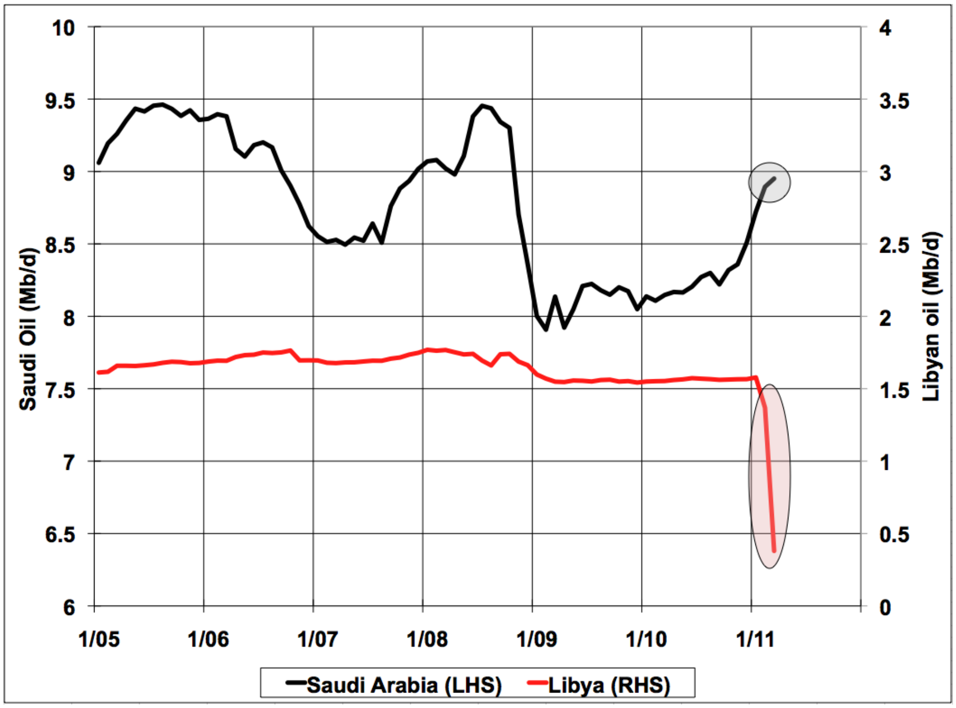
The Oil Drum
DISCUSSIONS ABOUT ENERGY AND OUR FUTURE

Saudi Arabia did not make up for Libyan oil

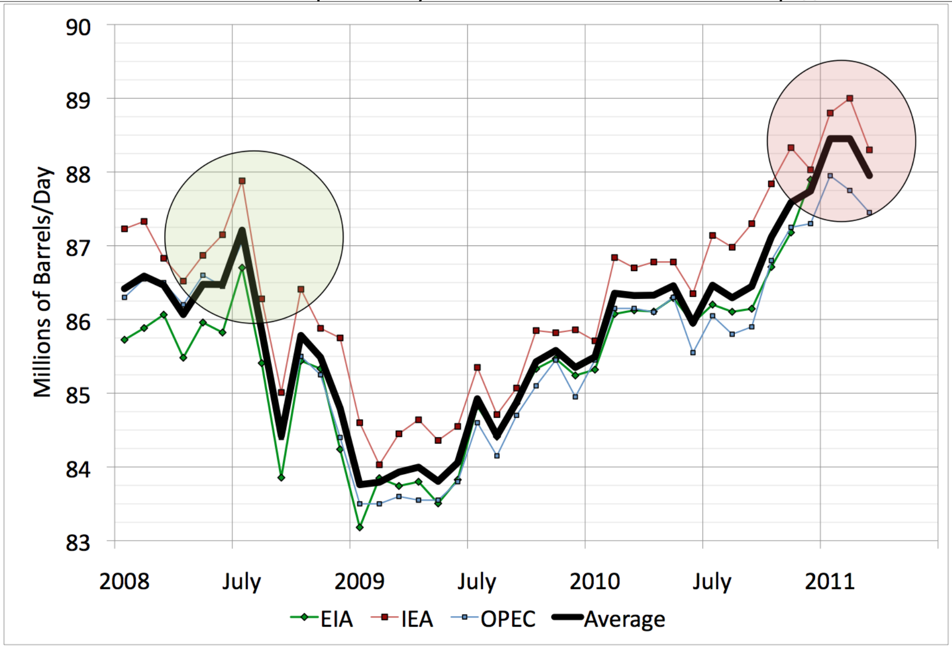
Posted by Stuart Staniford on April 15, 2011 - 10:43am



The OPEC Monthly Oil Market Report and IEA Oil Market Report both came out on Tuesday and allow us to see how events in the Middle East are starting to play out in global oil production statistics.

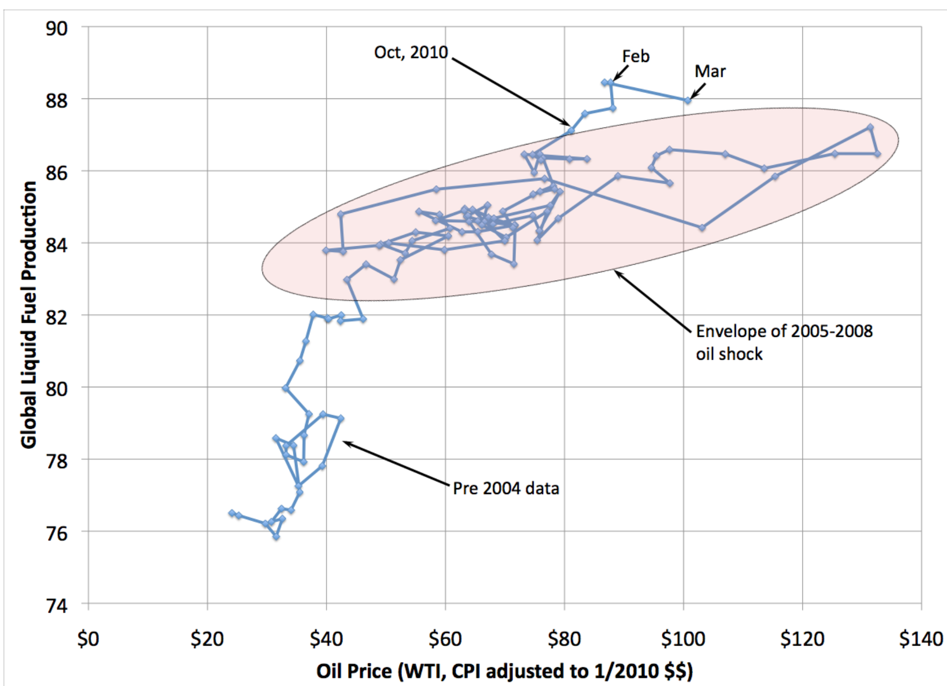
***NB:** This is a lightly edited crosspost from Early Warning*

In particular, here's the last three years of global total liquid fuels (not zero scaled):

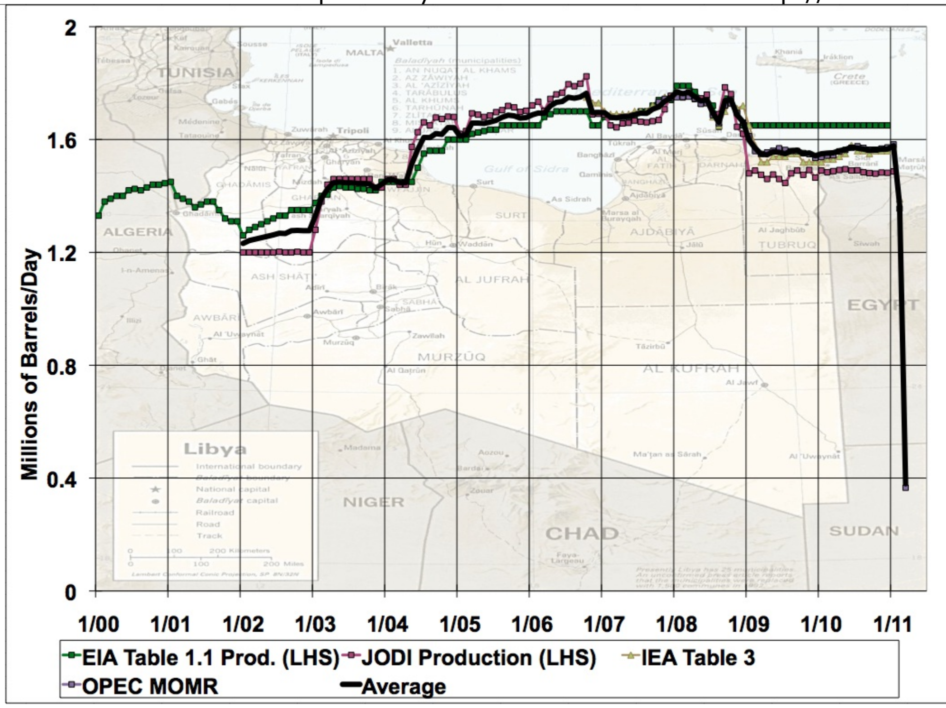


Note that the rise that's been going in since last fall has now been abruptly interrupted by the Libyan situation, and total oil production has fallen by about 0.5mbd. This is about 0.6% of global production, but given that the world economy has been growing rapidly and needing about another 0.5mbd/month, the shortfall over what would have happened in a counterfactual world with no Middle Eastern unrest is more like 1.2% of global production.

In terms of the price production picture, this has put us much more into territory akin to the 2005-2008 oil shock:



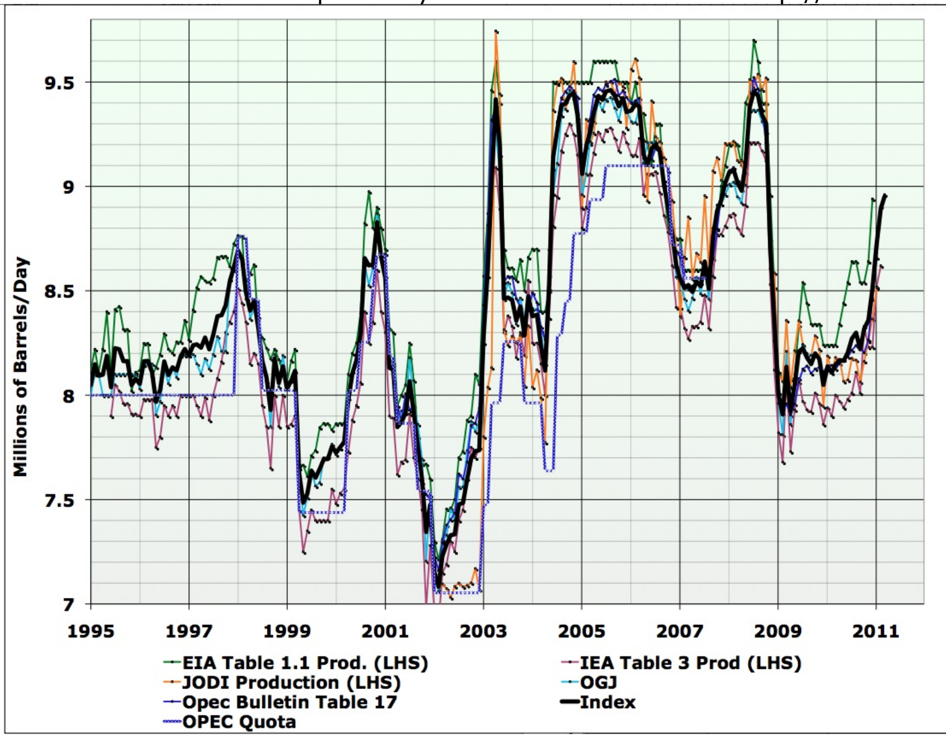
We can put the situation almost entirely down to two things: the fact that Libyan production has plummeted, and that Saudi Arabia has made no significant move to compensate. In fact, Saudi Arabia slowed down production increases that it had been making in prior months. First, here's all the Libyan data currently available:



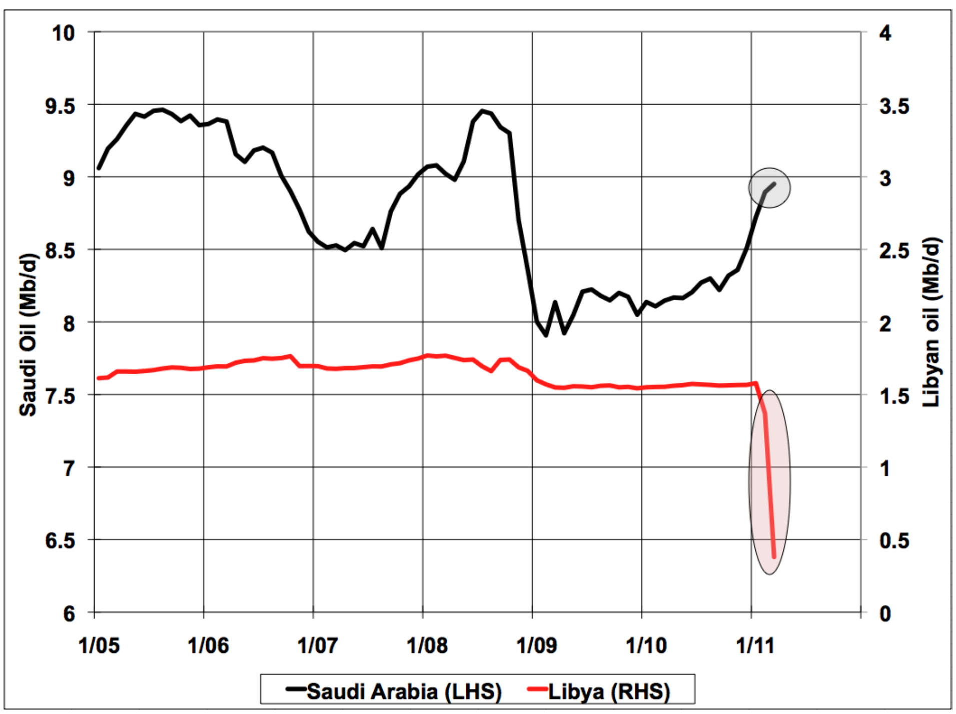
So the world has abruptly lost something like 1.3mbd of oil production between mid February and March. Now there were a lot of news reports in the business press at the time this was first happening that Saudi Arabia was going to make up the difference. For example, according to Reuters [at the time](#):

> Saudi Arabia has increased its oil production to more than 9 million barrels per day (bpd) to compensate for disruption to Libyan output, an industry source familiar with the kingdom's production told Reuters on Friday.
>
> "We have started producing over 9 million barrels per day (bpd). We have a lot of production capacity," the source said, but said he could not say when the change had taken place.
>
> Oil prices spiked to a 2-1/2 year peak of nearly $120 a barrel on Thursday, stoked by concern the wave of revolutionary unrest gripping world No.12 oil exporter Libya could spread to big oil producing countries in the Middle East.
>
> A report out of Washington by industry publication Energy Intelligence late on Thursday said Saudi Arabia had made the change quietly to try to avoid stoking regional tensions.
>
> "The Saudi move has not been announced publicly, most likely because of the political sensitivities in the region and the internal dynamics of OPEC," Energy Intelligence wrote.

Now that the stats are out, we can see that this was, well, let's just say "less than accurate". Here's all the Saudi production data I have (not zero scaled to better show changes):



Indeed Saudi production has increased to around 9mbd, but the timing makes it clear this has nothing to do with Libya. For better comparison, I have put both the Libyan and Saudi averages on the same graph (only since 2005), with the scales adjusted to allow easy comparison. In particular, note that the size of the units on both scales is the same, so similar vertical moves in both curves mean the same amount of oil, but the Saudi scale (left hand scale) has been shifted to put the Saudi curve next to the Libyan one (right scale):



I have circled the March data in each case. You can see what was going on. The Saudis were slowly increasing their production from last fall through February, presumably in response to growing global demand and rising prices. But then, in March, when Libyan production went into freefall, they put on the brakes and did almost nothing to make up for the shortage.

The burning question is: why? Back in 2006, when their production started to gradually decline from 9.5mbd even as global oil prices were in the worst spike since the 1970s, I was an advocate of the view that the decline was largely involuntary: they'd never produced more than 9.5mbd, they'd underinvested for decades, and some of their big fields were getting very tired (particular northern Ghawar and Abqaiq) and they were starting a big rash of new projects and ramping up their rig counts at the same time.

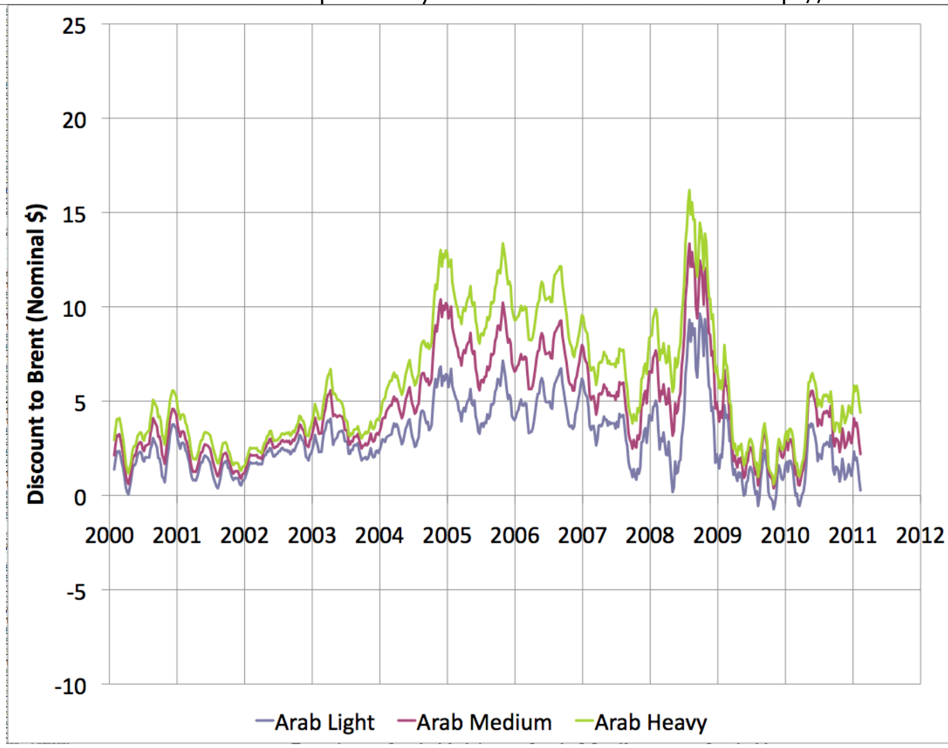
I see current events differently. The reduction in late 2008 was clearly voluntary to support prices in the face of the great recession. There's no new projects announced, and the rig count hasn't taken off. So my take is that the failure to increase production to compensate for Libya is deliberate. We can only speculate, but my guess is that, having watched how the west has helped to ease Mubarak and Ben-Ali out of power and is intervening in Libya to the same end, the Saudi regime is in no mood to care about our desire for more oil. Instead, they are very much in the mood to build as large a war chest as possible with which to appease their own population, strengthen their defense measures, etc.

So, instead of Saudi production increasing to compensate for Libya, total world production decreased, and oil prices went up sharply to enforce the necessary conservation on the world's oil consumers.

If you want further evidence, I note that on February 24th, I wrote a post suggesting, based on my reading of press coverage, that perhaps the Saudis were not planning on increasing production. Looking at the spread of Saudi grades of oil to Brent prices. I said:

> The real tell will come in a couple of weeks when we see what happens to these discounts once the Libyan situation comes out in the data. Will Brent spike while the prices of these Saudi grades languish, since after all, it's only the light sweet stuff that's in short supply?
>
> Here's my guess. When multiple major news sources run apparently independent stories at the same time, all propagating the same plausible but completely false line, I get suspicious and cynical. I think we are seeing the effect of someone's (rather successful) P.R. push. Someone, probably the Saudis, wants us to think that Saudi production can't be substituted for Libyan, and it isn't their fault. If that's true, then I hypothesize:
>
> - Saudi production is not going to increase in response to the Libyan cutoff, or not enough, anyway
> - Prices for Saudi grades of oil are going to spike in a very similar manner to Brent

So, here's the latest data on the discount of the three Saudi grades of oil, to Brent (with a seven week moving average applied to reduce noise):



You can see that these discounts have actually fallen to levels usually seen only in the depths of recessions when the Saudis are trying to raise prices. So rather than trying to flood the market with their oil to help supplies post-Libya, the Saudis are ramping back and taking profits.