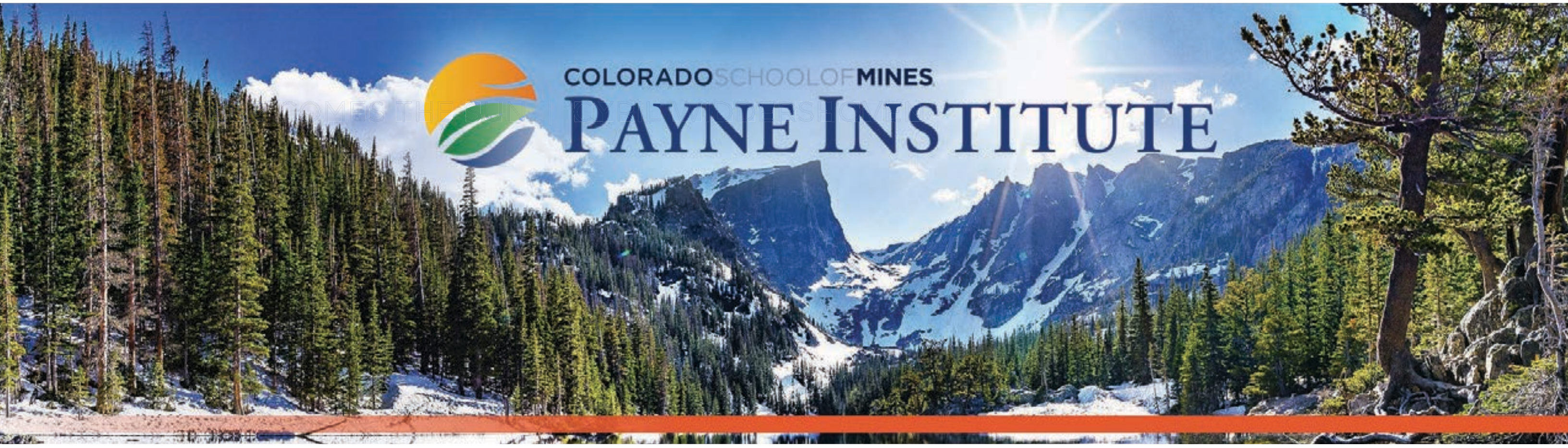

HERE COMES THE SUN
WASHINGTON AND U.S. SHALE NEED TO WATCH OUT FOR THE NEW SUN KING

BY CYRIL WIDDERSHOVEN
APRIL 2018

The world tour of Saudi Crown Prince Mohammed bin Salman (MBS) has generated enough interest and support in the West to proceed with his Vision 2030 and regional power plans. With his three-legged tour, visiting the U.K., U.S.A and France, MBS has shown a political prowess unseen before by other Saudi leaders, hitting the raw nerves of Western democracy and populism.

Even that a large public opposition exists in all Western countries, mainly focusing on Saudi Arabia's war in Yemen, the young Crown Prince has been able to charm most leaders with his direct and open approach and willingness to set up multibillion deals at the same time. The young Arab Grand Master of international geopolitical chess has been able to hide several of his main strategic goals in a fog of media buzz, visits to celebrities and tech giants. By entering the spotlights, MBS's position on the Middle East political chess board substantially improved. Saudi's pivotal role in geopolitics and economics was validated.

However, MBS plays on more than three chess boards at the same time. One is the well documented media frenzy around Saudi's move towards a more moderate religious and liberal society, while weaning itself from oil. At the same time, a vast list of multibillion dollars' worth of contracts has been presented in all three countries, linking the future of the Kingdom to the prosperity of these Western power players.

Who can object to these developments? No one, at least not if you are a Western politician or businessman. US President Trump, British Prime Minister May and French president Macron all have shown to be infatuated by the MBS charm.

With another superb strategic move, MBS has put Saudi Arabia on top of the list of investment destinations for renewable energy. On the 27th of March, MBS and Japanese SoftBank's CEO Masayoshi Son signed in the very early hours in New York, U.S.A., the largest solar power project ever. Both parties announced the investment, as mentioned in the Memorandum of Understanding (MOU), of $200 billion (R2.33 trillion). The latter is needed to install 200GW capacity. The first phase, which is 7.2GW, is estimated to cost $5 billion, of which SoftBank's Vision Fund (in which Saudi Arabia has invested) will provide $1 billion, while the remaining $4 billion will be via project financing. MBS's move to announce the deal while visiting the U.S. shows a strong knowledge of how to play Western media and politicians. By creating a solar energy hype, attention for Saudi's position in OPEC, its role with regards to U.S. shale (oil) and the ongoing geopolitical rapprochement with Moscow, were removed from the discussion on the frontpage of media outlets for days.

The OPEC leader, still known as the Kingdom of Oil, has shown its willingness to enter the energy transition era. By addressing these issues in the open, while visiting the U.S., media attention was also removed from the ongoing battle between Russia-OPEC (R-OPEC) and U.S. shale. By getting the spotlight on the solar project, discussions between Saudi officials, such as minister of energy Khalid Falih, Aramco's CEO Nasser and their American counterparts, were largely hidden behind a green smokescreen.

The whole European-U.S. tour of MBS has been linked to the dramatic economic-financial and political changes currently being implemented in the Kingdom. With a continuous media focus on MBS's Saudi Vision 2030, the weaning of oil and the necessary diversification of the economy, or the introduction of the so-called Giga Projects such as NEOM or Qiddiya (sports city), attention partly faded for one of the most pressing discussions on the table behind closed doors, the relationship between R-OPEC and U.S. shale. On the sidelines, but still making headlines, the future of the Aramco IPO was being addressed.

Still, the latter issues were intentionally snowed under by the front-page articles on Saudi entertainment projects, deals with Amazon, Google or vast defense contracts. Even that these contracts and deals are of the utmost importance, the most pressing issue for Saudi's future is the oil market and a strategy to counter perceived shale oil threats.

For U.S. analysts the message of the 200GW solar project should not be that the Oil Kingdom will become the new Solar Kingdom. The message of a title such as "Here Comes the Sun" is that "the Sun in the Kingdom of Oil is not reaching its Zenith." The sun is only being used as a new viable instrument to keep Saudi Arabia in the coming decades as the leading oil exporter in the world. The main reason that Riyadh, led by MBS and the likes of Al Falih and Nasser, are investing in solar power projects is to quell the internal threat to its own oil production volumes. The continuously growing Saudi population, in combination with a diversifying but growing domestic economy, is a direct and more challenging threat to Saudi's position within OPEC or on the global geopolitical arena, than U.S. shale.

With already a domestic demand for crude oil in the Kingdom of around 4 million bpd, which could even reach a level of 8 million bpd within the next decade, the overall position of Saudi Arabia is being threatened. With less export potential, the position of Saudi Arabia is in peril. The last couple of years, the Saudi leadership has clearly understood this internal threat, taking substantial measures to quell it. By removing part or all of the power generation use of crude oil, the Kingdom could regain a possible 800,000bpd of additional export capacity. Based on $70 per barrel, total additional revenues for the Saudi government is estimated to be around $20 billion per year, not even taking into account the option to decrease total electricity subsidies in future.

If at the same time, based on the implementation of Saudi Vision 2030's very aggressive industrialization and manufacturing programs, the economy will expand, additional demand for energy can and will be met by solar. Additional energy sources are also being targeted at present, as is shown in the Saudi wind and nuclear energy adventures.

Saudi's internal strategy doesn't constrain its regional and global ambitions at all. As the leading OPEC producer and exporter, Riyadh has set up a global market consolidation strategy which has led to the well documented OPEC – non-OPEC production cuts. MBS's rapprochement with Moscow, supported by leading OPEC members such as the UAE and Kuwait, has led to a stabilization of the global oil markets, after that the excess oil storage volumes have been reduced substantially.

The impact of U.S. shale has been felt for years, however adjustments have been made and production has been cut. The cooperation between the two former adversaries OPEC and Russia not only has led to a more stable oil market, but also resulted in a new potential power which could constrain U.S. shale in future.

The current discussion on a long-term OPEC Russia market strategy has not popped up without reason. The statements made by Khalid Al Falih, Russian minister of Energy Novak and OPEC's SG Barkindo, were stated to the press during MBS's tour in the U.S. The message was clear, at least when reading between the lines. Moscow, Riyadh and Abu Dhabi, in line with the majority of OPEC members, will take any appropriate measure to deal with instabilities in the global oil market, while indicating to U.S. shale the willingness to counter further expansion of the latter.

The current discussion, officially on a long-term strategic cooperation between Russia and OPEC with regards to managing and stabilizing the international oil markets, is the precursor for a full-fledged integration of the world's leading oil and gas producers, excluding the U.S.A. The need to manage the supply-side of the global oil market is clear, overproduction or increased price volatility is not positive for operators and investors at the same time. High price volatility, as shown the last years, resulting in a dramatic fall in prices and oversupply at the same time, has led to a steep decline of investments in upstream and midstream projects. The loss or deferral of more than $1 trillion in investments in upstream will not only lead to potential supply shortages but also an unwanted price increase. Managing the latter is needed, as sudden shocks in the market only will freak investors and operators, who will look for other more stable opportunities.

The role of U.S. shale is not underestimated by OPEC and Russia, but as Saudi and Emirati officials have reiterated, the increase of shale production (oil and NGLs) will not be enough to counter projected rise in demand worldwide. As shale oil needs continuing high investment levels, while salaries and rig availability already have become an issue, putting a damper on the overall future from the start. For U.S. shale another major bottleneck is still not solved, the lack of available oil pipeline infrastructure to reach potential markets. R-OPEC understands the current market situation and will take advantage of the fundamentals ruling U.S. shale, by stabilizing market share outside of the U.S., such as China-Japan or increase its volumes in India and other emerging markets.

To put in place R-OPEC at this precise moment is the right strategy. At present market players are still believing in the oversupply and peak-demand scenarios painted in full in the media. Looking at developments outside of Europe (where even demand has gone slightly up), demand for oil and petrochemical products is up, without any real danger on the horizon. For traditional oil producers the threat of U.S. shale oil is relatively small, as the latter's light crude version is not able to compete in the vast majority of the market place with more conventional crudes such as Saudi Light or Russian crudes. At the same time, price levels of U.S. shale are constrained by high production costs, the need to leverage companies' debt levels, while transport costs to Europe or Asia are much higher than other production areas.

Another threat to U.S. shale has not been discussed in full, but is playing into the hands of Saudi Arabia, Russia and its supporters. Most non-Western oil and gas production is in the hands of the majors, independents or smaller entities. Competing on the global market with giants such as Saudi Aramco, ADNOC, Gazprom or KOC, will be extremely hard. Their power stands at a different level than the myriad of small independent entities currently producing shale oil and gas.

On the mid- to long-term U.S. shale oil, if not able to consolidate their efforts in larger companies, will be fighting a lost battle. The American dream is now the main threat to the Shale Revolution. Being small can make you agile, however, globally you need to be a power player. This message will have been given behind closed doors by the Saudi delegation to their American counterparts, hence the indirect interest signals by Aramco in U.S. shale equity. The R-OPEC will survive any onslaught of U.S. shale, the question here is only "can U.S. shale survive the confrontation with R-OPEC." Without being able to lock in demand, which is the leading strategy of Saudi Arabia, Russia and some other Arab producers, U.S. shale companies will only be left to play with the left-overs that have fallen of the Chinese, Indian or European dinner table.

For American and European decision makers it will be now time to reassess their own energy (independence) strategies. The dream of energy independence is not feasible, there is only the option of "securing energy supplies." Even that U.S. shale has shook up the energy markets, leaving many casualties, the national oil giants have not been hit hard. The disadvantage of being a national governmental Moloch now has been an advantage in the end. Profit margins and shareholders of IOCs and independents are more a threat to private entities than national governments or royal families to NOCs. The latter's long-term strategies have resulted in continuing investments and acquisitions, while profit and short-term gains have blocked or diminished the position of commercial companies.

The new Saudi Sun King has shown to be able to play Western politicians, policy makers and media, in a way that the Kingdom has been promoted at all levels. At the same time, MBS has made clear that Saudi's current main revenue source, oil, is not going to bow for any U.S. or Western assault. Pressure on Riyadh is not going to result in openings wanted by Western companies or governments. Oil is still king, solar could be hoping to become crown prince soon. Both however are intertwined in a way that the Kingdom's strategic geopolitical position is enhanced, while openings are made to new friends to quell the assault of U.S. shale and Western renewables.

For some Western parties an old Greek story could hold a warning. "Icarus wanted to fly but came to close to the sun... his wings melted and he crashed to his death." Some indications are there that competitors of R-OPEC could experience the same very soon.

For the Trump Administration the shine and glamour of MBS should not lead to another Icarus experience too. The love for the limelight of Trump has not resulted in a better understanding of the strategies being implemented by Saudi Arabia's new Sun King. As the first Sun King in Western History, Louis XIV from France, has shown, the State and King are the same. Any move or statement made by MBS, if it is now related to OPEC, Aramco, Israel or Moscow, has only one main driver... the future of the Saudi Kingdom as a whole.

The Trump Administration at present seems to love to bask in the sun light spread by MBS but doesn't see the fact that Riyadh and Moscow are cozying up on all fronts. It is now time for Washington, and the Shale Revolution parties, to get back in the shadow and reassess the ongoing changes in the oil and gas markets. R-OPEC is not only build on oil futures, but on the position and future of the two leading countries involved, Saudi Arabia and Russia. Securing America's Energy Future could now mean opening up to a new power broker, one holding an increasing chunk of the oil pie.

COLORADOSCHOOLOFMINES
PAYNE INSTITUTE

ABOUT THE AUTHOR

Cyril Widdershoven is a veteran global energy market expert and founder of Verocy. A Fellow of the Payne Institute, he holds several advisory positions at various international think tanks and Western energy firms. With his regional expertise in Africa and the Middle East, Widdershoven oversees the Mediterranean Energy Political Risk Consultancy. Across the MENA region, he has been heavily involved in the oil and gas sectors throughout his career, holding positions at Capgemini Consulting (Principal Consultant Centre of Excellence Oil and Gas International (Calgary, Canada), Deloitte Financial Advisory Services (Senior Manager, Oil & Gas), and as Senior Financial Analyst Oil & Gas Sector FDA, where he managed and advised the oil and gas department on equity and bond markets.

Widdershoven has led energy publications, including North Africa Oil and Gas Magazine (now called Petroleum Africa) in Egypt, the Middle East Oil Gas Newsletter and Africa Oil Newsletter at Newsbase (UK). Over the span of several decades, he has lived and worked in Egypt, Lebanon, Jordan, Sudan, Iraq, and the U.A.E., and also taken on extended projects for clients in Oman, Iran, Syria, Tunisia, and Turkey. Widdershoven earned his post graduate degrees at King's College, University of London, Department of War Studies, and an MA in Middle East Studies at the University of Nijmegen, Netherland.

ABOUT THE PAYNE INSTITUTE

The mission of the Payne Institute at Colorado School of Mines is to provide world-class scientific insights, helping to inform and shape public policy on earth resources, energy, and the environment. The Institute was established with an endowment from Jim and Arlene Payne, and seeks to link the strong scientific and engineering research and expertise at Mines with issues related to public policy and national security.

The Payne Institute Commentary Series offers independent insights and research on a wide range of topics related to energy, natural resources, and environmental policy. The series accommodates three categories, namely: Viewpoints, Essays, and Working Papers.

For more information, visit PayneInstitute.MINES.edu.

@payneinstitute

COLORADOSCHOOLOFMINES
EARTH • ENERGY • ENVIRONMENT