Surprise oil production cut in response to recession concerns

Nick Beams
2 April 2023

In a surprise move, Saudi Arabia and other members of the OPEC+ oil group have announced a cut in production of just over one million barrels a day, to be borne mainly by the Saudis and Russia. The move appears to be a response to fears of a global slowdown resulting from the recent turmoil in the banking system.

Saudi Arabia said it would make a "voluntary" cut of 500,000 barrels a day, just under 5 percent of its production, in co-ordination with other countries.

The announcement led to a spike in the oil market when trading began for the week with both the American and global oil benchmark prices rising by 7 percent.

The decision was unusual in that it took place outside of a formal meeting of the oil-producing countries, "suggesting an element of urgency by the members taking part in the cuts," according to the *Financial Times* (FT).

The market was taken by surprise. Bloomberg reported that all 14 traders and analysts it polled last week predicted no change in production. They took their lead from Saudi Energy Minister Prince Abdulaziz bin Salman who said last month that the OPEC+ targets set last October were "here to stay for the rest of the year, period."

However, the financial turmoil, set off by the failure of the US Silicon Valley Bank, the second largest in monetary terms in US history, and the forced takeover of Credit Suisse by UBS appear to have changed those calculations.

There are growing concerns that the financial upheavals and the widely forecast ensuing credit crunch could trigger a slowdown in the global economy, if not a recession.

In the immediate wake of the banking crisis, oil prices fell to a 15-month low before recovering, but there are clearly concerns they could again fall if recessionary trends develop.

The *Wall Street Journal* (WSJ) cited "people familiar with the situation" who said the decision was "negotiated primarily between the Saudis and the Russians to get ahead of a global slowdown and raise prices to fund Saudi Arabia's ambitious domestic projects and replenish Russia's reserves."

The Saudi regime is undertaking massive spending to try to shift the economy away from its dependence on oil and turn it into a tourist and business centre.

The Saudi press agency called the production cut "a precautionary measure aimed at supporting the stability of the market."

Bloomberg cited comments by Gary Ross, a long-time oil consultant, who said the oil producers were being "proactive and ahead of the curve" and trying to free oil prices from the grip of macro sentiment, that is, the prospect the world economy is slowing.

The WSJ reported comments by Christyan Malek, global lead of energy strategy at JPMorgan Chase, who said: "Given the preventative nature of OPEC decisions, there is clearly something OPEC knows about the demand trend and inventories that we have yet to discover fully in overall supply and demand balance."

The decision will increase the growing friction between the US and its long-time ally, Saudi Arabia.

In response to the decision, a spokesperson for the US National Security Council said: "We don't think cuts are advisable at this moment given market uncertainty—and we've made that clear."

Saudi noses were put out of joint by an announcement last Thursday week from US Energy Secretary Jennifer Granholm. She said that the Biden administration was not going to move rapidly to replenish the stocks of its oil reserves which were run down in a bid to counter the rapid rise in petrol prices in the middle of last year.

Granholm told a Congressional hearing that it would take "years" to refill the US Strategic Petroleum Reserve. As far as the Saudis were concerned, this was a breach of a reassurance by the administration it would make new purchases for its reserve if the price fell.

Granholm said the US wanted to get back to where it would have been but added that "it will take a few years" and "it takes longer to refill than it does to extract."

The latest cuts come on top of those last October when the OPEC grouping cut production by around 2 million barrels a day.

Biden had made a trip to Saudi Arabia in July to promote increased production but came away empty-handed.

Instead, the Saudis announced cuts less than three months later, prompting the White House to accuse OPEC+ of siding with Russian president Vladimir Putin and warning there would be "consequences" for Saudi Arabia.

The latest Saudi move is indicative of broader economic and political shifts, which were pointed to by Helima Croft, head of commodity strategy at RBC Capital Markets.

"It's a Saudi-first policy. They're making new friends, as we saw with China," she said, referring to the recently concluded re-establishment of diplomatic relations with Iran orchestrated by Beijing.

Saudi Arabia was sending a message to the US that "it's no longer a unipolar world."

"We see this closely held decision as just one more indication that the Saudi leadership is making its oil production decisions with a clear eye on their own economic self-interests," she said.