China slowdown drives Saudi oil production cut

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7 June 2023

The most significant feature of the decision by Saudi Arabia to cut its production of oil by 1 million barrels a day in July, with a possible extension, is what it says about assessments of the prospects for the world economy.

The driving force of the decision, announced following the OPEC+ meeting in Vienna on Sunday, is that the much-touted "recovery" of the Chinese economy after the lifting of anti-COVID heath measures is not taking place, leading to a further slowdown in the world economy and sending down the price of oil.

The meeting was held two months after the cartel, which includes many of the world's major oil producers, announced production cuts to try to sustain prices. But these measures have proven largely ineffective, and the oil price has fallen by 12 percent since the middle of April, touching $70 a barrel at one point last week.

Saudi Arabia, under the direction of Crown Prince Mohammed bin Salman, has embarked on a major investment and infrastructure program to try to lessen its dependence on oil production. But the program, which has so far failed to attract significant international investor support, depends on oil revenue to be carried out.

The *Wall Street Journal* has reported that in recent months Saudi policymakers have been warned that "the kingdom needs elevated oil prices for the next five years to keep spending billions of dollars on ambitious projects that have so far attracted meagre investment from abroad."

According to the International Monetary Fund, Saudi Arabia needs an oil price above $80 a barrel to balance its budget and fund major projects. But as the world economy slows—the IMF has forecast that global growth this year will reach its lowest point, apart from the COVID-19 recession, since the financial crisis of 2008-2009—recessionary trends are exerting downward pressure on oil prices.

Since last October, when OPEC+ cut production by 2 million barrels a day followed by a further cut of 1.6 million barrels in April, the price of Brent crude, the major international benchmark, has fallen by around 20 percent.

Oil prices have kicked up at certain points going as high as $90 a barrel, but the dominant trend has been down. Predictions made earlier this year that the price could go to $100 a barrel have failed to materialise.

The latest Saudi cut is only for July at this stage, but it could be extended. Following the meeting, Saudi Energy Minister Prince Abdulaziz bin Salman, the half-brother of the crown prince, said it was a "Saudi lollipop," that is, a sweetener for the rest of the group which did not have to make cuts.

"We want to ice the cake with what we have done," he said. "We will do whatever is necessary to bring stability to this market."

And in an effort to cover over tensions within the group, he said that "the quality of cooperation is unprecedented." That seems not to be the case.

Saudi production will be reduced to 9 million barrels a day, compared to its maximum capacity of 12 million.

It appears that the Saudis wanted cuts from other producers but failed to obtain them. According to a WSJ report, there was a "fiery exchange" at the meeting as the Saudis pushed other members to make cuts "but faced stiff resistance, especially from some African producers."

It was reported that on Saturday Abdulaziz called some African delegates to his hotel suite in Vienna and told them their production quotas would be reduced,

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but they left the meeting without any agreement, and it was only at the last minute that Kuwaiti and Algerian representatives managed to secure a deal.

In the event, the best the Saudis could obtain was an agreement from others to stick to their existing production targets with the Saudi decision to voluntarily cut production, getting the deal over the line.

The tensions produced by the slowing world economy and its impact on the oil market were in evidence in the lead-up to the meeting.

Throughout this year Abdulaziz has been denouncing short sellers on Wall Street whose speculative activities have been causing prices to fall. Last month he warned they had to "watch out," an indication that the Saudis would at least try to induce a price increase so that they made losses by gambling on a fall.

In a further indication of the tensions, the Saudi energy minister excluded several journalists, including the entire teams from Reuters and Bloomberg, from coverage of the meeting, presumably because their reports had been encouraging speculation that oil prices would continue to fall.

But there are much more powerful forces at work than the writings of financial journalists. Besides the global slowdown, a major long-term factor is the attempt to shift away from carbon dependence.

In the immediate situation, the chief factor is the slowdown in China. All the latest data on industrial production, consumer spending, the housing and property markets and investment indicate that even the target growth rate of 5 percent for this year—the lowest in three decades—will be very hard to achieve.

The rest of the world, including the major economies, is facing a major slowdown in growth this year, if not a recession, because of the interest rate hikes led by the US Federal Reserve and followed by other central banks.

The hope, including by the Saudis, was that the global economy would be cushioned by Chinese growth after the ending of the COVID-19 lockdowns and other public health safety measures at the end of last year.

As *Sydney Morning Herald* economics columnist Stephen Bartholomeusz noted: "OPEC+ had expected a big rebound on demand for oil and in the oil price in the second half of this year, but unless China's economic engine stops sputtering and starts roaring, that would seem unlikely, which leaves further manipulation of the supply side as its major lever."

But with many producers, particularly in Africa, facing worsening economic conditions, there is little appetite for such moves and even the Saudis, as he noted, are only prepared to proceed a month at a time.

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