Over the weekend, Saudi Arabia’s King Salman restructured the Cabinet and replaced the long-standing Oil Minister, Ali al-Naimi, with the ex-CEO of ARAMCO (the state-owned oil company), Khalid al-Falih. Furthermore, the Governor of the Saudi Arabian Monetary Agency (SAMA), al-Mubarak, was replaced with Dr. al-Kholifey. In terms of policy shift, we believe the appointment of al-Falih is the most important signal that Deputy Crown Prince Mohammed bin Salman is gaining power and that the structural reform agenda to reallocate resources out of oil and into alternative production is taking hold.

What does this mean for oil? In our view, not much near term.

In short, this weekend's political shuffle reinforces our belief that Saudi Arabia will neither flood markets with supply nor cut volumes in order to drive up prices. Mohammad bin Salman has been consistent that Saudi Arabia will supply demand (i.e., supply exactly according to the demand curve determined marginally by Asia and the U.S.), rather than flooding the market to raise revenues. Furthermore, as Saudi Arabia continues to fight proxy wars with Iran, it is unlikely that an OPEC agreement to cut production is imminent; Saudi Arabia certainly has been consistent that it will not cut volume. Recent pricing contracts to Asia suggest that demand may indeed be driving the marginal price of Saudi Arabia oil, which is consistent with a Saudi Arabia that aims to produce according to demand and supply. In the near-term, the announcement should have no impact on the price of oil.
Over the medium term, the replacement of al-Naimi with a market-friendly ex-CEO of the oil giant ARAMCO signals that Mohammed bin Salman is serious about his Vision for Saudi Arabia in 2030, as privatization of ARAMCO (in part) was one key component of that plan. Diversifying Saudi Arabia away from oil is a priority and thus further evidence that oil volatility will remain as the market determines the price of oil.

If this reshuffle raises the likelihood that Mohammed bin Salman becomes King – though that is not our base case – then political infighting within Saudi Arabia heightens the risk of domestic uncertainty passing through to oil markets.

SUPPLY CUT IN CANADA IS LIKELY TO BE SHORT-TERM

In Canada over the weekend, the wildfires in the Alberta tar sands region took a turn for the better, as the draught conditions cleared up. Now, it is expected that the fires will be contained within a week and rebuilding costs and damage assessment can begin. To date only one company has reported minor damage and the lion’s share of the oil infrastructure has gone unharmed.

Therefore, current cuts to production due to skeleton crew production are unlikely to persist over the medium term; and if current weather conditions prevail, it is possible/likely that production resumes in full within weeks, rather than months or quarters.

CONCLUSION

• Near term, the supply of oil from Saudi Arabia should remain stable and from Canada likely higher: all else equal, a negative for oil near term.

• Seasonalities due to summer energy demand and cyclical real macroeconomic demand are likely the drivers of oil near term.

• Medium term, Saudi Arabia will continue to let market forces drive the price of oil.