Saudi Arabia and Russia Dig In for a Long, Bitter Oil-Price War

Jack Farchy and Javier Blas

Saudi Arabia and Russia Dig In for a Long, Bitter Oil-Price War

(Bloomberg) -- Saudi Arabia and Russia dug in for a long and destructive oil-price war, as Moscow responded forcefully to Riyadh's opening salvo.

If there was any doubt that the collapse of last week's OPEC+ talks created a lasting rupture between the world's top crude exporters, Russia dispelled it on Monday. Its largest producer will pump significantly more oil next month and Energy Minister Alexander Novak said the country's share of export markets -- under attack from Saudi Aramco's steep price cuts -- will be preserved.

The Kremlin didn't flinch despite the conflict's devastating toll: the biggest price plunge since the end of the 1991 Gulf War; hundreds of billions wiped off oil-company valuations; soaring bond yields in resource-dependent nations.

That was just day one. A prolonged struggle between the two powers -- with each seeking to maximize the price pain for their foe by pumping as much as possible -- could inflict lasting damage on the industry that produces the world's most important commodity.

"Playing Russian roulette in oil markets may well have grave consequences," said Fatih Birol, the executive director of the International Energy Agency.

The stability of countries such as Iraq, Angola and Nigeria may be threatened, while some oil-dependent nations may struggle to cover essential spending on health care, Birol said. The U.S. shale boom could come to an end, with production declining as companies suffer financial distress.

Putin Ally

Novak, speaking at a government meeting in Moscow, appeared to deflect blame for the current crisis. Russia had favored maintaining existing production cuts, but OPEC chose instead to open the taps and start a fight for market share, he said according to a statement. He also indicated that his country won't bow to price pressure.

"The Russian oil industry has a quality resource base and enough financial resilience to remain competitive at any forecast price level, and to keep its market share," Novak said at a government meeting in Moscow on Monday.

Rosneft PJSC, Russia's largest producer, is planning to lift oil production as soon as the current OPEC+ deal ends, according to a person close to the company. When asked how rapidly the company could increase production, the person said well-informed analysts estimate it could add 300,000 barrels a day within a week or two. That's enough to roll back all of Russia's OPEC+ output cuts, and then add some more.

There's no reason to doubt whether Rosneft's has the Kremlin's blessing. Chief Executive Officer Igor Sechin is a close ally of President Vladimir Putin and has been the most prominent naysayer of the country's cooperation with Saudi Arabia and other members of the Organization of Petroleum Exporting Countries.

The nation's other companies could follow suit, after Novak made clear that any OPEC+ production limits will no longer apply in April.

Higher production could go some way to offset lower prices, but Russia can also dip into its $150 billion wealth fund to offset the slump and bolster the ruble. Those reserves are sufficient to cover lost revenue "for six to 10 years" at oil prices of $25 to $30 a barrel, the Finance Ministry said.

Brent crude, the international benchmark, traded for about $36 a barrel on Monday.

Brutal Battle

"Who will win this price war? One has to assume it will be Russia," Ellen Wald, non-resident senior fellow in the Atlantic Council's Global Energy Center, said in a report. Novak and Putin "are experienced, tough, and have no reason to capitulate."

The Saudis don't see it that way. The kingdom isn't troubled by Monday's slump and remains determined to achieve its objectives, even if it takes months, according to people familiar with the country's stance.

The kingdom slashed its crude prices over the weekend, with the biggest reductions aimed at Russia's prime markets in Europe. Riyadh plans to maximize production to compensate for lower prices, the people said, potentially pumping a record 12 million barrels a day.

Even a 20% increase in oil production wouldn't compensate for crude prices that are less than half the level Saudi Arabia needs to balance its budget. The kingdom will suffer, but it won't be the first time.

"Saudi Arabia has waged a number of market-share wars," said David L. Goldwyn, chairman of the Atlantic Council's Energy Advisory Group. "All of these battles caused more pain than gain."

(Updates with comment from Novak in second paragraph. A previous version of this story corrected the attribution in the 12th and 16th paragraphs.)

--With assistance from Dina Khrennikova and Grant Smith.

To contact the reporters on this story: Jack Farchy in London at jfarchy@bloomberg.net;Javier Blas in London at jblas3@bloomberg.net

To contact the editors responsible for this story: James Herron at jherron9@bloomberg.net, Christopher Sell