Oil market's new world order

Robert Gottliebsen, The Australian, 9 October

The US blunders in the Middle East and Europe have set the stage for a totally new order in the oil market.

The US is left out in the cold

The combination of Russia, Iran, Iraq and Syria in the current Middle East war, if successful, is likely to be followed with new arrangements between this alliance in the oil market. And that new Russia, Iran, Iraq and Syria order will incorporate Saudi Arabia. The US is left out in the cold. Australia may be a winner.

While that might be the Russian plan it requires military success in Syria and a willingness of the Saudis to back Russia. A lot can go wrong but let's explore the Russian plan.

My recent visit to St Petersburg and Estonia (albeit on holidays) showed me what a mess the US and Europe have made in the Ukraine. They have greatly strengthened President Putin. Most of the media concentration is on the US military mistakes in the Middle East. Just as important are the US mistakes on the oil front, which have contributed to this new oil power game to be led by Russia.

The US oil mistakes

The US oil mistakes started around September last year when US Secretary of State John Kerry and the late Saudi King Abdullah met in Saudi Arabia. Kerry urged the Saudis to crash oil prices, which at the time were above $US100 a barrel.

Kerry had one agenda: making the pressure on Russia unbearable. America thought that the combination of trade sanctions and lower oil prices would force Russian President Putin to capitulate in the Ukraine and make Kerry and the US heroes. Kerry did not understand that the sanctions were already backfiring.

King Abdullah agreed to Kerry's request for a different reason: he wanted to hit US shale oil production, which was taking a big market share. Because it was high-cost oil the way to kill US production was to lower the price. The Saudi King must have been amused that the Americans were asking him to destroy their own industry in trying to attack Putin. The King got it right and US shale oil is on its knees and there are huge losses among the lenders to the industry.

Kerry damaged his own country

Kerry not only damaged his own country but the Russian rouble collapsed so Russia's production costs fell, so lessening the blow of the oil price fall. And as the sanctions strengthened Putin in Russia they helped give him the internal backing for the Syrian adventure. But an important precursor to the Syrian adventure was an invitation from Saudi Arabia for Russia to join OPEC. Moscow rejected it but that did not stop further talks.

If we go back just over 90 years ago we saw the most powerful world oil companies, led by Exxon (then the Rockefeller's Standard Oil), BP (then the Anglo-Persian Oil Co), the Rothschilds' Shell and others forming a great oil cartel. They split the market up between them. The cartel broke down after the Second World War.

A new cartel is not yet formed but…

A new cartel is not yet formed but the master strategist Putin is, step by step, putting all the links in place, including supply arrangements with China and Asian countries. With the American oil industry crippled and, hopefully, ISIS in retreat, the way is clear for a different geographic split up of the Middle East but more importantly a market-sharing agreement in the oil market.

That agreement will strengthen oil prices but will not set them to boom because that would encourage too much production and might restore the US. In the agreement Iran and Iraq production would have to be accommodated and that becomes possible now the US has been crippled.

China will go along with the game but will be wary. It will be looking to Australia for energy to be on the safe side. Our existing LNG producers have firm contracts with prices that are linked to oil. Their outlook will be improved if Russia is successful.

Footnote: The source for this material comes from my visit to St Petersburg and the many news reports and commentaries circulating in the oil industry including work by F William Engdahl in New Eastern Outlook.