Iraq, Saudi Arabia, Russia & Oil: Risks for the World Economy

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(This presentation is designed to follow that of Prof. Saikal on Iraq and Saudi Arabia)

World Oil Supply

	Reserves, % of world total	Capacity mmb/d	Production mmb/d
Saudi Arabia	25	10.5	9
Iran	9	4	4
Iraq	11	2.5	2
M.E./Persian Gulf			22
Total OPEC		31	29
Russia	5	9	9
China		3.5	3.5
USA	3	9.5	9.5
Other		30	30
World	100	83	81

Russia

Oil: production of 9m bpd; crude exports 5m bpd, products exports 2m bpd

- World Bank estimates oil sector contributes 18% of GDP

Main “privatised” oil “companies” are Yukos, Likoil, Sibneft, Tyuman, Surgetneftgas etc

- Khodorkovsky (majority owner of Yukos) in jail on fraud and tax evasion charges

Putin & Co clearly trying to bring oil producers under tighter Govt. control, in order to:

- Limit power of oil “oligarchs”
- Boost revenues to Govt coffers

Oil pipeline export capacity of 4m bpd (rest exported by rail):

- Controlled by Govt owned Transneft which wants to maintain virtual monopoly
- Many in Govt not want “private” pipelines, although not all

Foreign investment (FI) so far very limited

- And any surge in FI unliklely soon

Russian oil is and will not be a substitute for Saudi (and Iraqi?) oil

Oil Supply & Demand

Earlier table showed present world oil <u>supply</u> at about 81m bpd
World oil <u>demand</u> is about 81m bpd, of which:

- US 20m bpd (11m bpd, or 55%, imported)
- Rest of OECD 29m bpd
- China 6m bpd (3m bpd imported)
- Rest of World 26m bpd

(Persian Gulf supply equal to 27% of demand)

US DoE estimates world oil <u>demand</u> of 89m bpd in 2010, of which

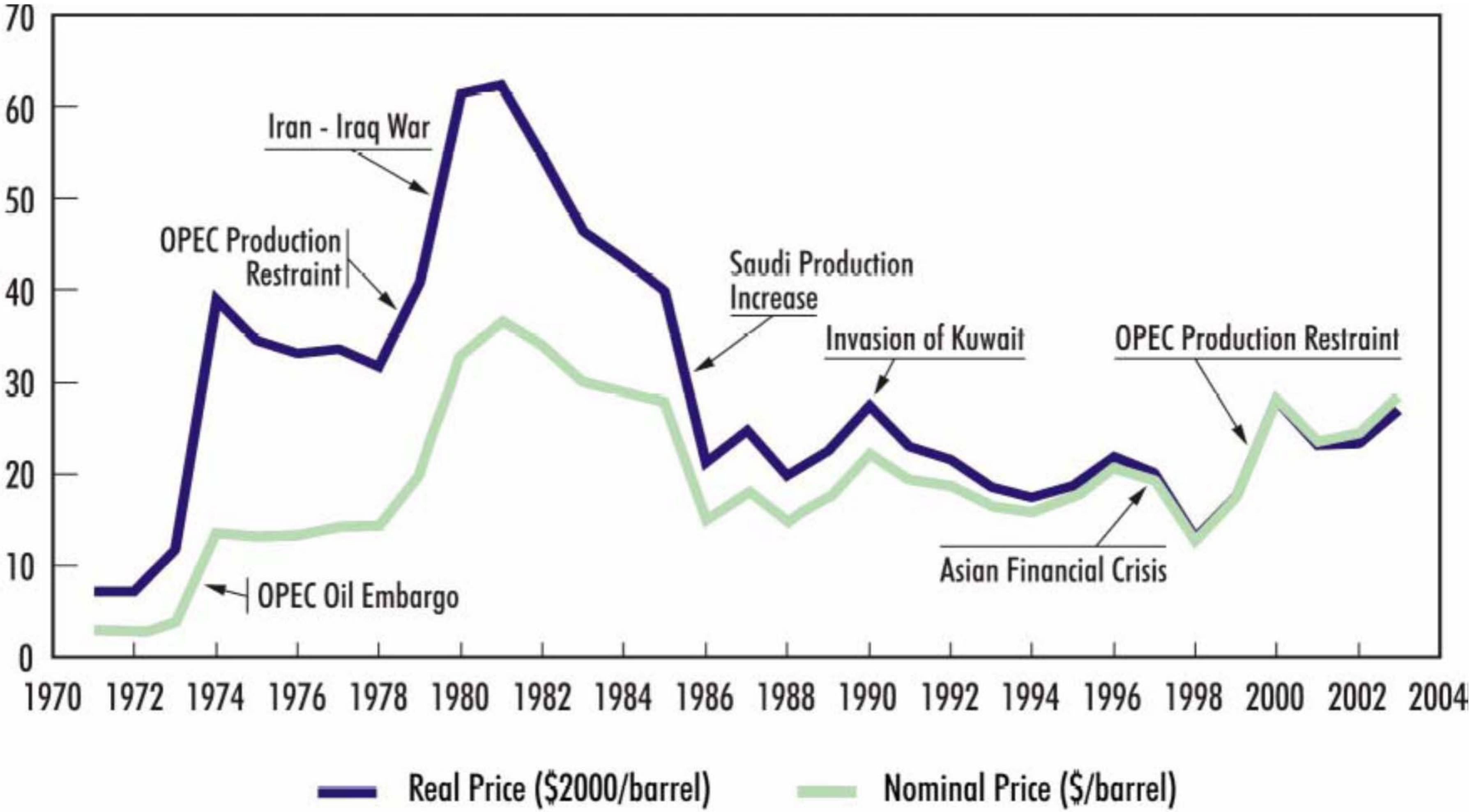
- US 23m bpd (13m bpd, or 58%, imported; and expected to reach 70% by 2025)
- China 6.5m bpd (3m bpd imported)

DoE assumes <u>supply</u> will rise to (surprise!) to 89m bpd in 2010, of which:

- Saudi Arabia up to 13m bpd (and up to 22m bpd in 2025)
- Iraq 3.7m bpd (and 6.6m bpd in 2025)
- Persian Gulf 25m bpd (equal to 28% of demand; and expected to reach 35% in 2025)
- US 9.5m bpd
- Russia 10m bpd

Doe assumes price of $US 25 per barrel in 2010

Oil prices



70
60
50
40
30
20
10
0
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
Iran - Iraq War
OPEC Production Restraint
Saudi Production Increase
Invasion of Kuwait
OPEC Production Restraint
Asian Financial Crisis
OPEC Oil Embargo
Real Price ($2000/barrel)
Nominal Price ($/barrel)

Oil Prices & World Economy

Effect in 2004 of price being $US35/barrel rather than $US25 at start of 2004 and remaining there (according to IEA, OECD, IMF joint analysis)

	GDP	CPI
US	-0.3	+0.5
Japan	-0.4	+0.3
Euro zone	-0.5	+0.5
OECD	-0.4	+0.5
China	-0.8	+0.8
India	-1.0	+2.6
Latin America	-0.2	+1.2
World	-0.5	

US Expenditures in Iraq

So far:

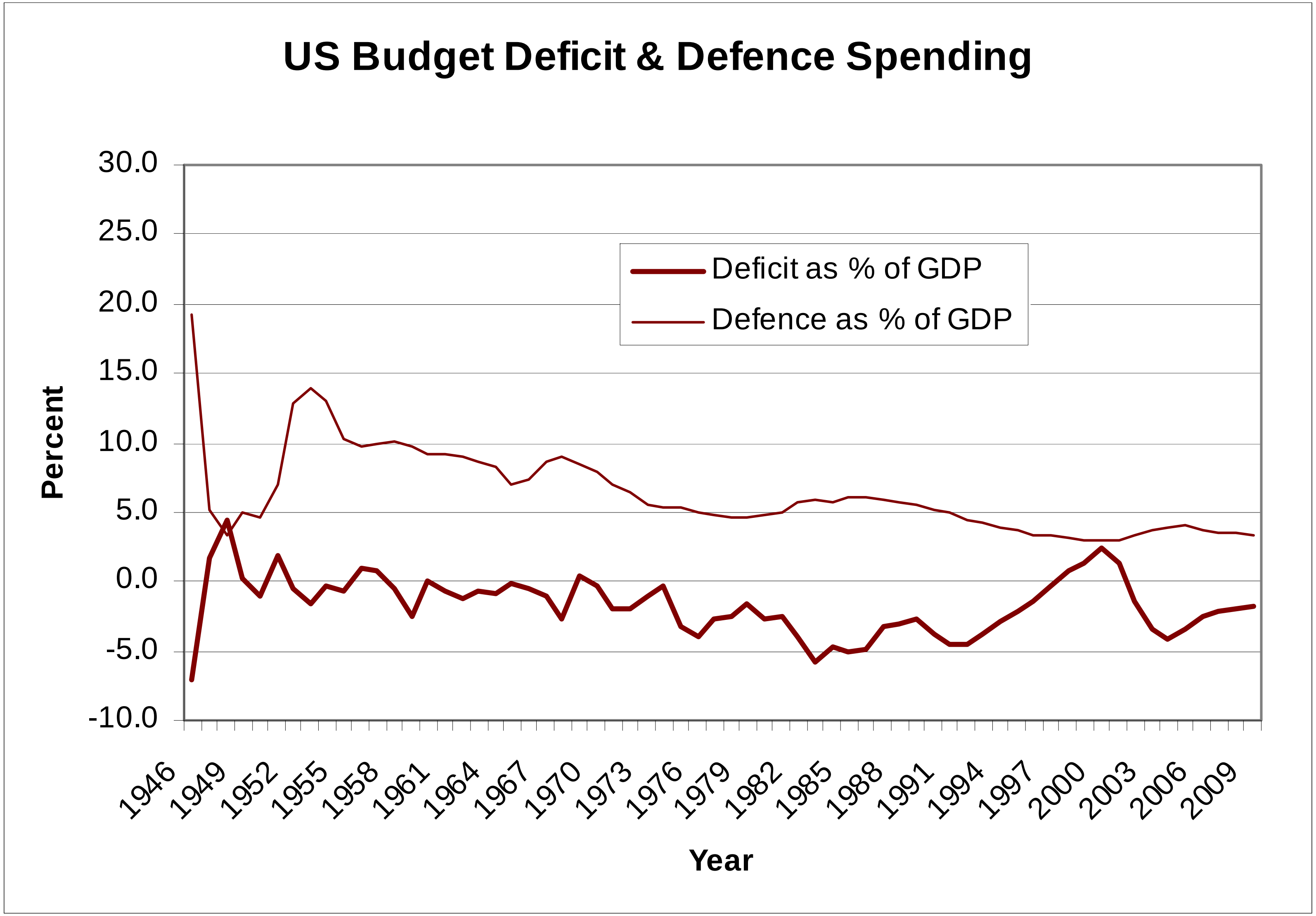
- $US4.4bn per month, or about $US383,000 per soldier
- total of $US95bn to end FY2004

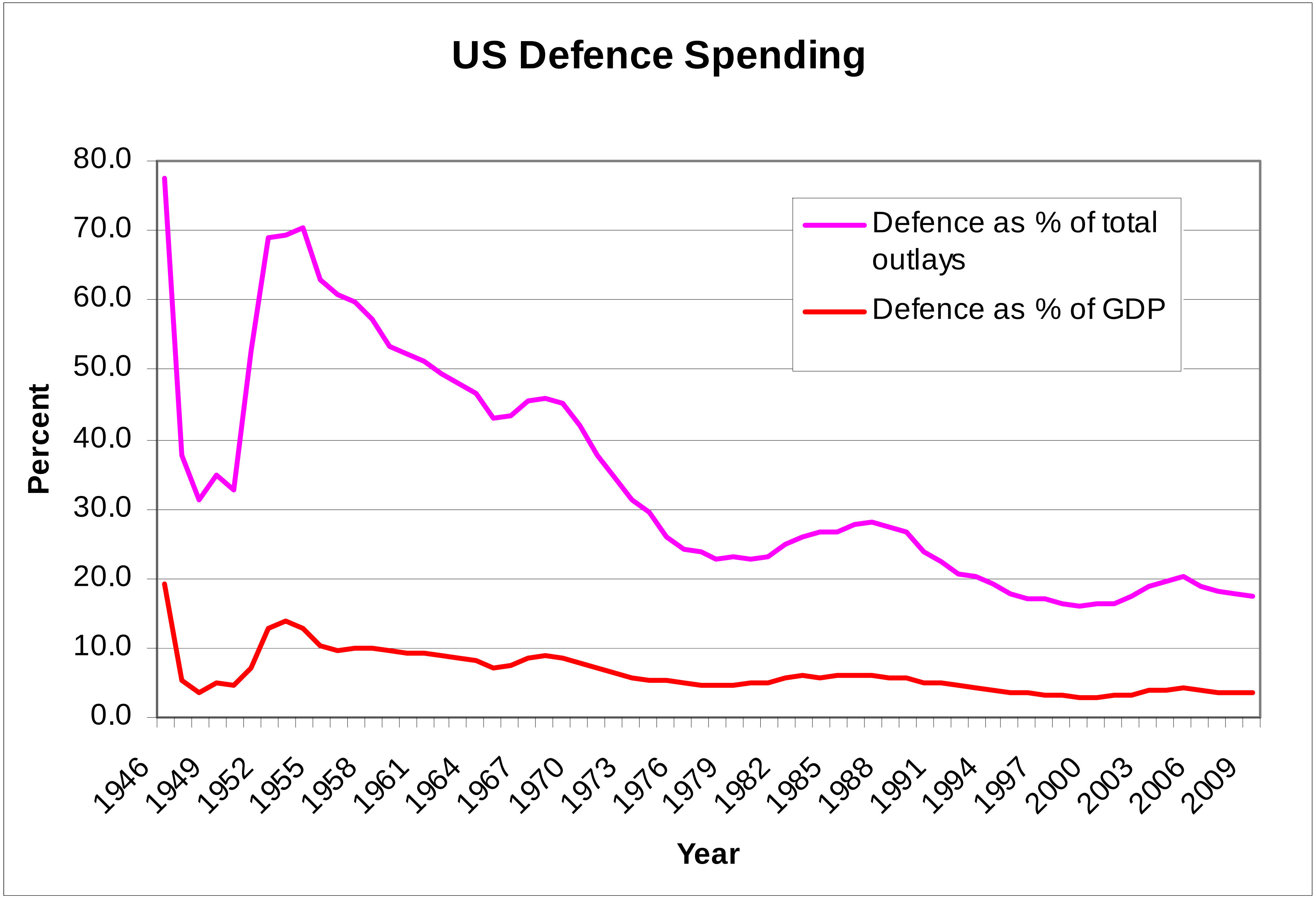
Future:

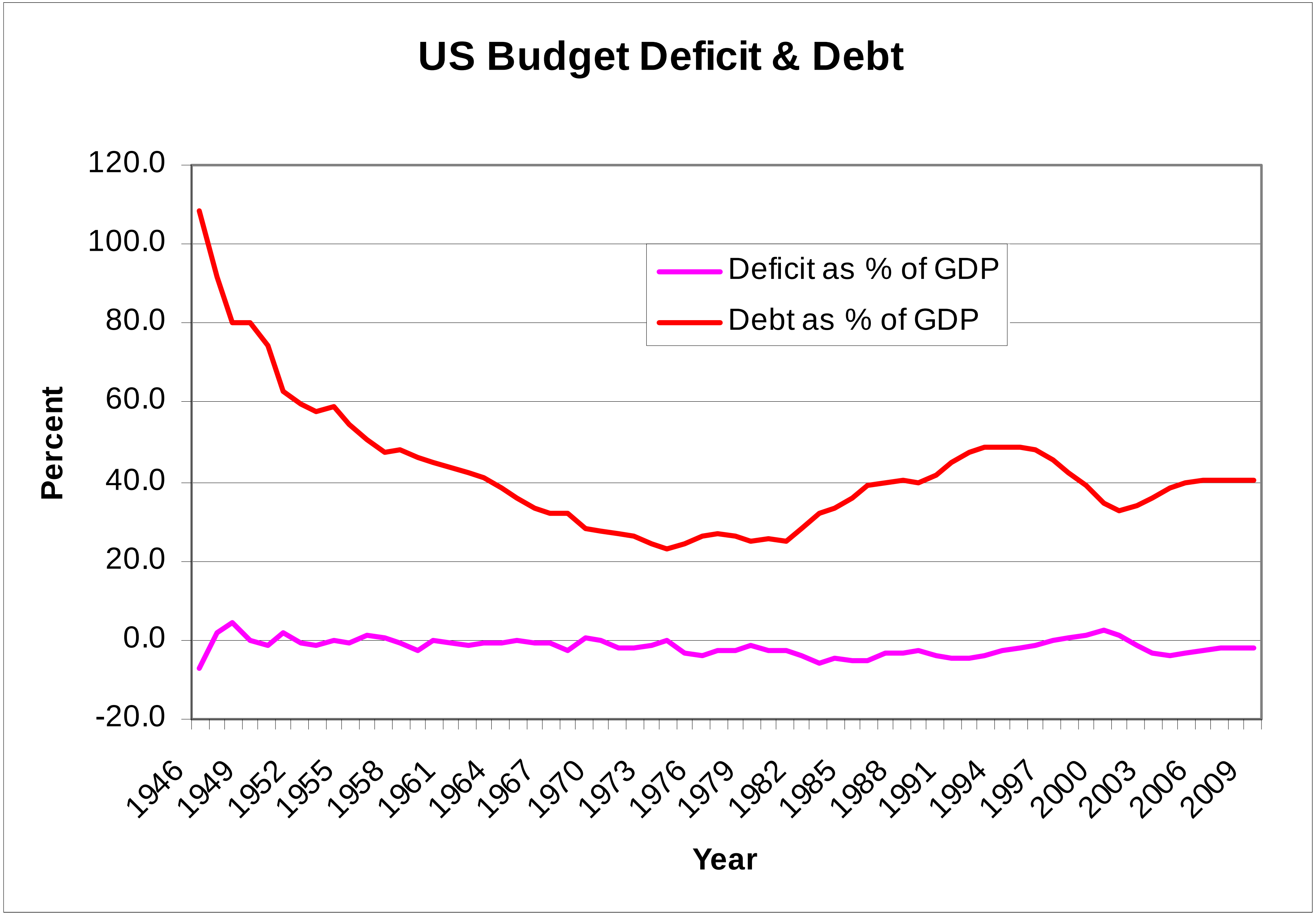
- CBO say $US56bn in FY2005 for present total theatre force of 160,000
- $US350,000 per soldier
- CSBA says cost will be $300bn by end decade if present troop number constant until end 2005 and then reduced by 20/25% per year

Perspectives:

- 2004's $70bn = 0.6% of GDP, 4% of federal spending
- Direct cost of Vietnam was about $US590bn (in 2004 $'s)
- 0.6% of Australia's GDP would be about $A5bn


US Budget Deficit & Defence Spending
Deficit as % of GDP
Defence as % of GDP
Percent
30.0
25.0
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
1946
1949
1952
1955
1958
1961
1964
1967
1970
1973
1976
1979
1982
1985
1988
1991
1994
1997
2000
2003
2006
2009
Year


US Defence Spending
Percent
80.0
70.0
60.0
50.0
40.0
30.0
20.0
10.0
0.0
1946
1949
1952
1955
1958
1961
1964
1967
1970
1973
1976
1979
1982
1985
1988
1991
1994
1997
2000
2003
2006
2009
Year
Defence as % of total outlays
Defence as % of GDP



US Budget Deficit & Debt
120.0
100.0
80.0
60.0
40.0
20.0
0.0
-20.0
Percent
1946
1949
1952
1955
1958
1961
1964
1967
1970
1973
1976
1979
1982
1985
1988
1991
1994
1997
2000
2003
2006
2009
Year
Deficit as % of GDP
Debt as % of GDP

“Good, Bad & Ugly”

The “Good” case:

- *Saudi Arabia*: domestic stability; each year oil production increase each year to reach (say) 13m bpd in 2010
- *Iraq*: domestic stability; massive FI in oil sector; oil production reach (say) 3.7m bpd or more by 2010
- *Russia*: Khodorkovsky & Co left alone; FI in oil fields and pipe-lines
- *Oil prices*: price falls as supply increase faster than demand
- *US Budget*: fast withdrawal of US troops from Iraq; cost down to $US10bn per year by 2006
- *GDP & Inflation*: world growth remains good with little inflation rise
- *Interest rates*: world rates up only a touch

"Good, Bad & Ugly"

The "Ugly" case:

- *Saudi Arabia*: domestic instability; oil exports fall
- *Iraq*: domestic instability; oil exports less than Saddam era
- *Russia*: very little FI; slow oil export growth
- *Oil prices*: price rises as demand increase faster than supply
- *US Budget*: troops in Iraq cost $US50bn per year for next 5 years

- *GDP & Inflation*: would GDP growth be 2 percentage points less and inflation 2 percentage points higher than otherwise?

- *Interest rates*: cash rates rise, but the big increase is in bond yields

“Good, Bad & Ugly”

<u>“Bad”</u> is best bet:

- “Good” needs <u>unrealistic</u> combination of favourable events
- “Ugly” needs many unfavourable events

But:

- “Ugly” may be greater risk than “Good”
- if Saudi and Iraq problems increase, there is little capacity in Russian oil or the US Budget to easily absorb long/large shocks

US between a rock and a hard place:

- needs guaranteed long-term access to Iraqi and/or Saudi oil
- given the Iraq sunk-costs and Saudi risks, US will not readily surrender ultimate control in Iraq

Prof. Saikal’s insights on Saudi Arabia and Iraq may thus best the best “economic” advice you will get for some time.