

## **Saudi Oil Output Falls by 5.7 M. BPD on Terror Attack, Triggering Oil Price Spike**

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On September 14, Yemen's Houthi rebels carried out drone attacks on the core of oil production and shipment facilities in eastern Saudi Arabia, heavily damaging these oil facilities. The attacks on the Abqaiq and Khurais facilities operated by state-run Saudi Aramco forced the facilities to cut oil production by 5.7 million barrels per day, according to a Saudi announcement. The oil production decline amounts to some 60% of Saudi Arabia's total oil production in July, meaning a 6% loss in global oil supply.

The Abqaiq and Khurais facilities are very important for Saudi Arabia's oil production. Particularly, Abqaiq features the world's largest crude oil pretreatment infrastructure, representing the heart of Saudi oil production. Crude oil from major Saudi oilfields undergoes preprocessing to become ready for refining through component and characteristic adjustment before being shipped. The Abqaiq facilities are the core of such preprocessing facilities, having the greatest significance among Saudi oil supply infrastructure. Given their significance, they have been put under tight security.

A Houthi spokesman said that the rebels used 10 drones for the strikes that came as a counterattack in their armed dispute with Saudi Arabia and others since 2015 and that Houthi counterattacks would continue as far as Saudi Arabia continues attacks and containment. Houthi rebels also conducted a drone attack on Saudi Arabia's Shuaiba oilfield in August, attracting attention from stakeholders as a long-range attack from Yemen. The latest drone attacks on the heart of Saudi oil production circumvented tight security, shaking the world anew.

Meanwhile, there are conflicting reports about the details and background of the attacks. A report said that the United States was looking into the possibility of the attacks having been done with cruise missiles. There was no proof that the attacks had been launched from Yemen, U.S. Secretary of State Mike Pompeo noted, indicating Iran's involvement in the attacks. Iran has categorically denied its role in the attacks. Indications are that the Middle East situation would grow uncertain and destabilized.

While the attacks on oil facilities have cut oil supply by 5.7 million bpd, fire at the facilities has been put under control, according to a report. However, it is pointed out that how long the production and supply suspension would continue should be checked further, indicating an unpredictable situation. Concern is growing that the international oil market would be destabilized if the suspension is prolonged.

In response to the large-scale disruption to Saudi oil production, various market stabilization efforts and initiatives have been launched. Saudi Arabia vowed to restore the affected oil facilities and use inventories to make up for the production and supply loss. U.S. President Donald Trump said that

he would consider using strategic petroleum reserves as necessary. The International Energy Agency, which takes care to stabilize the international oil market, has called for a cool response to the Saudi event, indicating that the international oil market has sufficient inventories and stockpiles.

However, the attacks on the key Saudi oil facilities and the subsequent massive oil supply loss could shake the stability of the international oil market or the entire international energy market. The weekend oil supply disruption was followed by crude oil spikes in Western markets on September 16 after the weekend. In Europe, the benchmark Brent crude oil futures price shot up by \$12 per barrel or 19% from the previous weekend to \$71.95/bbl briefly before closing at \$69.02/bbl. The U.S. West Texas Intermediate crude futures price soared by 15% to \$63.38/bbl before finishing at \$62.90/bbl. Since August, the crude oil market had been preoccupied with global economic risks and the fate of the U.S.-China trade war, with prices remaining slack around \$60/bbl for Brent and \$55/bbl for WTI. On the oil supply disruption and growing risks, however, the market could go in a new direction.

Key factors for analyzing the impact of the oil supply disruption are divided into the following three points: First, it is significant that an oil supply disruption has been realized. Attacks on oil tankers and the shutdown of a U.S. military drone near the Strait of Hormuz from June heightened geopolitical risks remarkably but fell short of bringing about any oil supply disruption. In the latest development, geopolitical risks have actually and directly caused an oil supply disruption. Market players may view this point as important. Second, the massive supply disruption came in Saudi Arabia, the center of global oil supply. The oil kingdom is the world's largest oil exporter, representing the gravity center of oil supply. The attacks and supply disruption came in Saudi Arabia that has given top priority to oil facility security to protect oil supply. The scale of the supply disruption at 5.7 million bpd rivals oil supply losses during the past oil crises, the Gulf War and the Iraq War, indicating a large-scale supply loss. The third key point is that Saudi Arabia was attacked and suspended oil supply. Saudi Arabia has the most important surplus oil supply capacity, serving as the last resort to stabilize the market. It is significant that the key oil producing country was attacked. Saudi Arabia can make up for a production drop in any other oil producing country. However, no country can cover any large-scale production loss in Saudi Arabia.

Given the above, the first important point is that future developments may depend on the huge damage and the time required for the restoration of the affected facilities. If the restoration is smooth with oil supply resumed promptly, crude oil price spikes may be short-lived. If the restoration takes much time, however, oil prices may raise their fluctuation ranges substantially amid concern about a tighter supply-demand balance and future uncertainties. The second important point is how geopolitical risks would develop in response to the Saudi event or whether the event could lead to another oil supply disruption. Market players may have no choice but to become nervous about this point. If any large-scale oil supply disruption comes again, the international oil market may go in the direction of destabilization.

The Institute of Energy Economics, Japan, estimates that a \$15/bbl rise in crude oil prices could push Japan's economic growth rate down by 0.2 percentage points. The stability of the international oil market is very significant for energy security and economic management for oil importing countries such as Japan. Stable energy supply is significant for not only Japan but also the entire world. We must closely watch the future Middle East situation, crude oil price trends and the future course of the international energy market.