

Industry Briefing

Middle East oil: Oil and the street

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The Arab Spring is having a knock-on effect on energy demand in the Gulf. Unchecked, this will eat into oil supplies to the outside world.

The Arab Spring has disrupted energy markets. Worries concerning the movement's effects have centred mostly on factors such as the interrupted flow of oil from places like Libya and Syria and an augmented "risk premium" in the oil price. Yet the upheaval in the Middle East that began last year is having the less noted but nonetheless significant effect of boosting energy demand in parts of the region. The risk is that, increasingly, oil on which the rest of the world is counting will be burnt in the countries where it is produced.

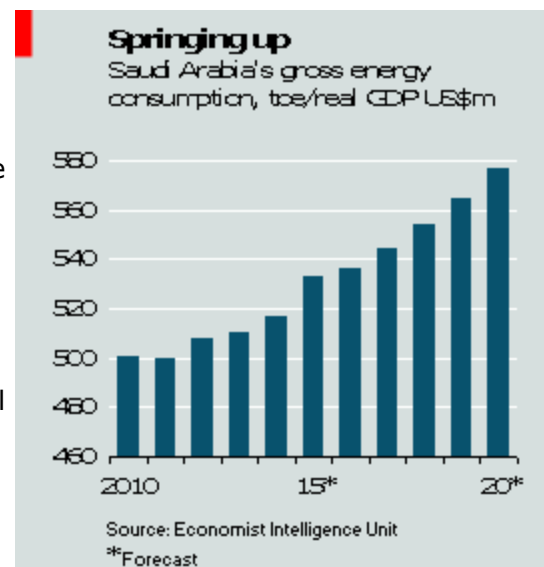
Governments in the Middle East that have survived the popular unrest, especially those in the oil-rich Gulf monarchies, are shoring up citizen loyalty in ways that will stoke energy consumption. Energy-use patterns in the six-member Gulf Cooperation Council (GCC) were already a matter of concern before the unrest. Even as most of the world has been becoming more efficient, squeezing more economic activity from each barrel of oil consumed, the trend among important GCC members points in the opposite direction. In Saudi Arabia, the world's top oil producer, energy intensity rose by a quarter between 2000 and 2010, according to Economist Intelligence Unit estimates, and will stay on an upwards trajectory (see chart). Partly as a result of this, Saudi energy consumption is brisk, growing nearly 7% last year.

Subsidising inefficiency

Underpinning the GCC's rising energy use are some of the world's biggest fossil-fuel subsidies. In Kuwait, for instance, electricity has been fixed at under one US cent/kwh for decades—less than a tenth the rate in the US. Low prices encourage waste: homes are responsible for nearly 70% of consumption in Kuwait, versus about 30% on average in the OECD.

This eats into the oil reserves on which Kuwait's economy is founded. In 2010, an estimated 70% of power was generated by burning oil. Saudi Arabia, meanwhile, consumes more than a quarter of its own oil production.

As a result, many Gulf leaders recognise the need to raise energy efficiency—and they understand that doing



so means energy-price hikes. Tentative moves in this direction were afoot before the Arab Spring. Saudi Arabia and the United Arab Emirates nudged up prices on big residential electricity consumers and further rises were mooted. But unrest in the region has knocked energy reforms off the table in the Gulf Arab states.

Indeed, as rulers have shifted into self-preservation mode, they have replaced reforms with generous giveaways to their citizens. Governments in the region splurged US\$150bn on salary hikes, construction of new electricity infrastructure, houses and the like, according to Merrill Lynch Bank of America. Sweeping commitments such as a pledge by Saudi Arabia's King Abdullah to spend US\$70bn on building 500,000 new homes will spur power consumption. Already, around 54% of Saudi electricity is consumed in the residential sector, much of it to keep air conditioners running. This proportion is set to keep edging up.

Burning money

It is not all bad news. Iran, which demolished some US\$60bn in energy subsidies as the uprisings broke out, held fast. Neither has any of the six GCC members responded by slashing electricity rates or petrol prices, as they have in the past. Yet the danger is that mounting home-grown demand will soon start to eat into some Gulf countries' oil exports.

A December report by London's Chatham House, "Burning Oil to Keep Cool", finds that "Saudi Arabia's domestic energy consumption could limit its exports of oil within a decade". Demand growth at present rates would eventually cut into the kingdom's spare oil-production capacity, and Saudi Arabia would become a net oil importer by 2038. Since Saudi Arabia's "reserve margin" is an important moderator of price swings (allowing it, for instance, to increase output and calm markets when revolution in Libya last year took 1.6m barrels/day off the market), its diminution would weaken an important safety mechanism for the global economy.

Domestic electricity demand in some of the world's chief producer countries could therefore put a strain on energy markets and even inhibit global economic recovery. The UK and Japanese governments have begun quietly advising Gulf countries on improving energy efficiency. But achieving this will be politically difficult. In Saudi Arabia, the EIU forecasts that energy intensity will climb by 15% this decade, spurring an over 50% rise in oil consumption. The world's biggest oil producer is set to become an ever larger consumer of its most precious commodity.

Source: [Industry Briefing](#)