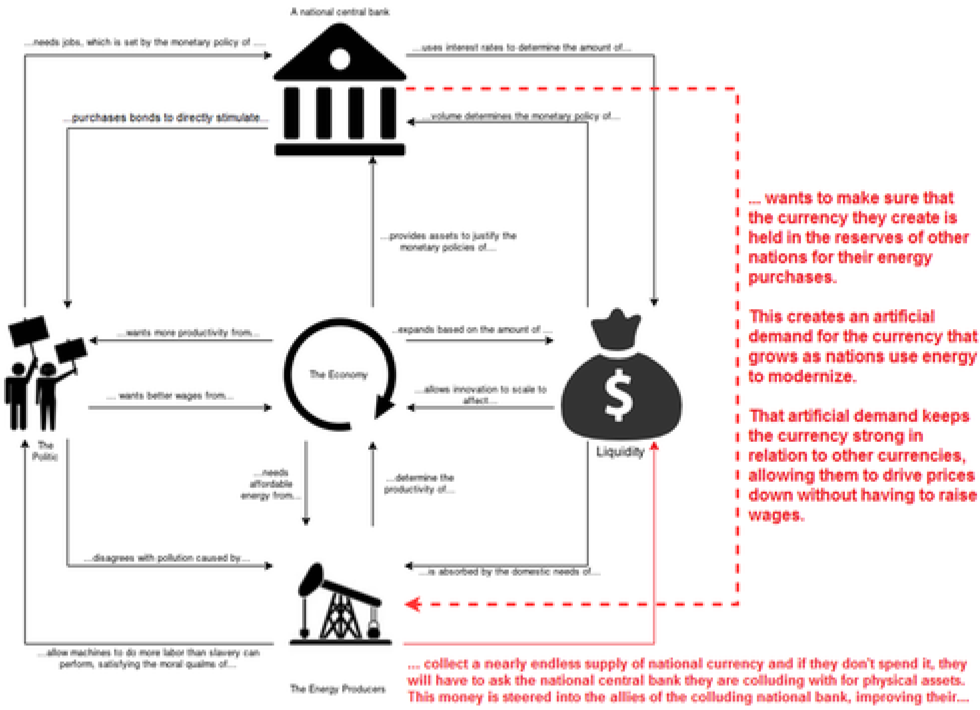
Petrodollar Cracks: Saudi Arabia Considers Accepting Yuan For Chinese Oil Sales

Description

USA: One of the core staples of the past 40 years, and an anchor propping up the dollar's reserve status, was a global financial system based on the petrodollar – this was a world in which oil producers would sell their product to the US (and the rest of the world) for dollars, which they would then recycle the proceeds in dollar-denominated assets and while investing in dollar-denominated markets, explicitly prop up the USD as the world reserve currency, and in the process backstop the standing of the US as the world's undisputed financial superpower.



Those days are coming to an end.

One day after we reported that the "UK is asking Saudis for more oil even as MBS invites Xi Jinping to Riyadh to strengthen ties", the WSJ is out with a blockbuster report, noting that "**Saudi Arabia is in active talks with Beijing to price its some of its oil sales to China in yuan,"** a move that could cripple not only the petrodollar's dominance of the global petroleum market – something which Zoltan Pozsar predicted in his last note – and mark another shift by the world's top crude exporter toward Asia, but also a move aimed squarely at the heart of the US financial system which has taken advantage of the dollar's reserve status by printing as much dollars as needed to fund government spending for the past decade.

According to the report, the talks with China over yuan-priced oil contracts have been off and on for six years but have accelerated this year **as the Saudis have grown increasingly unhappy with decades-old U.S. security commitments to defend the kingdom**.

> The Saudis are angry over the U.S.'s lack of support for their intervention in the Yemen civil war, and over the Biden administration's attempt to strike a deal with Iran over its nuclear program. Saudi officials have said they were shocked by the precipitous U.S. withdrawal from Afghanistan last year.

China buys more than 25% of the oil that Saudi Arabia exports, and if priced in yuan, those sales would boost the standing of China's currency, and set the Chinese currency on a path to becoming a global petroyuan reserve currency.

As even the WSJ admits, a shift to a (petro)yuan system, "would be a profound shift for Saudi Arabia to price even some of its roughly 6.2 million barrels of day of crude exports in anything other than dollars" as the majority of global oil sales—around 80%—are done in dollars, **and the Saudis have traded oil exclusively in dollars since 1974, in a deal with the Nixon administration that included security guarantees for the kingdom**. It appears that the Saudis no longer care much about US "security guarantees" and instead are switching their allegiance to China.

As a reminder, back in March 2018, China introduced yuan-priced oil contracts as part of its efforts to make its currency tradable across the world, but they haven't made a dent in the dollar's dominance of the oil market, largely because the USD remained the currency of choice for oil exporters. But, as Pozsar also noted recently, for China the use of dollars has become a hazard highlighted by U.S. sanctions on Iran over its nuclear program and on Russia in response to the Ukraine invasion.

Today's historic transition is not exactly a surprise: China has been stepping up its courtship of the Saudi kingdom in recent years, helping Saudi Arabia build its own ballistic missiles, consulting on a nuclear program and investing in Crown Prince Mohammed bin Salman's pet projects, such as Neom, a futuristic new city.

Meanwhile the Saudi relationship with the U.S. has deteriorated under President Biden, who said in the 2020 campaign that the kingdom should be a "pariah" for the killing of Saudi journalist Jamal Khashoggi in 2018. Prince Mohammed, who U.S. intelligence authorities say ordered Mr. Khashoggi's killing, refused to sit in on a call between Mr. Biden and the Saudi ruler, King Salman, last month.

It also comes as the U.S. economic relationship with the Saudis is diminishing: the U.S. is now among the top oil producers in the world, a stark reversal from the 19980s when it imported 2 million barrels of Saudi crude a day but those numbers have fallen to less than 500,000 barrels a day in December 2021. By contrast, China's oil imports have swelled over the last three decades, in line with its expanding economy. **Saudi Arabia was China's top crude supplier in 2021, selling at 1.76 million barrels a day, followed by Russia at 1.6 million barrels a day,** according to data from China's General Administration of Customs.

"The dynamics have dramatically changed. The U.S. relationship with the Saudis has changed, China is the world's biggest crude importer and they are offering many lucrative incentives to the kingdom," said a Saudi official familiar with the talks.

"China has been offering everything you could possibly imagine to the kingdom," the official said.

In retrospect, we now know the reason why MBS wasn't taking Biden's phone calls.

Needless to say, the US is not happy with this historic transformation: a senior U.S. official told the WSJ that the idea of the Saudis selling oil to China in yuan "highly volatile and aggressive" and "not very likely." The official said the Saudis had floated the idea in the past when there was tension between Washington and Riyadh.

It is, of course, possible that the Saudis could back off. Switching millions of barrels of oil trades from dollars to yuan every day could rattle the Saudi economy, **which has a currency, the riyal, pegged to the dollar**. Prince Mohammed's aides have been warning him of unpredictable economic damage if he moves ahead with the plan hastily. Or perhaps, Saudi Arabia is merely preparing for the day when the peg will be broken to sever the last major linkage to the US.

Doing more sales in yuan would more closely connect Saudi Arabia to China's currency, which hasn't caught on with international investors because of the tight controls Beijing keeps on it. Contracting oil sales in a less stable currency could also undermine the Saudi government's fiscal outlook.

As the WSJ adds, the impact on the Saudi economy would likely depend on the quantity of oil sales involved and the price of oil. Some economists said moving away from dollar-denominated oil sales would diversify the kingdom's revenue base and could eventually lead it to repeg the riyal to a basket of currencies, similar to Kuwait's dinar.

"If it is (done) now at a time of strong oil prices, it would not be seen negatively. It would be more seen as deepening ties with China," said Monica Malik, chief economist at Abu Dhabi Commercial Bank.

Still, the Saudis still plan to do most oil transactions in dollars, **but the transition has begun, and the move could tempt other producers to price their Chinese exports in yuan as well.** China's other big sources of oil are Russia, Angola and Iraq.

"The oil market, and by extension the entire global commodities market, is the insurance policy of the status of the dollar as reserve currency," said economist Gal Luft, co-director of the Washington-based

Institute for the Analysis of Global Security who co-wrote a book about de-dollarization. **"If that block is taken out of the wall, the wall will begin to collapse."**

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While nothing new to regular ZH readers (see this from 2017, "The World's New Reserve Currency? Everything You Need To Know About PetroYuan"), the idea of a new global reserve currency was reintroduced last week by none other than former NY Fed staffed Zoltan Pozsar who wrote in his latest must read note that "*when this crisis (and war) is over, the U.S. dollar should be much weaker and, on the flipside, the renminbi much stronger, backed by a basket of commodities. From the Bretton Woods era backed by gold bullion, to Bretton Woods II backed by inside money (Treasuries with un-hedgeable confiscation risks), to Bretton Woods III backed by outside money (gold bullion and other commodities).*"

And so the pieces of the endgame are falling into place: Russia starving the western world of much needed resources, sending commodity prices ever higher, while its silent partner China quietly picks up the monetary pieces and takes advantage of the Western scramble to secured resources at all costs, and approach all those other "non-western" former petrodollar clients – who are also rich in other resources – to offer them a new product, the yuan, which Beijing is now actively and aggressively pushing to dethrone the dollar as a global reserve currency.

by Tyler Durden

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