Why We Shouldn't Underestimate China's Petro-Yuan Ambitions

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The de-dollarization of the global oil industry is in a treacherous mission creep phase. Things like this don't happen quickly, but determinedly and gradually, not exactly fitting into today's media headline game that only considers instant developments. But it is happening and the tide will not be turned based on current and near and medium-term geopolitical developments. Credit Suisse's Zoltan Pozsar recently warned clients, in essence, that the de-dollarization of the global oil industry is in full swing–even if we can't see the final end game from here.

And it's all about China, of course. Pozsar does the OPEC math for us.

Some 40% of proven oil reserves belonging to OPEC+ members is owned by Russia, Iran and Venezuela–all of whom are selling to China at major discounts, and all of whom are on board with Beijing's petro-yuan plan.

The countries of the Gulf Cooperation Council (GCC)–most notably Saudi Arabia and the UAE–account for another 40% of proven oil reserves, and they are increasingly cozying up to China.

The remaining 20% is also accessible to China, and China is already the largest importer of crude in the world.

What it all means is that de-dollarization is marching to the beat of a fairly steady drum. In terms of global trade, the yuan accounts for around 2.7% of settlements, while the dollar accounts for 41%. These are the numbers that prompt the new trend of instant gratification to suggest this is not an imminent threat to the dollar. They are wrong. The biggest threats take a significant amount of time to develop. From here on out, the pace will pick up momentum.

China and the GCC

As Oilprice.com reported earlier in December, Chinese President Xi Jinping has pledged to ramp up efforts to promote the use of the yuan in energy deals, suggesting at a summit in the Saudi capital that the GCC countries should make full use of the Shanghai Petroleum and Natural Gas Exchange to carry out its trade settlements in yuan.

The year we just exited should be considered the year in which the petro-yuan really took hold, as China forges a path of increasingly oil and gas purchases from places that are petro-yuan friendly. Russia's war on Ukraine and the Western sanctions response has only acted as a further catalyst.

In a note to clients carried by the Irish Times, Pozsar warns: "China wants to rewrite the rules of the global energy market", and it will do it by first removing the dollar from the orbit of the Bric countries (Brazil, Russia, India, China) that have been affected by the "weaponization" of dollar foreign exchange reserves meant to punish Russia and keep Putin from filling his wartime coffers.

What's happened here is a window of enormous opportunity for Beijing, which has now told the Gulf countries that they are absolutely guaranteed buyers for oil and gas, for payment in yuan, with Xi promising to "import crude oil [and natural gas] in a consistent manner and in large quantities from the GCC".

Xi's trip to Saudi Arabia in early December was precisely about the yuan. This was the defining moment for the petro-yuan. It was an invitation, and it was well-received. China and Saudi Arabia signed over $30 billion in trade deals during the visit. That's $30 billion in leverage that will only help further promote the petro-yuan plan.

More than 25% of China's crude imports come from Saudi Arabia, and it seems inevitable that the GCC will gradually adopt the petro-yuan, even if there will be a lot of roadblocks along the way due to their exposure to Western financing.

What Western minds are banking on–quite literally–is the fact that China alone has $1T in U.S. Treasury bonds. And as for the Saudis, they are truly tied to the Western financial system and the petrodollar. De-pegging the riyal from the dollar, though it has been discussed very quietly (only from a purely research perspective), would be a rather dramatic shock for the Kingdom–one the Crown Prince won't likely be willing to risk for a very long time. But he will actively discuss oil deals with China in yuan.

The Chinese goal is much more patient than any Western mind can fathom. It's about slowly chipping away at the dollar's throne in oil and commodities markets, and as the reserve currency of choice. That is what Brics and the Shanghai Cooperation Organization (SCO) is all about.

And with every geopolitical upset on the level of Russia-Ukraine, and with every tightening of the sanctions screws by the West, Beijing gets a little further with its petro-yuan goals.

There won't be any announcement. There won't be any loud noise. It will happen gradually. It will happen very slowly. And the West will struggle to find its footing when a new global energy order emerges in the longer-term future.

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