The Moscow Times
30 YEARS
INDEPENDENT NEWS FROM RUSSIA

News Analysis: Saudis Need to Undercut Russia

By The Moscow Times

June 30, 2011

The Saudis restrained output while Russia has been pumping freely. **Didi Cutler**

SINGAPORE — Top exporter Saudi Arabia is struggling to sell more crude to Asia because rival producer Russia has taken an expanding share of the world's fastest-growing market.

To get an edge in the competition with Russia and ship more barrels into Asia, the Saudis will have to take the next painful step in reducing global oil prices — slashing their own.

The kingdom has ignored opposition from fellow OPEC members and moved to boost oil supplies to cool prices that have slowed economic growth. Most of any increase in Saudi supplies would flow eastward to feed rapid Asian economic expansion.

Russian supply to northeast Asia is almost five times more than in 2008 as crude flows through the East Siberia-Pacific Ocean (ESPO) pipeline.

"Not only will the Saudis need to amend official selling prices to a level that would entice refiners, but you may also see competition from alternatives," said Harry Tchilinguirian, head of commodity markets strategy at BNP Paribas in London. "And if ESPO keeps building up, the pressure keeps on growing."

A glut in North American crude markets has made it unprofitable to send ESPO crude to the U.S. West Coast, leaving more supply in Asia. The United States typically absorbs the surplus.

The emergency release of oil stocks by International Energy Agency members Japan and South Korea, two of the region's top consuming nations, is adding even more oil to the market. With so much crude on offer, refiners have been reluctant to sign up to buy more from Saudi Arabia.

ESPO is also higher quality than most Saudi crude, giving refiners that lack capacity to process heavier crude little incentive to buy more Arab grades.

Oil pumped through the ESPO pipeline has changed the game in Asia, previously almost captive to Middle East sellers. Russia sells 300,000 barrels per day to China, while another 600,000 bpd can be shipped to the Pacific and onto the Americas and even Europe.

OPEC member Saudi Arabia and independent producer Russia pump almost a quarter of the globe's crude, each holding a similar share of about 10 million bpd. While the Saudis have restrained output since the financial crisis with OPEC agreements, Russia's non-alignment has allowed it to pump freely.

Russia is pumping ESPO crude directly to China through a new pipeline section that opened this year, obviating the need for some imports from Saudi Arabia. In addition, rising exports of East Siberian oil through the Pacific port of Kozmino have gained acceptance among refiners on three continents.

"The waterborne nature of ESPO from Kozmino is allowing Russia to target northeast Asian markets that it could not reach economically before, and it's also better quality than most of the Saudi crude," said John Vautrain, director at Purvin & Gertz energy consultants in Singapore.

Five ESPO cargoes due to load in Kozmino by early August have yet to be sold as the arbitrage to the U.S. West Coast remains closed.

More supplies are adding to that surplus this week, with tenders for late-August and early-September lots. The release of crude from the Strategic Petroleum Reserve in the United States may keep the arbitrage closed.

Tightness for Brent-related grades in Europe because of Libya's civil war and wide discounts for crude priced off the Dubai benchmark, including ESPO, have created unprecedented opportunities for East Siberian cargoes to move as far away as Spain, at least on paper.

"The ESPO quality is closer to the Libyan crude," a trading source familiar with purchases of Saudi crude said. "It's also attractive versus crude from West Africa, which is linked to more expensive Brent."

The discount of Dubai crude to Brent widened to $9.20 a barrel on June 15, the biggest since

October 2004, less than a week after the Saudis signaled they would increase supplies to Asia. That discount prompted Repsol-YPF, Spain's largest oil company, to buy a cargo of ESPO blend.

The competition for market share in Asia is the latest in a long tussle between the two giants of the oil producing world. Moscow provoked the ire of some OPEC members after failing to deliver on pledges to trim output in line with record cuts by the Organization of the Petroleum Exporting Countries in late 2008.

"There has never really been much cooperation between Russia and OPEC," said Greg Priddy, global oil analyst at Eurasia Group in Washington. "The Saudis have never expected Russia to cooperate or share their burden as a swing producer."