

Walking a tightrope

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Asia walks a fine line in pursuit of affordable oil

- S&P Global Commodity Insights analysts expect Dated Brent to average \$104/b in 2022
- China, India increase purchases of discounted Russian crude
- South Korea, Japan turn to fuel subsidies to ease retail price pain

Striking a balance between managing ballooning crude import bills and keeping retail oil prices affordable is proving a tough balancing act for Asian oil importers in 2022.

A sustained revival in Asian oil consumption, tight global crude supplies and triple-digit crude oil prices have forced policy makers to rethink both trade and fiscal policies to ensure that the trickle-down effect of the evolving trends has minimal negative impact on domestic oil demand and national economies.

Asian governments had hoped the sharp rise in crude prices following Russia's invasion of Ukraine would be short-lived but have now accepted the price surge was not just a knee-jerk reaction.

The recourse to various fiscal steps, as well as increased dependence on Russian crude by some Asian consumers, reflects their strong belief that expensive oil is not going away anytime soon as supply outlooks remain tight.

While some leading consumers like China and India have turned to importing the discounted Russian oil shunned elsewhere, South Korea and Japan have stayed away from buying from the non-OPEC supplier and have instead looked at domestic policy measures to ease the pain of sky-high oil prices.

As Russian crude flows shifted in the first half of the year, Asia's four major crude importers altered their buying strategies to take advantage of the situation.

South Korean and Japanese refiners started securing incremental supplies from Middle Eastern producers, while India and China slashed intake from the Persian Gulf to make room for attractively priced Russian cargoes.

South Korea's imports from top supplier Saudi Arabia rose 2.9% year on year to 165.5 million barrels in H1, while Japan took around 2.51 million b/d of crude from Middle Eastern producers, making up 93% of its total crude imports in H1.

In reverse, South Korea and Japan's loss of interest in Russian cargoes accelerated the decline in Russian spot prices, helping refiners in India and China to take advantage of the situation.

New Delhi and Beijing have ignored calls to shun Russian crude, keeping their commercial interests in mind. With Russian oil still not under any sanctions, refiners in those importing nations have been shipping in ample barrels of Russian crude, which has been offered at discounts of up to 30% to the market price.

India's imports of Russian crude rose to 05,000 b/d in H1, up 220,000 b/d from a year earlier, while China's rose 54,000 b/d over the same period to 1.66 million b/d, according to S&P Global analysts.

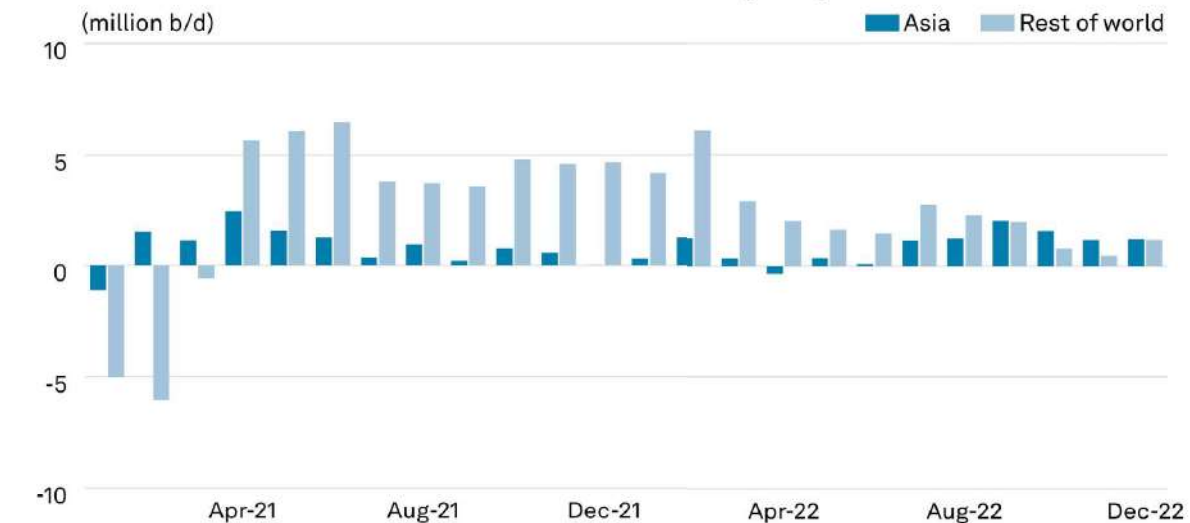
Although India has emerged as a big swing buyer of Russian oil in recent months, competition from Chinese refiners has narrowed the hefty Urals price discounts. The increased share of Russian oil has created direct competition with Middle East sour crudes, and the latter's share in India's crude basket fell from 70% in April to around 60% in June.

Rush for barrels

The competition to secure crude barrels is intensifying among Asian consumers as demand shows signs of a sustained recovery.

S&P Global analysts expect Asian refinery runs to grow by 1.4 million b/d year on year in H2, outpacing growth of 325,000 b/d in H1, on the back of rising Asian consumption and arbitrage opportunities to send products to other regions, including gasoil to Europe.

Asia vs rest of the world incremental runs (y-o-y)

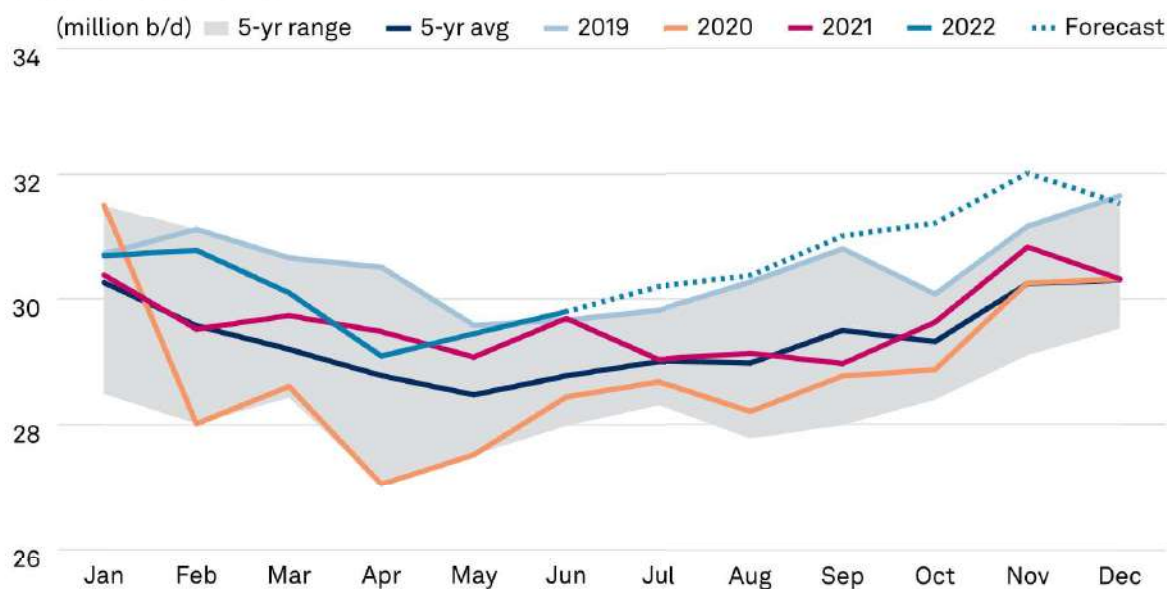


Source: S&P Global Commodity Insights

Asian crude imports are expected to be higher in H2 than in H1 as incremental runs are projected to rise 1.1 million b/d over the same period. Importantly, the region is expected to account for nearly half of global incremental

runs in H2, up from about 10% in H1. This will take Asia's total refinery runs to 30.5 million b/d in 2022, slightly above pre-pandemic 2019 level, the analysts added.

Asia's crude runs



Source: S&P Global Commodity Insights

While demand shows a steady uptrend, on the supply side, regional refiners are not overly excited about the OPEC+ decision to raise September production quotas by 100,000 b/d over August, believing it would be difficult for the producer group to further lift crude output due to limited spare production capacity.

In times of accelerating inflation, high oil prices and rising shipping costs, the most efficient refinery feedstock procurement strategy would be to buy in bulk from a select few major Middle Eastern producers rather than pick up numerous spot cargoes from various suppliers across the world.

As a result, some buyers like India are exploring options to sign new term deals with countries like Brazil.

Fiscal route

According to S&P Global analysts, Dated Brent prices are expected to average \$104/b in 2022, up from \$71/b in 2021, before easing to \$85/b in 2023. Asian governments are now formulating policies to battle oil-led inflation in the hope that it's better late than never.

While some Asian countries, such as India, are reluctantly giving up some revenue by slashing taxes on fuels, other countries, such as South Korea, are shelling out subsidies to ensure the recovery in oil demand remains intact after two painful years due to the pandemic.

"Oil prices are a big concern for the Indian government and the economy now because of its cascading effect. We estimate that every \$10/b rise in the price of Brent crude would raise the headline consumer price index by about 40 basis points," said Dharmakirti Joshi, chief economist at CRISIL, a unit of S&P Global.

As oil prices bite, governments in the region are desperate to come up with policies that will ensure that the impact of high oil prices is minimized without letting the fiscal deficit shoot up or capital expenditure fall drastically.

As an example, South Korea's government has responded to surging retail diesel prices having dampened consumer sentiment by providing more diesel subsidies to cargo truck and taxi drivers to ease the fuel cost burden and revive consumer confidence, according to the Ministry of Economy and Finance.

The threshold diesel price set for subsidy payments was lowered from Won 1,850/l (\$1.45/l) to Won 1,750/l (\$1.37/l) June 1, and the government will compensate half the difference between the average retail price and the threshold base price through subsidy, the ministry said.

Diesel subsidies were first offered in May and slated to expire July 31 but were extended until the end of September.

The moves come after retail diesel prices rose above gasoline prices May 11 for the first time since the global financial crisis amid tight global supply of gasoil. Retail diesel prices had previously long been priced at a discount of about Won 200/l (15.7 cents/l) to gasoline.

Japan has also taken the subsidy route and pledged to increase fuel subsidies to refiners, providing subsidies for gasoline, kerosene, gasoil and fuel oil since January.

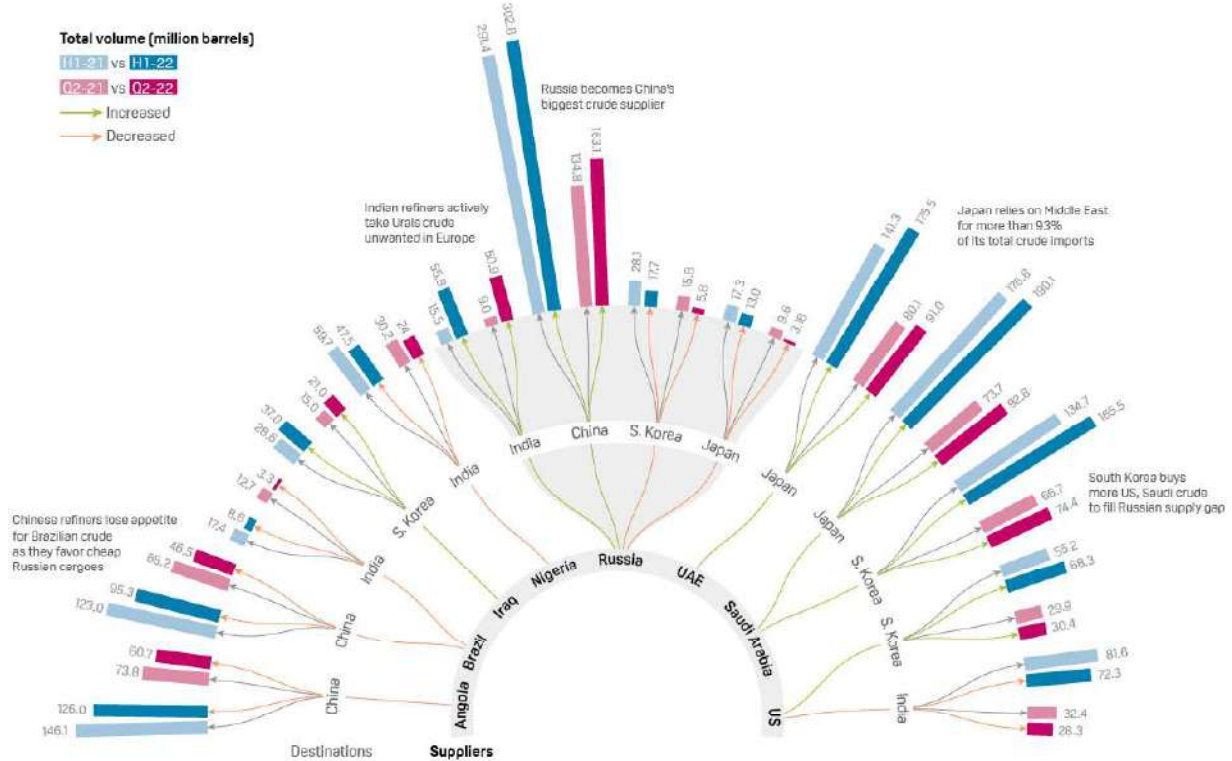
Without the subsidies, the retail gasoline price would have reached Yen 205.2/l on May 23 but was suppressed to Yen 68.8/l, according to the Ministry of Economy, Trade and Industry. Gasoil was suppressed by Yen 36.4/l and kerosene by Yen 35.8/l, it said.

Oil's slide from 2022 highs maybe be providing some comfort to import-dependent Asia, but with the geopolitical situation remaining volatile and the competition for barrels set to remain acute, governments will be reluctant to roll back some of the policies implemented to battle high oil prices too soon.

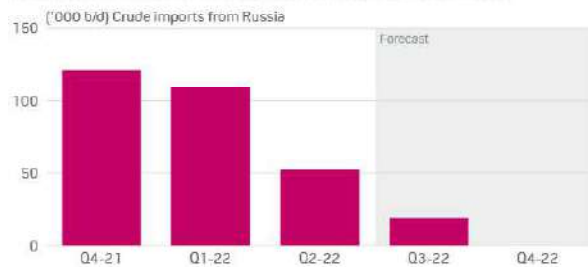
ASIA'S CRUDE OIL DIPLOMACY

Hefty discounts on Russia's crude are increasingly whetting the appetite of China's state-run and independent refineries, while Indian refiners' demand for cheap Russian crude is the strongest ever. Both China and India are stepping up efforts to ensure that surging global prices do not hinder the fragile economic recovery and nascent revival in domestic oil product consumption. However, South Korea and Japan are leading the regional alliance against Russian oil, with refiners indicating that cheap barrels from Russia are not worth taking for those keen on maintaining corporate reputations and willing to stand in solidarity against all acts of violence.

India, China embrace cheap Russian crude but South Korea, Japan comply with sanctions



JAPAN DETERMINED TO END RUSSIAN CRUDE IMPORTS



RUSSIAN CRUDE SPOT DISCOUNTS LURE INDIAN, CHINESE REFINERS

