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the Price War as Necessity  
Nikolay Kozhanov**

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## **Saudi Arabia in Struggle for the Chinese Oil Market: the Price War as Necessity**

### **Nikolay Kozhanov**

#### *Introduction*

The new agreement between the OPEC members and a group of non-OPEC countries (so called OPEC+ group) that was reached on 12 April 2020 does not necessarily mean the end of the price war.

Starting from May, the participants of the renewed Vienna agreement are expected to cut their production by 9.7 million barrels a day in order to raise and maintain the stability of the oil prices. The deal is also supposed to end the oil price war which started after the failure of the [previous attempt](#) by the OPEC+<sup>1</sup> to coordinate the production cuts for April and beyond. However, this will not happen, at least for now. In [mid-April, Saudi Arabia](#) surprised market observers by the declaration of official selling prices (OSP) on its oil for May. Initial expectations were that, in May, Riyadh would increase them to support the common OPEC+ struggle for higher oil prices. However, while raising the OSPs for the US market and keeping them close to the April's low level for Europe, Riyadh further

downed prices for Asia.<sup>2</sup> Moreover, [as reported by Reuters](#), Saudi Aramco tried to provide its oil consumers with options to delay payments for supplies for up to 90 days. These moves clearly showed that Saudi authorities continue their struggle for dominance at the oil markets and consider Asia (first of all, China) as their top priority in this fight. However, this decision by Riyadh should have been expected.

#### *Why China?*

Saudi Arabia traditionally considers Asia and, first of all, China as its main consumer market. Riyadh has never stopped fighting for it with other suppliers to secure Saudi leading positions. Thus, even during the 2015-19 "honeymoon" in Russia-Saudi relations, Riyadh positioned Moscow as its main rival in the Chinese market, occasionally entering into an active struggle for consumers in different regions of the PRC (for example, in the Dalian region). In 2019, Saudi Arabia was even able to push Russia from the first place in the list of oil exporters to this Asian country that Moscow had occupied for several years in a row.

Today, the Saudi struggle for the Chinese market is determined by a serious economic necessity. The current fight for oil markets is different from what Saudi Arabia has experienced before. Previously, its rivalry with other suppliers was to a certain extent indirect: in most cases, it

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<sup>1</sup> In 2016, the joint efforts of Riyadh and Moscow led to the signing of the Vienna Agreement between OPEC and non-OPEC countries (Azerbaijan, Bahrain, Brunei, Kazakhstan, Malaysia, Mexico, Oman, Russia, Sudan, Southern Sudan and Equatorial Guinea (joined the OPEC in 2017)), which was aimed at decreasing oil production to prevent the fall of oil prices and ensure their stability. The participants of this deal were named OPEC+ group.

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<sup>2</sup> It is notable that the discounts provided by Saudi Aramco for Asian consumers in April had already been unprecedented.

has never led to the decrease in the physical oil supplies to China by any of the players. Thus, in 2015-19, Riyadh and Moscow were rivaling for the right to satisfy new oil demand volumes generated by the Chinese economic growth or competing for the possibility to replace Iran and [Venezuela](#) as oil suppliers when these countries almost completely left the Chinese market under the influence of the US sanctions. Now, the global supply glut aggravated by the [unprecedented fall in oil consumption](#) makes the Saudis fight for existing shares in order to ensure that its oil can still be sold. The global oil market is not simply oversupplied but it is also shrinking. The new OPEC+ deal will not [immediately change the situation](#): in May – June it will be able to take from the market only up to 65 per cent of the oversupply. For Riyadh, whose economy is heavily dependent on oil, the preservation of the market share is a matter of life and death. The situation is also aggravated by the domestic fall in Saudi oil consumption and limited available storage reserves. If Saudi Arabia fails to find consumers for its oil, this might not only lead to the fall in the exports incomes, but also to the physical decrease in the output when the storages are full. China with its expected restoration of oil demand (which seems to have already started) and traditionally higher netbacks is naturally drawing Saudi attention. The Chinese appeal is getting even stronger for the KSA as the prospects of European and US recovery from the negative impact of COVID-19 remain unclear and the US authorities are threatening to limit the presence of foreigners in the American oil market.

### *Saudi Chances for Victory*

The Saudi starting point in this struggle is not ideal. Saudi production limits under the renewed OPEC+ agreement make it impossible for Riyadh to affect its positions at the global markets using the status of a 'swing' producer. Meanwhile, Saudi Arabia is not the only one that keeps an eye on the Chinese oil market looking for signs of its recovery and hoping to find an extra place for its oil. West African, Latin American and other Gulf oil producers as well as the US companies are keen to ensure their presence in China. Unprecedentedly low oil prices open the Chinese market for those oil grades that have previously been unheard of selling there. Chinese consumers, in turn, demonstrate no loyalty to traditional suppliers – whether Saudi or Russian – giving preference to those who can offer better prices.

It should not also be disregarded that in the mid-Jan 2020, China and the US signed the so-called "phase one" trade deal that implies Chinese pledge of multibillion oil and petrochemical exports from the United States. [This pledge can definitely](#) help the US in its struggle for the Chinese oil market, negatively affecting the chances of Saudi Arabia to increase its market share in the PRC.

### *Fighting with the Russian Bear*

Russia is not to be forgotten, as well. In March 2020, Saudi discounts for April reduced the appeal of Russian ESPO crude for China. Yet, the situation with the Urals crude oil actually challenged Saudi interests. Traditionally, this grade of the Russian oil was exported predominantly to

Europe. In March, the price of Urals crude fell significantly under the negative impact of COVID-19 on fuel demand in Europe. As a result, even with all high transportation costs added, the Urals suddenly became no less interesting for Chinese consumers than Saudi oil. Subsequently, in March, Chinese oil importers signed deals with Russian suppliers for a record level of Urals' oil deliveries in [April – May 2020](#). Apart from that, falling domestic fuel demand in Russia caused by the COVID-19 and planned maintenance work on some of the Russian refineries also provided Moscow with additional volumes for exports, further bringing down the prices on Russian oil.

Russia's geographical proximity to China remains another important factor. It helps Moscow reduce the transportation cost of its supplies as well as the delivery time. In case of Saudi Arabia, the time and cost of transportation might be a real challenge. In March, Saudi and Emirati plans to increase the volume of oil exports substantially raised the demand for tanker freight and carrier services. The increased cost of rent reduced the Saudi price advantage over Russian oil in April. This problem can be partially solved if the Saudi Arabia decides to use its oil reserves storage in Okinawa to supply China. Yet, given the limited volume of these reserves, this will be only a temporarily solution.

### *Saudi Fatigue?*

The Chinese strategy of diversification of hydrocarbon supplies may play its role against the Saudi interests at the Chinese market. By 2020, the KSA, indeed, managed to significantly increase its share of the

Chinese market. However, this arguably happened by accident: Chinese leadership urgently needed a supplier to replace Iran, Venezuela or the US and it did not have time to properly choose among available options. This, in turn, required China to deepen oil price discounts for Asia in May.

Finally, the 2019 raise in Saudi share of Chinese oil imports goes against the Beijing principles of national energy security which encourage further diversification of oil suppliers. Consequently, in 2020, Beijing will perhaps try to slow down the growth of its dependence on Saudi Arabia. In this regard, maintaining or increasing reliance on non-Gulf suppliers appears to be a more likely scenario for China.

### *Riyadh's Response*

This situation has determined the Saudi price moves in April. Further discounts on May prices for Asia, while either raising or maintaining the prices for other regions, allowed Riyadh to achieve multiple goals at the same time. First of all, Saudi Arabia compensated for the negative effect from the March increase in tanker freight cost. Second, the additional discounts made the ESPO crude even less appealing for the Chinese than it was before, and evened Saudi oil odds with the Urals crude. It also made American and West African offers less competitive. Third, higher prices for Europe and the United States naturally diverted Saudi oil flows from other regions of the world to China, handling the issue of decrease in Saudi production capacities after April. Finally, Riyadh also reduced its competition with the US producers at

the American market. This was not just a way to appease Trump who was seriously concerned about Saudi rivalry with the US oil producers. By doing this, the KSA encourages the Americans to concentrate on their own market first instead of looking at Asia.

In addition, the Saudis have their extra trump cards up their sleeve. The low cost of production (both in terms of operating and capital costs) and wide range of oil grades produced in the KSA provide the Kingdom with both an access to a significant number of consumers and the ability to play with the OSPs. Riyadh's reliance on long-term supply contracts and active investments in the end-users of its oil can ensure a guaranteed market share for Saudi hydrocarbons. Thus, in 2018 – 2019, KSA actively tried to expand its presence in the petrochemical sector of China, preliminarily agreeing to purchase shares in a number of refineries in the country. Finally, Riyadh is able to use its oil storages to react to any raise in Chinese demand without any need to immediately increase the output.

All of these make Riyadh not only determined but ready to wage a war for its share of the Asian market and do its best to preserve its position until the OPEC+ production restraints are eased later this year.

#### **About the author:**

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