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Saudi June Export Cuts Penalize Gulf Refiners

East and West Coast markets treated better.

Morningstar Commodities Research
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Data Sources for This Publication
Energy Information Administration
ClipperData

To discover more about the data sources used, click here.

Rationing Rationale

At the OPEC meeting in May, the Saudis promised to reduce exports to the United States in hopes of encouraging a faster crude inventory drawdown here to bolster market confidence that OPEC production cuts were having an impact. At the latest OPEC gathering in St. Petersburg, Russia, last week, the Saudi oil minister promised that the kingdom would take further action to cap overall crude exports at 6.6 million barrels/day, or mmb/d, during August to speed up the rebalancing of world supply and demand to support prices. The latest Saudi moves have spurred a recovery in the price of U.S. benchmark West Texas Intermediate crude closer to $50/barrel this week—helped by higher refinery throughput and exports. However, Saudi export strategy walks a tightrope between supporting prices and trying to preserve market share. In this note, we take a detailed look at Saudi cuts to their exports to the U.S. during June to show which regions received preferential treatment and which refineries faced the deepest cuts.

Competing Demands

Competing policy demands complicate Saudi market strategy over the past three years since oil prices crashed in 2014. On the one hand, the world's largest petroleum exporter needs higher oil revenue to replenish coffers drained by low prices and to attract a higher valuation for their proposed flotation of national oil company Aramco next year. On the other hand, cutting production and exports exposes the Saudis to loss of market share to non-OPEC rivals such as U.S. shale producers. These competing demands were on display in Saudi tactics regarding crude exports to the U.S. during June. The Mideast powerhouse appears to have carefully targeted the customers they rationed to maximize the impact on U.S. Gulf Coast inventory levels at the same time as trying to protect their market share.

June Cutbacks

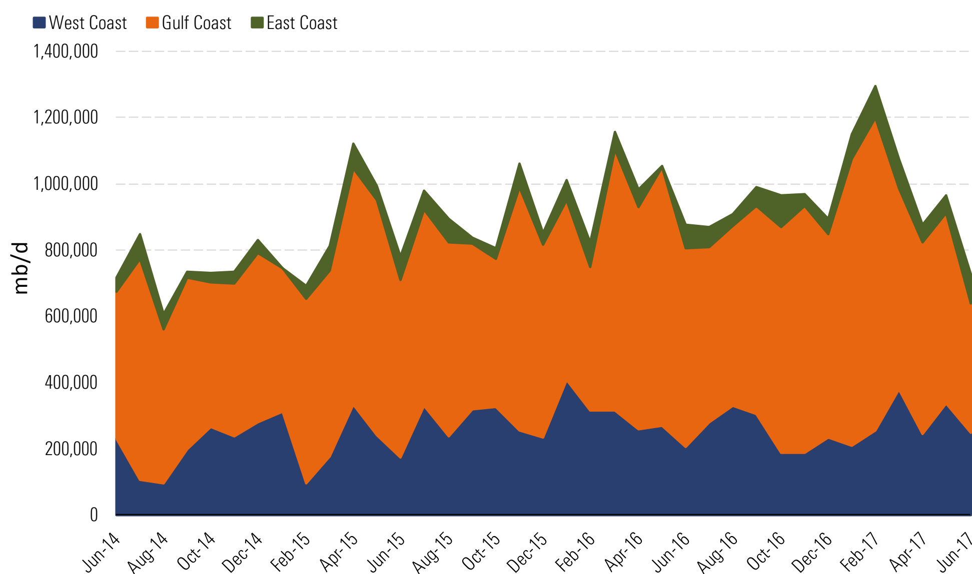
Preliminary data from the U.S. Energy Information Administration indicates that weekly average U.S. imports of Saudi crude during June 2017 amounted to 876 mb/d, or just 72% of the average during the first five months of 2017 and 83% of June 2016 imports. ClipperData projects further significant reductions in Saudi imports during July and August based on crude shipments making the five-week voyage. Our analysis of ClipperData's detailed shipping flows for June[1] indicates that the cutbacks were applied differently by crude region and that the Saudis penalized their refining subsidiary, Motiva, at the expense of other Gulf Coast customers.

1 ClipperData is now available to Commodities and Energy subscribers, click here for more information

Regional Bias

Exhibit 1 shows ClipperData for Saudi crude imports to the U.S. between June 2014 and June 2017, aggregated on a monthly and regional basis. The green shaded area represents imports to two East Coast refineries owned by PBF Energy—the only regional plants that process Saudi crude. These imports averaged 73 mb/d during the first five months of 2017 but increased by 23% to 90 mb/d in June even as other regions were penalized. West Coast Saudi imports (blue shading) averaged 285 mb/d during the first five months of 2017 but fell by 13% to 248 mb/d during June. But it was the Gulf Coast that bore the brunt of Saudi cutbacks. Imports to that region (orange area) took a hefty 46% hit in June from an average 714 mb/d between January and May 2017 down to 390 mb/d in June.

Exhibit 1 Saudi Crude Imports by Region



Source: ClipperData, Morningstar

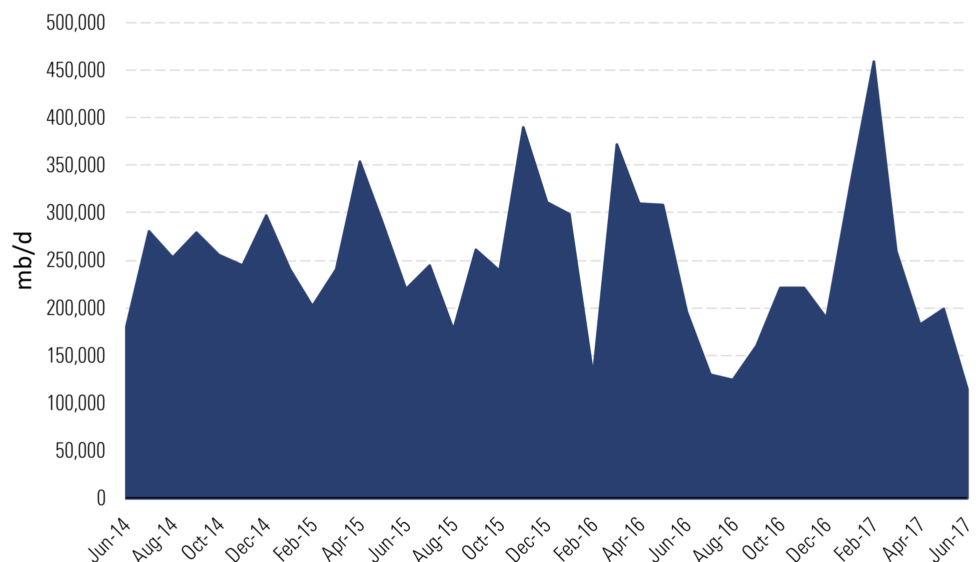
We don't know for sure why the Saudis showed this regional bias in their crude rationing, but a couple of reasons spring to mind. First, the Gulf Coast is a more important barometer of the U.S. market because over 50% of refining capacity is in the region. If you want a visible impact on crude inventory levels, then reducing imports to the Gulf Coast will create more headlines than would the less significant West or East Coast markets. Second, the West Coast is a more competitive market for the Saudi's than the Gulf Coast. On the West Coast, Saudi crudes compete with closer by Latin American producers for market share. Since Saudi crude travels farther to reach the West Coast and since Latin producers such as Brazil (not an OPEC member) have been increasing production lately, the Saudis probably consider their market share is under greater threat on the West Coast. The recent decision of OPEC member Ecuador to abandon its production target underlines this concern. Last, the East Coast market is smaller for the Saudis but is nonetheless important because they risk losing their foothold there with only two refineries buying the type of crude they supply.

Family and Friends

Another good reason for the Saudis to ration imports to the Gulf Coast more severely is that they own the largest refinery in the region outright and have a strong supply relationship with two other plants. This "family and friends" supply relationship allows them to penalize these refineries more than other customers that they do not wish to upset. These three refineries are the 603 mb/d Motiva Port Arthur, Texas, the 228 mb/d Shell Convent, Louisiana, and the 226 mb/d Shell Norco, Louisiana, plants that previously formed the refining assets of the Motiva joint venture between Saudi Aramco and Shell that was unwound in May 2017. In the breakup, Port Arthur went to the Saudis and the Louisiana plants went to Shell.

Exhibit 2 shows ClipperData monthly flows to the three Motiva refineries since June 2014. During 2016 the Saudis delivered an average 221 mb/d of crude to these plants. They then upped their shipments by nearly 50% over the 2016 average in January 2017 to 328 mb/d and then doubled the 2016 average by delivering a whopping 459 mb/d during February. We believe these shipments were planned just before the OPEC cuts came into effect in January 2017 since they would have been shipped out of Saudi in November and December 2016. In effect, the Saudis were front-loading their joint venture refineries ahead of the expected rationing. Shipments to these refineries nose-dived to 260 mb/d in March and again to 182 mb/d in April as the initial OPEC cuts kicked in. During June, the Saudis limited deliveries to the Motiva refineries to just 114 mb/d—about 50% of average deliveries in 2016. The June sacrifice for the Motiva plants represented a cut of 85 mb/d over their May deliveries. That 85 mb/d represents 46% of the total 183 mb/d June cutback in Saudi crude supply to the Gulf Coast region.

Exhibit 2 Saudi Crude Deliveries to Motiva



Source: ClipperData, Morningstar

Pragmatic Approach

So, while Saudi Arabia pledged to do “whatever it takes” to rebalance the oil market at the OPEC meeting in May, in practice the Saudis have adopted a more pragmatic approach. Their caution is understandable. As we pointed out in a June note after that OPEC meeting (see Falling U.S. Crude Stocks Don’t Help OPEC) lower U.S. inventories may actually represent a threat to Saudi market share, since they reflect higher exports of both crude and refined products that compete against OPEC producers. Back in February we also described how record U.S. crude exports resulted from lower OPEC production (see Crude Exports Top 1 Million Barrels/Day to Plug OPEC Gap). And crude inventories still haven’t fallen significantly in the U.S. On July 21, 2017, total U.S. commercial crude stocks were 483 million barrels—still only just below the top of the 10-year range for this time of year. In this respect, the sale of U.S. strategic crude reserves to raise money for the federal government blunted the impact of lower crude imports, but at the same time U.S. producers have continued to increase output—up 640 mb/d between Dec. 30, 2016, and July 21 this year, according to weekly EIA data. Other, less-disciplined OPEC producers have also increased production since January to undermine the impact of the cuts.

In the circumstances, the Saudis are in a predicament. They need to be seen to support prices by cutting deliveries and persuading fellow producers to join them, but by following that policy, they risk losing market share. The details of their rationing policy in the U.S. during June indicate how they are trying to navigate this tightrope as best they can. We believe their only respite can come from a recovery in market demand. That will provide support for prices and better prospects for retaining their share of an expanding market. M

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