

Sino-MENA: China doubles down in Iraq

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- China's oil and gas buying spree is expected to spill over into the first half of 2021 as operators and refiners stock up to meet the surge in heating demand.
- With China's petroleum reserves reaching capacity and oil prices slowly rebounding, China's import binge will likely start to wind down.
- The Iraqi government has taken a crude supply prepayment from China, in a deal where oil is effectively being used as security for a loan, for the first time in the MENA region.

Sino-MENA: 2020 Energy Highlights

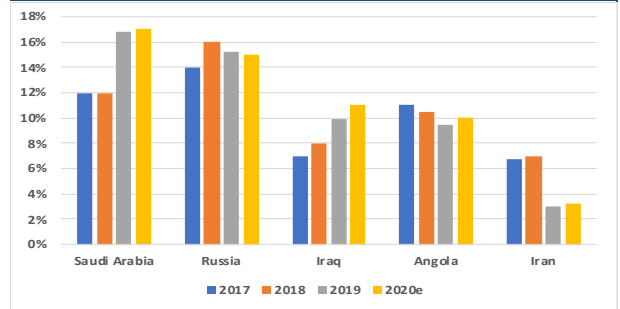
China went on an oil and gas buying spree in 2020 as it took advantage of the low oil price environment and suppliers' price cuts. China's new oil import quota for 2021 (18% higher than 2020) suggests that, with increased demand, the race between Russia and Saudi Arabia to become the top oil supplier to the country will continue.

- Saudi Arabia's oil exports to China have grown significantly over the past decade as the main pillar of bilateral trade.
 - In 2019, Saudi Arabia overtook Russia to become the top supplier to China. It supplied 1.7M bpd of crude oil, worth USD 40B, up 61% YoY from 2019 and representing 19% of total Chinese oil imports.
 - This compares with Russia, which exported 1.5M bpd in 2019 (USD 37B), up some 9% from the previous year and accounting for 15.3% of China's total oil imports.
- The deep price cuts in 2020 saw Saudi Arabia overtake Russia as the top supplier to China once again.
 - Between January and November 2020, Saudi Arabia exported between 1.6M and 2M bpd to China, a 2.2% YoY increase compared with the same period in 2019.
 - The latest data reveals that November exports in 2020 posted a 43% MoM increase. This means the kingdom has solidified its position as the largest oil supplier to China for the second consecutive year.
- Russia came in second place in 2020, as oil exports to China during the same period stood at 1.7M bpd, a 13% YoY increase from 2019.
 - Saudi Arabia's unilateral decision to cut oil output by an additional 1M bpd over February and March 2021, while Russia raises production by 650k bpd over the same period, provides Russia with the opportunity to export more to China, at least in Q1 of 2021.
- Iraq remained the third largest supplier with about 1.2M bpd sold to China in 2020, but its exports saw the largest rise among the top three oil suppliers in 2020. Oil supply to China rose by nearly 190k bpd during January and November 2020.
 - Available data reveals that oil shipments from Iraq to China have increased by 27.5% YoY during H1 of 2020 to 28.8M tonnes from 22.6M tonnes in the same period last year.

Underscoring China's continued interest in Iraq's oil sector, despite the political uncertainties and the ongoing pandemic, an increase in investment is expected moving forward, with financial precedents along the way.

- Iraq's State Oil Marketing Company (SOMO) signed a deal with China's ZhenHua Oil to supply 130k bpd -

Figure 1 – China's Oil Imports by Country (Share of Imports)¹



about 4M barrels a month - over the next 5 years, starting July 2021.

- Under the terms of the deal, China will advance a one-year upfront payment for the supply, amounting to USD 2B.
- The Iraqi cabinet agreed to renew the contract with ZhenHua Oil after a joint-venture deal between the two in 2018 was put on hold due to disagreements.
- To meet the new order supply from China, three new directional oil wells are set to be drilled in the oil field of east Baghdad. The field has approximately 8B barrels worth of oil.
 - This is the first time the Iraqi government has taken prepayment and is one of the largest contracts with oil effectively being used as security for a loan in the MENA region.
 - Globally, it is the second largest contract after the USD 10B record deal raised by Russia's state-run Rosneft in 2013 from European trading companies, Vitol Group and Glencore.
- Meanwhile, China's state-owned oil giants, China National Petroleum Corporation (CNPC) and China National Offshore Oil Corporation (CNOOC) are reportedly weighing a deal to acquire Exxon Mobil's remaining 32.7% stake in Iraq's West Qurna 1 field for USD 500M.
 - West Qurna oil field is one of the world's largest fields with expected recoverable reserves of over 20B barrels. The site currently produces just below 500k bpd.
 - No decision has been made as of now, but this Chinese acquisition, if completed, is expected to open the door to more contracting opportunities.
- China is already dominant at the West Qurna site, not only because of the 32.7% stake held by PetroChina - the listed arm of CNPC - but also through its active acquisition in a range of 'contract-only' deals made on the field.
 - A notable example includes the USD 121M engineering contract won by China Petroleum Engineering & Construction Corp (CPECC) in 2019, the parent company of CNPC, to upgrade the facilities used to extract gas during crude oil production at West Qurna.
- More recently, Iraq has awarded a consortium of Chinese companies construction projects worth USD 20B in al-Muthanna province located in southern Iraq.
 - The projects include the construction of a 1000 MW power plant which is set to launch in Q1 of 2020, along with several industrial projects in the coming quarters for the production of ceramic, paper, and health and sanitary equipment.
- We note that Chinese investments in Iraq total over USD 20B YTD and mainly target the energy sector.
- It is not clear whether the new contracts are within the oil-for-projects agreement signed by Iraq and China in 2019, but with new projects in the pipeline, we expect to see more Chinese investment arrive and potentially expand into non-traditional sectors.

¹ Arabia Monitor; EIA.

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