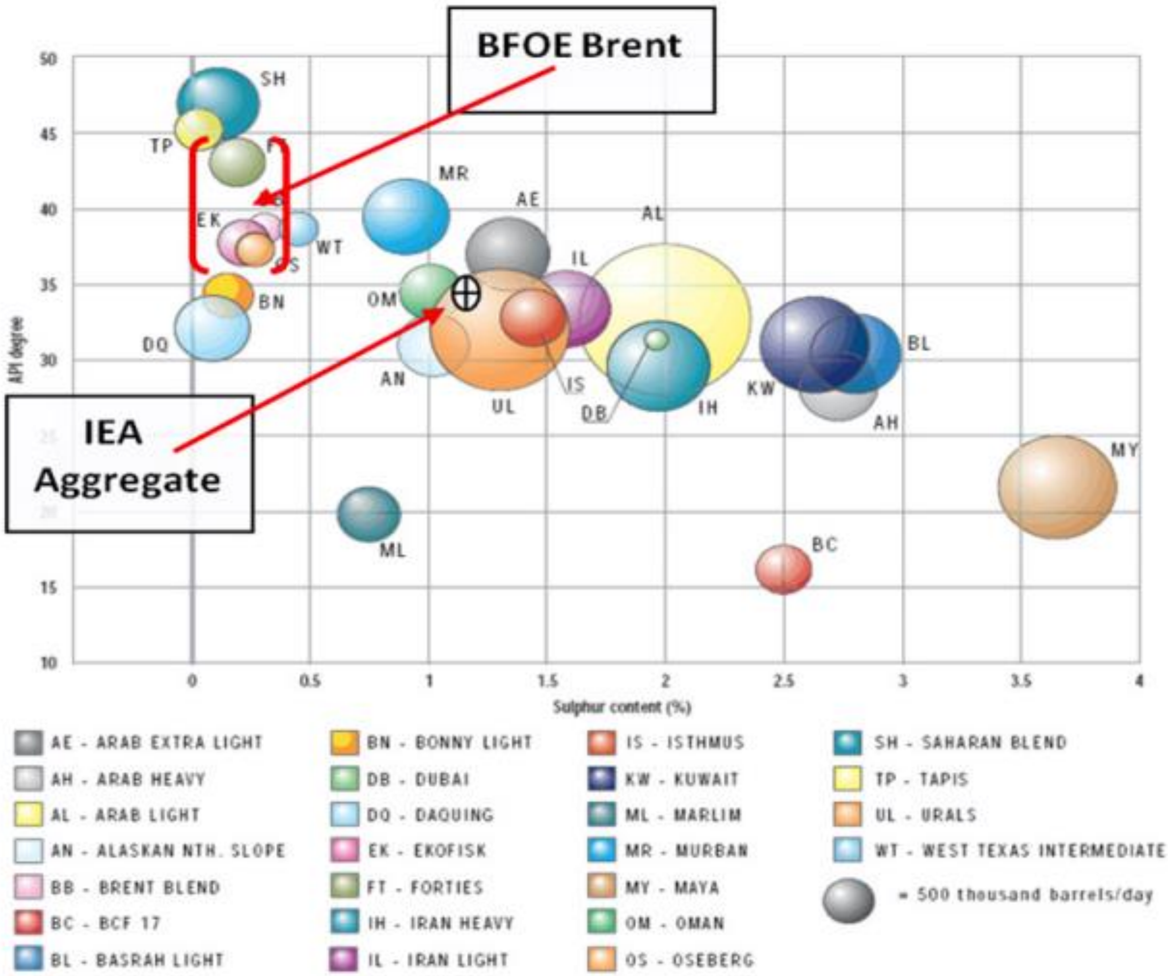
Why China and India Won’t Stop Preferring Russian Oil Imports for a While

Before the start of the Russian “special military operation” in Ukraine, both China and India had radically different positions regarding Russian oil imports. In 2021, Russia accounted for 15.5% of China’s oil imports and was its second-largest supplier after Saudi Arabia. In the same year, Russia’s share of oil imports into India was around 1% with its largest and second-largest suppliers being Iraq and Saudi Arabia.

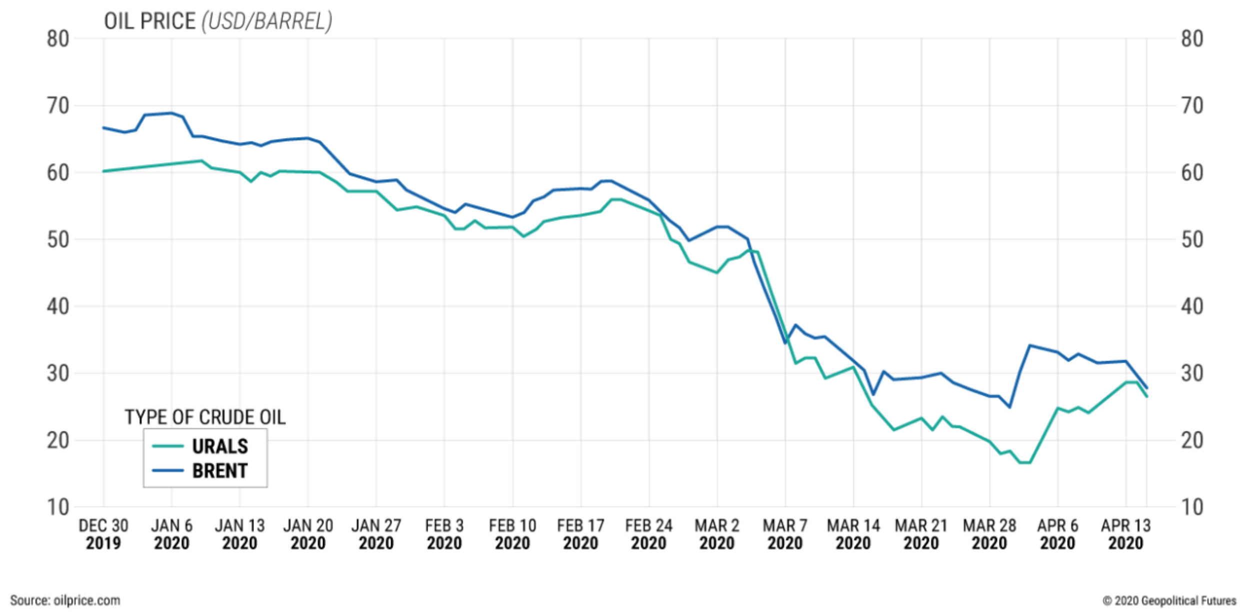
While China is – of course – closer to Russia, the reason for Indian oil buyers not vastly preferring Russian oil imports is two-fold and interrelated. The first one is historic: there are long-established logistical networks from the Middle East and other oil-exporting countries that had enabled a smooth flow of energy products into India. The second is that the quality of Russia’s oil generally less has higher sulphur content and lower density than Brent and other grades.

GLOBAL CRUDES AND THEIR PHYSICAL CHARACTERISTICS – DENSITY AND SULPHUR



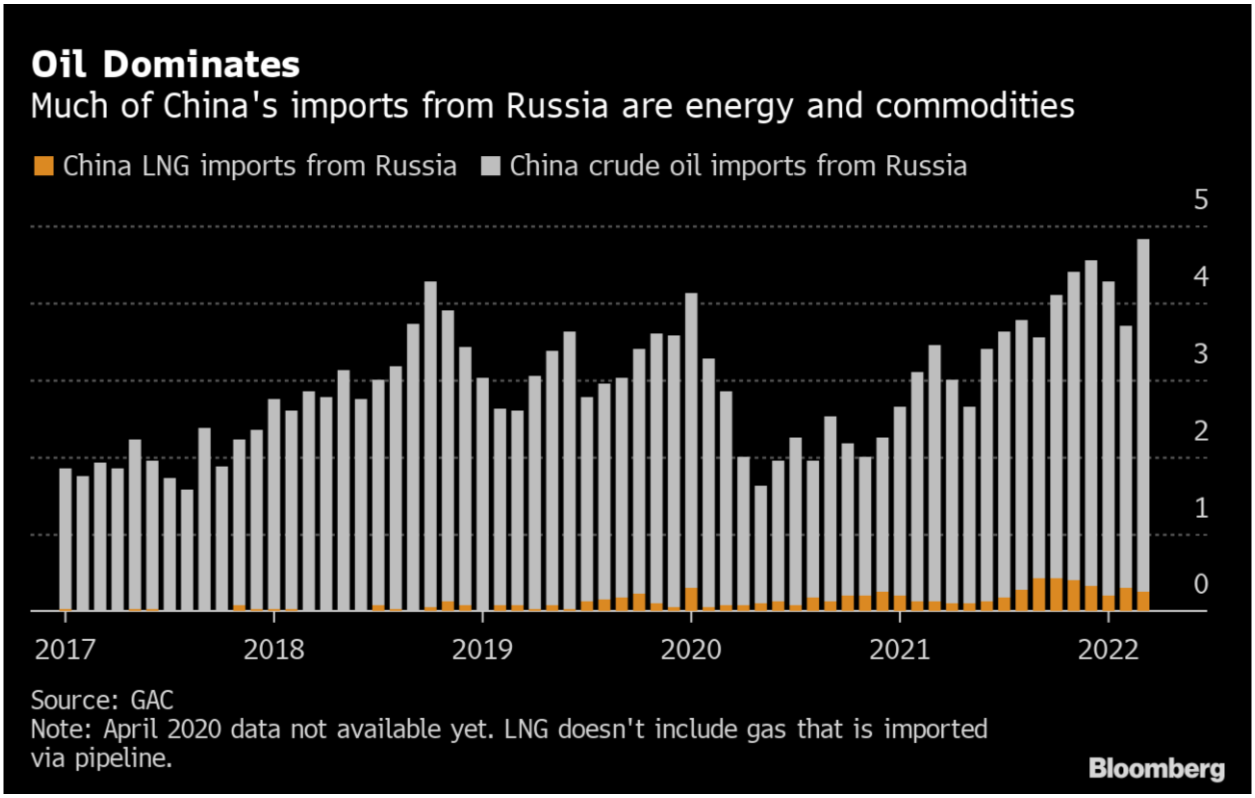
Source: ENI World Oil & Gas Review

Despite the difference in Ural oil grades versus (for example) Brent, the price differentials have narrowed over the years, thereby making the switch rather uneconomical.

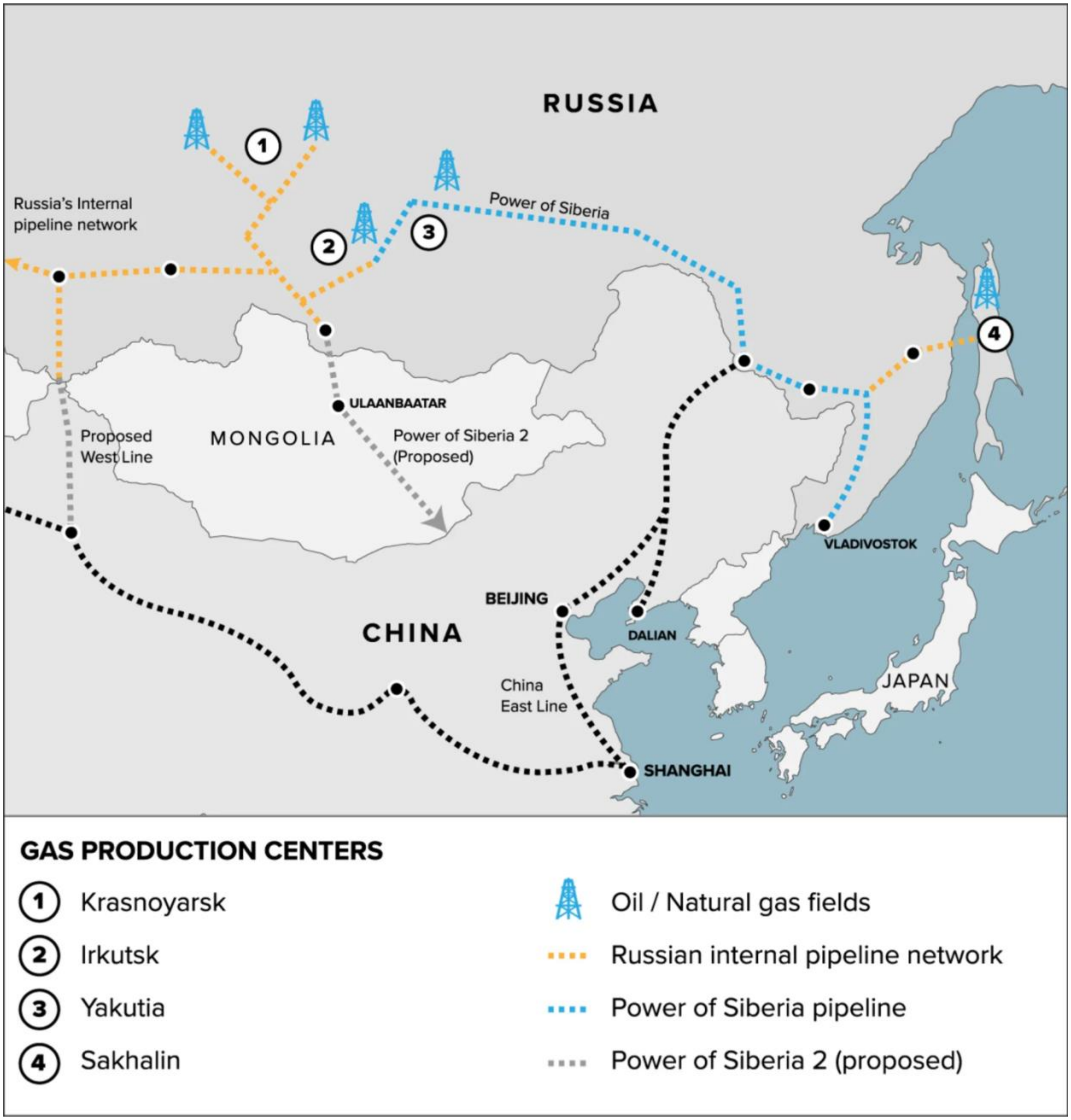


Russia’s oil exports have always been Euro-centric. For instance, most of Russia’s top oil exports have been European countries (after China) in 2020:

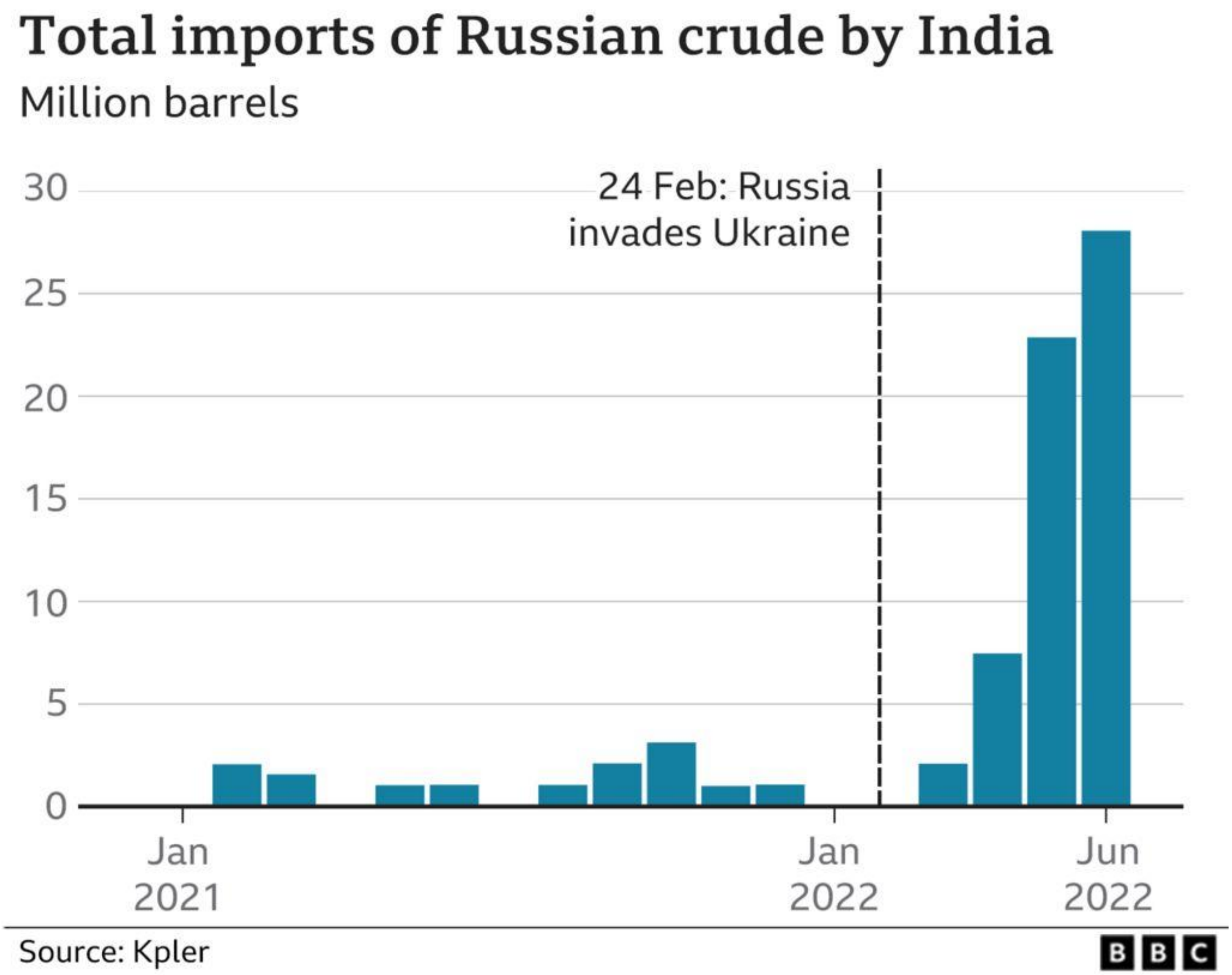
Since the start of the “special military operation”, China has been making a steady increase in its imports from Russia:



In a mark of the Russo-Chinese energy relationship deepening, a new pipeline going through Mongolia and traversing central China all the way through to the prosperous Eastern province is expected to go live by 2024:

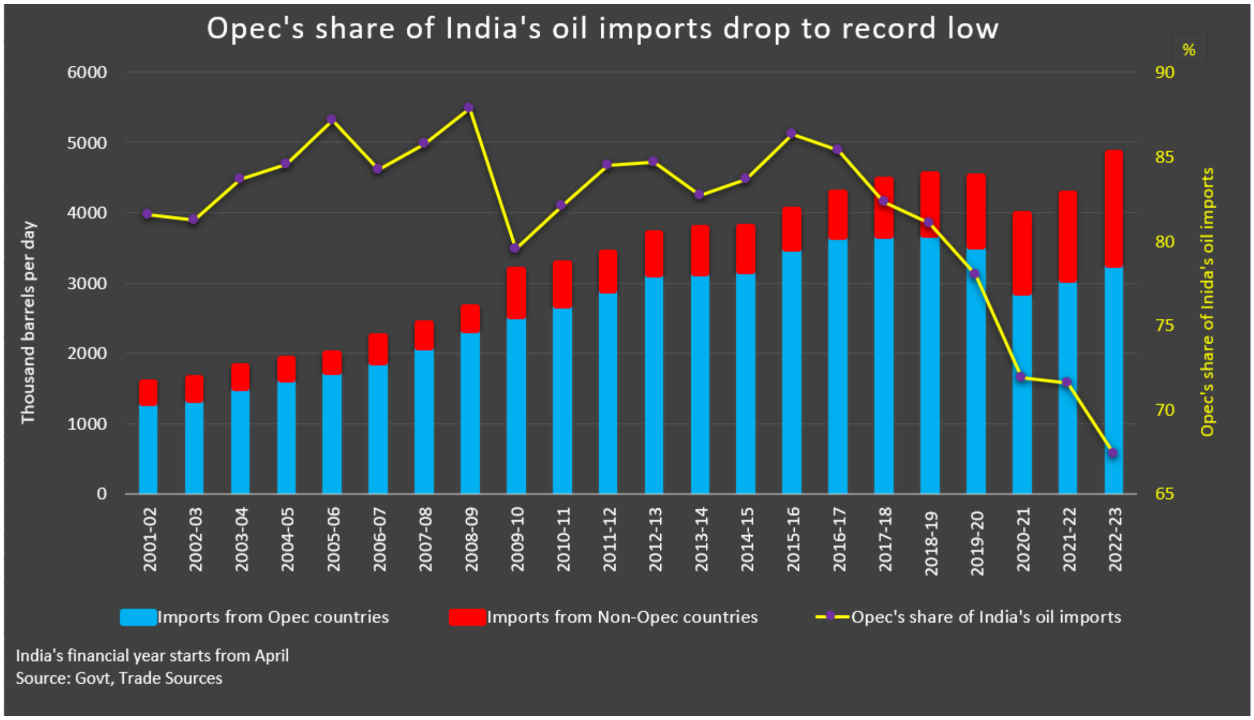


After the start of Russia's "special military operation", trends in India have been changing as well. For the months of May and June, Russia has been the republic's largest oil supplier after Iraq, while Saudi Arabia remained in third spot.



In June, Russia's share in India's oil imports stood at 19.8% of total oil imports (a long, long way away from 1%) while of imports from Commonwealth of Independent States (CIS) countries account for about 24%

Imports from OPEC nations, in the meantime, are at 20-year lows:



A key factor in this lay behind the Russian government - in a bid to continue its presence in the energy market - offering Indian importers steeply discounted oil from April onwards. Under the discount regime and factoring in the increased transit risks as well as the lower grade of oil, the deal was estimated to have a slight upside for the importers. Cheaper Russian oil helped reduce losses for state-run Indian refiners selling subsidized fuel to the domestic market, while adding to profits for private firms Reliance Industries Ltd and Nayara Energy, which export most of their refined products.

Now, while European nations (along with the UK) have passed a slew of sanctions to defang the Russian war machine's revenues, these sanctions have a rather cynical "carve-out": while the EU/UK axis effectively bans Russian energy transactions *in* its territory, it doesn't prohibit energy imports *into* their territories. Thus, the net effect of these sanctions would impact developing nations' consumption far more than the public in Europe. Both India and China are acutely aware of this.

China and India are the world's second- and third-largest energy consumers and have repeatedly petitioned OPEC over the past several years to increase production quotas to no avail. With the current U.S. administration also turning away from issuing new licenses for oil exploration, there is significant gap between growing energy demand and current sources of supply. For India, the net effect of Russian discounts works out to a concession of about $10 per barrel which isn't insubstantial.

Attempts by European and U.S. politicians to shame India and China into participating in sanctions against Russia drew significant ire in both countries. In April, during the course of a "India-US 2+2 Ministerial Dialogue", Indian Foreign Minister Jaishankar's response to the U.S. delegation went viral:

"If you're looking at India's energy purchases from Russia, I'd suggest your attention should be on Europe. We buy some energy necessary for our energy security. But I suspect, looking at figures, our purchases for the month would be less than what Europe does in an afternoon"

In the same month, a popular opinion piece in a Chinese state-owned newspaper (which had no byline; a practice to indicate this view can be considered as an "extension" of the government's position) stated, "By prolonging the war in Ukraine, the US government is trying to shift the problems to other countries. But this is just drinking poison to quench their thirst."

In the GLOBSEC 2022 Bratislava Forum early in June, Minister Jaishankar went viral yet again when a "moral argument" was made for India to stop buying Russia oil:

"Europe has to grow out of the mindset that Europe's problems are the world's problems but the world's problems are not Europe's problems. If it is you, it's yours. If it is me, it's ours."

Both countries' diplomats and officials, despite their fierce rivalry with and growing tensions between each other, are united in their response to any attempts by "outsiders" from steering their nations' destinies. Added to this is the historical component: since their liberation from foreign powers, the USSR – modern Russia's predecessor – lent an unwavering hand in building up both countries' industrial base and military forces until its dissolution. Modern Russia has inherited substantial goodwill from its predecessor, which it has been careful to further nurture.

It has been reported that Indian refiners have made the modifications necessary to process the lower-grade oil from Russia. In the event that the discounts end before the hostilities in Ukraine, the Urals oil – which tends to be discounted relative to Brent – would likely continue to find a market in India, unless Russia begins to divert supplies back towards Europe.

Immediately after World War II, the U.S. dollar was deemed the world's "reserve currency" after the U.S. government agreed to redeem any U.S. dollar for an equivalent value in gold if other countries pegged their currencies to the dollar. The "gold standard" ended in 1971 after stagflation increased gold redemption requests. However, after Saudi Arabia agreed to price oil contracts in U.S. dollars in 1979, the U.S. dollar went on to become the norm for pricing oil contracts everywhere. The dollars residing in oil exporting nations' vaults was essentially outside of U.S. domestic money supply and were called "petrodollars".

Both countries have been working on denominating oil contracts on their respective currencies for some time now and their efforts are beginning to bear fruit: a consortium of Indian and Russian banks have concluded discussions on an agreement to directly translate roubles to rupees without the U.S. dollar as a benchmark and outside of SWIFT primarily to support energy transactions. The Russian institutions could also receive authorization to invest in Indian assets with idle rupee balances. A framework for transacting foreign currencies without requiring the U.S. dollar as a benchmark is currently being worked out by India in Asia, with the UAE and Indonesia showing immense interest in this. Similarly, China has been negotiating with Saudi Arabia an agreement to settle oil contracts in Chinese yuan. Once these kick off, it's an even bet that exporters such as Saudi Arabia, Iraq, Iran and Russia will iron out similar deals with *both* importers and possibly others.

So what of the petrodollars held in the exporters' reserves? These petrodollars would end up being repatriated back to the U.S. and create an increase in money supply, which would exacerbate inflationary pressures in coming years.

Given the state of the Western nations' image in the East on account of their moralistic and high-handed commentary made with little regard for history and offering virtually nothing in terms of pragmatic solutions for real problems, it's an opportune moment to reflect on what's really at stake and if all possible avenues for finding common ground have been pursued to engage with the resurgent East and its teeming billions.