

As Iraq sells more oil to Asia, quality issues emerge
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Iraq's rush to pump more oil to Asia has coincided with complaints from some buyers about the quality of its crude, casting doubt on whether Baghdad can increase the volumes of its key Basra Light grade to the region by a third in 2014.

The Gulf producer has managed to smooth out kinks in its supply chain that curbed Basra Light exports from southern oil terminals last year. The higher output has helped cap oil prices pushed up by recent geopolitical tensions and supply disruptions in Libya, Iraq's own north and elsewhere.

Since December, however, three buyers in north Asia, including two state oil companies in China, have complained about high water content in Basra Light that could mean more upgrading work is needed on Iraq's oil infrastructure or that it needs to slow down loading schedules again.

"Production is indeed higher, but the time needed for base sediment and water to settle down is not enough," said one of the buyers who declined to be named because he was not authorised to speak to the media. "They are just shifting their problems to us."

The three buyers said water has made up 0.3 to 1% of several 2-million-barrel cargoes, resulting in losses of up to US\$3 million (RM9.72 million) each assuming crude at US\$100 a barrel.

The buyers have sought compensation on pricing from Iraq's State Oil Marketing Organisation (Somo) but said they have not received any response to their requests. Somo officials have not responded to e-mail and phone calls seeking comment and further information on the water issue.

Two South Korean buyers said they have not encountered high water content in Basra Light cargoes, while sources at Indian refineries could not say if they have received such shipments. Most refineries can tolerate up to 0.1% water content. Refiners would usually let crude with a higher water content settle in a tank to give time for the two fluids to separate, and then dispose of the water.

It was not immediately clear why higher water content has turned up in some Basra Light cargoes since December, although Iraq has been bringing on new oilfields to boost its output. An official at state-run South Oil Company (SOC), which oversees Basra Light output, said there would have to be further upgrades of oil treatment facilities to resolve the issue.

Current treatment stations for crude produced from Iraq's southern oilfields were designed to process dry oil, not wet, the SOC official said.

The water issue emerged just before Iraq's exports from the south started hitting new peaks after years of struggling to meet supply commitments despite aging terminals and insufficient storage. Volumes, though, remain erratic.

Basra Light exports hit a 35-year high of 2.5 million barrels per day (bpd) in February – up about a quarter from the previous month – before dropping back slightly in March.

In April, exports from the southern terminals are expected to rebound to more than 2.5 million bpd.

Russia's Lukoil began commercial output from one of the world's largest untapped oilfields at the end of March as Baghdad moves closer to this year's production target of 4 million bpd. Output from the giant West Qurna-2 field – a Basra Light producer – is expected to reach 1.2 million bpd eventually, up from an initial 120,000 bpd.

Upgrades at southern oil terminals to be completed later this year and other new output coming online will allow Iraq to ship more crude, potentially meeting contractual commitments of up to 2.8 million bpd of Basra Light in the second half of 2014.

Asian buyers led by China and India signed annual contracts to buy nearly 60% of Basra Light exports this year, or almost all of Iraq's increase in production in 2014, lured by Somo's competitive pricing on the crude.

Still, with the water problem cropping up and with loading still slow sometimes, Iraq is having trouble shaking the reputation built up over the past few years.

"Port conditions are terrible, it's often they make us wait a week (for loading)," said an executive at a Japanese refinery who declined to be named due to company policy.

Somo's terminal upgrades shortened some loading times to as little as five days in March, down from as long as two weeks earlier, traders said, although it is not certain how consistent that will be.

"Iraq is saying that they are doing a lot more improvements, more production and less delays," an analyst with an Asian oil company said. "They will still maintain a discount (to Arab Medium price) but it will not be as cheap as before."

Somo has already narrowed Basra Light's discount against rival Arab Medium from Saudi Arabia this year on growing confidence it will be able to meet contract obligations with fewer delays.

But buyers still worry that political instability in Iraq and disputes between Baghdad and Kurdistan over oil could continue to disrupt supply of its other crude grade Kirkuk.

Opec's overall oil output fell in March to its lowest since December, according to a Reuters survey, mainly due to lower shipments of Kirkuk crude because of pipeline sabotage. – Reuters, April 9, 2014.

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