

GX EUROPEAN REFINED PRODUCTS MARKET ANALYSIS

The Big Picture

- Brent stems losses after recent energy crisis rally
- Record USWC gasoline pricing could attract more barrels from Europe
- Biden outlines new travel policy; European air traffic recovery continues over half-term
- Asia Spotlight: China issues 4th round crude import quotas

Eurobob Oxy Gasoline NWE FOB Barges

800.00 -8.25
EUROBOBC 

Jet Fuel NWE CIF Cargoes

747.50 -4.00
JETNWECC 

ULSD NWE CIF Cargoes

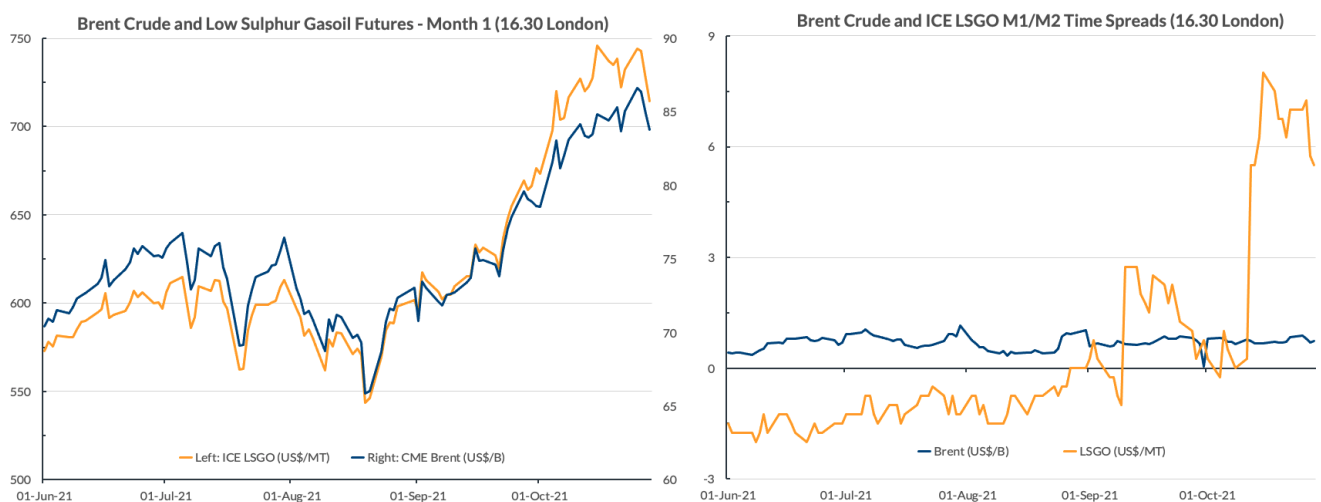
719.50 -8.00
ULSDNWECC 

Naphtha NWE CIF Cargoes

757.75 -3.00
NAPNWECC 

Macro Update: Brent stems losses after recent energy crisis rally

Markets sold off after hitting fresh highs, as the underlying winter energy momentum began to show some tentative signs of easing. Prompt CME Brent futures reached \$86.60/b at 16.30 London time on Monday, but fell to around \$82.40/b in early trading on Thursday before recovering later in the session.



Prices have been supported this month by firm distillate demand and sky-high gas and electricity prices pulling up prices for heating oil, LPG and crude. In recent days, some support also came from crude production outages in Libya and Nigeria. On 27 October, Shell declared force majeure on Bonny Light – Nigeria’s flagship crude – while output of Libya’s key export grade Es Sider is down slightly owing to a pipeline leakage. OilX expects November loadings of the latter grade to be down 26,000 b/d as a result. And the release of a fourth batch of crude import quotas for Chinese teapot refiners briefly led to a jump in east of Suez crude prices and a wider backwardated structure (*see Asia Spotlight analysis below*).

But cooling Chinese coal prices and fresh comments from Russian President Vladimir Putin indicating an imminent increase in Russian gas supplies to Europe could be easing fears of a winter energy crunch. Further supporting the sell-off was a 4.3mn bl rise

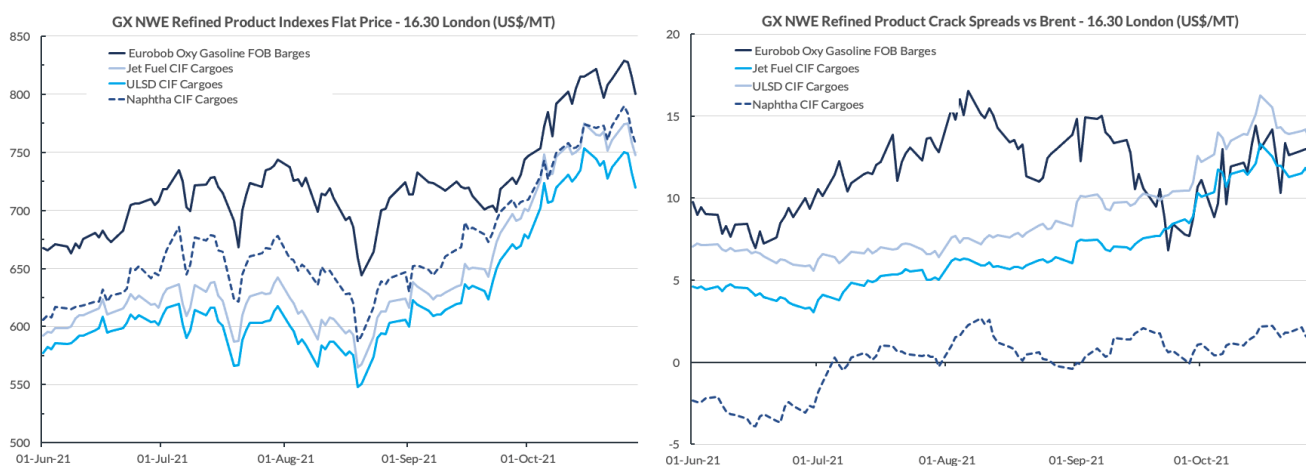
in US commercial crude stocks in the week to 22 October, eating into crude's recent gains. Despite the broader rise in US crude stocks, one noteworthy development is the decline of stocks at Cushing, Oklahoma – the delivery point for WTI futures – by 3.9 mn bl last week to 27.3mn bl, or the lowest level since October 2018.

Saudi Arabia's energy minister Prince Abdulaziz bin Salman told Bloomberg Television on Saturday that the crisis (of demand) was contained but not over and preaches caution, justifying the measured return of oil output. So did Timipre Sylva, the Nigerian petroleum minister, using the recent slowdown in the Chinese economy as an example of potential bearish influences on demand. Despite this anticipated risk and the appearance of some fresh Covid-19 clusters in China, for example, the global demand outlook remains positive in the medium term.

Negotiations over the Iran nuclear deal are set to resume within five weeks, which could lead to a further downward move in crude should further supply be brought back to the market from the OPEC member-state. Analysts at ING estimate Iran's production could reach 3.2mn b/d over 1H2022, up from around 2-2.5mn b/d currently. However, as we saw last time negotiations picked up, the parties involved remain relatively far from reaching an accord.

On Thursday, 28 October at 16.30 London time, the front-month Brent contract was last reported trading at \$83.80/b, up \$0.14 /b on the week. In Northwest Europe, ICE Low-Sulphur Gasoil futures had last traded at \$714.25/MT, down \$12.75/MT day on day and \$8/MT on the week. The Eurobob gasoline November swap was heard around \$780.84/MT, down \$9.37/MT on the day and up \$3.35/MT on the week.

Middle distillates trended flat-to-a touch bearish for most of the past week, suggesting some stability after a transformative summer for diesel and jet fuel's fortunes. The crack spreads for the key transportation fuels have each rallied by more than \$10/b since July, with jet fuel and diesel peaking above \$13/b and \$16/b, respectively, by mid-October. Prices have subsequently dropped back to around \$11.20/b and \$13.40/b. Energy Aspects described diesel as in the grip of a "spiralling supply crunch" as natural gas prices impact refinery output and the curtailment of Chinese exports squeezes the global distillate pool. "European refiners, pinched by record gas prices, are sacrificing diesel yields to cut sour crude intake," EA analysts also wrote in a recent report. The cooling over the last 10 days of diesel cracks could therefore be a sign of a market pausing for breath. The fundamentals, encapsulated by the \$5.50/MT backwardation over the ICE LSGO M1-M2 timespread, remain overwhelmingly bullish.



Light ends remain strong globally, particularly on petrochemical feedstocks. Indeed, the natural gas crunch is keeping European LPG prices above \$800/MT, with Propane and Butane CIF NWE Large Cargoes pegged at \$807/MT and \$824.50/MT respectively on 27 October. Consumers looking for alternative feedstocks have turned to naphtha, which is still trading at a sizeable discount to both C3 and C4, lifting demand for naphtha. However, the spike in energy prices has kept refinery run rates in check which in turn is placing some strain on naphtha supplies. With ethylene demand for November expected to be high and ethane supplies obviously limited by the general gas market tightness, prices are expected to remain supported in the coming month. In the gasoline market, trading activity picked up significantly on finished-grade gasoline barges in the end-of-day trading window in October, compared to September, usually indicative of stronger gasoline cargo export interest to West Africa – a topic we will explore in next week's digest.

Biden outlines new travel policy; European air traffic recovery continues over half-term

In aviation news, the Biden administration, after much delay, this week released details of its new non-essential travel policy, while European air traffic climbed to within 24% of 2019 levels—the narrowest on this metric since the pandemic began.

From 8 November, vaccinated travellers from several dozen countries, including the UK, most of continental Europe, China, and India, will be allowed entry into the US if they show proof of a negative Covid-19 test within three days of travel. The unvaccinated must show a negative test within one day of travel. Children under 18 won't need to be fully vaccinated but will still have to return a negative test to travel.

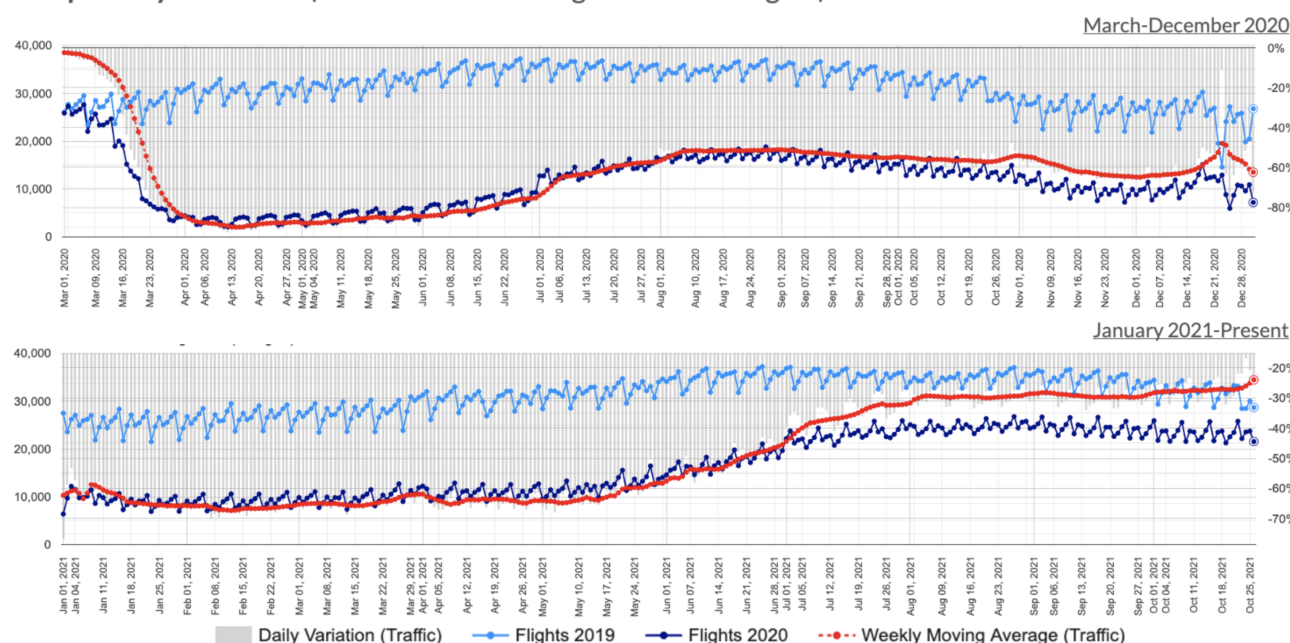
News of a shift from the Trump-era travel ban was first signalled by the White House on 20 September, when world leaders gathered in New York for the UN General Assembly, but the relaxation date of 8 November was not announced until 15 October.

Flight bookings to the US jumped after each announcement and now stand at more than 70% of pre-pandemic levels, industry title *Travel Weekly* reported this week, citing ticketing data from research company Forward Keys. "This data yet again demonstrates the enormous pent-up demand for travel," Juan Gómez, head of market intelligence at ForwardKeys, said.

Other expectations, however, are more moderate. "Anyone hoping for an explosion of international inbound visitors will be disappointed," Henry Harteveltdt, a travel-industry analyst in San Francisco, told the *Associated Press*. "Nov 8 will be the start of the international travel recovery in the US, but I don't believe we see full recovery until 2023 at the earliest."

Closer to home, Eurocontrol data shows that while the overall number of flights is falling in line with seasonal expectations, traffic volumes taken as a percentage of 2019 flights have closed the gap on pre-pandemic levels. On 26 October, flight volumes were exactly 24% behind this stage in 2019. This is the narrowest the gap has been on a percentage basis since 17 March, 2020.

Europe Daily Air Traffic (Total Network Manager Area - All Flights): Eurocontrol



A boost in capacity in Western Europe linked to the half-term holidays has supported volumes, with the number of seats scheduled in the region rising 2.8% to 16.336mn for the week commencing 25 October, according to aviation analysts OAG. This put capacity 24.2% behind 2019 levels. Capacity also increased by 1.6% across Eastern/Central Europe to 3.5mn seats, 10.8% behind 2019 levels.

OAG said UK traffic has been bolstered by British Airways and Ryanair “both adding back some capacity this week and breaking back through the two million seats a week mark for the first time since the week commencing 23rd March 2020”. Tanker tracking shows seaborne jet fuel imports into the UK are expected to reach 555,000 MT in October, the highest monthly figure since January’s 596,000 MT, according to Kpler. UK air traffic is some 37% behind 2019 levels, the best since 19 March 2020, Eurocontrol data shows.

Record USWC gasoline pricing could attract more barrels from Europe

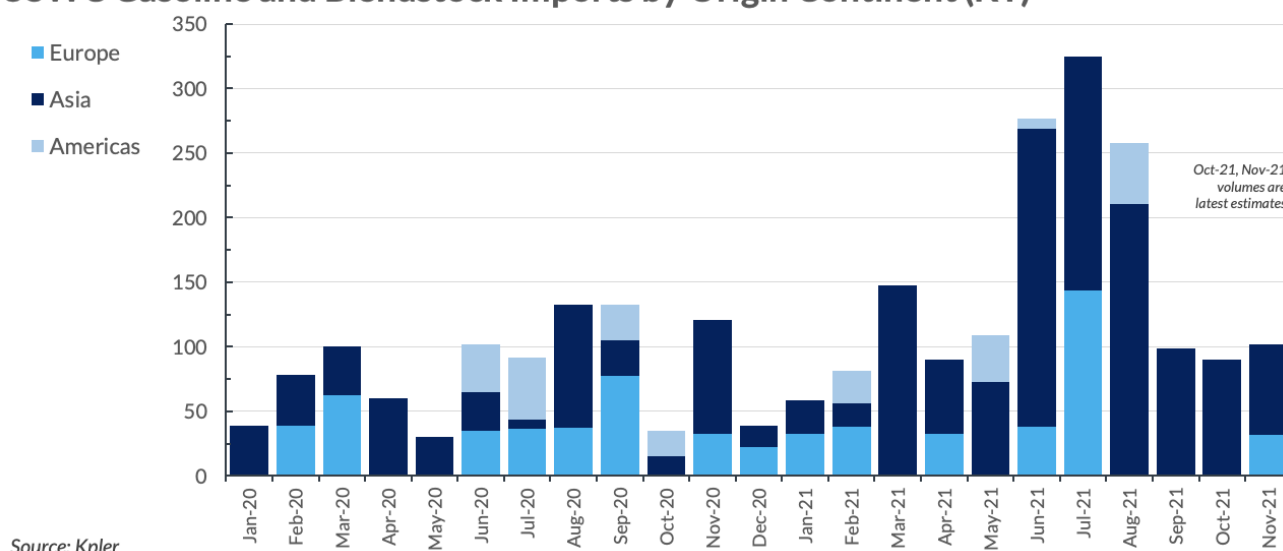
Record retail gasoline prices in California are yet to attract the kind of inbound arbitrage cargoes seen in the past when fuel prices sharpened, but some barrels are already set to move from Europe.

The retail price in San Francisco hit \$4.76/gal on Wednesday, beating the record set in 2012 after a Northern California refinery fire, according to auto club AAA. The price has risen 39% since October 2020. Differentials for blendstock in the San Francisco cash trade have been rising.

Despite strong margins in California, gasoline imports into the US West Coast (PADD 5) region have not topped 150,000 b/d – the equivalent of three cargoes a week – since early September, according to EIA data. West Coast gasoline import flows routinely topped that threshold in the first half of 2021 as demand rose and California eased pandemic restrictions.

The Asian market – typically a top source of gasoline flows into PADD 5 – is getting tighter as China keeps more product within the domestic market, cutting exports. Analysts at OilX peg the Asian gasoline supply-demand balance at a -559,000 b/d deficit in October. The Middle East, from which gasoline has also shipped to PADD 5 previously, is pegged at a -35,000 b/d deficit this month. And North West Europe – having enjoyed a 162,000 b/d surplus last month, is looking at close to balanced this month, as per OilX estimates.

USWC Gasoline and Blendstock Imports by Origin Continent (KT)



Europe last shipped a substantial volume of gasoline/blending components to PADD 5 in July, when Kpler data shows 39,000 b/d or the equivalent of four medium-range vessels were exported from Wales and the Netherlands.

The *Navig8 Ametrine* could also reportedly be moving gasoline from Europe to the US West Coast. Kpler tanker tracking predicts there’s around a 36% chance the vessel, which loaded at Finland’s Porvoo refinery last month, is moving 32,000 MT of gasoline to Long Beach, California, where it is due 1 November.

Shipping fuel to California is complicated on a number of fronts. The journey across the Pacific takes more than three weeks, leaving a shipper exposed to potential value swings while the ship is in transit. Plus a refiner seeking to leverage the cargo market would have to make gasoline to meet California strict pollution specifications – the toughest in the U.S.

Northern California gasoline has been supported recently by refinery production issues at plants near San Francisco.

Asia Spotlight: Better late than never - China issues 4th round crude import quotas

Chinese authorities issued the fourth round of 2021 crude import quotas last. Many had been predicting another round of quotas being issued due to below-average volume quotas being approved in the third batch.

The quotas are reproduced here (in '000 MT):

Company	Latest batch	Total 2021
Hengli Petrochemical Dalian Ltd	3000	20000
China National Chemical Corporation Ltd	2570	17120
Shenghong Petrochemical	2000	2000
North Huajin Chemical Industries Group Corporation	1240	8300
Shandong Tianhong Chemicals Company Limited	660	4400
Hebei Xinhai Petrochemical Limited	560	3720
Lihuayi Lijin Refining and Chemical Company Limited	520	3500
Tenglong Aromatics (Zhangzhou) Company Limited	1000	4000
Shandong Chambroad Petrochemicals Company Limited	490	3310
Shandong Jincheng Petrochemical Group Company Limited	450	3000
Shandong Shenchì Chemical Group Company Limited	380	2520

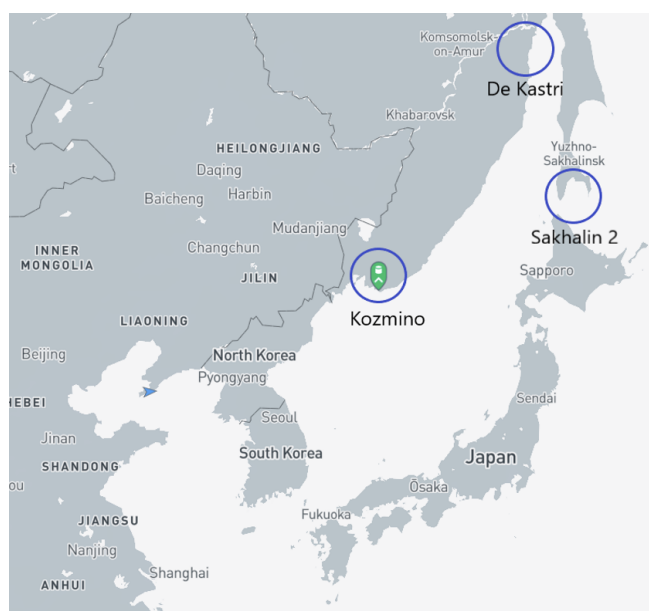
Shandong Kenli Petrochemical Group Company Limited	380	2520
Wudi Xinyue Chemical Company Limited	720	2400
Jiangsu Xinhai Petrochemical Company Limited	340	2300
Jinao Science and Technology Hubei Chemical Company Ltd	340	2300
Shandong Qicheng Petroleum Chemical Company Limited	240	1600
Total	14890	

Apart from the usual quotas, special concessions were also made for Rongsheng which has expanded their Zhejiang Petrochemicals refinery to 800,000 b/d. A whopping 12mn MT worth of quotas was issued to the Chinese mega-refiner.

These quotas emerged unusually late in the season, given that trading for December-loading cargoes is already underway in earnest. This created logistical issues for some teapot refiners because they risk being unable to import crude cargoes for delivery by 31 December. This is a major sticking point as quotas can only be used for crude arrivals in 2021. Having leftover unused quotas also mean firms would have more difficulty in applying for quotas in early 2022.

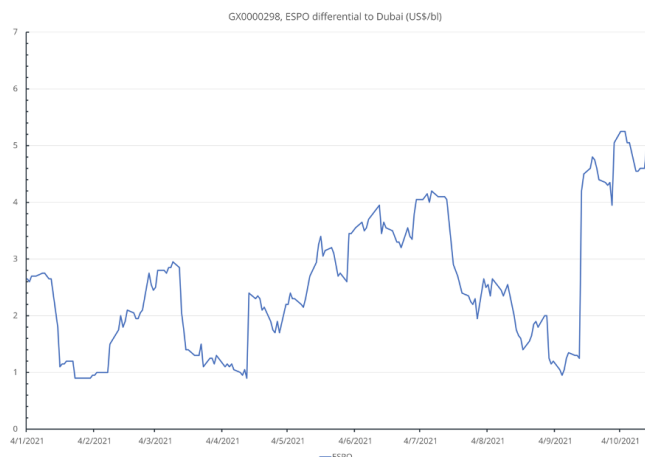
Cross the stream where it is the nearest

The resulting dynamic thus pushed up demand for crudes loading nearer to China. In practice, this means ESPO and Sokol crudes which ship from the ports of Kozmino and De Kastri in eastern Russia. Sakhalin crude also ships from the same region but in much smaller quantities.



A typical journey from eastern Russia to the eastern coastal areas of China takes roughly a week, enabling producers to expend import quotas allocated for 2021. In contrast, Middle Eastern crude takes 20 days to a month depending on circumstances.

Increased demand for Russian grades were clearly felt in differentials reported for spot tenders for ESPO crude. Levels heard this month were around a \$5.50/b premium to Dubai, which is much higher than usual.

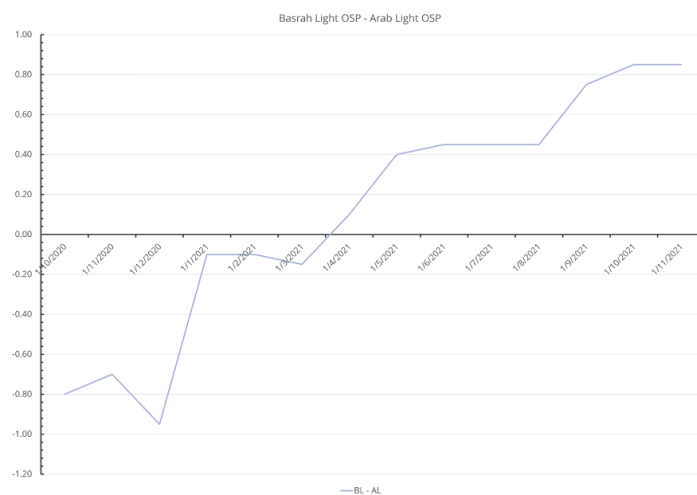


Global prices also rose on 25 October, following the release of quotas. In what could be described as a knee-jerk reaction, flat price and term structure had a breakthrough post-quota announcement: in the trading window on Monday, prices for Dubai partials hit their highest in a year, while the M1/M3 Dubai structure hit +\$2.86/bl – the widest in a year. Granted, there were other factors at play as well: low crude inventories in the US midcontinent hub of Cushing and a generally tight market amid the winter energy squeeze. But Chinese quotas contributed to the upswing as players thought Chinese entities would acquire large volumes of crude from the spot market.

Offsetting this bullishness somewhat, however, is the fact that major teapots like Rongsheng have already pre-purchased their cargoes in anticipation of receiving quotas. *“Rongsheng quota only covers what they already have on books, floating position and remainder of term contracts”*, said a trader familiar with the Rongsheng situation. This will likely cap the amount of quota-related incremental crude supply into China.

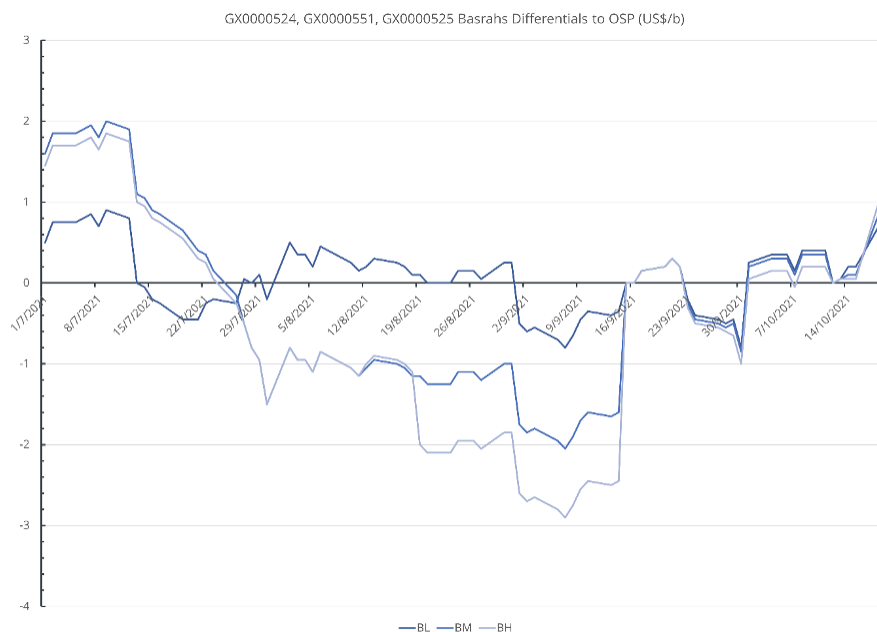
Knock on effects

Related also to Chinese import distributions was the rise in prices of Iraqi Basrah grades. Basrah trades one month ahead by convention, which encourages purchases from refiners interested in avoiding year-end uncertainties with regards to quota management.



Apart from logistical factors, Basrah has also been attractive to refiners due to its official selling price (OSP) being set competitively against other regional grades. As can be seen in the chart (below), recent months have seen Basrah Light's OSP set at discounts of more than \$0.80/bl to competing (Saudi) Arab Light:

Refiners have acknowledged this, bidding for spot Basrah grades at high premiums in October. Amongst them were Japan's ENEOS and South Korea's SK Energy which bought cargoes priced at US\$0.70-1.00/b premiums to Dubai. Petraco seemed to have caught on to the trend earlier, obtaining a good Basrah deal for closer to a US\$0.20/b premium earlier in the cycle. Months earlier, Basrah grades had been trading at deep discounts to their OSPs.



In July, SOMO even struggled to sell spot crude due to extremely low differentials submitted by bidders, as evidenced by multiple unawarded tenders.

David Elward

Senior Pricing Analyst

delward@general-index.com

ICE Chat: davelward

+44 (0)20 3983 7198

To enquire about subscribing to this report, please contact

sales@general-index.com or +44 (0) 203 983 4440

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