

# GX EUROPEAN REFINED PRODUCTS MARKET ANALYSIS

### The Big Picture

- · Key middle distillate themes from 2021
- Uptick in LPG spot activity, but prices remain stable as US stocks hold at 5-year low

Eurobob Oxy Gasoline NWE FOB Barges 696.00 -3.75

EUROBOBC €

ULSDNWEC □

Jet Fuel NWE CIF Cargoes 695.25 +7.50 JETNWEC □

ULSD NWE CIF Cargoes 660.50 +3.25

Naphtha NWE CIF Cargoes 694.00 +2.25 NAPNWE ⊞

## 2021 Middle Distillates: The pitfalls of making predictions during a pandemic

At the start of the year, we reflected on "signs of strength in European middle distillates". The coronavirus pandemic had upended normal work/life routines and sent oil demand into freefall in the first half of 2020, leaving excessive supplies of jet fuel and diesel. Key swaps pricing indicators were plunged into historic weak contango, with prompt prices sliding to wide discounts to future levels. This would only be reversed when European traders cut down on imports from overseas suppliers and instead set to work, through a mixture of regional sales and to buyers further afield, finding homes for the millions of tonnes of fuel which had accumulated on tankers deployed as floating storage at sea around North West Europe, as well as in on-land inventories. This supply recalibration helped put regional pricing in a stronger position heading into 2021.

We wrote back on January 7: "As we embark on a new year, there is reason to believe – despite the ongoing coronavirus-related lockdowns and the knock-on effect on fuel demand – that extreme pricing volatility (negative prices, steep contango) and unusual trade-flow phenomena (voluminous floating storage, record Europe-to-US diesel exports) are behind us, and markets could this year return to some semblance of normality. The rollout of Covid-19 vaccines has provided a boost to global financial markets and brought hope that there is light at the end of the tunnel."

In this final edition for 2021, we explore how the year actually panned out for jet fuel and diesel markets in North West Europe. Couching the outlook as a return to "some semblance of normality" was a way of hedging our bets. Middle distillates would indeed continue to strengthen. But you don't need a spoiler alert from me to know the recovery would come later than expected, prove to be far from a smooth ride, and conclude with yet more uncertainty as we approach another new year.

Here are three key themes:

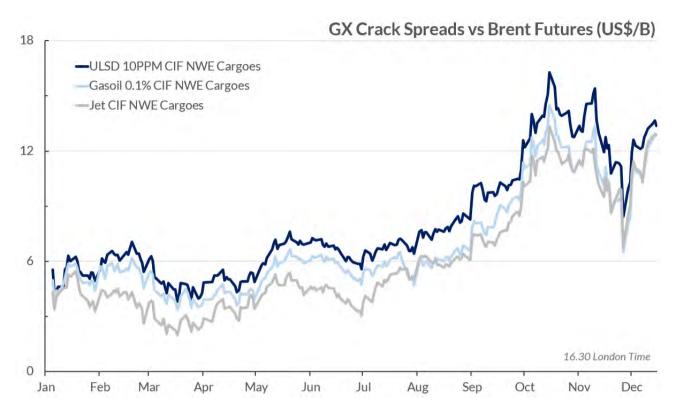
 Cautious NWE refinery output growth laid groundwork for H2 2021 margin recovery

Bruised by plunging margins in 2020, Europe's refiners, already under pressure from rising energy transitions costs at home and an influx of cheaper imports from competitors in the Middle East, took a cautious approach to raising production levels up from record lows in the hope of driving stronger margins as demand returned following a successful Covid-19 vaccine rollout.

See our special report from May for more on the European refinery landscape.

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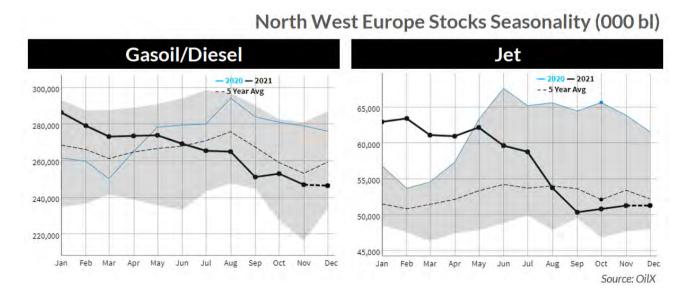
GX crack spreads broadly held rangebound over January-July, only rallying after government policymakers took advantage of what were (at least then) 'game changing' vaccine rollouts to lift restrictions and enable a more 'normal' summer holiday period of higher road and aviation fuel demand.



For jet fuel, consumption rose by some 45% over the year to come within 26% of 2019 levels in December, according to OilX. Regional refinery output expanded more slowly, up 18% over the year to end 45% behind pre pandemic levels. For diesel/gasoil, the recovery has seen demand rise by 25% since January, and current December demand is estimated to be ahead of 2019 by some 1.2%. Meanwhile, refinery output rose by nearly 9% to round out the year 8% behind 2019 levels.

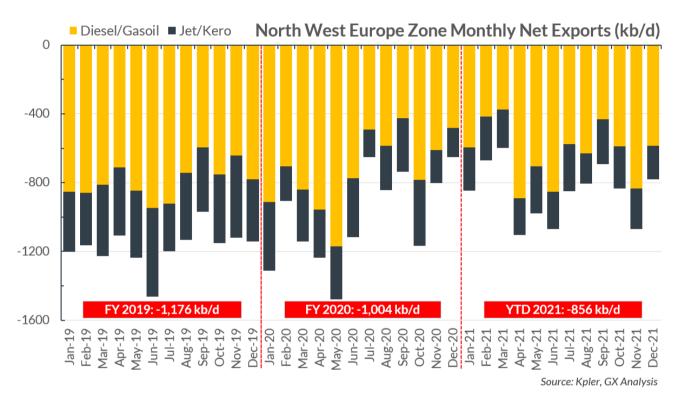
On a yield basis, jet has climbed 1% year on year to 5.1% of NWE refinery output this month (compared to 8.4% in Dec-2019). For gasoil/diesel, the yield is at 38.7%, down 0.4% on 2020 and up 0.4% on 2019.

# 2. Stocks down as NWE imports fall and exports rise to avoid repeat of 2020 supply glut



A reduction in imports and higher exports were two key middle distillates trade flow trends seen this year across North West Europe, as refiners and traders attempted to keep tighter control on regional balances amid an improving, but uncertain, demand landscape. The recovery in consumption was instead partly met by drawing down inventories which had soared to record levels by the summer of 2020.

For diesel and gasoil, stocks are set to decline by 14% or over the year, according to OilX. That equates to almost 40mn bl or 5.4 mn MT – enough to meet Belgium's entire diesel/gasoil demand for six months in 2021. For jet fuel, the draw down (proportionally) has been even greater. Stocks will fall by more than 18%. That's 11.7mn bl or 1.48mn MT – enough to meet jet fuel demand in the Netherlands for more than seven months of this year.



Trade flows of seaborne cargoes in 2021 were characterised by lower imports of jet fuel and higher exports of diesel/gasoil to reduce overall net-exports (i.e. a net short trade flows balance) to the lowest volume since 2017, according to Kpler tanker tracking.

On imports, diesel/gasoil arrivals overall were flat year on year. But this was in part due to a rise in intra-NWE flows offsetting reduced imports from outside the region, such as from the US (*more detail below*) and East of Suez. Russian exports to NWE were stable. Jet fuel imports fell from both inside and outside the region to the lowest since Kpler started compiling data.

Diesel and gasoil was arbitraged in even larger volumes from NWE to the United States this year, extending an unusual, reverse trade flow I had said (wrongly as it turned out) might not last into 2021. More bullish pricing Stateside has attracted  $56,000 \, \text{b/d}$  or  $2.75 \, \text{mn}$  MT so far this year, up 67% on 2020, according to Kpler. The relative strength of the US market also meant more diesel being sold into the domestic pipeline market, rather than pushed out via the US Gulf Coast. Exports to NWE fell 47% to  $2.35 \, \text{mn}$  MT.

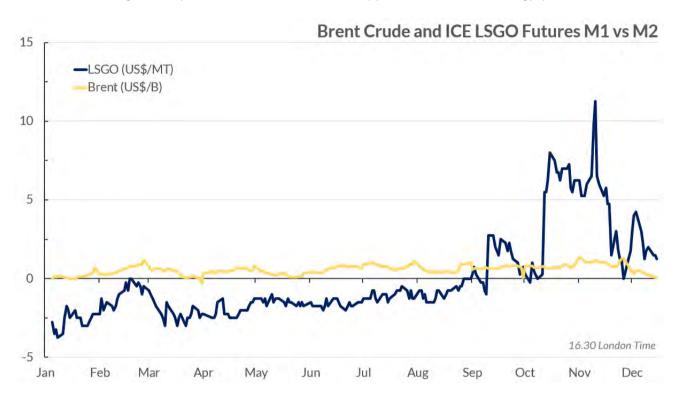
The volume of jet fuel exported from NWE to US used to be relatively small, between 1,000-3,000 b/d; but it soared this year to 14,000 b/d or 641,000 MT. The reverse trend was seen on US-NWE flows. Exports fell from 14,000 b/d in 2019 to 3,000 b/d in 2021.

European diesel futures weakness persisted until Hurricane Ida and natgas price spike shook market



While pandemic uncertainty was certainly a strong possibility this year (look no further than the historic price crash caused by fears around new Covid-19 variant Omicron), you'd have been hard pressed to find many lining up to predict September's natural gas price spike roiling oil markets.

For most of the year, Europe's diesel futures (aka ICE Low-Sulphur Gasoil) showed only gradual signs of its contango structure (i. e. a sign of weak market fundamentals of supply outstripping demand) narrowing. That all changed in September when disruption to US Gulf Coast refining caused by Hurricane Ida was soon followed by price shocks across the energy spectrum.



Reuters commentator John Kemp wrote at the time: "Fund managers have become especially bullish about prices for middle distillates such as US diesel and European gas oil, where the ratio of bullish long positions to bearish short ones has climbed to 8.6 to 1. The bullish ratio was the highest since October 2018."

Gas-to-oil switching strengthened demand for crude, middle distillates, fuel oil and LPG after gas and other energy prices spiked due to supply shortages and a jump in demand as industrial activity emerged from its pandemic slumber.

The injection of cash, confidence and consumption drove a renewed bullish outlook, having already been bolstered by strong global economic recovery in distillate-intensive activities such as manufacturing and freight.

Spot window trading activity for ULSD 10ppm FOB NWE Barges (basis ARA) totalled 390,140 MT in September's MOC, the highest monthly volume this year. ICE LSGO futures—which reflects the same product, grade and location as the ULSD benchmark—shook off the weak contango structure which had been engrained since the start of the coronavirus pandemic to swing into a bullish backwardation. The trend would accelerate through to November's contract expiry when the backwardation peaked above \$11/MT.

The scale of bullish bets placed would be revealed after Omicron fears resulted in double-digit percentage drops in the flat price of LSGO and crude futures, leading to an exodus of speculator interest. *Bloomberg* reported on 9 December total open interest in diesel contracts slumped by more than one-third since October to fall to its lowest since 2015. Investors have let the air out of the diesel balloon, setting the market up for a recovery when the Omicron dust settles. When exactly? Let's check back again in 12 months' time...

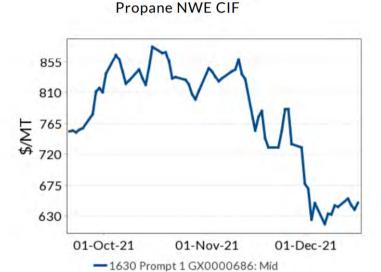
Uptick in LPG spot activity, but prices remain stable as US stocks hold at 5-year low

LPG markets continued their recent form of stability this week.



The last seven days have seen the return of activity in the physical propane window, with bids and offers being placed for cargoes for late December to early January delivery. The most notable was an uncharacteristic bid by Equinor for a ToT for late December delivery in Stenungsund.

Price movements have remained within \$10/MT of last Thursday's Propane NWE CIF Large Cargoes assessment, with this Wednesday's assessment of \$639/MT only \$7/MT higher than that of the prior week. This has led to a strengthening of the propane crack to crude, which has improved from -\$19.7/b to -\$17.8/b over the past seven days.



US propane stocks have fallen this week and remain at the bottom end of their 5-year range, however this has not been driven by exports to North West Europe, as they have fallen to a two-month low. Beyond last Thursday's activity, which drove the physical butane to naphtha ratio below 100%, the physical butane window has remained quiet.

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#### Butane Ratio of Naphtha (Basic MOC)

The price decrease that accompanied the fall in the butane-naphtha ratio led to the butane crack to crude declining \$3.80/b in one day. Since then however the butane crack to crude has increased by \$2.60/b, driven by a flat and stable price, which has contrasted the falling value of Brent this week.

The naphtha crack to crude has increased \$0.30/b whilst the physical pro-nap is currently set at -\$33.75/MT, a \$28.50/MT increase from last Wednesday.

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