



## **Global Oil Markets Are Now Balanced, Russia's Novak Says**

(Bloomberg) – Global oil markets have rebalanced following last year's historic collapse in demand, according to Russia's deputy prime minister.

“The last few months we have seen low volatility, which means the market is balanced, and the prices we see today certainly correspond to the situation in the market,” Alexander Novak said on state television channel Rossiya 1 on Sunday. Crude will probably average \$45 to \$60 a barrel this year, according to Novak, who was Russian energy minister before President Vladimir Putin promoted him in November.

Benchmark Brent crude has surged 22% this year to top \$63 a barrel as energy use recovers in the U.S. and China and nations roll out coronavirus vaccines. Prices have also been

buoyed by deep supply cuts from the Organization of Petroleum Exporting Countries and its partners, who are trying to clear surplus stockpiles built up during the pandemic.

The oil market “has partially recovered, but not completely yet,” Novak said, adding that global demand was about 8% to 9% below pre-pandemic levels by the end of last year, compared with a decline of 20% to 25% in April and May.

Most members of the OPEC+ coalition, which has been gradually restoring barrels halted during the crisis, are pausing the process for two months. But Russia secured a 65,000-barrel-a-day increase in its quota for February and March, while Saudi Arabia is implementing a unilateral cut of 1 million barrels a day. OPEC+ ministers will meet in early March to discuss next steps.

Novak also commented on the Nord Stream 2 project, a natural gas pipeline being built under the Baltic Sea from Russia to the German coast. Despite U.S. sanctions targeting the project, it will be completed, Novak said. Work on the line resumed in late 2020 after being halted for a year.

(Updates with further Novak comment in fourth paragraph.)

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# US oil demand is emerging after months of Covid paralysis

Bloomberg / New York

US oil demand is finally starting to emerge from the grips of pandemic after months with Asia serving as the lone bright spot in the global market market.

American refiners are processing the most crude since the economy ground to a halt in March in anticipation of a vaccine-driven boost in gasoline demand this summer. The uptick means that the refiners are competing for domestic barrels that for months were sent to more robust markets in Asia. Prices for cargoes of grades like West Texas Intermediate crude have picked up by at least 50 cents a barrel from earlier this month.

The return of US demand, which began when a global vaccination campaign kicked off in December, is the latest development in oil's recovery from the depths of the pandemic. For months oil

prices were managed by Opec and its partners with production cuts, without the help of demand outside of Asia.

As domestic oil demand recovers, it could meet with supply shortages. Economic-driven output declines took about 2mn barrels a day of local crude off the market from the peak of 13.1mn, after dozens of drillers slashed budgets and filed for bankruptcy. The US government sees production recovering to only 11.5mn barrels a day in 2022.

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## **Rosneft Returns to Profit, Signaling 2020 Dividend Payments**

Russian oil giant Rosneft PJSC returned to profit in the fourth quarter of 2020 after signing a multibillion dollar

deal to sell a share of its Vostok Oil mega-project in the Arctic to trader Trafigura Group.

The results signal that the producer will be able to pay a dividend for 2020 even after historic crude-price declines and production cuts. The company reported a record quarterly net income of 324 billion rubles (\$4.36 billion) in the three months through December, above analyst estimates. That offset earlier losses, resulting in a full-year profit of 147 billion rubles.

“Despite all the difficulties of 2020, the company has achieved a net income, which will be the basis for the distribution of dividends,” Chief Executive Officer Igor Sechin said in a statement on Friday. Rosneft’s management will recommend the board to make 2020 payouts to shareholders fully in line with the company’s dividend policy, First Vice-President Didier Casimiro said on a call with investors.

Big Oil has mostly reported disappointing fourth-quarter earnings, signaling the industry’s recovery from the pandemic will be long. While most international producers, such as Royal Dutch Shell Plc or Exxon Mobil Corp., remain committed to making or even raising dividend payouts, investors question just how soon the sector will be able to improve its cash flow.

Russian oil companies have been under even more pressure due to output constraints that are part of the country’s deal with the Organization of Petroleum of Exporting Countries. Accounting for 40% of the nation’s total crude production, Rosneft bears the biggest burden.

Based on its full-year results, the producer, which distributes a half of its net income to shareholders, is set to pay some 7 rubles per share in 2020, according to estimates from BCS Global Markets and Sova Capital. That would be Rosneft’s smallest shareholder payout since 2016. The company

scrapped its interim dividend for 2020 after losing money in the first half of the year.

Rosneft shares advanced as much as 1.1% to 506.50 rubles, the highest level in more than three weeks.

## **Arctic Foray**

Rosneft expects Vostok Oil, an ambitious Arctic development valued at \$85 billion, to drive future dividend yields and shareholder value, Sechin said.

Rosneft received 7 billion euros from Trafigura for 10% of Vostok Oil in December, according to the financial statement. The deal allowed “for the practical start of the execution of the project,” Sechin said.

The Vostok project envisions production of some 25 million tons of oil per year, or around 500,000 barrels a day, in 2024, and twice as much in 2027. At its peak, the remote development is set to produce as much as 100 million tons per year. That compares with Russia’s total crude oil and condensate production of 513 million tons for 2020.

Rosneft is in discussions with other potential partners in Vostok Oil, Casimiro said, adding that international trading houses, global oil majors and crude-importing nations like India are interested. Russia will keep a controlling stake in the development, he said.

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# Total quits US oil lobby over climate policies

Reuters /London

Total yesterday became the first major energy company to quit the main US oil and gas lobby due to disagreements over its climate policies and support for easing drilling regulations. Total said it would not renew its 2021 membership with the American Petroleum Institute (API) following a review of the lobby's climate positions, describing them as being only "partially aligned" with Total's.

Its withdrawal from the century-old API comes ahead of a sweeping change in policy direction in the United States, with incoming President Joe Biden promising to tackle climate change and bring the country to net-zero emissions by 2050. The points of difference include API's support for the rollback of US regulation on emissions of methane, a potent greenhouse gas, for oil and gas drillers as well as on how to assign a price to carbon, seen as a critical method to curb emissions.

“As part of our Climate Ambition made public in May 2020, we are committed to ensuring, in a transparent manner, that the industry associations of which we are a member adopt positions and messages that are aligned with those of the Group in the fight against climate change”, Total chief executive Patrick Pouyanné said.

In a statement, the API thanked Total for its membership.

“We believe that the world’s energy and environmental challenges are large enough that many different approaches are necessary to solve them, and we benefit from a diversity of views,” the API said.

Total’s operations in the United States include a number of offshore oil and gas fields in the Gulf of Mexico, a major refining and petrochemical plant in Port Arthur, Texas as well as renewable energy businesses.

Total last year announced plans to cut its carbon emissions, with the aim of reaching net zero emissions from its operations and its energy products sold to customers in Europe by 2050 or sooner.

Europe’s top energy companies, including BP and Royal Dutch Shell, have outlined plans to curb emissions and boost renewable energy output following years of growing investor pressure.

Total, BP and Shell have already pulled out of the American Fuel & Petrochemical Manufacturers, a US oil refining group, also due to differences over climate policies.

They also said they would regularly review their alignment over climate with industry associations but until Friday those companies had elected to remain in API, the primary trade group for the oil and gas industry.

BP last year decided to remain in the API even though it was only partially aligned with the lobby.

Andrew Logan, director for oil and gas programmes and clean energy investor group CERES, said the announcement was significant and would put pressure on other European oil majors.

“Given the size and influence of API, this is a much more



significant move than previous decisions to pull out of more niche trade groups like AFPM.

I think that we will see other companies follow suit,” Logan said.

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## **Freight Boom Fires Buffett Trains, Maersk Ships and Oil Prices**

(Bloomberg) – A great global restock is at hand, filling ships, trucks and trains, and also firing oil demand.

During the depths of China’s coronavirus crisis at the start of the year, shipping behemoth A.P. Moeller-Maersk A/S

reported an unprecedented number of canceled sailings as the Asian country all but shut itself off from the world. Since then, the company's shares have surged to the brink of a record in Copenhagen. In the U.S., BNSF Railway Co., the freight giant owned by Warren Buffett, is riding a boom that's pushed the number of carloads and containers it hauls up year-on-year in recent weeks.

A shift in consumer behavior, particularly in western countries, has driven oil prices above \$50 a barrel in the past few weeks. People have been diverting expenditure previously earmarked for now-unattainable things – like holidays and meals in restaurants – toward purchasing physical goods. And that's only the start of it: stores, warehouses and industries have undertaken a huge inventory restocking phase. As more boxloads of stuff get moved across the planet, so demand for fuel to power ships, trucks and freight trains has soared.

“This is the perfect storm for global container flows,” said Lars Mikael Jensen, head of network at Maersk, which marshals a fleet of almost 700 ships. “The current restocking in the U.S. and Europe raises demand, whilst global measures to contain the pandemic cause severe strain across the supply chain from lack of vessels, containers and trucking capacity.”

While beneficial to oil prices and freight haulers, the boom is straining important transport infrastructure. Bottlenecks are worsening at ports around the world, contorting supply chains for everything from car parts to cosmetics. The recent closing of freight deliveries from France into the U.K. serves as a reminder that things could become even more snarled – but also that the full economic and trade impacts of the coronavirus remain far from certain.

Los Angeles is emblematic of the turnaround in activity. Together with Long Beach, L.A. is a corridor for the import of goods from Asia into the U.S. Earlier this year, thousands of

empty containers were sitting at the dock in Los Angeles, a symptom of both trade tensions with China, and Covid. Today, imported goods are now flooding in.

“Right now, what we are grappling with is a change in buying habits,” said Gene Seroka, executive director of the Port of Los Angeles. “Where we were once buying mainly services, now you and I have turned back to buying products and those warehouses need to be restocked. Folks have been ordering so much for delivery, we can’t process it fast enough.”

Exports from China are surging, pushing the country’s trade surplus to a record. The nation’s companies shipped \$268 billion of goods in November, a 21% increase year-on-year.

In India, the lifting of lockdown restrictions and a full resumption of intra-state vehicle movement led to a boost in road transport fuel consumption in October, with diesel demand growing more than 7% year-on-year, according to Senthil Kumaran, head of South Asia oil at industry consultant FGE.

Shipping rates are going crazy. Moving a 40-foot steel box by sea from Shanghai to the European trade hub of Rotterdam costs about \$6,500 per container, the most for the time of year since at least 2011, according to data from Drewry.

The trends matter for the oil market because trucking accounts for about 16% of global oil consumption and almost half of all diesel demand, according to 2019 data from the International Energy Agency.

The rebound in activity, combined with the onset of Northern Hemisphere winter, has been lifting a previously disastrous market for the fuel for about two months.

Back in September, the so-called crack spread – diesel’s premium to crude – plunged as low as \$2 a barrel in Europe.

As well as stuttering demand, a key cause of the diesel-market

weakness was a collapse in global aviation. Oil refineries responded to that slump by diverting output of jet fuel into making diesel instead, boosting output when consumption was weak. In addition, because people were often staying off public transport to avoid catching the virus, refineries needed to keep high output levels to service gasoline demand – further swelling diesel supply at a time when it wasn't needed.

Those dynamics have turned. Last week, the crack spread rallied to \$6.28 a barrel. That's at a time when the underlying price of crude oil has also rallied strongly.

### Keep on Trucking

In the U.S., freight by truck is the primary influencer of diesel and viewed as a sign of the health of the wider economy. Interstate miles covered by trucks are up above 9% over last year, while traffic for all vehicles is down more than 10%, federal Department of Transportation statistics show.

A proxy for demand in U.S. is how much of a petroleum product oil refineries supply. And in the week to Dec. 11, they supplied 4 million barrels a day of distillate fuel oil, the category that includes diesel. Back in May, that figure slumped to 2.7 million a day, the lowest in decades, Energy Information Administration data show. Stockpiles remain high but are far less bloated than they were earlier this year.

The pull on diesel can be seen in excess demand for deliveries this year. Data from consultant Freight Waves show that 26% of requests for freight hauling are being turned down this quarter, double the rejection rate from a year ago.

While trucking may be the mainstay of diesel demand, one of the largest U.S. buyers of the fuel – after the Navy – is Buffett's BNSF Railway. It too reports surging activity.

“We have seen a strong recovery in intermodal volumes as an increase in e-commerce sales drives demand for parcel and truckload intermodal shipments on our network,” said Tom G. Williams, BNSF group vice president consumer products. “As cities and states began reopening, intermodal demand was further supported by recovering brick-and-mortar retailers.”

Current volumes at some of BNSF’s intermodal facilities are as much as 20% higher than they were at this time last year, and the company is continuing to work with its customers to meet a “consistent surge” in demand while replenishing inventories that have been low since the onset of the pandemic, he said.

Even Europe

Over in Europe, the continent’s biggest owner of trucks reports the same dynamics, filling the company’s fleet and boosting usage of diesel.

“There is definitely a new consumer pattern,” said Kristian Kaas Mortensen, an executive at Girteka Logistics, a Vilnius, Lithuania-based owner of more than 7,500 trucks. “Because we can’t give it face-to-face we are shipping it.”

Girteka is so busy that it’s giving overflow business to other trucking companies. It anticipates the busiest year-end in its history.

In Germany, miles driven by large trucks have been steadily rising since September and are currently their highest in a month, according to the nation’s statistics office. Polish heavy traffic in the week to Dec. 20 is about 20% higher than the equivalent year ago. It was a similar picture in the U.K. prior to the country’s most recent set of lockdown rules.

But it’s a surge that’s global and may well be without precedent, according to Gebr. Weiss, a 500-year-old firm that lays claim to being the world’s oldest logistics company.

“Looking back at our history, you could say we’ve weathered a few challenges: a war, a revolution or two but still, in all my years in logistics I’ve never had a year like this,” said Gebr. Weiss board member Lothar Thoma. “Covid choked up, disrupted transport arteries on a global scale, messed the cycles of goods-in, goods-out, be it air, sea, rail or road.”

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## **Exxon Signals Historic Fourth Consecutive Loss on Demand Hit**

(Bloomberg) – Exxon Mobil Corp., which is struggling to maintain a \$15 billion-a-year dividend program, indicated it

incurred a fourth straight quarterly loss.

Exxon confirmed in a filing Wednesday it will take a writedown of as much as \$20 billion on its upstream assets, a possibility first disclosed at the end of October. It also reported much smaller non-cash impairments related to its refining business.

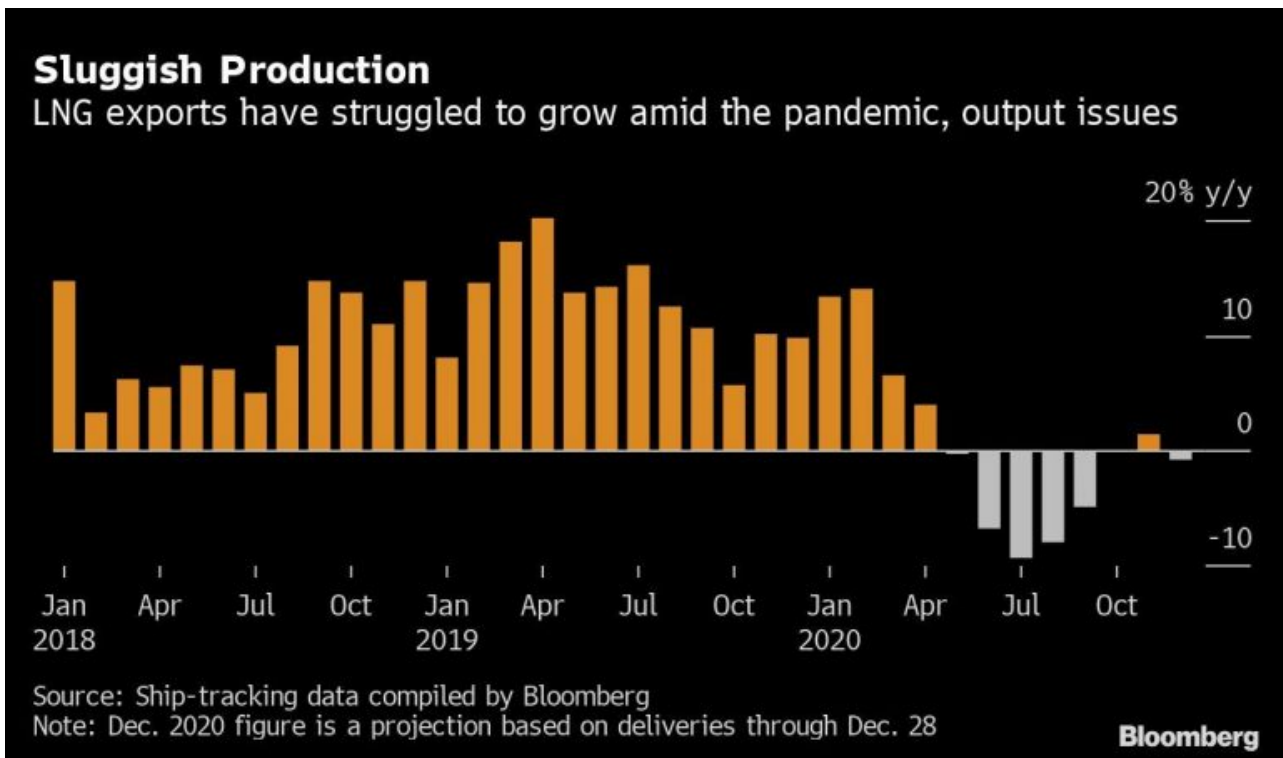
There were some positives. Higher oil and gas prices had an impact of up to \$1 billion on upstream profits compared with the third quarter. The chemicals segment saw an earnings boost of as much as \$400 million due to improved margins. Exxon's shares were little changed in after-hours trading in New York.

Still, a fourth-quarter loss would confirm Exxon's challenges in covering both dividends and capital expenditures from operational cash flow, and remains reliant on debt. The last time the Irving, Texas-based company generated enough free cash to cover its payout was the third quarter of 2018, according to data compiled by Bloomberg.

Exxon is set to disclose its full quarterly results on Feb. 2, amid one of the most-punishing periods in the company's 150-year history. Its stock cratered to a 22-year low during 2020 amid a worldwide glut of oil and collapsing demand that gutted cash flow, spurring widespread job cuts. Exxon was kicked out of the Dow Jones Industrial Average, warned it will incur the biggest writedown of its modern history, and was assailed by activist investors seeking better returns and more climate accountability.

Exxon, which has long prided itself on its decades-long record of annual dividend increases, may have opened the door to changing course in late November, according to Cowen & Co. analyst Jason Gabelman. Whereas company executives touted Exxon's "reliable and growing dividend" during an October conference call, a Nov. 30 statement announcing writedowns and spending cuts only mentioned its commitment to a "reliable"

payout, Gabelman said in a note to clients.



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(Bloomberg) – Liquefied natural gas traders anticipate a swift demand recovery in 2021 after a year in which the coronavirus pandemic prompted dramatic price swings.

Colder weather in key importing nations, outages at major production hubs and congestion along global shipping routes already have combined to push spot prices in Asia to the highest level since 2014. That's a more than sixfold jump from a record low in April, making Asian LNG the best performer among major commodities in 2020.

Demand for the fuel used in heating and power generation is growing faster than for any other fossil fuel as nations look for a cheap, reliable and cleaner alternative to coal. The pandemic derailed that growth for 2020, but China and India are emerging as major sources of demand.

"A lot of countries are looking to import LNG," Tom Holmberg, a partner at law firm Baker Botts LLP in Washington D.C., said by phone. "I still think we are going to see growth in the LNG market." Below are the key areas likely to shape the market in 2021:

## Uneven Demand Recovery

Global LNG imports in 2020 were roughly equal to the previous year, according to ship-tracking data compiled by Bloomberg. That was a big disappointment for an industry that has enjoyed 10% annual growth rate since 2016.

However, global gas demand is expected to resume growth next year. LNG demand, which makes up roughly 10% of the total, may rebound even faster, depending on how Pakistan, India and Bangladesh perform, said Manas Satapathy, a managing director in Accenture's Energy business.

Shipments of the fuel into Asia have mostly recovered since the height of the pandemic, and the region's LNG demand will rebound sharply next year, according to S&P Global Platts.

On the last day of 2020, spot Asian LNG price – the Japan-Korea Marker benchmark – rallied above \$15 per million British thermal units for the first time since April 2014. “It has been interesting to see how quickly Asian demand seems to have ramped up,” Holmberg said.

The picture in Europe is very different as countries grapple with a new surge of infections and lockdowns that sap energy demand. The continent is headed for a “very neutral recovery” in 2021, according to Satapathy.

Europe mainly relies on storage and pipeline gas shipments, which may be boosted with flows from a new link from Azerbaijan and the controversial Nord Stream 2 project that's nearing completion.

### Supply Woes

Unplanned maintenance at LNG export facilities from Australia to Qatar to Malaysia has led to a tighter than expected market in the second half of the year. And delays in navigating the Panama Canal curbed supplies to Asia. If these disruptions persist well into the year, then prices could remain elevated well above current levels.

The Gas Exporting Countries Forum, which represents 60% of global LNG exports, expects supply to climb by 6% to 7% next year, up from 2% to 2.5% in 2020. LNG trade was much more resilient to this year's challenges than imports in the fuel's gaseous form, the group said in its short-term outlook.

The market will likely remain oversupplied next year, according to Vitol SA and Trafigura Group Ltd., two of the biggest trading houses active in LNG. Beyond that they expect the market to tighten.

More Cancellations?

Traders will be watching to see if buyers of U.S. LNG scrap any cargoes next year. About 200 cargoes were canceled in the summer after the pandemic hit spot prices in Europe and Asia. While there's unlikely to be a repeat of that in 2021, traders do expect some cancellations to help balance the market.

American gas exports are rising to fresh records every month as new facilities come online. But any dip in demand could force suppliers to shut-in cargoes. The nation has become a swing supplier because its contracts allow for scrapping deliveries, which enables exports to quickly respond to volatile markets.

China-U.S. Relations Trade relations between the U.S. and China will be a key focus. China is the fastest-growing LNG importer, and the U.S. is ramping up exports. There's few long-term supply deals between the two nations even though LNG was a focus of President Donald Trump.

Joe Biden takes over as president on Jan. 20. A number of proposed U.S. LNG projects are hoping for more normal relations to help them sign deals with Chinese buyers.

"This certainly affects the LNG markets, particularly the LNG coming from the U.S.," Holmberg said. And with Chinese economy roaring back and offices open, Jack Fusco, chief executive officer of Cheniere Energy Inc, anticipates that "deal making environment looks good for 2021."

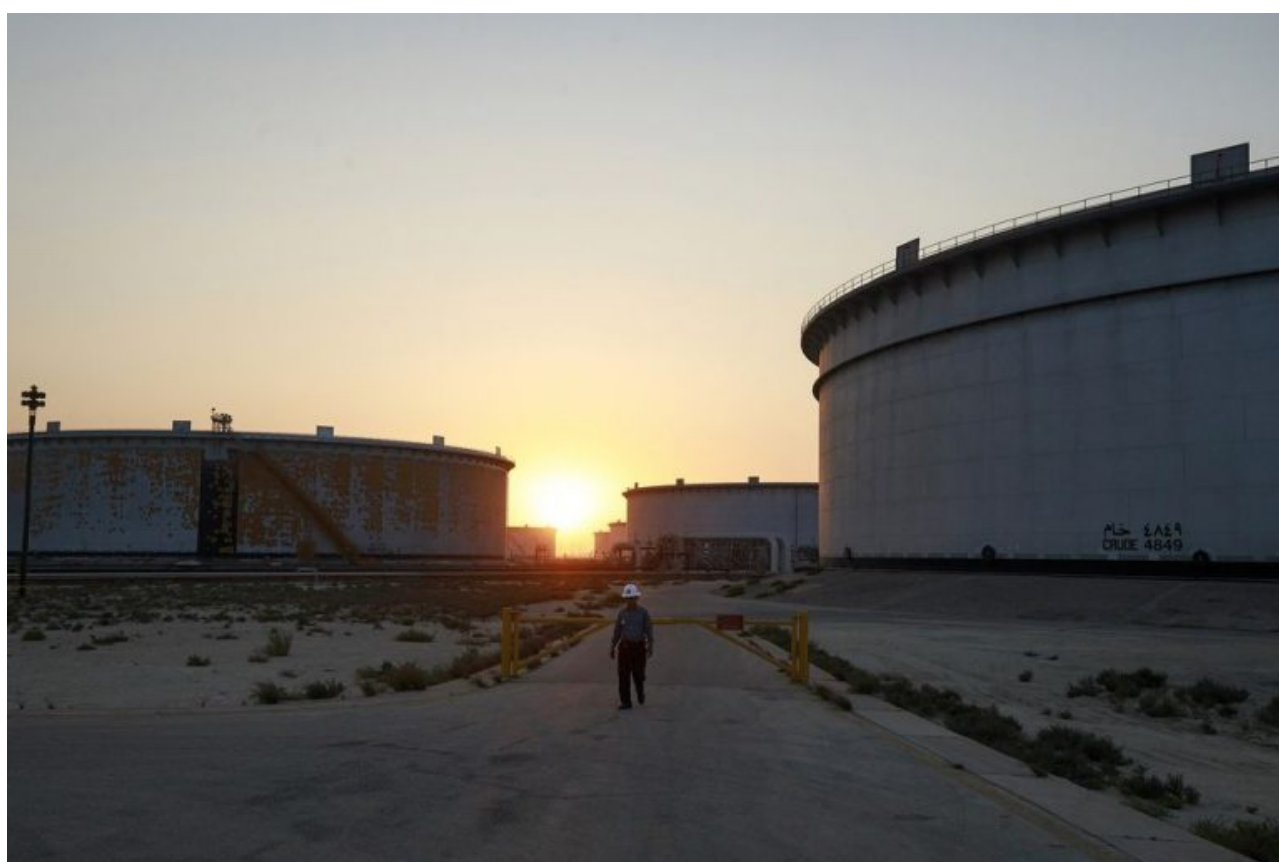
Green Ambition Environmentalists are increasingly looking at natural gas as a major polluter. After years of focusing on coal and oil, they're turning their attention to how to zero out emissions from all fossil fuels. That shift has suppliers, buyers and shippers thinking green initiatives to clean up activities linked to methane and greenhouse gas emissions.

Half of the carbon footprint in the life cycle of an LNG cargo comes from upstream, Fusco said. The LNG producer is pushing for more transparency on carbon emissions for the fuel.

“Our customers are going to want to be sure that they can validate and audit what we’re telling them our carbon signature is,” he said.

The world’s first supply contract that required a declaration of emissions was signed this year while so-called carbon-neutral cargoes started flowing to China and Japan as nations outline ambitious targets to effectively zero out emissions.

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## **OPEC+ Treads a Narrow Path as Demand Outlook Weakens Again**

Producers need to maintain supply restraint amid a sluggish recovery if they’re to shrink stockpiles

The light at the end of the tunnel isn’t getting any

closer for OPEC and allied oil-producing countries, as forecasts of the world's need for their supplies next year are cut again.

The world's three major oil agencies – the International Energy Agency, the U.S. Energy Information Administration and the Organization of Petroleum Exporting Countries – all reduced the outlook for global oil demand in 2021 in their latest monthly reports. With two of them also increasing their forecasts for non-OPEC crude production next year, the gap that needs to be filled with barrels from the OPEC countries continues to get smaller.

The most difficult period for the producer group will be the first half of the year, before vaccinations against the Covid-19 pandemic are sufficiently widespread to allow governments to lift restrictions on movement and gatherings that have had such a dramatic impact on people's lives and on demand for oil in 2020.

In a normal year, the first quarter is typically the weakest for oil demand, and 2021 will still be far from normal. The usual early-year weakness will be compounded by the fact that, even in the affluent countries that have secured large quantities of the most advanced vaccines, the roll-out of inoculations will take time. Working-age people outside the key healthcare sector could be among the last to benefit, which may continue to dampen economic activity and energy demand.

All three forecasters see global oil demand in the first quarter of next year remaining between 4.5% and 5% below the level seen during the same period in 2019. Any quarter-on-quarter increase from the current period will be small, with the IEA seeing no growth at all.

In that context, the decision by the OPEC+ group of countries to limit the easing of their output cuts to just 500,000

barrels a day in January, about one-quarter of the initially planned increase, makes sense.

Among the three forecasters, only the EIA saw stockpiles continuing to fall in the first half of next year if the OPEC+ countries had gone ahead with the 1.9 million barrel a day output increase they had originally planned for January (see chart below).

Limiting the output increase to 500,000 barrels a day would suffice to drive the supply/demand balance into deficit, with stockpiles falling at a rate of between 800,000 barrels a day and 2 million barrels a day in 1Q21, according to the three outlooks. Stock draws in the second quarter would be between 1 million barrels and 2.4 million barrels a day and they would increase further in the second half of the year (see chart below).

## **The Old Plan**

How global oil stockpiles would change if OPEC+ eased output as originally planned

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## **The New Plan**

How global oil stockpiles would change if OPEC+ doesn't ease production limits any further after the increase agreed for January

The producer group has retained the ability to make further

monthly adjustments to supply targets, either upward or downward, but the latest forecasts suggest that they may want to hold off on any further easing, unless oil demand recovers faster than expected.

## **Slow Drain**

A weaker demand outlook means OPEC sees stockpiles falling more slowly than it did in October, despite a smaller easing of output cuts

Despite keeping a tighter rein on oil supply, the deteriorating global oil demand outlook means that OPEC's own analysts now expect stockpiles to be higher throughout 2021 than they saw them just two months ago (see chart above). By the end of next year, even with no further easing of output cuts beyond the 500,000 barrels a day agreed for January, the producer group expects global oil stockpiles to be some 670 million barrels higher than they were at the end of 2019.

The goal of bringing inventories back down to more normal levels seems ever more elusive. Since July, when OPEC first began publishing its quarterly forecast for next year, its estimate of global demand over the five quarters from 4Q 2020 to 4Q 2021 has come down by an average 2 million barrels a day, while its assessment of non-OPEC output over the same period has risen by 1 million barrels a day. That combination has cut the anticipated call-on-OPEC crude by an average 3 million barrels a day. OPEC and its allies are going to have to maintain discipline amid supply restraint for longer than they had hoped.

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## **U.S. petroleum stocks nearing normal after wild 2020**

Total stocks of crude and products, excluding oil stored in the strategic petroleum reserve, ended the year 6% above the seasonal average for the previous five years, down from a surplus of 14% at the start of July.

Excess petroleum inventories were still in the 74th percentile for all weeks since the start of 1995, on the high side, but down from a surplus in 92nd percentile at the middle of the year.

Total inventories, including the strategic petroleum reserve, have declined in 21 out of the last 26 weeks, by a total of 136 million barrels.

Gasoline and distillate stocks have shown the fastest return to normal while commercial crude stockpiles have faced a more



sluggish adjustment.

By the end of December, gasoline inventories had been reduced to almost exactly in line with the five-year average, down from a surplus to the five-year average of nearly 13% in April.

Distillate stocks, which include road diesel and heating oil, had been reduced to a surplus of 7%, down from 29% at mid-year, according to weekly statistics from the U.S. Energy Information Administration.

Commercial crude stocks were still 10% above average, down from 19% in the middle of the year, indicating slower progress ("Weekly petroleum status report", EIA, Jan. 6).

## **NEARING BALANCE**

Oil producers and refiners have adjusted at an exceptionally fast pace following the record shock to oil consumption caused by the first wave of the coronavirus and the associated lockdowns.

On the crude side, excess inventories have been cut by lower output from domestic shale producers and a fall in imports especially from Saudi Arabia.

On the products side, stocks have been cut by slower crude processing and a decision to focus on gasoline at the expense of middle distillates such as diesel and jet fuel.

In final week of December, U.S. refineries processed 14% less crude than average for the previous five years, even though domestic consumption was down by just 7%.

Processing restrictions are likely to persist in for the next 2-3 months which should ensure stocks of products end the first quarter below average.

Lower product stocks will support higher refining margins and a sharp increase in crude processing during the second quarter.

Based on futures prices, refining margins for gasoline and distillate delivered at the end of the second quarter have already risen by 40% and 60% from their post-crisis lows.

The principal risk to rebalancing comes from a resurgence in coronavirus and the possibility of new lockdowns to contain it, which could force fresh cuts in margins and processing.

## **DISTILLATE REBOUND**

Consumption of petroleum products has recovered strongly, ending the year 7% below the five-year average up from a deficit over 30% at one point in April.

The strongest rebound has come in distillate, where consumption ended the year running above the five-year average.

Distillate use is closely linked to the business cycle, especially manufacturing and freight transportation, so it has bounced back in line with the surge in manufacturing.

The resurgence in diesel use is consistent with the widespread reactivation of manufacturing reported in the Institute for Supply Management's monthly surveys and the Federal Reserve's industrial production index.

Gasoline consumption has also recovered, ending the year 10% below the five-year average, but improvement has stalled and even reversed since the end of third quarter, when consumption was down 5%.

Gasoline consumption has been hit by the new wave of coronavirus infections and reimposition of travel restrictions and work from home orders.

The worst-affected segment remains jet fuel, however, where consumption ended the year 35% below the five-year average as a result of international travel restrictions and nervousness about flying during the epidemic.

But the reduction in excess distillate inventories and the strength of diesel demand is encouraging refiners to end their focus on gasoline production and target a more normal distribution of product outputs.

U.S. refiners boosted their combined production of distillate and jet to 74% of their output of gasoline in the final week of the year, up from a recent low of just 55% in mid-October.

If manufacturing and freight transport remain strong, while private motoring is hit by renewed coronavirus controls, refiners will shift to prioritise distillate consumption by the end of the first quarter.



# Oil Rises From the Ashes as the Big Coronavirus Recovery Trade

Brent crude topped \$50 a barrel last week for the first time since March, a milestone for an oil market that's been grinding its way back out of a deep slump for months.

Things aren't back to normal yet, but the positive signals are proliferating. The enormous glut of fuel that accumulated this year on everything from tiny barges to giant supertankers is being steadily depleted.

While the coronavirus pandemic is worse than ever in the U.S., demand in Europe is bouncing back as a second wave of lockdowns eases and Asia continues to pull in huge volumes of crude.

But there's more to this than a realignment of supply and demand – huge financial flows are also driving the price rally. In a world that's expecting to see travel recover sharply next year, crude has become a hot Covid-vaccine trade.

“Oil is the cheapest of all reflation assets,” said Amrita Sen, co-founder of London-based consultant Energy Aspects Ltd. “With vaccines slowly rolling out, we expect investors to start returning to the oil sector and for prices to continue firming.”

In some corners of the world, the recovery in demand is almost complete. India's largest refiner said last week its plants are processing at full capacity and it's expecting a v-shaped rebound in fuel use. Consumption of gasoline is also at or near pre-Covid levels in China and Japan, the world's second and fourth biggest oil consumers.

European motorists are hitting the roads again as governments

relax national lockdowns in countries including the U.K., Spain, and France, according to an index of road usage and traffic compiled by Bloomberg News. Road freight is sharply higher as companies rebuild inventories and the Christmas shopping season gets in full swing.

As demand is recovering, the Organization of Petroleum Exporting Countries and its allies are keeping tight limits on production. The group canceled January's 1.9-million-barrel-a-day supply hike and will instead add no more than 500,000 barrels a day to the market each month in the new year. Estimates for U.S. shale oil output are still falling.

Cargoes of crude are changing hands at higher prices from the North Sea to the U.S. shale heartland of Midland, Texas as consumers trawl the globe for extra supplies. Saudi Arabia raised the cost of its oil for Asia – a benchmark for the world's refiners – by the most since August last week.

## **Hot Money**

A more subtle shift in the market has also got traders excited. For most of December, nearby crude futures have been trading at a premium to later-dated ones, a price structure known as backwardation.

That buying of contracts at the front of the so-called price curve is evidence that managed money is flowing into the market, Eagle Commodities said in a note. The steeper the backwardation, the greater the return from holding futures from one month into the next, which encourages further buying in a "self-reinforcing cycle," the brokerage said.

In recent weeks, cash has poured back into energy markets. Holdings of energy contracts rose by \$3.6 billion through early December, according to JPMorgan Chase & Co., driven by inflows into Brent and West Texas Intermediate. Investors pumped money into U.S. exchange-traded energy funds last week,

with a swing of almost \$400 million from the prior period's outflows.

## Price Risks

"Right now, oil has priced in that promising future," said Victor Shum, vice president of energy consulting at IHS Markit Ltd. in Singapore. "While we have to deal with the immediate dark Covid winter."

There are reasons to think \$50 could be oil's ceiling for now. The price could tempt producers from Baghdad to Oklahoma to increase production. There are already tensions within OPEC+, with some members chafing at the cartel's self-imposed supply limits.

"A persistent rally could turn OPEC+ much less conservative, in turn driving a price pullback," said Citigroup Inc. analysts including Ed Morse.

The backwardation that's attracting speculators could also draw real barrels into the market, because the price structure isn't profitable for any traders still storing physical crude.

On the west coast of South Africa, a supertanker loaded oil from the tanks at the Saldanha Bay storage terminal earlier this month before sailing to Asia. It's a reminder that there are still plenty of barrels left over from the spring surplus.

Relentless Asian buying may pause at some point, especially with Lunar New Year celebrations starting in early February. Higher-cost crude will start to dampen the profitability of refiners in the region. A standard refining process in Singapore is now loss-making when using five of the eight oil grades tracked by Oil Analytics Ltd.

For now, positive trends in fuel consumption are buoying traders' desire for both real and paper barrels. And there could be more hot money coming down the pipe.

At the start of 2021, billions of dollars of commodities investments will be affected by a broader rebalancing of portfolios. The move could attract \$8 billion of inflows into Brent and WTI futures, according to Citigroup.

“There’s been a distinct shift in the financial oil market,” said Michael Tran, an analyst at RBC Capital Markets. Speculators are buying futures and holding onto them, scared that they’ll miss out on a further rally, he said.

– *With assistance by Sarah Chen, and Sharon Cho*