

# China refiners curb fuel output after massive new plants stoke glut



Reuters/Singapore/Beijing

China's fuel producers are making extended curbs to their output in the third quarter after supply from mammoth new refineries stoked an already-sizeable glut, potentially dragging on crude oil demand from the world's biggest importer of the commodity. Private refiner Hengli Petrochemical ramped up its 400,000-barrels per day (bpd) plant in northeast China to full capacity in May, while Zhejiang Petrochemical began trial runs around the same time at a similar-sized refinery on the east coast. In the wake of that wave of fresh supply and amid slowing local demand for fuels such as gasoline and diesel, refiners are cutting their crude processing, or throughput, industry sources and analysts said. That drop should sap their appetite for crude imports, pulling down on international oil prices that have already been hit by fears over a slowing global economy. The swollen surplus of fuel products could also send China's fuel exports surging to new

highs and further pinch Asian refining profits. "For markets that are already consumed with fears about a global recession...headline numbers of oil demand growth slowing alongside talk of run cuts seem to reinforce a bearish narrative," said Michal Meidan, a London-based analyst at Energy Aspects. Small-scale refiners known as 'teapots', mainly located in Shandong province, are coming under most pressure to make fresh output cuts, analysts said, extending curbs many of them made in May and June. Teapots have been seen as a bellwether for China's oil demand since 2015 when they became first-time crude oil importers. They now make up a fifth of the nation's total crude imports. Dongming Petrochemical Group, the province's largest independent refinery, is closing its 240,000-bpd plant this week for two months of maintenance in the wake of "poor margins", according to a company source. That comes after plants were losing 300-350 yuan (\$44-\$51) on each tonne of crude oil they processed in June, their largest such loss in nearly four years, said Shi Linlin, an analyst at consultancy JLC, and analyst Wang Zhao at Sublime China Information, another consultancy in the province. Seven plants in Shandong – including Dongming – with total crude processing capacity of 470,000 bpd will be offline in July for overhauls, JLC estimates. That's equivalent to a throughput cut of 14mn barrels of crude in July alone, or nearly 4% of the country's processing levels in May. Meanwhile, two major coastal plants run by Sinopec Corp, Asia's largest refiner, are planning to trim throughput by nearly 2%, or roughly 10,400 barrels per day, in July-September from the second quarter, plant sources said. That comes after these two plants were hit by refining losses in June for the first time this year. Sinopec did not respond to a request for comment. All refinery sources declined to be named as they were not authorised to speak to the media. The losses at small refiners come a month after behemoth Hengli cranked up operations at its plant in the northeastern port of Dalian. Hengli, traditionally a polyester maker, shipped its first gasoline cargo in early June. That

was 80,000 tonnes sold to Sinopec at 5,300 yuan (\$769.48) a tonne at an ex-plant rate, which is 700 yuan, or 12%, below prices offered by Shandong teapots, said two sources with direct knowledge of the transaction. The refiner in June placed a total of over 500,000 tonnes of gasoline at 300 to 500 yuan a tonne below market rates on average and sold a similar amount of off-specification diesel fuel with smaller discounts as its fuel quality has yet to stabilise, the sources said. "We were indeed marketing at promotional rates to build our customer base. But this is a temporary marketing strategy as we are new to the market," said a Hengli spokesman, without elaborating. The Hengli and Zhejiang plants are together expected to account for about 6.4% of total Chinese crude oil throughput.

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**OPEC warns that trade tensions are hurting global oil demand**



LONDON (Bloomberg) – OPEC said that international trade tensions are hurting demand for oil, slashing its estimates for consumption earlier in the year and predicting further challenges ahead.

The organization, due to meet in the coming weeks to set production levels for the second half, said demand increased by less than 1 MMbpd in the first quarter after cutting its assessment by more than 20%. The world economy is headed for its weakest growth in a decade, buffeted by a prolonged tariff battle between the U.S. and China.

“Throughout the first half of this year, ongoing global trade tensions have escalated,” resulting in “weaker growth in global oil demand,” the cartel’s Vienna-based secretariat said in its monthly report. “The observed slowdown in the global economy in the first half will be further challenged in the second half.”

Oil prices slumped into a bear market last week, sinking below \$60/bbl in London for the first time since January, on concerns that faltering demand would lead to a crude surplus

even as the Organization of Petroleum Exporting Countries and its allies keep supply in check. Prices surged 3% today on suspected attacks on oil tankers in the Persian Gulf.

Although OPEC reduced demand estimates for the first quarter, it kept forecasts for 2019 as a whole mostly unchanged and projects that consumption growth will accelerate during the rest of the year. World demand will rise by 1.14 MMbpd, or 1.2%, on average this year, down from an estimate of 1.21 MMbpd in last month's report.

As a result, the report signaled that if OPEC maintains production at current levels then global markets should tighten significantly during the third quarter, by about 1.3 MMbpd. Output from its 14 members fell by 236,000 bpd to 29.9 MMbpd last month as the U.S. tightened its squeeze on Iranian exports, it said.

Nonetheless, as OPEC and its partners prepare to meet in Vienna, its members appear focused on continuing to restrict supplies.

Saudi Arabian Energy Minister Khalid Al-Falih said in St. Petersburg last week that the organization is aligned on maintaining its output curbs during the rest of 2019, and awaits only a similar commitment from its ally, Russia.

As the booming American shale industry propels U.S. production to new records, United Arab Emirates Energy Minister Suhail Al Mazrouei even indicated that OPEC may also need to constrain supply in 2020. The cartel pumps about 40% of the world's oil.

Although the policy decision looks straightforward when OPEC and its partners convene, the producers are still struggling with one issue. As the tensions between Saudi Arabia and Iran continue to heat up, members are bickering over exactly which date to meet.

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# **Saudi Arabian crude inventories sink to historic low**



## **Riyadh's production cuts to support the oil price have caused domestic stocks to plummet**

Saudi Arabia's crude oil inventories have fallen under 200 mn bl for the first time in a decade as the Kingdom's production cuts continue, according to Jodi data released on Wednesday.

The Kingdom's oil stocks fell to 193.4mn bl in April, representing a 17pc drop year-on-year. It is the lowest inventory level since February 2009, when the price of WTI was just \$35/bl.

The decline in stocks continues a trend that has gathered speed since the inventory peaked at 329mn bl in September 2015. The trend accelerated in Q1 due to crude refinery runs

growing 8pc to 2.653mn bl/d and a 7.4mn bl draw during April alone.

However, the inventory decline comes despite a rise in average production in the Q1, year-on-year, by 0.7pc to 9.993mn bl/d. Average monthly oil exports during Q1 2019 were 1pc lower than the same period in 2018, at 7.137mn bl/d.

## **Opec+ production**

Opec+ members agreed last December to cut a combined 1.2 mn b/d of production. Saudi Arabia is contributing the lion's share of Opec's 800,000 bl/d contribution, which equates to roughly 6pc of its income.

Saudi Arabia needs to maintain stable production and export figures to limit the damage to the government's coffers.

Saudi rulers are also mindful maintaining good relations with the US Trump administration. By ensuring the global oil market is well supplied it bolsters the partnership that is aligned against the shared regional rival, Iran.

The price of WTI plummeted 23pc from a high of \$66.5/ bl in mid-April to \$50.82/ bl in early June, led by global demand concerns worsened by the US-China trade war as well as continued growth of US inventories.

The price slide persisted until a bomb attack on shipping in the Gulf led to rising tensions and a subsequent price surge starting 19 June.

All eyes are now on the Opec+ meeting to be held in Vienna on 1-2 July, where the organisation will decide whether to extend the cuts.

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# Saudi Aramco allows sneak peek into its finances



The world's focus, not surprisingly, has been on Saudi Aramco's \$111bn of net income recorded in 2018, making it the most profitable company in the world. But elements of the upstream story were largely ignored.

For example, the prospectus showed the company's largest oilfield, Ghawar, undershooting what many had thought was its current capacity of around 5mn bl/d, instead coming in at 3.8mn bl/d.

Ghawar has contributed about half of the estimated 150bn barrels of crude that Saudi Arabia has produced to date. Without doubt, Ghawar is an enormous field. Its remaining reserves are put at 48bn bl, so there is still a lot of oil out there, but it will get harder to recover, and require substantive expenditure.

Aramco is developing new fields to plug depletion, with half a dozen expected to come on stream by 2026 – adding an extra 1.25mn bl/d, according to data from consultancy Energy Aspects. Its co-founder Richard Mallinson emphasises that future upstream development is designed to keep things steady “at current capacity levels...Aramco is not talking, as it has



done in the past, about possibly raising potential capacity from 12mn bl/d to 15mn bl/d.”

Still, Aramco is not giving up on Ghawar anytime soon. The prospectus says field facilities and infrastructure there remain a central component in the company’s long-term strategic framework.

“The scope of the utilisation and maintenance of the established infrastructure has expanded to be a hub for development of secondary reservoirs and satellite fields,” says the prospectus.

The prospectus also shows how it has boosted production at other fields. At Shaybah in the south of the kingdom, and at the offshore Safaniyah field in the Gulf, Aramco reported production was close to double earlier Western estimates. At the Khurais field, near Ghawar in the east of the country, a “mega-project that started in 2009 with initial capacity of 1.2mn bl/d, has hoisted production to 1.5mn bl.” In 2018, Aramco produced 13.6mn bl/d of oil, including 10.3mn bl/d of crude.

## **Half a century of reserves**

Overall, Aramco’s reserves come in at a similar level to an independent audit published earlier this year: 261.5bn bl of crude and condensate, sufficient for proved reserves life of 54 years, “significantly longer than the 9 to 15 year proved reserves life of any of the five major IOCs based on publicly available information”, claims the prospectus. The document also records 36.1bn bl of NGLs and 233.8tn ft<sup>3</sup> of natural gas.

Another scarcely mentioned disclosure in the prospectus was Aramco’s shift to lighter-grade oil, in terms of projects that have come on line, and new ones in the pipeline. The question now is the extent to which Aramco can match this type of product to demand in the marketplace. The move to lighter is

good in terms of petrochemical demand and positive when gasoline/diesel demand is strong.

The prospectus flags Aramco's rock-bottom cost of production based on a comparison of data of the five major IOCs and other leading oil and gas companies. The company's "average upstream lifting cost was \$2.80/bl" of oil equivalent produced in 2018. Revenue from upstream operations stood at around \$217bn, while downstream revenue was \$139bn. It had \$86bn in free cash flow at the end of 2018, with minimal debt.

But all that glistens is not gold. Aramco may be the world's most profitable oil company, producing more than 10pc of global crude, but the prospectus shows the state's reliance on the company means it generates less per barrel than privately-owned competitors. Riyadh relied on the oil sector for 63pc of its total revenue in 2017, according to the prospectus. In 2018, Aramco paid about \$160bn to the government in dividends, taxes and royalties.

## **Top credit rating**

The transfer of funds from Aramco to the kingdom meant the oil company made about \$26/bl last year, compared with \$38/bl for Shell and \$31/bl for Total. That's why Moody's and Fitch assigned the company ratings of A1 and A+, respectively, arguing the government's reliance on the oil producer to fund its budget acted as a cap on its creditworthiness. ExxonMobil is rated AAA by Moody's.

The linkage between the state and company is an important one in the debate about whether Riyadh really does intend to float a minority stake in Aramco in 2021. Investors worry about the government's control over the oil giant and whether future decisions will be made for the benefit of the state or shareholders.

Andy Critchlow of S&P Global Platts says "investors may be

cautious about an IPO because of uncertainty linked to sovereign risk and the kingdom's future potential financing needs [particularly if prices crash due to a swifter switch to green technologies]".

In the interim, the company is shoring up its defences in an uncertain world. It plans to double its refining network, mostly outside the country. The idea is to feed about 50pc of its oil into its fully-owned or joint-venture refineries, making it the largest consumer of its own crude. The prospectus states categorically that refinery expansion was a means "to secure crude oil demand by selling to its captive system" of refineries.

Also revealed is the way Aramco ensures it always has enough spare capacity up its sleeve. The aim is to have "the average maximum number of barrels per day of crude oil (MSC) that can be produced for one year during any future planning period".

## **Sovereign wealth boost**

As of 31 December 2018, MSC stood at 12mn bl/d of crude. Spare capacity afforded by maintaining MSC enables the company "to increase production above planned levels rapidly in response to changes in global crude oil supply and demand".

Saudi Arabia is drawing on Aramco's cash to bolster its sovereign wealth fund to develop new industries to break the kingdom's reliance on oil. It is also trying to extract more profit from the crude it pumps by turning it into gasoline and diesel, as well as plastics and other materials used in consumer goods. The \$69bn purchase of Sabic was a case in point and a major factor behind the bond offering.

The aim is to provide more cash for the Public Investment Fund, the kingdom's sovereign wealth fund, to invest both internally and overseas to wean Saudi off its addiction to fossil fuels. It is a race against time as the bond prospectus

indirectly acknowledges via its references to risk factors that span climate change, among others. And that raises, once again, the issue of an IPO down the line in which the Saudis would like to raise a cool \$100bn.

A listing may be better sooner than later if you believe in the relentless switch to cleaner fuel sources. That said, traders are wondering whether Aramco and Riyadh really need the money.

After all, have they not demonstrated how easily they can tap the bond markets for credit?

Scott Modell, head of geopolitical risk at Washington-based consultancy Rapidan Energy, disagrees with this thesis. "An IPO is necessary [otherwise MBS's] ambitious Vision 2030 programme designed to reduce oil dependence [could end up becoming] Vision 2130," he says. "And for that reason, the IPO [postponed last year] is certainly back on the table."

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## **Trump talks to Saudi crown prince on Iran, oil**



(Reuters) – U.S. President Donald Trump spoke on Friday to Saudi Crown Prince Mohammed bin Salman about Middle East stability and the oil market, the White House said, after tensions with Iran prompted a rise in oil prices.

“The two leaders discussed Saudi Arabia’s critical role in ensuring stability in the Middle East and in the global oil market. They also discussed the threat posed by the Iranian regime’s escalatory behavior,” White House spokesman Hogan Gidley said in a statement.

The phone call took place in the wake of Iran’s shooting down of an unmanned U.S. drone in the Gulf region, which prompted Trump to prepare but ultimately hold back from launching a retaliatory attack.

There was no word from the White House statement on whether Trump raised with the crown prince the death last October of Saudi journalist Jamal Khashoggi.

A 100-page report by the U.N. special rapporteur on

extrajudicial executions, Agnes Callamard, earlier this week accused Saudi Arabia of a “deliberate, premeditated execution” and said the crown prince should be investigated for it.

(Reporting by Steve Holland; Writing by Doina Chiacu; Editing by David Alexander and James Dalglish)