SECTOR UPDATE

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OIL & GAS

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Range-bound crude price in H2CY24: Oil Brokerage

- **Crude price likely to remain range-bound against expectations of spike in H2CY24**
- **Diesel cracks could normalise by Q4 as weaker margins result in slower pick-up in refining runs and drawdown of excess inventories**
- **While range-bound crude means lower pressure on OMC marketing margins, weaker refining margins will likely continue in the near term**

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We summarise the key takeaways from our interaction with Anoop Singh, Global Shipping Research Head with Oil Brokerage, Singapore.

Crude price to remain range-bound over H2CY24: Crude price may not see a material pick-up in Q3CY24 as it is possible demand pick-up will be weaker in Q3. Current product flows and the sharp drop in refining margin do not corroborate with expectations of a pick-up in demand in Q3. This, with a higher level of product inventories, could result in lower pick-up in refining runs. Also, the OPEC+ group may dial down exports even below its low production levels to drawdown inventories.

Diesel crack could normalise in Q4: Diesel spreads reduced over the past quarter with counter-seasonal build-up of inventories in the Atlantic Basin, Asia and Middle East. This is likely a result of higher-than-normal hedging activities undertaken in H1. However, excess stocks could get consumed over Q3 with a slower pick-up in refining runs, setting the stage for normalisation of cracks in Q4. Higher hurricane disruptions in the US or outages in Europe could bring forward this normalisation.

Non-OPEC production set to grow through the decade: Non-OPEC production is set to meet typical incremental annual demand of 1m-1.2mb/d through CY30, particularly with continuing growth in US shale production, Brazilian offshore production and Guyana. This is likely to make it difficult for OPEC to unwind cuts. OPEC spare capacity is likely to rise to 5mb/d by CY25 per EIA.

Crude tanker market tighter for medium term: This market is supported by a) limited deliveries of new VLCCs over the next three years amid a high level of booking in shipyards for LNG carriers, and b) blockage of significant numbers of carriers in non-traditional trades.

Read-across for Indian oil & gas sector: While range-bound crude pricing could mean lower pressure on oil marketing companies' (OMCs) marketing margins, we still expect any excess benefit to be passed on to consumers. With higher diesel yield in slate, refining margins for OMCs are likely to remain muted in the near term.

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Read-across for crude markets

Crude price to remain range-bound over H2CY24

Crude price may not see a material pick-up in Q3CY24, with demand possibly turning weaker than current forecasts of different global agencies. Weaker demand, coupled with higher product inventories, could result in lower pick-up in refining runs. Further, higher levels of crude stocks may prompt the OPEC+ group to export even below its lower production levels to drawdown inventories.

Q3 demand may turn out weaker than current market expectations

While global agencies (International Energy Agency [IEA], US Energy Information Administration [EIA] and Organization of Petroleum Exporting Countries (OPEC) are looking for a significant increase in oil demand in H2CY24, current product flows and a sharp drop in refining margin does not corroborate expectations.

Recent pick-up in trade volumes is not driven by demand uptick

The pick-up in trade volume over Mar-May was likely driven by hedging activities adopted by refineries and end users to cushion against uncertainties. These trade volumes have resulted in counter-seasonal increases in inventories in the Atlantic basin (ARA, EU18, US) as well as Asia and the Middle East. This increase in inventory levels, along with a drop in refining margin, raises questions on underlying end-use demand.

Weaker demand could limit rise in refining runs in Q3CY24

Weaker demand could result in slower pick-up in refining runs or curtailments and, in turn, lower demand for crude. Refinitiv has started highlighting recent cuts by some Asian refiners.

OPEC may reduce exports in Q3 to clear inventories

While OPEC's exports were in line with its production quota over Apr-Jul'23, OPEC's exports have been higher than quotas since Nov'23. This has resulted in the build-up of global crude stocks. OPEC's recent decision to continue with cuts through H2 indicates it is drawing down inventories to reduce pressure on global markets. Further, OPEC may even export less than its production quota to help accelerate the drawdown in inventories.

Crude to remain range-bound even in Q4, with increasing OPEC export

While reduction in stocks over Q3CY24 could improve underlying markets, it could help OPEC to start some unwinding of production cuts from Q4CY24 to increase production and exports. This could keep crude price range-bound even in Q4CY24.

OPEC's comfort in unwinding could be a positive signal

OPEC is likely to unwind cuts only when member countries become comfortable with inventory levels and underlying demand. In that spirit, unwinding of cuts could be a positive signal of improved demand.

Diesel spread could normalise in Q4

Diesel crack impacted by counter-seasonal build of inventory

Hedging by refineries and end users has increased product inflows into western markets in H1CY24. This resulted in counter-seasonal increases in inventories in the Atlantic Basin (ARA, EU18, US) as well as Asia and the Middle East.

Lower pick-up in refining runs could help clear inventories in Q3CY24

While this will weigh on diesel crack in Q3CY24, lower-than-expected pick-up in refining runs could help draw down these stocks over Q3CY24. This could set the stage for normalisation of diesel cracks in Q4CY24.

Q4 cracks dependent on US hurricanes and European outages

Besides inventory, tightness in diesel crack will also depend on the hurricane season in the US and maintenance outages in Europe. Disruptions to the US refining system from higher hurricane activities could tighten cracks earlier. Similarly higher outages in European refining could also tighten refining.

US crude production and exports will continue to increase

US crude production and exports will continue to increase with increase in shale gas production, particularly in the Permian Basin. The recent halt in the increase in crude exports out of the US is mainly due to the limitation of gas take-out capacity from the Permian Basin. This will start increasing again after the US adds 2.5Bcf/d gas take-out capacity in the Permian Basin by Sep'24.

At this juncture, the Permian Basin accounts for nearly half of the US's crude production. With a drop in breakeven cost to US$30/boe (from US$50/boe earlier) and increasing deployment of technology and capital to develop shale acreage, Permian gas production and associated crude production are set to continue to increase going ahead.

New refineries to improve product supply from H2CY24

Two large refineries – the 600kbpd Dangote refinery in Nigeria and the 340kbpd Olmeco refinery in Mexico – are being commissioning and could significantly improve product supply once they reach around 60-70% utilisation.

Non-OPEC production to grow through end of decade

Various global agencies are currently looking for 1m-1.8mb/d increase in CY24 and an almost similar increase in CY25. The increases are likely to continue through the decade.

US shale: With consolidation in Permian and other shale basins, acreage is now owned by larger players with deep pockets. With a significant drop in breakeven costs, US shale production is likely to grow through the decade.

Brazil: Brazil is set to add more than 40 floating production, storage, and offloading (FPSO) vessels through CY30, with the addition of nine in CY24. This could help increase production by 200-400kb/d annually in Brazil.

Guyana: Guyana is set for a big step up to 800kb/d by CY25 and to 1.5mb/d by CY30 with targeted projects.

Increase in non-OPEC production to pose risks to oil price

With non-OPEC production likely to meet a typical annual increase of 1m-1.2mb/d, OPEC could find it increasingly difficult to unwind cuts. OPEC’s spare capacity is projected to increase to 5mb/d by global agencies.

To regain market share, OPEC may need to fight off shale producers. With a significant decrease in breakeven cost for shale production, this may not be an easy fight.

Outlook for tanker markets

Crude tanker market tighter than market expectation

Oil Brokerage has been more constructive on the crude tanker market than current indications from derivative markets. Oil Brokerage expects the VLCC rate to increase to US$60k-63kt day vs current indications of US$55k/day. The following are key drivers that will support VLCC markets.

VLCC supply is not going to grow over next 3 years

As shipyards are largely booked for LNG carriers at this stage, very limited deliveries of new-build VLCC are likely over the next three years (four in CY24, five in CY25 and 13 in CY26). Even this delivery is likely to be offset by planned/ likely retirals.

Significant supply is tied in non-traditional trades

Significant supply or tonnage of ships is tied up in non-traditional trades or sanctioned trades like Iranian and Russian trade. This is reducing availability of VLCCs for traditional requirements.

- **Iranian trade –** More than 120 VLCCs ships are permanently out of traditional markets.
- **Russian trade –** This has taken out 25 Suezmax and 50 Aframax carriers permanently, and another 25 Suezmax and 70-80 Aframax carriers for more than 50% of the time. Further, the utilisation level of swing carriers is significantly lower due to the time spent on ship-to-ship transfers, and the need for additional idle time before returning to traditional trades.

VLCC rates will see lower impact on resumption of Suez Canal

The benefit of the Suez Canal disruption was significantly lower for the VLCC market than for the product or clean tanker markets. Only 1mb/d of crude movement shifted to a long journey around the Cape of Good Hope from the Suez Canal and the same will unwind as and when the situation normalises.

VLCC tightness will not impact crude supply

While the VLCC market is likely to remain tight over the medium term, the need for crude supply could be met by a couple of options.

- **VLCCs can reduce voyage time to improve availability:** VLCCs can increase speed by 10% above current average speed of 12.5 knots.
- **Suezmax and Aframax can fill gaps:** Shipyards are currently still building Suezmax carriers, which could be used on VLCC routes as substitutes – should there be a need.

Product tanker market to ease in 2HCY24

Even after resolution of the Suez Canal disruption, the market is likely to be strong structurally over the medium term.

Disruption of Suez Canal benefitted product tankers

The Suez Canal is used to transfer refinery products from Asia and the Middle East to the Atlantic Basin and the US. The clean tanker trade increased 2.5-2.8x pre-disruption levels during this disruption. This resulted in spikes in rates for clean product tankers.

Clean tanker market starts to ease over Q3

With a high level of diesel stocks in most geographies (ARA, EU-18, US, Asia), demand for product tankers is likely to reduce in Q3, setting the stage for the easing of product tanker prices.

Suez Canal disruption could ease over Q4

While it is difficult to predict the end of any geopolitical event, there is a good possibility that the Suez Canal disruption will start to unwind over Q4 upon the de-escalation in political satiation.

New refineries set to lower demand for product tankers

Stabilisation of new refineries in Nigeria and Mexico could reduce imports of products into the region and impact the demand for clean product tankers.

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