KPLER

Crude Oil Weekly

US SPR release continues to support commercial stocks, but weighs on imports of heavier crudes

September 2022

SUMMARY

1.

Executive Summary

Atlantic Basin: The ongoing SPR release continues to support commercial inventories whilst weighing strongly on imports of heavier grades from Latin America, which have eased to a multi-year low in early September. Nevertheless, crude throughput in the USGC continues to remain robust, potentially setting the stage for higher imports of heavier grades over the remainder of the month.

Europe and FSU: As Europe is seeking to revamp its benchmark grades and the fundamentals underpinning them, Iraqi is increasingly set to capitalize on the opportunities emerging after December 2022.

Middle East and Asia: Amid a wave of Western oil companies cutting ties with Russia, operator ExxonMobil also stopped Sokol Blend production at the Sakhalin-1 field, reducing exports to almost zero over the past 4 months. With some indications of increased Sokol production surfacing, deliveries towards India and China could ramp up over the next months.

2.

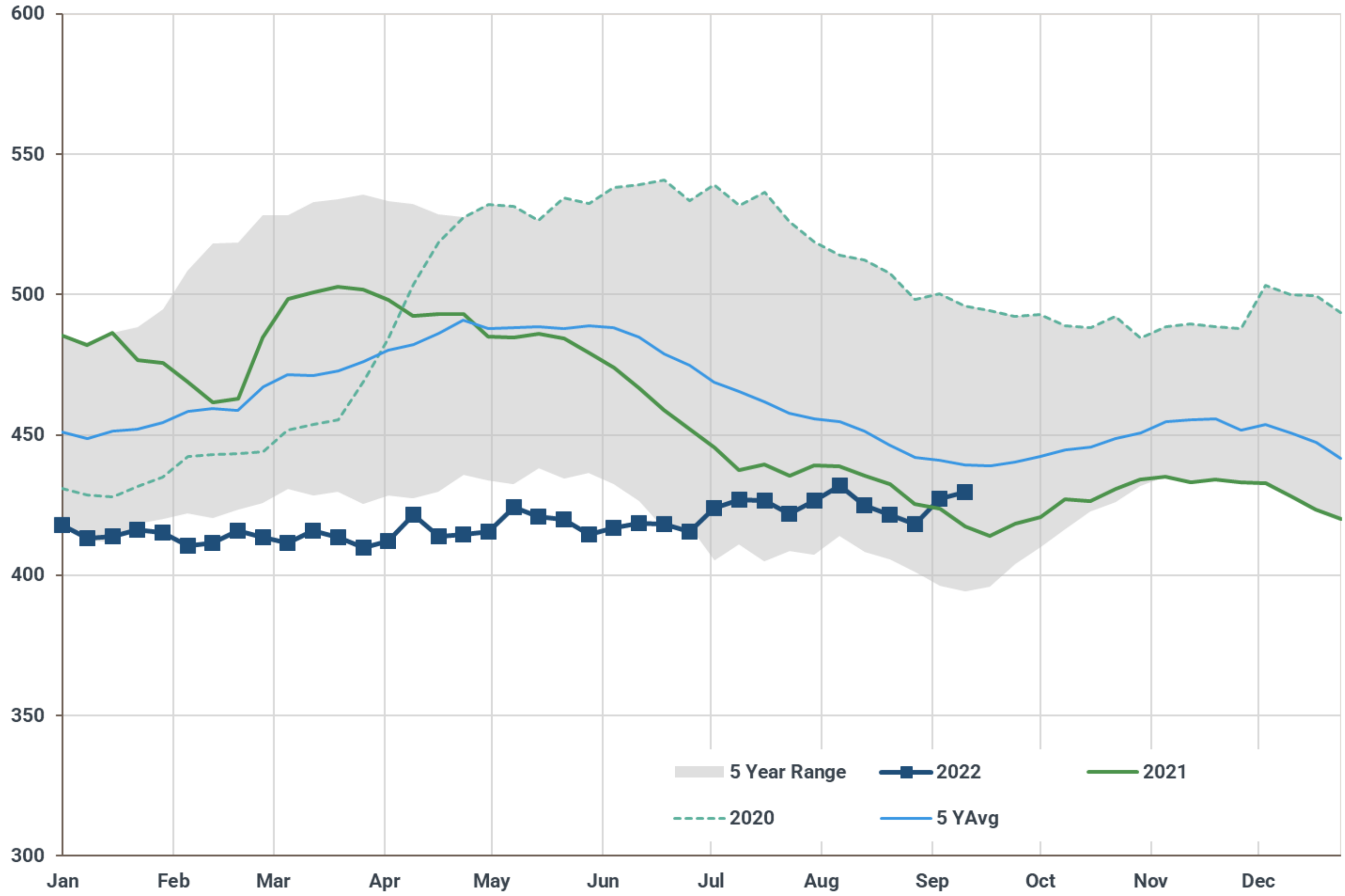
Atlantic Basin

SPR release continues to support commercial crude stocks but weighs on imports of heavier grades

Commercial crude stocks continued their ascent for the week ending 9 September, with inventories climbing for a second consecutive week, tacking on about 2 Mbbls w/w and settling at the second highest level this year at 430 Mbbls. Whilst this increase stands in contrast to previous years, as crude stocks typically ease until late September, **market participants likely were expecting a stronger build, given that API inventory figures for the US predicted an increase of 6 Mb for the same period.** Considering this, WTI Houston futures remained supported and settled just shy of $90/bbl on Wednesday, marking an increase of almost $10/bbl since reaching a 10-month low late last week. What is more, additional support has come from rumors that the DOE will consider replenishing SPR stocks at or below $80/bbl, but this assumption has already been refuted by officials.

The rise in commercial stocks can be attributed primarily towards a strong draw in the US SPR, which has been easing more strongly as of late and declined by over 8 Mb last week, equivalent to a decrease of some 1.2 Mbd. **This has seen the US SPR drop to only 434 Mbbls, a level not seen since November 1984, and one that likely will continue to decline in the coming weeks as we approach the end of the US' ongoing 180 Mbbls SPR release.** Given that the IEA recommends that countries hold a minimum of 90 days of net imports of crude and products domestically in order to ensure national security, this would, in theory, allow the US to release even more barrels from its SPR come October, should the Biden Administration be willing to do so. However, with crude prices as well as fuel prices having come down strongly from their highs since June, with the former remaining around early 2022 levels at the time of writing, the possibility of additional releases remains less likely. On a similar note, **further releases likely would result in stronger OPEC management, which would arguably lead to a decline in output from the group and offset any effects such a release would have on crude markets.**

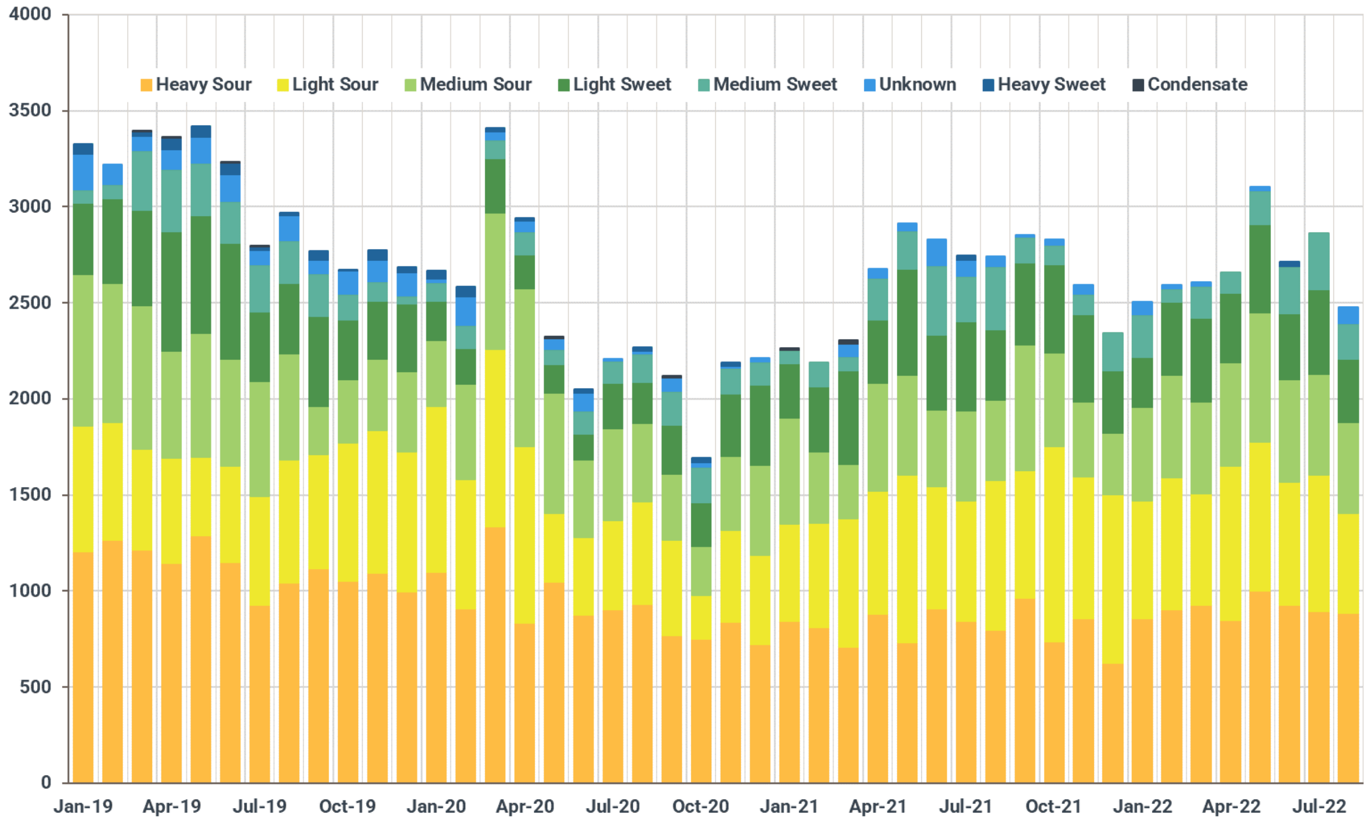
US crude inventories, Mb



Source: Kpler based on EIA

The rise in crude availability domestically, which has come on the back of the ongoing SPR release, has seen US crude and condensate imports come increasingly under pressure recently, with exports to the country averaging only around 2 Mbd so far this month, which is even lower than the multi-month lows seen in August (see chart). Even though this value likely will change and could potentially move higher over the remainder of the month, weekly data over the last two weeks has shown that there has been a substantial drop in crude flows to the country, with the 4-week moving coming in at only 2.2 Mbd for the week beginning 5 September. **Notably, this marks a decrease of about 300 kbd (12%) vs month-ago levels and is equivalent to the lowest level since February 2021.**

Crude and condensate exports to the US (Mbd)



Source: Kpler

Whilst the decline in US crude imports is to be expected for this period, given that many refineries undergo maintenance between September and October, the decrease in imports is impacting primarily heavier crudes from Latin America. In fact, combined exports of Maya (API gravity: 22°), Vasconia (API gravity: 24.3°), Castilla (API gravity: 17.7°), Hebron (API gravity: 20.1°), which have been coming in between 800 kbd to 1 Mbd consistently so far this year, **have been averaging only around 300 kbd in early September, equivalent to the lowest level in our records, which go back to 2012.** The decline comes amid a decrease in imports from all grades, with Maya (-200 kbd m/m) and Castilla (-100 kbd m/m) making up most of the downtick in early September.

Notably, crude throughput in the USGC, which is a region that typically consumes heavier crude grades, has remained essentially unchanged at around 8.8 Mbd since last month, which compares to the 5-year average of only 7.7 Mbd over the same period. This is the result of refineries delaying and/or reducing maintenance in order to take advantage of still elevated margins, particularly those for middle distillates. **If overall demand in the USGC continues to remain robust, we could see exports of heavier grades to the US, particularly Maya, pick up strongly compared to current levels moving forward.** Moreover, we should see crude throughput begin rising again in other regions (excluding the USGC), which in fact, have seen crude intake decline over the past EIA readings and remain roughly in line with seasonality, which will help lift demand for crude from Latin America further and support imports over the coming weeks as well.

3.

Europe and FSU

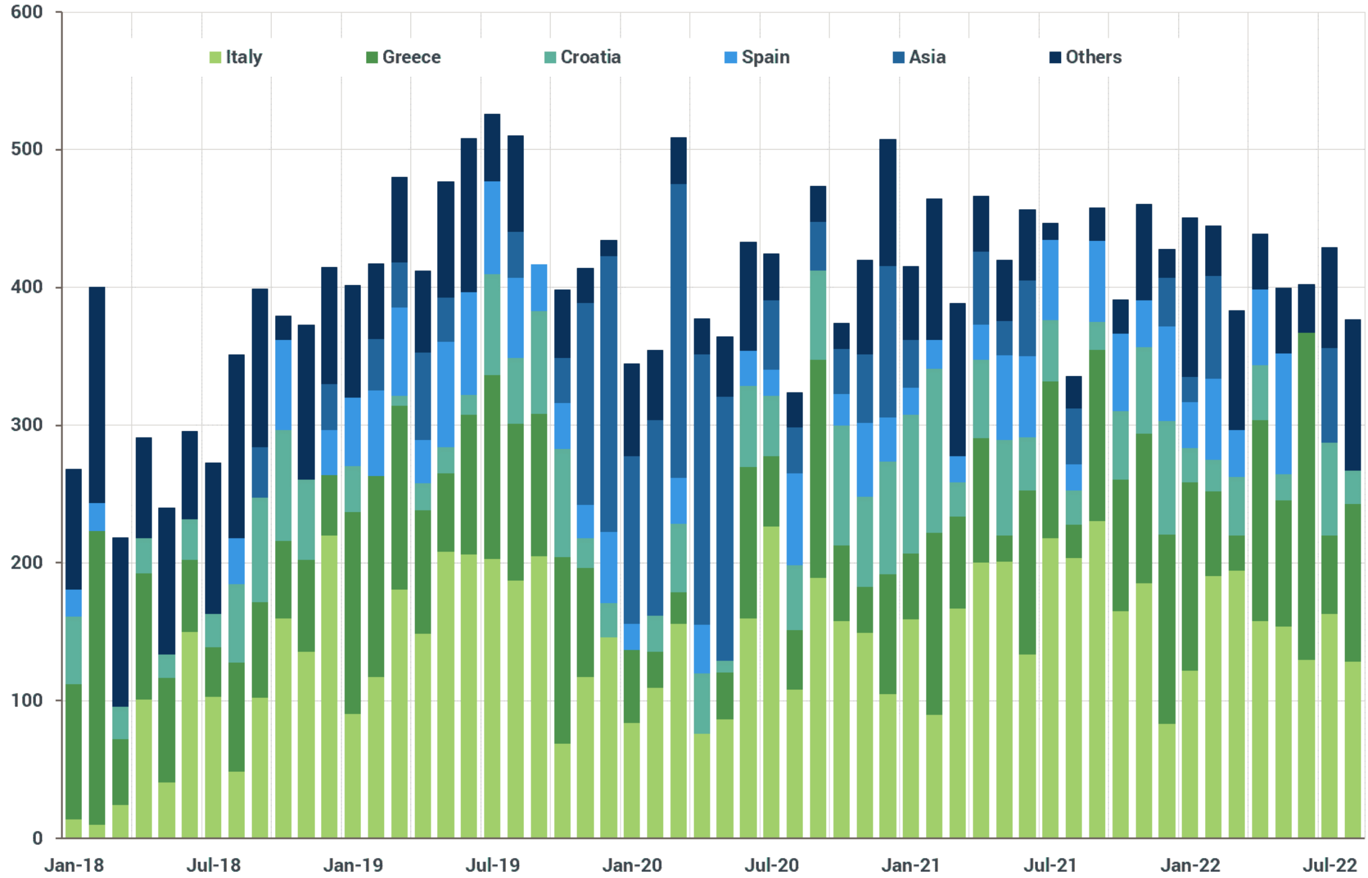
Iraq eyes expansion into Mediterranean markets in 2023

Mid-September has brought a period of relative lull when European trade flows are continuing more or less as previously. With autumn maintenance works kicking in across the continent, most of high-impact developments have come from other trading regions, be it the future of the US SPR (see Atlantic Basin segment) or China's lockdown woes. In the background, however, work is in full swing to delineate the future of European oil markets, specifically in creating new benchmarks that could supplant Urals as the continent's medium sour pricing compass. **Over the last couple of weeks, the world's leading price reporting agencies, S&P Global Platts and Argus Media, have both launched their respective sour crude indexes.** Their approaches are different – whilst **Platts decided to base the sour index around Johan Sverdrup** (its relative weight equals to 65% of the European Sour Crude Index, with Grane accounting for 30% and Flotta Gold for the remaining 5%), **the Argus Brent Sour index will reflect the lowest value of the following North Sea flagship grades – Johan Sverdrup, Grane, Flotta Gold, Brent and Forties.** The latter's choice is of particular interest because if the same rationale would be applied retroactively, for the overwhelming majority of 2021 trading sessions it would be Johan Sverdrup setting the new benchmark. **This year, of course, is anything but normal (last month Sverdrup traded above Forties, a phenomenon that should by default be rare given the quality difference between the two) but once the dust settles in 2023, we would expect some sort of normality to kick in, presumably making Johan Sverdrup the cheapest grade of them all once again.**

Thus, it seems that Europe will need to get accustomed to a new modus operandi, with an increasing rift between NW Europe and the Mediterranean. **Building a new medium sour benchmark around Johan Sverdrup makes perfect sense for the North Sea area, however, it is of little applicability for the Mediterranean where the Norwegian grade is a rare visitor** (flows in 2022 averaging 20 kbd to date). Taking a deeper dive into the Mediterranean, we struggle to see a grade that could supplant Urals as a regional indicator – Libyan grades are too disruption-prone and generally lighter, Algeria's Saharan Blend is too light and just as likely to end up in NWE as in the Med, whilst Middle Eastern grades lack secondary markets and are based off respective OSPs. **Meanwhile, Med Urals is reported to be trending around a -$20/bbl discount to North Sea Dated for more than a month already, implying that there is still very little visibility of actual trades.**

KBT/Kirkuk Flows by Country of Destination (kbd).

Except for two cargoes loading in July, Chinese buying of KBT has been non-existent in 2022 so far.



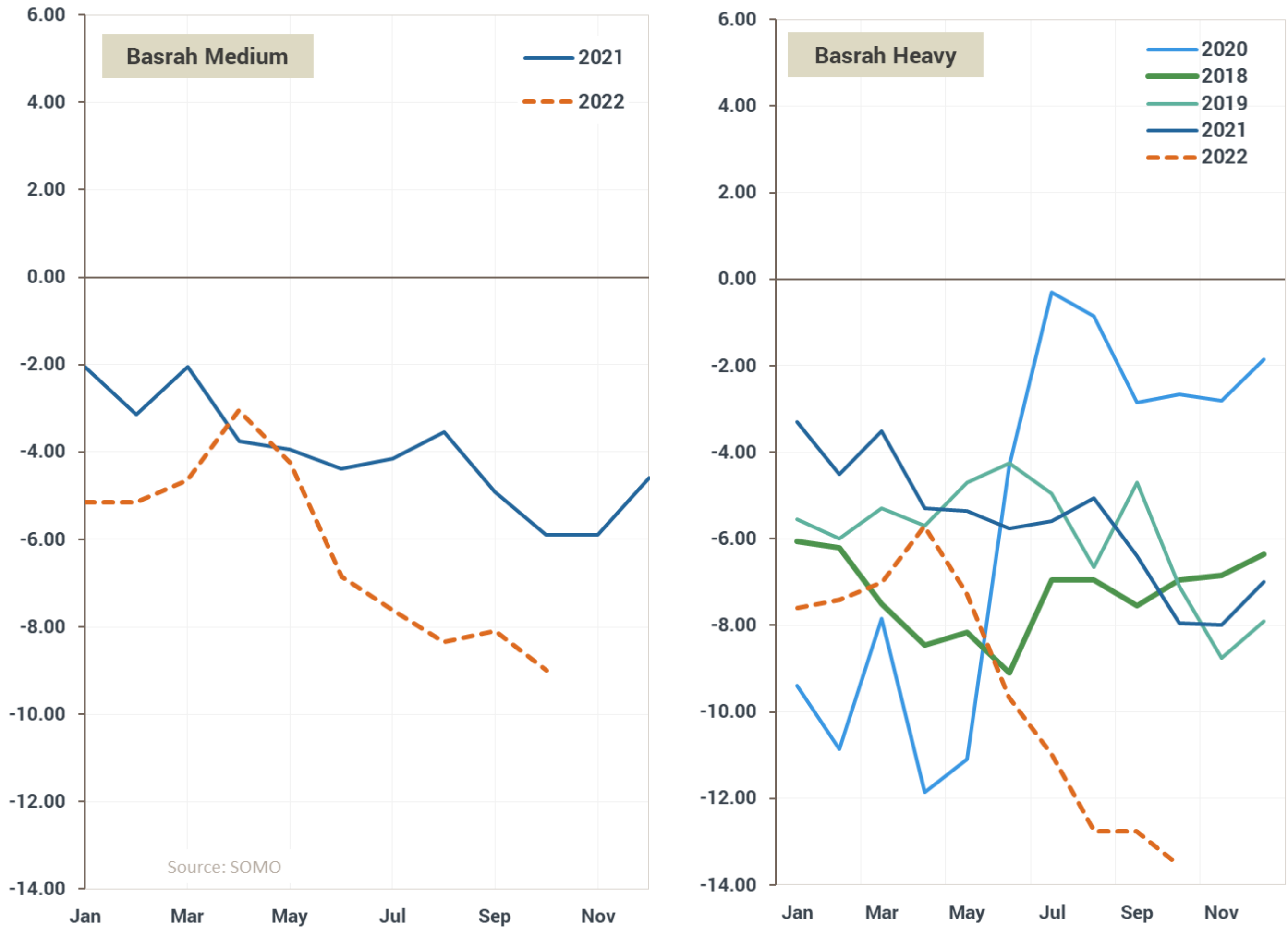
Source: Kpler

Whilst Urals differentials have been fairly stagnant over the past weeks, one of the few remaining grades the pricing of which is still following that of Med Urals, namely the Kurdish KBT, saw its differential to North Sea Dated drop to the lowest point on record. **KBT is currently trading at a -$19/bbl discount to NSD. Initially, the decline of the grade stemmed from plummeting Urals differentials as the two historically tended to compete for the same buyers.** Nowadays, however, the structural weakness seems to be stemming from an intensifying clampdown of Iraqi authorities on KBT, a grade that is often labelled as “smuggled” or “illicit”. Following the February 2022 decision of the Iraqi Supreme court, declaring all KRG contracts as unconstitutional, Iraqi Kurdistan has already seen an exodus of Western companies, primarily oil service majors such as Schlumberger, Baker Hughes and Halliburton. **From what it seems, now the pressure will be ramped up on buyers of Kurdish crude, mostly Mediterranean countries. The Iraqi state oil marketer SOMO now has an additional lever over such buyers – with the EU ban on Russian crude starting in less than three months, Iraq is increasingly shaping up to be a key supplier of incremental volumes into the European market.**

Expectations of higher Iraqi flows to Europe in 2023 can be corroborated by more frequent bilateral talks on the subject, such as the May ministerial visit to France specifically to discuss ramping up exports there, however we would argue that the European OSPs issued by SOMO are arguably the best confirmation thereof. **Continuing a downward trend that has been in place since May, the Iraqi oil marketer cut formula prices again, dropping Basrah Medium to a -$9/bbl discount to NSD (-$0.90/bbl vs September) and Basrah Heavy to an unprecedented -$13.55/bbl discount to NSD (-$0.80/bbl m/m). Needless to say, for both marketed grades these are the lowest levels on record.** The peculiarity of the m/m downward change is that the steep front backwardation that has marked the summer months of 2022 has now eased to pre-invasion levels, with the ICE Brent 1-month spread averaging $1/bbl this month so far (Marketview). **Given that SOMO-marketed Iraqi barrels are priced against Dated Brent, this marks yet another occasion in which the Iraqi firm has signaled its readiness to be flexible around pricing issues.**

SOMO OSP Adjustments in Europe vs Dated Brent ($/bbl).

Interestingly, SOMO's Asian OSP for October 2022 were lowered by $3.00-3.70/bbl, i.e. less than Saudi Aramco's.



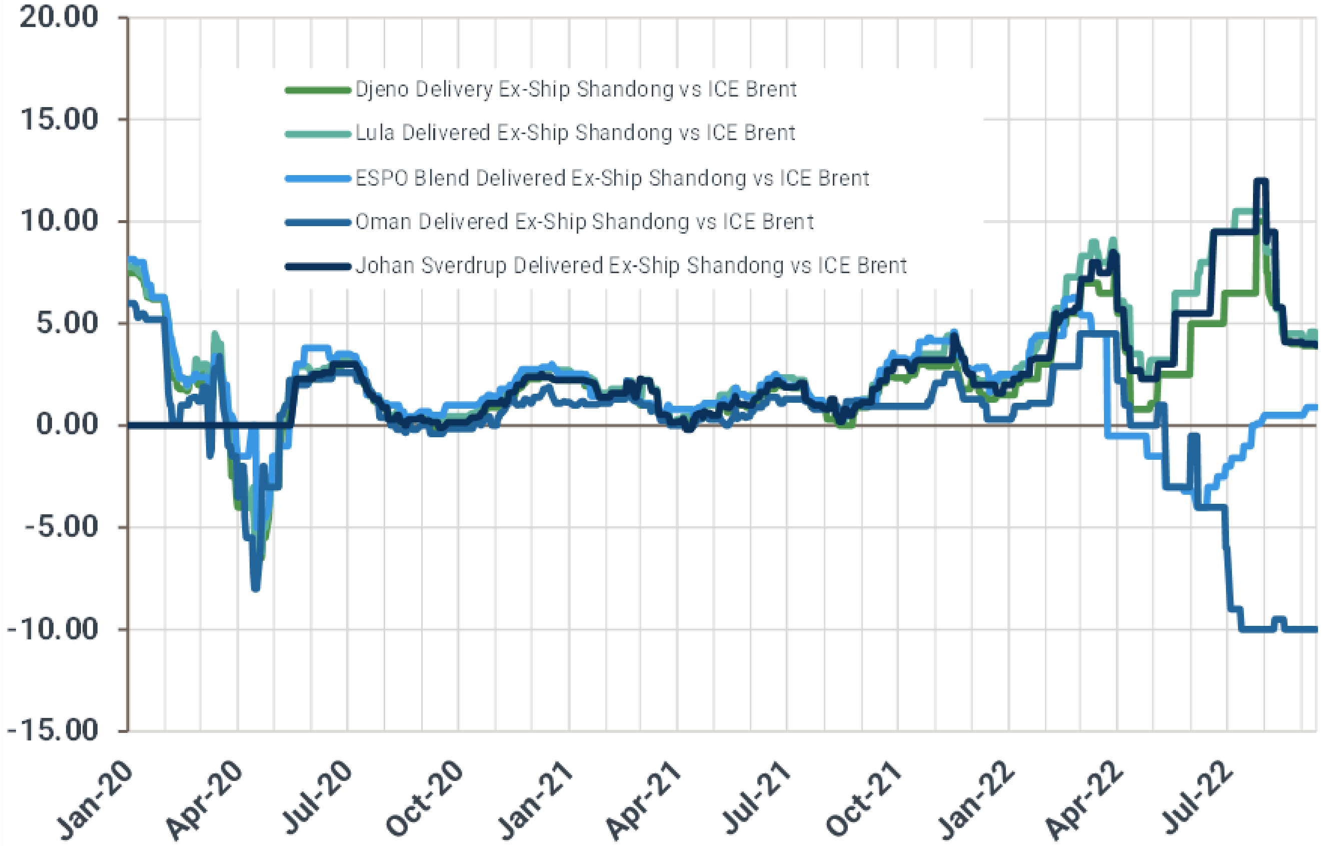
4.

Middle East and Asia

Russian Sokol flows to Asia could continue soon after 4-month production halt at Sakhalin-1

Asian prompt crude demand fell last month, manifested in Dubai M1/M3 backwardation halving vs July levels (to $5.4/bbl currently) and Asian light sweet spot premiums dropping massively, with Malaysian Kimanis, Kikeh, Tapis differentials vs NSD weakening by $5/bbl vs their H1 August highs. Valuations of DES Shandong delivered grades from Congo and Brazil also fell by similar amounts, with Djeno and Lula diffs vs ICE Brent currently trading around $4/bbl (vs early August at $10/bbl). On the other hand, ESPO Blend diffs vs ICE Brent have steadily recovered from their lows in June, currently trending at their strongest levels since March (see chart). ESPO Blend valuations have been supported by firmer demand from India and China, especially due to independent Chinese refiners, which are estimated to have bought more than 5 Mb for October delivery. ESPO Blend has also risen against the Dubai benchmark to its firmest differentials since March as two October-loading cargoes were sold in late August at discounts of $1.50-2.50/bbl vs Dubai (Argus Media).

Shandong Market: Crude differentials vs ICE Brent ($/bbl)



Source: Argus Media

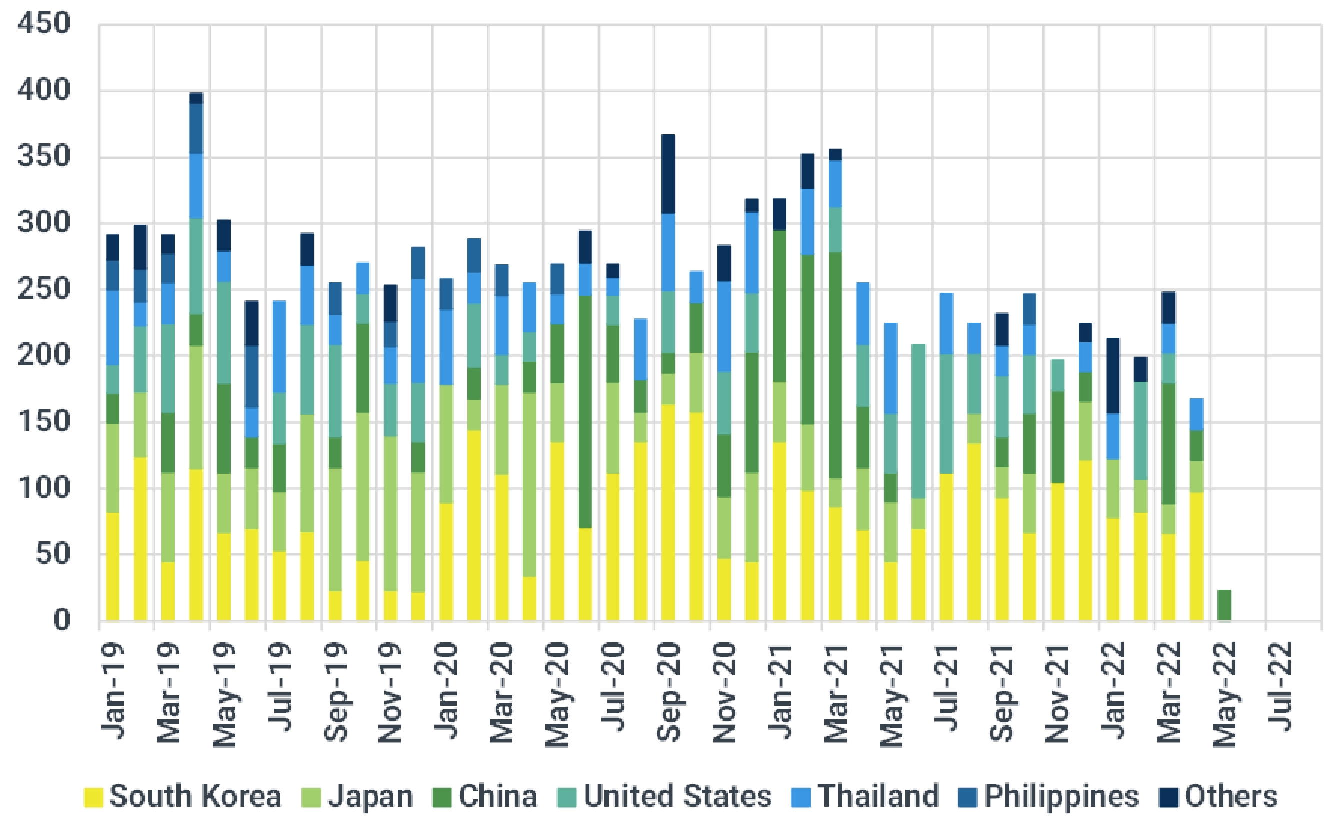
A weakening Dubai market structure in August prompted Middle Eastern crude producers to cut Asia-bound October OSPs across the board, with Saudi Aramco reducing formula prices by $3-$4.5/bbl m/m, following three consecutive months of increases. Similarly, Iraq's SOMO slashed October formula prices for Asia-bound shipments of its Basrah Medium and Basrah Heavy grades by $3.70 and $3/bbl m/m, respectively, pushing the former's premium to the monthly average of Oman/Dubai assessments to its lowest premium in 6 months. Kuwait's KPC adjusted next month's OSPs for Kuwait Export Crude (KEC) by $4/bbl lower vs September, resulting in a $3.80/bbl premium to the monthly average of Oman-Dubai assessments.

However, over the past few weeks, Dubai M1-M3 backwardation has strengthened again, from a $3.2/bbl spread in mid-August to $5.4/bbl in mid-September, a trend that should continue for the rest of the month. **This comes as the Asian crude balance is expected to tighten again over Q4, with our estimates seeing Asian crude demand grow to 39.6 Mbd in December, 1.2 Mbd above current levels, driven by growing crude appetite in China, India, South Korea and Japan.** Despite China's COVID-19 squeeze, the country's crude intake should grow by 3% q/q, also supported by the fourth batch of allocated product export quotas (additional 1.5 Mt), which will allow a boost in Chinese gasoil/diesel exports. In line with seasonal trends, **Indian crude runs should also grow considerably over the next months, driven**

by healthy transportation fuels demand, after August data showed domestic gasoline demand rise by 7% m/m (to 820 kbd), close to the all-time high levels seen at the end of Q2. In the case of **Japan and South Korea, crude runs should be boosted by rising products demand across the barrel** (but particularly kerosene demand for heating), with intake expected to surge in November by 240 kbd (to 2.8 Mbd) and 100 kbd (to 3 Mbd) vs current levels, respectively (Kpler estimates).

Looking at crude flows from Russia to the EoS, preliminary ship-tracking data is showing that the region might satisfy more of its crude needs with Russian Sokol Blend going forward. This comes after Russian Sokol Blend exports were stopped altogether in late April amid a sanctions-triggered halt in production. The offshore Sakhalin-1 field, which produces 220 kbd of medium sweet Sokol Blend, is operated by Exxonmobil, which intended to sell its 30% stake in the project after the Russian invasion of Ukraine in March amid a wave of western oil companies cutting ties with Russia. However, Exxonmobil's plans to exit the venture were blocked by President Putin signing a presidential decree that banned foreign majors from selling stakes in energy projects. **Due to the limited ability to sell Russian crude to major buyers South Korea, Japan and US, and lacking storage capacity on the offshore platform, Exxonmobil curbed production at the Sakhalin-1 field to 10 kbd vs the usual 220 kbd.**

Russian Sokol Blend exports by country of destination (kbd)



Source: Kpler

However, after a 4-month hiatus, it appears that Sokol exports to the East are slowly resuming, with one Aframax going to India in September and potentially more vessels booked for departure in the next months. While the September cargo could be the result of selling Sokol crude accumulated in storage after 4 months of 10 kbd production, further cargoes would imply a production ramp-up at the Sakhalin-1 field. Exxonmobil's partners in the project include Russia's Rosneft (20%), Japan's Sodeco (30%) and India's ONGC Videsh (20%), and in August Exxonmobil said that it was in the process of transitioning its 30% stake in the Sakhalin-1 project to another (unnamed) party. Hence, it is possible that Exxonmobil has shifted its assets to Rosneft, a move that reminds of similar manoeuvres by Western oil companies in the wake of sanctions. In July, France's TotalEnergies agreed to transfer its 20% stake in Russia's Kharyaga oil field to Russian state producer Zarubezhneft. With regards to potential destinations of these October cargoes, countries that have historically received most of Sokol exports, including South Korea, Japan and the US, will likely not be future recipients, as they are committed to halting trading oil with Russia. **In case that a supply ramp-up actually materialises, we expect that India and China will become the main buyers of the currently heavily discounted grade.** According to Argus Media pricing, Sokol Blend valuations have been trending at a $22/bbl discount to Dubai swaps since March. If trading would start again, we reckon that the price level of the grade would come close to the similar-quality ESPO Blend, which traded at a $2/bbl discount to Dubai in H1 September.

Thank you !

Get your free trial for Kpler Insight

Contact: sales@kpler.com

https://www.kpler.com/kpler-insight