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Asia starts to drive global base oil market

by Jeroen Looye

THE WORLD IS CHANGING.

In 2009, base oil prices started at the bottom with prices around US$420 per metric ton for SN500 FOB Europe. A strong pull from the Asian countries prevented the market to collapse even further. Nevertheless, it was a year full of uncertainty and cautious buying. Prices rebounded from March onwards, reflecting an improved sentiment in the financial market, improving macro-economic data and a substantial increase in crude oil prices which started in mid-February 2009.

After the summer, economic data got more mixed and crude prices started to move sideways and seemed to trade range bound. As buyers in the base oil market were still cautious and unwilling to take on stock, prices peaked and then stayed basically flat until the end of the year.

In the first quarter of 2010, prices were at US$810 per metric ton FOB Europe for SN500, which is almost twice as much as selling prices in March 2009 but close to year-end 2009 prices.

The most activity in 2009 was seen from February to July. European and U.S. selling prices were at very low levels, which created buying interest from countries like India and China. Prices kept on rising over the next months to US$840 per metric ton FOB Asia. After the depreciated feedstock had been depleted and refineries adjusted their productions levels, the global base oil market found a new equilibrium.

Little activity was seen for the rest of the year.

This continued into the first months of 2010. In March, prices rose again to US$1,010 per metric ton FOB Asia for BS150. This was due to tightness for especially heavy grades in the Asian region.

In Asia, buying activity remained stable up to the Lunar festivities in mid-February. At the end of February, there was upcoming interest due to seasonal demand for lubes in China. Prices started to firm up as Petrochina and Sinopec increased their domestic prices. The shutdown of S-Oil refineries for Group II and III, the explosion at the Pertamina refinery in Indonesia and the shutdown of some refineries of Petrochina and Sinopec added to the tighter supply conditions. Base oil prices for SN500 rose by about US$80 per metric ton in the last five weeks of quarter one.

European and Russian base oil prices were also mainly stable in the first quarter of 2010. Prices started to rise only in the second half of March. Recent prices heard were US$775 per metric ton FOB Europe for SN150. Price movement in Europe was mainly due to production and demand from the Far East and Africa. European demand for base oils remained weak nevertheless. From Russia, exports are expected to decrease due to domestic demand and the closure of the Yaroslavl refinery for maintenance. Another three refineries are expected to go off-line for maintenance in May.

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This quarter, India imported more than 230,000 metric tons of base oils.

It seems there is a surplus of inventories. Therefore, buyers were reluctant to accept the increase in domestic prices being imposed by some major refineries, including Bharat Petroleum, Hindustan Petroleum and Indian Oil, in April. Hindustan Petroleum even tendered a total quantity of 5,000 metric tons of SN500 and BS150 for export in March.

In the U.S. market, base oil prices remained fairly unchanged in the first few months of 2010. In mid-February, there was an explosion at the Calumet refinery at Shreveport, Louisiana. This refinery was offline for three weeks. Nevertheless, prices started to rise only in mid-March. Domestic prices were around US$970 per metric ton for SN500. Tight supply of the heavier base oil grades was mainly caused by crude oil prices and expectations of higher demand for vacuum gas oil.

These developments indicate that base oil markets worldwide are now currently pre-dominantly driven by the Asian economies. This time, the start-up of the Asian engine comes together with the tightness of availability of base oils in Asia, Russia and the U.S., driving up base oil market prices.

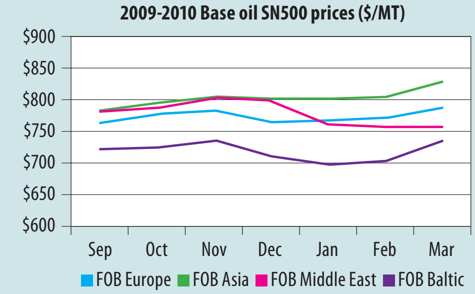
This is not surprising considering the fact that substantial economic growth can only be found in Asia and some emerging economies elsewhere. The U.S., Europe, the U.K. and Japan are recovering slowly from the worst economic crisis since the 1930's. However, a large part of the economic growth seen in these countries is due to huge government stimulus programs and both conventional and unconventional monetary policy from central banks. We expect growth in these economies to fall back once the inventory cycle ends and governments start to address their fast-growing deficits.

Asian countries will remain the growth engine of the world and will claim a larger position in the world economy. The ever increasing importance of Asian countries in the base oil market reflects this fundamental development.

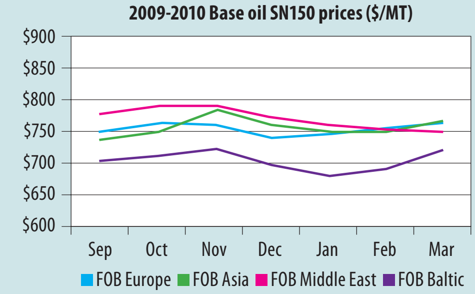
It remains to be seen whether high growth in Asian countries and emerging countries around the world will be sufficient to offset the structural lower growth in the U.S., Europe and Japan. Both crude and base oil prices ultimately depend on the level of economic growth and the related demand for finished products. The uncertainty of future economic development is now higher than usual. We will closely monitor economic developments in the coming months to see where the world economy is headed and what the longer term trend in crude oil and base oil markets will likely be. In the meantime, it pays to be cautious.

Jeroen Looye spent seven years as a base oil trader for AP Chemicals in Belgium. He is now an entrepreneur based in The Netherlands and is director of the Dutch company Losiwo B.V. that launched the base oil platform, www.baseoilmarket.com, in 2008.

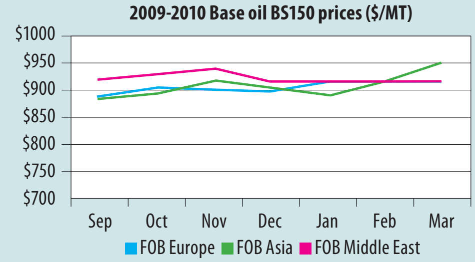
2009-2010 Base oil SN500 prices ($/MT)



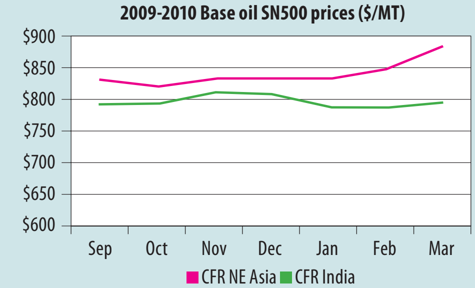
2009-2010 Base oil SN150 prices ($/MT)



2009-2010 Base oil BS150 prices ($/MT)



2009-2010 Base oil SN500 prices ($/MT)



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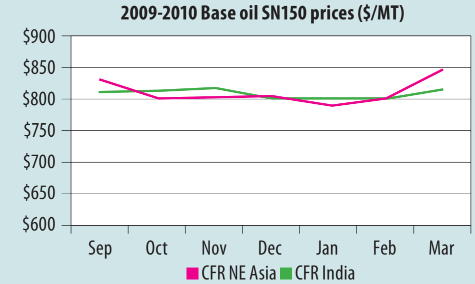
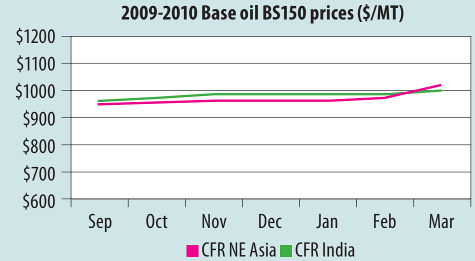


2009-2010 Base oil BS150 prices ($/MT)



Source: www.baseoilmarket.com