



In search of a new EQUILIBRIUM

A review of the global base oil market

by Jeroen Looye

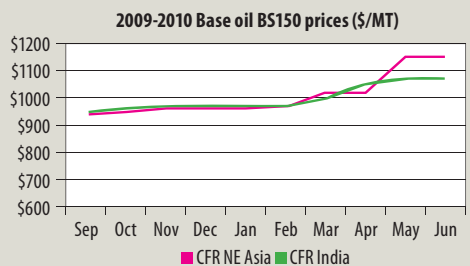
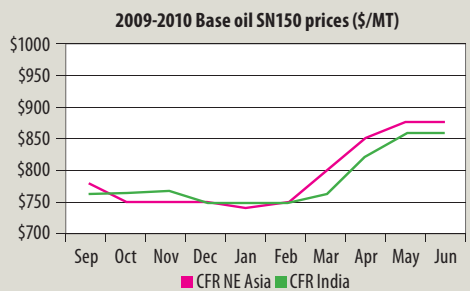
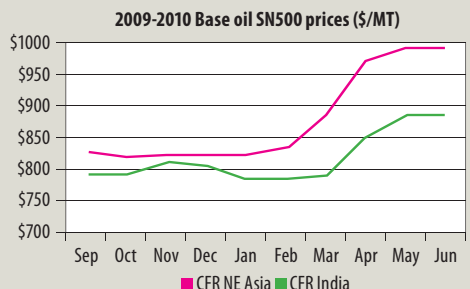
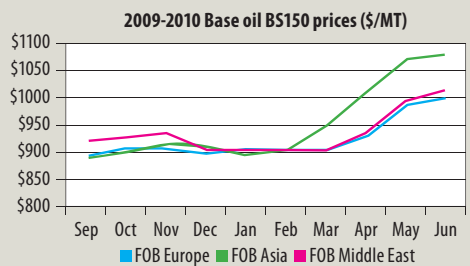
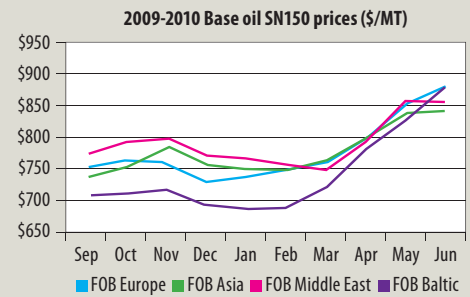
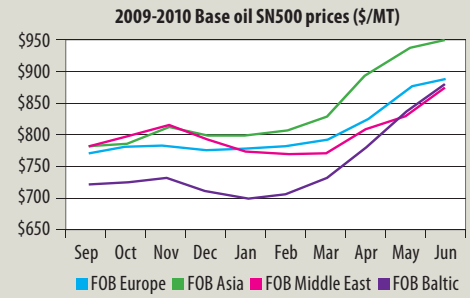
IN RECENT MONTHS, THE GLOBAL BASE OIL MARKET HAS BEEN very anxious. High volatility in the crude oil market has made many producers and buyers cautious.

Since the end of April, the next phase of the global credit crisis seems to have started. The focus of financial markets started to shift away from the economic recovery that started in the first quarter of 2009. Markets are now focusing on the fact that no real solution for the credit crisis has been presented. All we have seen so far is a transfer of debt from the private sector (mostly financial institutions and households) to governments.

The resulting explosive increase in government deficits has gone unpunished until then, when Greece's government bonds began to fall sharply and borrowing costs for the Greek government more than tripled. Interest rates of other financially weak countries in the European Union, such as Portugal, Ireland and Spain also rose sharply. The only way to restore normal borrowing costs is to significantly cut back on government spending and raise taxes. Large economies such as the U.S., the U.K. and Japan have similar problems and they will at some point also have to spend less and save more. Since this will sharply reduce economic growth, as government spending has become a more significant part of these countries' gross domestic product (GDP) during the global financial crisis, equity and commodity markets dropped sharply. Consequently, the benchmark crude, West Texas Intermediate (WTI), dropped from US\$86 per barrel to less than US\$70 in three weeks, after which it recovered to around US\$74 per barrel.

The dynamics in the regional base oil markets are different, however. In Europe and the U.S., base oil prices continued their upward trend convincingly, while Asian markets were hesitant and lagged behind the west. Higher prices in the west were mainly driven by tight supply. There were even trades from Asia to the U.S., which is unusual. The U.S. was exporting more base oils to China, than vice versa, in recent years.

"In Search of a New Equilibrium" continued on page 12 >>



Source: www.baseoilmarket.com

>> "In Search of a New Equilibrium..." cont. from page 8

But during the second quarter, tight supply in the U.S. and a slowdown in demand in Asia opened a small window for arbitrage from Asia to the U.S.

In Europe, where export has a larger effect on prices than in other regions, base oil prices increased significantly during the quarter, particularly for SN150 and SN500. Domestic prices in Europe increased by US\$170 and US\$110 per metric ton for SN150 and SN500, respectively. In March and April, prices were pushed up by high crude oil prices and exports to Asia. After the decline in export volumes to Asia, prices continued to rise as demand from the U.S., Africa and Turkey grew. Europe exported both SN500 and SN150 to the U.S. during this period. Meanwhile, strong demand for SN150 from Turkey resulted in a steep price increase. Spot trades were concluded at US\$940 per metric ton CFR Gebze for Russian SN150. On the production side, tight supply, partly as a result of numerous turn-arounds in Russia this quarter, also pushed European base oil prices higher.

After strong demand for base oils in Asia during the first quarter, trading activity to Asia has slowed down in recent months. As a result, base oil prices CFR North East Asia for SN150/SN500 only increased between US\$30 and US\$40 per metric ton. Higher price levels were mainly driven by price hikes by Asian refineries, including PetroChina and Sinopec in China, Formosa Petrochemical in Taiwan and ExxonMobil in Singapore. Buyers, however, were reluctant to purchase base oils at these higher

prices. The finished lubricants market had difficulties absorbing the cost of higher raw material prices. Also, the recent drop in crude oil prices could push base oil prices lower in the near term. In this environment, it is very hard for buyers and sellers to reach an agreement on a trade price. Thus, trading in recent months has been thin. This stand-off is expected to continue at least until September. In the meantime, supply in the Asian region remains tight. Exports from Asia to other regions were seen from refineries in Taiwan, China and India.

Base oil prices in the U.S. continued to firm up due to an increase in domestic demand and as a result of the limited allocation of production to base oils. This resulted in higher base oil prices in the U.S. compared to other regions. Domestic prices rose to US\$1,230 per metric ton for SN500 and US\$1,240 for BS150. As the U.S. market could not provide sufficient base oils for its current domestic demand, base oil cargoes were imported from both Europe and Asia.

Base oil markets are looking for a new equilibrium. On one hand, supply is tight in several regions and may very well stay tight, partly because supply is artificially limited to support current prices. On the other hand, current price levels are difficult to pass on to finished products. The sharp fall in crude oil prices suggest that base oil prices may well come under pressure in the near term. Participants in the base oil market have adopted a wait-and-see attitude. If the near-term economic outlook does not improve significantly, we expect that current price levels will not be sustainable and base oil prices will have to trend lower. ♠

>> "Greening Trucks" continued from previous page

91% of particulate matter (PM) emissions. Fuel costs can be 60% of truck operating costs in Asia, making it an even more attractive area for cost reductions than in the U.S., where driver wages are the largest cost component.

So what can be done to clean up trucks in Asia? First, ample options exist for engines and fuels, such as using low-sulfur diesel fuel, lower viscosity, as well as higher grade and higher quality, lubricants and oil filtration. Diesel particulate filters and other emission control devices can reduce between 60% up to 90% of air pollutants of PM, hydrocarbons and carbon monoxide. Truck performance can be improved through truck weight reduction, improving aerodynamics to reduce drag, reducing tire rolling resistance, or installing technologies that allow the driver to reduce idling, such as auxiliary power units. A recent pilot project in Guangzhou tested several of these technologies.

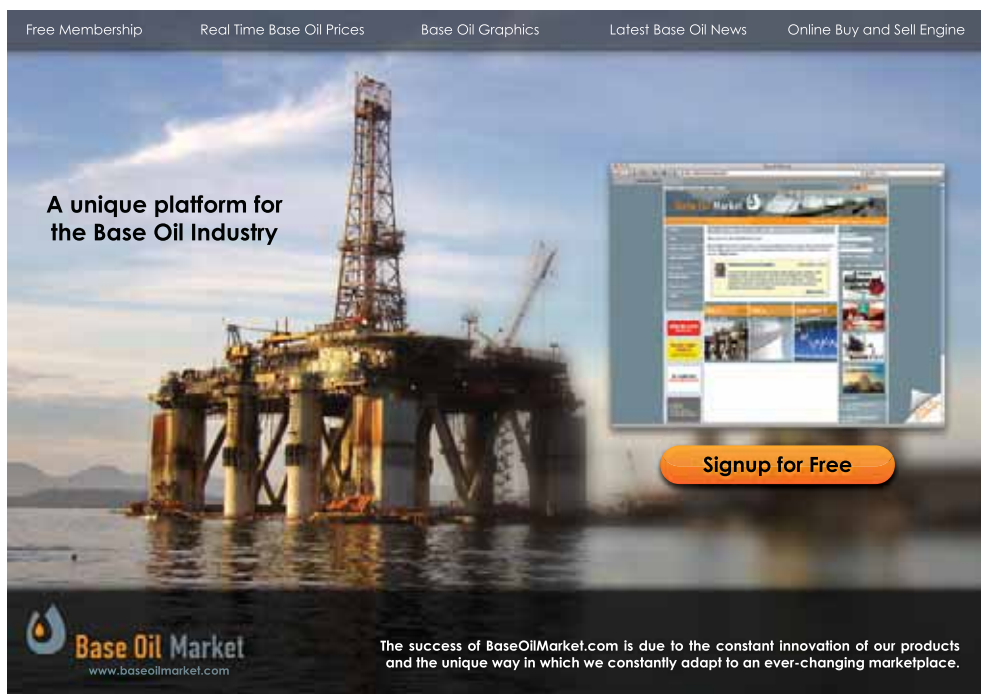
In the U.S., the difference in fuel consumption between the best and the worst drivers was found to be as high as 35%. Eco-driving and better maintenance therefore are low-cost options that can result in significant savings. Old and polluting trucks can be replaced with newer trucks or electric-hybrid trucks and are particularly attractive for large fleet operators. Improving freight logistics would involve integration of truck companies as well as logistics centers.

This is badly needed as overloaded trucks and empty hauls are a severe problem across Asia. For example, about 40% of trips in Guangdong Province are empty. Freight could be better allocated across different modes, including trucks, rail, ships and airplanes. High commodity and perishable goods will continue to be transported by trucks and airplanes, but rails and ships are very suitable for bulk and lower value commodity goods, such as coal and other raw materials for industry.

To capitalize on the fuel and other cost savings potential of these various strategies, a dedicated program for the freight sector is needed. There is an opportunity to build on successful programs elsewhere, such as the SmartWay program in the U.S. and similar programs in Europe and Australia. A program will only work if supported by shippers, carriers, government and other stakeholders, and should cover technologies, logistics, financing, policies and information. The CAI-Asia Center will be designing such a Green Freight Program for China, which could also serve as a model for other developing countries. ♠

Free Membership Real Time Base Oil Prices Base Oil Graphics Latest Base Oil News Online Buy and Sell Engine

A unique platform for the Base Oil Industry



Signup for Free

Base Oil Market
www.baseoilmarket.com

The success of BaseOilMarket.com is due to the constant innovation of our products and the unique way in which we constantly adapt to an ever-changing marketplace.