AFFINITY

MACRO TOPICS

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POLICY: LIBERTÉ, EGALITÉ, GDP

While France holds the EU's future in its choice of president, our attention is more immediately drawn to the Far East.

As expected, France will choose between the untested presidential candidates Emmanuel Macron and Marine Le Pen, following Sunday's first round of presidential elections. The Euro has gained against other currencies as investors expect Mr Macron to head off the nationalist tendency in France, at least for now. Perhaps the ex-banker, ex-economy minister can turn France's fortunes around, perhaps not, but other EU leaders will be praying for his victory on 7th May. Europe's economic future, as well as its political future, may depend on his success.

In the closer term, our attention is drawn today to several data releases which suggest that the Asian economic recovery continues to gain ground. Japan's leading index of economic indicators rose to 104.8 in data published today, though it refers to February 2017 and is barely a leading index now. The data is up 0.1 points on January, which was below the 105.0 reported for December. Year-on-year, the index was up 5.7 points from 99.1, so the direction of travel is positive.

Taiwan reported industrial production data for March today. Year-on-year growth was 3.22 per cent, an eighth straight gain, though the figure was lower than the Jan/Feb average of 6.22 per cent. The data follow industrial production growth of 5.14 per cent in 1Q17, following 6.23 per cent growth in the previous quarter. The overall picture is positive, though a 5.09 per cent fall in chemicals production affected the numbers. That reflects increasing competition from the Chinese mainland.

Exports from Thailand rose 9.2 per cent to USD 20.87 Bn, following a 2.8 per cent drop in the prior month. The figure came in better than market expectations of a 1.9 per cent rise, driven by rubber and computers. Considering the first three months of 2017, outbound shipments rose 4.9 per cent compared to the same period a year earlier. For 2017, the government expects sales to increase by 5 per cent, after 0.45 per cent growth in 2016. The export figure is an important indicator as exports account for as much as two-thirds of Thailand's GDP. Although it is known for its rice and rubber exports, it also exports hi-tech equipment, textiles, auto parts, and is highly exposed to US and EU markets. Its export increases bespeak the ongoing global recovery.

The Singapore consumer price index rose 0.7 per cent year-on-year in March as a 4.5 per cent increase in transport costs was offset by falling housing and utilities (-3.2 per cent) charges. Inflation of non-housing costs was 2.0 per cent year-on-year, 0.2 per cent month-on-month and 1.3 per cent for 1Q17 over 1Q16 (data from Dept of Statistics, Ministry of Trade and Industry, Republic of Singapore). In other words, inflation is accelerating, which we take to be a sign of rising demand compared to productive capacity.

On Tuesday, Hong Kong reports imports, exports and trade balance data, which will need to be considered in the context of ever-increasing competition from Shenzhen and related cities in Guangdong province. We will also watch out for April's Bloomberg China Economic Survey number, which we expect to be positive. If Chinese data for 1Q17 and its leading indicators are positive, we may become more optimistic about the macro outlook for the balance of the year.

CRUDE OIL: A BALANCING ACT

Growing expectation of prolonging the Opec cut has provided a bit of optimism.

After a week of registering consecutive losses, oil prices are on the rise again. A wave of supply-heavy US data had instigated the decline, but the see-saw of US supply versus Opec cuts has now swung back the other way, somewhat aided by the news that Emmanuel Macron, a pro-European candidate, made it through to the second round of the French Presidential elections. Apparently we are now that desperate.

A technical committee comprising of Opec members and other countries, which are participating in the global cut, has reportedly concluded that an extension of the current cut deal by a further six months would be necessary to keep prices from falling further. The committee has revealed that compliance with the cuts across the board in March was 98 per cent, an improvement on February.

However, questions remain over the sustainability of the cuts. The economic struggles of a number of Opec members in the face of low oil prices have been well-documented, and some, notably Saudi Arabia, are drawing up long-term plans to diversify their economies away from oil.

However, Oman, one of the non-Opec countries currently participating in the cut deal, is now looking into privatising elements of its state-owned oil industry infrastructure to drum up some much-needed cash. Over the past two years, the sultanate has faced a budget deficit of around 17 per cent of GDP, and oil minister Mohammed al-Rumhy has revealed that Oman is looking into proposals to sell downstream assets, including Salalah Methanol Company and a drilling project.

Iranian crude oil exports are expected to fall to a 14-month low in May of 1.7 Mn bpd, according to the Opec member's tanker loading schedule. This is despite not being shackled by the Opec cuts, which suggests that the country may be struggling to drum up exports, having cleared the oil in storage. Moreover, demand from the East, notably India and Japan, is on the wane; loadings destined for the former are set to fall to a one-year low, while demand from the latter has fallen by 50 per cent on the month.

For India, it is now a matter of politics. Indian state-owned refineries have collectively agreed to cut their total annual imports from Iran by 20 per cent in order to put pressure on Tehran to award its Farzad B gas field to an Indian consortium.

On the other hand, Iran became South Korea's second-biggest oil supplier during a quarter for the first time during Q1 2017. In March, exports on the year rose by more than 100 per cent up to just shy 600,00 bpd, according to Korea National Oil Corp. During the first three months of the year, Iran supplied an average of 519,000 bpd, again more than double the amount during Q1 2016; only Saudi Arabia supplied more with 857,000 bpd.

In other news, the Trump administration has blocked ExxonMobil from drilling for oil in Russia. Current sanctions imposed on Russia prohibit US companies from working with Russian entities, but Exxon applied for an exemption to continue its joint venture with Rosneft, a deal which was signed in 2011, but this was rejected. "The Treasury Department will not be issuing waivers to US companies, including Exxon, authorising drilling prohibited by current Russian sanctions," said Steven Mnuchin, the US Treasury Secretary.

Sources: FT, Reuters, Bloomberg, the Independent

PRODUCTS: NO MORE DIRTY DIESEL, SAYS AFRICA

Nigeria & Ghana will ban imports of high-sulphur vehicle fuels, but the move may prove expensive for the two countries.

Nigeria and Ghana could be the torch bearers for adopting Afri-4 fuel standards in the continent. The African Refiners' Association (ARA) is backing a move to adopt Afri-4 specification to lower the quantity of sulphur allowed in motor fuels. Nigeria and Ghana will ban the imports of high-sulphur fuels starting 1 July. In December last year, Nigeria's Minister of Environment Mrs Amina Mohammed announced the government's plan to ban imports of diesel with sulphur content higher than 50 ppm and gasoline and kerosene with a sulphur content higher than 150 ppm. Presently Nigeria allows imports of diesel up to 3,000 ppm sulphur and gasoline with up to 1,000ppm sulphur content. The Minister is keen to adopt environment-friendly practices and to be a pioneer in the region.

Ghana, another major crude exporter in the region, will ban the import of all diesel and gasoline with Sulphur content more than 50 ppm. In December last year, the five West African Nations; Nigeria, Ghana, Benin, Togo and Cote d'Ivoire backed the plans for adopting policies to promote clean fuels as a part of a United Nations Environmental Programme. However, only Ghana and Nigeria have an adoption timeline so far.

ARA acknowledges that its clean fuel drive was enhanced by a critical report published by a Swiss NGO, Public Eye in September 2016. It outlined how Africa is used as a dumping ground for the fuel which is not permitted in Europe. Following the report, governments in the region were pressed further by environment agencies and the ARA. ARA has approached the 54-nation African Union to get broad agreement on the adoption of Afri-4 in lieu of present Afri-3 standards. Due to weak regulatory standards in the country, traders can import fuel with sulphur content more than 300 times the levels permitted in Europe.

Previous attempts to enforce clean fuel regulations took a long time to establish. It took almost a decade to enforce the regulation for use of lead-free gasoline. However, this time, the two nations and the respective ministers in charge look eager to adopt the new regulations. Banning the imports might be a good start in a series of overhauls and costly changes in order to completely eradicate the use of toxic fuel. Even after China started taxing diesel & gasoline imports, light cycle oil (LCO), imports of which were not taxed, was shipped into the country and was sold as low-grade diesel. The "Dragon Taxes" if implemented next month, will take care of this loophole for China. In Nigeria, traders and local importers compete to supply fuel and the lowest bidder wins. This makes it difficult for clean fuel to make way in the country. Overhauling and keeping a check on the system will increase the regulatory costs for the state.

NNPC (Nigerian National Petroleum Corporation) confirmed that the three domestic refineries are exempted from the regulations until 2020. This means that Nigeria will have to import most of its domestic motor fuel requirements. Nigeria faces recession and the unavailability of US dollar will only make it difficult to import clean fuel. Nigeria's key source of refined products since the time of recession has been its DSDP agreement. Direct Sale, Direct Purchase agreements allow Nigeria to trade crude for refined products. Whether the NNPC refineries or TOR or Ivory Coast's Société Ivoirienne de Raffinage will be able to suffice clean fuel demand for their respective domestic markets remains questionable. Upgrades worth millions will be required to equip these refineries with desulphurization and other necessary units.

The changes are sensible but implementing them will prove to be expensive. If enforced, we can expect increased amount of motor fuel imports in the region, until 2020 when the domestic refineries will be ready to suffice domestic demand partially. The demand of refined products in Africa is expected to rise to 148.3 Mn T by 2030 from 81.6 Mn T in 2016, as per Citac, the energy consultants to the ARA. This will be a good news for the MR market which will take a hit if the so called dragon taxes are enforced on the import of LCO, Bitumen-blend and Aromatics.

Sources: Argus Media, Reuters, The Punch, UNEP Newscentre

GAS: CAN ARGENTINA BECOME AN EXPORTER BY 2023?

Argentina's incentive gas prices are proving successful in driving investment to the country.

As one of the most promising shale plays outside of North America, Argentina's Vaca Muerta shale play is seeing a positive trend in both production levels and investment. Overall, natural gas production has finally increased for the first time since 2006, but the country still finds itself as a net importer of the fuel. However, the aim is to reverse this trend as soon as the early 2020s and, so far, there has been positive movement.

Recently the government has strengthened their pricing incentives for natural gas produced from the Vaca Muerta shale through to 2021. This has spurred development of the shale through those seeking to capitalise on the current, artificially high prices. The new incentives will pay producers USD 7.50/MMBtu for output up to 2018, before declining slightly to USD 6/MMBtu until 2021. After 2021 it will be likely that free market pricing will take effect. These incentives will therefore help boost initial production, as the faster a company can develop and produce the gas, the more rewarding the incentives will be. Investment has been spurred even further by recent agreement with the government, which not only extends the gas pricing incentive but improves labour productivity laws and cap taxes.

Those seeking to capitalize on incentives include ExxonMobil. They are now evaluating the potential of the large Toldos 1 Sur Block which will require a 35-year production licence. This will bring total investment by ExxonMobil into the Vaca Muerta to USD 750 Mn. This additional investment should see production rise to 5 Mn cbm per day over the next two or three years. Alongside their onshore arm XTO, they have also launched a project in the Bajo del Chioque and La Invernada blocks, investing around USD 250 Mn with a potential total project investment of USD 13.8 Bn. Development of these fields could require the drilling of 556 horizontal wells. Other companies such as Tecpetrol have also announced that they will invest around USD 2.3 Bn to ramp up production to 10 Mn cbm per day

The reason behind the incentives is clear. Argentina wants to end reliance on costly imports and would like once again to be an important export hub in the region. But before this can happen, it still needs to close the 30 per cent production deficit which currently stands in the way. With a target set between 2021-2022, allowing it to become self-sufficient may sound like a pipedream but Argentina does hold the world's second largest shale reserves of natural gas. With an estimated 308 Tcf of dry wet and associated gas resources and with its neighbours, such as Chile, relying more and more on the fuel, Argentina could turn the natural gas market around in South America. The geology is good, the technology is there and so too is the demand. It seems that the only thing that was lacking is now finally catching up: investment.

Sources: Platts, Upstream

CONTAINER: JEBEL ALI T4 GOING SLOWLY BUT ON PLAN

...while new alliances could boost Oakland boxship business.

Container Terminal 4 at Jebel Ali, the new gigantic terminal in Dubai, has started taking shape with plenty of shipments of cargo handling equipment already having arrived at the facility during the last couple of months. However, it is not yet clarified by DP World, the developer, owner and future operator of the terminal, when the terminal will be launched formally. The market earlier expected that operations of the terminal would commence at some point in 2018, but it seems like DPW deliberately slowed the process to avoid adding capacity into a rather contracted market. In 2016, Dubai handled 14.77 Mn Teu, down 5.3 per cent when compared with volumes handled in 2015.

As stated in the DPW annual report for 2016, due to the current difficult market environment, it made no sense for port capacity to be under-utilised; “We only want to add capacity when there is a demand for it. So, in the softer economic conditions we witnessed in 2016, we have decided to postpone some of the planned capacity additions for Terminals 3 and 4 at Jebel Ali port.” 1.50 Mn Teu of extra capacity has been planned to be added to Jebel Ali Terminal by the end of 2017, but as no proposed launch date for the new Terminal 4 has been disclosed, we still have to wait to see when the process will be completed. Numerous ship-to-shore cranes and rail-mounted yard gantries have already been installed, but the DP World's new jumbo pier will not launch before 2018. “It is all about employing capital sensibly and keeping the flexibility to adjust capacity growth depending on market conditions,” DP World added.

Once the first phase of the new pier is finished, Dubai's annual handling capacity will increase by 3.10 Mn Teu, and is thus set to surpass 22 Mn Teu. 13 remote-controlled 'Megamax'-sized ULCS ship-to-shore gantries will be featured on a 1,200-metre pier. Focusing on the yard, 15 fully-automated storage blocks will be served by 35 automated rail-mounted gantry cranes. At a later phase, the new terminal will be further expanded in line with demand. When the 2,800-metre deep-water pier is completed, the new terminal could reach a design capacity of around 7.80 Mn. The difference it has from all other terminals located on the mainland, Jebel Ali Terminals 1, 2 and 3, Terminal 4 will be developed on an artificial island, some 1,500 metres offshore. The terminal is already linked to the mainland by a road bridge. Last month, DPW announced improved financial results for the full year 2016. The good performance was driven by the increased volumes which reached 63.7 Mn Teu. Revenue increased 4.9 per cent and adjusted EBITDA grew 17.4 per cent, with profit attributable to DPW's owners having reached USD 1.13 Bn.

Elsewhere, even larger vessels are expected to call at the US port of Oakland, driven by new networks, while efficiency gains will further increase, according to port authorities. Port maritime director John Driscoll expects higher container volumes after the introduction of the new shipping alliance networks at the start of April, who commented, "We will get more container moves per vessel, which increases the efficiency of operations.". The alliance reshuffle will most probably result in a new weekly offering, with Taiwan's Wan Hai Lines planning to start a new route linking Asia to Oakland. Direct calls from thirteen different Chinese ports are also considered very possible to happen, with six weekly calls from Taiwan, four from Southeast Asia, and seven weekly services from Oakland to ports in Japan. In early April, eleven major global shipping lines commenced the service networks of three new alliances, allowing them to pool vessels on ocean routes in an effort to minimise expenses while increasing their market cover.

The port further added that carriers are considering dispatching bigger ships in the alliances and transporting more containers to the US West Coast. This move could reduce the number of voyages required to transport similar cargo volumes. New alliance networks will most likely have a significant impact on operations at Oakland's three international marine terminals, with all of them believed to be well prepared for some terminal changes for vessels. The truth is that port authorities expect cargo volumes to remain rather stable, but with fewer and larger boxships, laden with more containers, calling on a weekly basis. "When shipping lines can be more efficient – and healthier financially – we all benefit,” added Mr Driscoll.

"What's good for our customers is good for the Port of Oakland.“ The port authority stated that a two- to three-month adjustment period is expected before all the alliance changes become obvious. "The process includes slotting vessels into new service rotations. In some cases, older ships will be replaced with newer, larger ones.“ Earlier this month, the port reported a post-Lunar New Year boost with import cargo volumes having grown 19 per cent the month before.

Port authorities commented that the results contrasted sharply with a 9.2 per cent decline suffered in February shipments to Oakland. Total container volumes loaded were up 9.3 per cent in March, reflecting a return to normal trade patterns after the Chinese New Year celebrations in February, when shipping demand to the US was strongly down.

Sources: Alphaliner, Lloyds List

DRY CARGO: DECLINING STEEL INTENSITY A WORRY

Steel demand growth will remain below GDP growth, suggesting dynamic structural changes in the global steel industry.

On the positive side, recovery has globally shown signs of broadening and strengthening, but in the meantime there is no strong growth engine to support any long-term optimism. Both the IMF and OECD recently highlighted the improving picture of the global economy for 2017 and 2018 accompanied by improving business and consumer confidence. For the next year, according to the same market outlooks, all regions/countries excluding China are expected to show growth, as the cyclical upturn in steel demand is set to take place in the next couple of years.

However, this growth rate will only remain close to 1 per cent while the global GDP growth could exceed 3.5 per cent. This pattern means that the steel demand growth will now stay below the GDP growth despite the cyclical upturn. This comes as a surprise, as steel demand growth typically outpaced GDP growth during a cyclical upturn in the past, while a cyclical downturn usually meant that steel's demand deceleration outpaced GDP deceleration. Behind this story, the structural changes of the global steel industry has now become far more obvious than in the post-crisis period.

Since the peak of Chinese steel demand in 2013, the growth engine shifted away from China to much smaller regions, especially emerging economies across the Indian subcontinent and the rest of Southeast Asia. These countries have been the main contributors to growth, but are still much smaller in size than the Chinese market, as expected.

In the meantime, there hasn't been a lot of interest from the investors side globally since the financial crisis, with the economic recovery mainly driven by consumption rather than investment. As an example, even China has been rebalancing toward consumption, while other major emerging economies have suffered structural problems, as several developed economies went through deleveraging. General steel demand is considered to be far more responsive to investment than it is to consumption.

Another important aspect is the globally declining steel intensity which is believed to be a trend to last and expand through time, mainly driven by tougher environmental regulations and the always more efficient use of materials requiring lighter but stronger steel. This has been a phenomenon seen again and again in the past, for example after the oil crises of the mid 70's until the year 2000, when the steel intensity of GDP declined at an annual rate of 1.7 per cent.

Major producing countries such as Australia try to remain optimistic based on US President Donald Trump's plan to upgrade his country's infrastructure, which could be enough to drive demand for steel and support iron ore prices. This could prove vital for the industry, especially after the plans mentioned by the Chinese Premier Li Keqiang last month to cut his nation's steel capacity. China is Australia's biggest trading partner and iron ore exports account for more than 3 per cent of Australia's GDP.

Sources: Worldsteel, Bloomberg

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