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MACRO TOPICS

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POLICY: FROM MUNICH TO BEIJING VIA BEER, NATURISM & TRUMP

A quiet week for economic data allows space for political speculation

It's a quiet week for data announcements from the main economic blocs around the world. Germany publishes preliminary PMI data on Tuesday, followed quickly by the preliminary Eurozone PMI. Both are expected to show an increase but market impacts may be limited until the official number is published. On Wednesday, Germany's IFO business climate index is released and is also expected to show an increase, this time after a reduction in January with the issuer, CESIFO Group Munich, attributed to a fall in the six-month outlook among manufacturers, construction and wholesaling, in contrast to a positive assessment of the current business situation. That might be natural German conservatism.

Munich itself has been in the news as the venue for the Munich Security Conference, a shindig for ministers, government representatives, private companies, lobbyists, journalists and soldiers from around the world – just the sort of elites that have been given a bad name in the last couple of years either for being too conservative or too liberal. Poor elites, they just can't win! Munich can claim to be Germany's natural home for such an international conference, being a city where one can enjoy a curry sausage with Danish lager while sitting in the shadow of the Chinese Tower in the English Garden while German naturists disport themselves in adjoining pastures. The MSC was notable mostly for US Vice President Pence giving support to NATO, but endorsing President Trump's call for more direct defence spending among European members.

Mr Pence also said that the US would continue to support Ukraine-related sanctions on Russia while seeking to improve the partnership between the US and Russia. This will surely disappoint the conspiracy theorists who claim that the US president was helped to the White House by Russian hackers dishing dirt on Hillary Clinton and that Mr Trump has been gifted nearly 20 per cent of Rosneft in exchange for dropping sanctions. These days we have news, fake news and outright speculation; it gets easier to keep an open mind and harder to trust what is presented to us as the evidence.

Staying in politics, Mr Trump has reportedly now endorsed the One China policy, reversing his previous position that his administration might bargain with it for an altered trade deal with China. This may provoke shrugs of disinterest among Mr Trump's supporters but it counts as a big win for President Xi Jinping who took the lead on the steadfast view that the One China policy was non-negotiable. The Chinese president may use this demonstration of his successful handling of the new US administration to further strengthen his position and court at home, especially with Politburo positions available at this Autumn's 19th party congress.

Still, if a week is a long time in politics in more normal times, then the distance between now and the Autumn offers scope for all manner of policy inversions and disruptive events, so we won't be leaving any hostages to fortune on US-China relationships. If the container lines are to be believed, rising trans-Pacific contractual shipping prices for 2017 suggest that politics is not yet getting in the way of increased US consumer demand for overseas manufactured goods. There is still room for the optimistic view that trade will trump nationalism (pun intended) and that the business cycle, having bottomed out in 2016, may continue to flourish this year in spite of all the political shenanigans.

CRUDE OIL: DELAYING THE INEVITABLE

A number of countries are just waiting for the agreement to expire before ramping up production even more than before.

Published in its latest monthly report, Opec cut a net 890,200 bpd in January, according to secondary sources. The Middle East led the way emphatically; Saudi Arabia, Iraq, the UAE, and Kuwait all cut well above 100,000 bpd. But already a number of these countries are in the process of planning ahead.

The production cut is set to expire in six months, and Kuwait has already announced that it will increase its output as soon as the agreement expires in June. CEO of Kuwait Oil Co. (KOC) Jamal Jaafar has said that regardless of whether Opec decides to extend the agreement, his country will increase its current production capacity of around 3.15 Mn bpd by 500,000 bpd.

Kuwait is currently producing 2.718 Mn bpd, a little over its 2.707 Mn bpd quota, and a five-year plan is in place to increase output to 3.65 Mn bpd by 2021, to which the country intends to adhere. Jaafar has revealed that KOC has signed deals with Shell and BP on E&P projects, and the company intends to drill its first offshore exploration wells by the end of the year.

Iran was one of the few countries exempt from Opec's cut, was granted an increase of 90,000 bpd up to 3.797 Mn bpd. In January, it fell just shy on 3.775 Mn bpd, a monthly rise of just over 50,000 bpd. But Iran seems to be paying little attention to its quota, announcing that production will rise to 4 Mn bpd by April. Over the next five years, Iran intends to drill another 500 wells, with the goal of producing 4.7 Mn bpd by 2022.

Neighbour Iraq has, meanwhile, claimed that its oil reserves have increased by approximately 10 Bn barrels following exploration and appraisals carried out on seven oil fields located in central and southern Iraq.

Libya, too, is jumping on the bandwagon. Jadalla Alakokali, a board member of the Libyan National Oil Corp., revealed that production has now exceeded 700,000 bpd and is set to continue to rise. Crude output is now expected to reach 1.2 Mn bpd in August, before rising to 1.7 Mn bpd by March 2018.

Within six months, then, the 900,000 bpd which Opec has so far cut from global supply could return with interest, should Nigeria also manage to continue its recovery. Russia, too, has revealed its intent to boost its own output to record highs by the end of the year, once it has complied with its own quota.

Opec, it would seem, is doing little more than staving off the inevitable. Already it is looking increasingly unlikely that the deal will be extended by a further six months. Crude oil prices are at around the mid-USD 50s per barrel, and it appears that they have hit a ceiling. US production continues to rise and is looming ever larger, while news that the cuts are just a temporary ceasefire will do little to improve sentiment.

The onus falls on Saudi Arabia then, which is already losing ever more market share to its Middle Eastern rivals, to take matters further, and to consider cutting even more to offset the inevitable increases. Whether that will be enough remains to be seen.

Sources: Bloomberg, Reuters, FT, Times of Oman, seekingalpha.com

PRODUCTS: EUROPEAN REFINERS SAVOR THE OPEC CUTS

Exemption of cuts for Libya and Nigeria has favoured the European refineries

European refineries have been under pressure from the state-of-art refineries in Asia and USA. There are now 77 refineries in Europe, down from 101 ten years ago, according to France's refinery representative body, UFIP. The news of production cuts must have only added to their concerns and misery. But about two months after the cuts have been adopted, these refiners are the happiest of the lot.

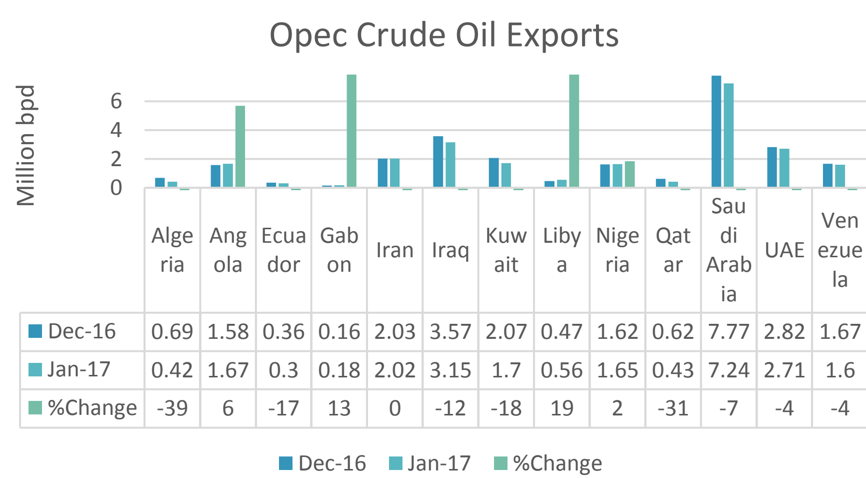
Refineries in Europe are older, less complex and require light sweet crude as their crude-slate. These refineries have found it difficult to maintain margins against new refineries like Reliance's mammoth plant in Jamnagar. These refineries can easily process heavy sour crude. The price of crude is the single highest cost that comprises of about a third of refineries' total costs. Feedstock, production and operational costs for refineries in northwest Europe and the Mediterranean are around USD 63 per barrel and USD 60 per barrel respectively, which are USD 3 per barrel and USD 8 per barrel above those in the Middle East and South Asia, according to PetroLogistics.

The cuts adopted by Opec exempted the only two large producers of, otherwise sought after, light sweet crude, Libya and Nigeria. This means that of the 1.8 Mn bpd cut, most production cut was that for the heavy sour grade. The buyers have been outbidding each other for the sour barrels ever since. Heavy sour grade is however cheaper because of excessive production from USA, but the spread between the two has narrowed. Refinery margins for a simple plant processing Brent crude in Rotterdam was USD 7 per barrel, which is 50 per cent above the first quarter average last year.

Some of the newer and complex refineries, particularly the ones in Asia, are built to run on the heavy grades. The cuts hence have favoured US heavy crude exporters. The teapot refinery owners in China are importing crude all the way from North America. With reduced exports of heavy crude from major Opec producers, Saudi Arabia and Venezuela, Asian refiners are finding it more economical to ship crude from Russia, the Atlantic Basin and the United States. As reported by Reuters today, nearly 600,000 barrels of US Gulf Coast Blend, a heavy crude made up of a blend of various U.S. and Canadian grades crude, were exported in January.

The humongous appetite of Europe for diesel supports the European refiners. European refiners have some of the world's highest middle distillate yields but the region still has to import about a fifth of it's 1.3 Mn bpd consumption.

Source: PetroLogistics, OPIS, Thomson Reuters, UFIP



	Algeria	Angola	Ecuador	Gabon	Iran	Iraq	Kuwait	Libya	Nigeria	Qatar	Saudi Arabia	UAE	Venezuela
Dec-16	0.69	1.58	0.36	0.16	2.03	3.57	2.07	0.47	1.62	0.62	7.77	2.82	1.67
Jan-17	0.42	1.67	0.3	0.18	2.02	3.15	1.7	0.56	1.65	0.43	7.24	2.71	1.6
%Change	-39	6	-17	13	0	-12	-18	19	2	-31	-7	-4	-4

GAS: CAN A REFORM IN NATURAL GAS MARKET ACCELERATE GROWTH?

China natural gas usage continues to grow but will it realize its full potential

Already one of the largest natural gas markets in the world, the Chinese gas market still has many opportunities for growth. After all, two-thirds of China's energy comes from coal (wherever it is sourced) and the opportunity to claim some of this market is huge. One major requirement for growth would be the need for the gas market to be more liquid (pardon the pun) in China. The step from coal to gas is hindered by state sector inefficiency and high gas prices which are 3-4 times the natural gas price in America and 50 per cent higher than the LNG landed price in Asia.

As energy producers want to pass on the costs of signing supply contracts at high prices, China must decouple the gas price from the oil-linked contracts to that of a more global benchmark for it to be competitive. At the moment there is a big drive for coal to gas conversions that is mainly policy-driven rather than based on the economic arguments (no different to the rest of the world then) and without a more liquid market, it will continue this route.

We have seen some initiative in China to address the higher cost of gas including promising subsidies to rural areas for the next three years to offset the higher cost. Growth will come quite soon with the number of coal to gas conversions, with Deutsche Bank reporting that conversions have become increasingly important to drive volume growth for gas distributors in China.

Still, without any further market policy changes, China Gas expects sales of natural gas to reach 30 Bn cubic metres within five years as natural gas is used more frequently to outplace coal, particularly in the north. This target is nearly double the current amount of 11 Bn cubic metres. Much of this growth will be driven by coal to gas switching which could add an additional 40-50 Mn natural gas users according to Kevin Zhu Weiwei, vice president of China Gas. The cities looking to fully replace coal within cleaner energy include Beijing, Tianjin, Hebei, Henan, Shanxi and Shandong.

Internally China's domestic gas production is also set to rise by up to a quarter of total production which has increased from 136 Bn cubic metres in 2016 to a planned 170 Bn cubic metres in 2017. This year alone will see an additional 3.5 Bn cubic metres of shale gas production. China is also building the capacity to store much of this additional production by the creation of three new natural gas storage facilities this year totalling 300 Mn cubic meters.

But for gas usage to really step up and compete with coal, there has to be a large-scale gas market reform to allow gas to compete not just through various policies but also through economics. This could also come through customer pressure for competition or from allowing competing for supply options. If the latter option has any credibility with the government, one should be able to see it in the next five year plan, which would have to include initiatives for producing, importing, distributing and marketing more natural gas.

Sources: Interfax, Platts, Reuters

DRY CARGO: KIM'S COAL & THE EFFECT OF CHINESE SANCTIONS

A closer look at how China's recent ban on North Korean coal is likely to affect seaborne trade.

North Korea, the despotic dominion of Kim Jong Un, is perhaps not the first country that comes to mind when thinking of nations that can influence shipping demand. Yet while the country's trade suffers under international sanctions, partially related to its nuclear weapons programme, the country supplies 22.48 Mn tonnes of anthracite, a high energy coking coal, in 2016 to China, or about 85 per cent of China's total imports. As its only ally, China's continued coal imports are the lifeblood of the North Korean economy, and its main source of foreign currency. That, however, is about to change as Beijing caught steel mills and traders off guard on Sunday by imposing a surprise ban on coal imports from its otherwise isolated neighbour.

The ban, a response to recent North Korean ballistic missile tests, is according to the Chinese commerce ministry set to be operational until the end of 2017, meaning that steel mills will have to look further afield to cover their coking coal demand. Natural substitutes would include Russian, Indonesian and Australian coal, a change that is good news for the Pacific coal shipping market.

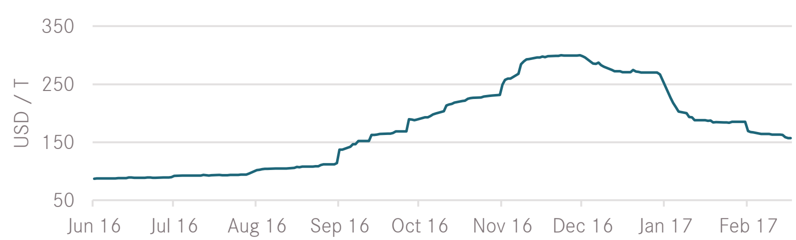
Taking a closer look at the Australian example shows just how significant the impact of these latest sanctions can be for the dry market. Assuming 36.5 day round trips from east coast Australia to north China on Kamsarmaxes loading 80,000 tonnes per shipment, a 22 Mn tonne shift in demand would generate 2.3 Mn tonnes of additional Dwt demand per year or the equivalent of around 28 Kamsarmaxes. With the current Kamsarmax and Panamax fleet clocking in at a little over 146 Mn Dwt, this means that the ban would create 1.6 per cent extra demand growth for the segment in 2017.

Despite the shorter distance, the scenario remains more or less the same when assuming that demand would shift to Indonesia, as a result of longer loading times.

Whether this ban will last beyond the period currently stipulated is however very uncertain. While China can afford to cut economic ties with North Korea, it is in China's interest to maintain stability in the region, particularly from a geopolitical point of view. South Korea's close ties to the US means that any war in the region would be swift and could allow the US military to establish a more northerly border on the peninsula. Naturally, this is not in China's interest. The ban is, therefore, likely to be lifted before the fragile economy of the country implodes. However, given the eccentricity of the North Korean leadership, it is rather difficult to predict how Pyongyang will respond, adding another layer of complexity to the very uncertain times we live in.

In the short term, however, this is nothing but good news to the seaborne freight market and should be taken advantage of, and it is fair to expect rates to increase as a consequence.

TSI FOB Australian Premium Coking Coal



CONTAINERS: NACHRICHTEN FROM GERMAN BOX PORTS

Hamburg has to wait even longer to complete the deepening of the Elbe river, while Bremerhaven invests to avoid future disruptions.

Recent data suggest that Germany's biggest container port, Hamburg, handled 8.91 Mn Teu in 2016; its throughput increased by 1 per cent from 8.85 Mn Teu in 2015. To no surprise, China is still the main trading partner, with volumes of more than 2.5 Mn Teu during 2016, up by 1.6 per cent year-on-year. In the meantime, some of the port's other relations improved significantly, such as with Russia (up by 4.5 per cent, reaching 0.45 Mn Teu) and the US (up by 11 per cent, reaching 0.36 Mn Teu). Growth at the German port has been similar to growth at Rotterdam (up by 1.2 per cent), but much lower than Antwerp's growth of 4 per cent. In parallel to that, the country's other container gateway, Bremerhaven, experienced losses in its volumes by 1 per cent during last year. In total, volumes handled at the "Big Four" North European ports expanded by 0.54 Mn Teu, up by 1.5 per cent since 2015. Q4 2016 had the best results, with volumes increased by 0.32 Mn Teu against last year's same period. For the entire year, Rotterdam continued leading with 12.4 Mn Teu handled, with Antwerp (10.0 Mn Teu), Hamburg (8.9 Mn Teu) and Bremerhaven (5.5 Mn Teu) following.

Apart from the competition it has to face, the port of Hamburg has been struggling with its plan to deepen the Elbe river. The country's highest federal administrative court, based at Leipzig, last week came to a final ruling on the seaward access channel of the country's largest port. After more than a decade of legal battles, the court provided its permission to the plan, but tied to a number of conditions which will delay the dredging program to be completed by 2020. This means that the project developers will not start dredging any time soon. The delay is linked to the German legislation which provides environmental groups far more rights to sue than in any other European country. The delay is expected to affect Hamburg's plans to take full advantage of its favourable geographic location and proximity to consumer markets.

Remaining draft-restricted means that carriers could only employ ships able to enter at reduced draft at their intra-European port rotations calling at Hamburg. With more ultra-large container ships delivered, the first inbound or last outbound call on the Asia - Europe mainline trade won't be served at Hamburg.

The permission to complete the plan is more than positive news, but the delay for a decade sets obstacles for any dynamic growth of the region's most significant infrastructure. We should also highlight that Hamburg used to be Europe's second-largest container hub, but was recently surpassed by Antwerp, which now handles about 1 Mn Teu more per year.

In the meantime, the German Eurogate group recently ordered six ultra-large ship-to-shore container cranes for its NTB Terminal, a dedicated Maersk Line facility at Bremerhaven. The German manufacturer Liebherr's Irish subsidiary will deliver the order in 2018, with the cranes expected to upgrade and rejuvenate the crane fleet at Europe's fourth-largest container port. During 2016, operations at NTB were disrupted when several ship-to-shore gantries went out of service for unscheduled repairs.

With each crane weighing around 2,225 metric tonnes, the new STS will have an overall height of 135 metres and an outreach of 73 metres. This design allows them to work on the latest generation of ULCS. No price has been disclosed so far by NTB, the joint venture of Eurogate and APMT. However, it has been commented that the investment volume was in the double-digit million Euro range.

Source: Alphaliner

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