Oil Market Report – May 2015

With the world awash with oil, a natural question to ask would be “where is it all going”? World demand may still be edging upwards, but production has truly rocketed over the last 3 years and most estimates now put excess production at circa 3m barrels per day (bpd). That’s a daily product surplus of 470m litres – a volume that is technically doing nothing.

Early beneficiaries of the product surplus were the oil stocking agencies who took the opportunity presented by low prices to bolster emergency stocks. Facilities such as Cushing in Oklahoma have quickly filled up and much of the inventory at this location is owned by the USA’s Strategic Petroleum Reserve (SPR). On the other side of the world the Chinese have also been stocking up, with emergency stocks rising from 14bn litres to 20bn litres in the first quarter of the year. But 20bn litres only equates to 20 days of consumption in China and with a target of 90 days (ie, 90bn litres), it will be no surprise if a great deal more of the world’s surplus oil is quietly put out to rest in one of China’s vast inland tank farms.

Another logical destination for excess oil is refining. Current refining margins are (temporarily) strong, which means that, those who can, are processing as much crude as possible. This explains why worldwide refining is currently running at a virtually unheard level of 90% capacity. But simply increasing refining runs does nothing other than shift the problem further downstream. After all, a 3m bpd crude surplus also equates to a (refined) product surplus one way or another – be it on a particular grade or in a particular region. So a further solution to the problem of excess oil is still needed, and the oil storage industry provides the answer…

To the man on the Clapham Omnibus, the concept of an industry dedicated to nothing other than the storage of oil would surely seem bizarre. And the idea that there is commercial viability in simply filling giant tanks with oil and then leaving that oil untouched for a few months, would also be deemed as equally absurd. But this seeming commercial fantasy is actually a major commercial reality and like everything in the oil world, storage is a huge going concern. In Europe alone, total tank storage for hire is in excess of 60 billion litres and a selection of Europe’s mega storage terminals are listed in the table attached. Just to reiterate the point, these tank farms are nothing to do with refineries or oil producing facilities. They are simply huge tanks doing nothing other than storing oil.

The phenomenon of oil storage is partly explained by the process of oil extraction and refining – neither of which can easily be interrupted. In short, the product must keep flowing and the storage industry benefits from these dynamics. Even better is when the oil markets move into a “contango” structure. This (faintly ridiculous word) describes a situation where future prices have a greater value than today’s spot prices – a scenario often seen on the back of massive drops in oil prices (such as we saw at the tail-end of 2014) and a consequent confidence that prices will rebound in the near-future. In effect, an incentive is created for oil companies to forward sell their oil for delivery at a later date rather than here and now. It certainly partially explains why the oil storage industry is currently booming, with almost all European tanks filling in Q1 2015 and a further 40 or so VLCC’s (Very Large Crude Carriers) on permanent charter. Not sailing anywhere, just moored up and being used as extra storage facilities…“Where to Captain”? “Nowhere. Just go back to your bunk and check the anchor on the way…”

All the while, more tanks are springing up and more and more players are trying to enter this niche market. Back in February, Zenith Energy – a company backed by a $600m hedge fund – purchased the giant Bantry Bay Oil Terminal in Ireland with a staggering 1.3 trillion litres of oil storage capacity! Oil traders such as Vitol have rapidly added storage capacity to their asset portfolios with new terminals being built in Algeciras (20 tanks / 400m litres of storage) and Cyprus (40 tanks / 800ml). Even the refiners – perhaps sensing that strong margins are likely to be short-lived – have been turning many of their refineries into storage only locations (ENI in Sicily, MOL in Northern Italy and Total on the French Mediterranean coast).

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In the same way that Shell's purchase of BG (see last month's report) was a harbinger of our fossil fuel future, the tankage revolution may well be a pointer to where the European oil industry is heading. Our refineries are old and largely unable to meet demand on specific grades such as diesel and jet fuel. If demand can't be met by local refineries, then oil imports via hired storage will have to bridge the gap. Therefore it seems fairly probable that the next decade will see a great many more new oil storage terminals springing up across Europe.