

**ANALYSIS-Asia diesel outlook glum after Europe's brief lift**

1336 words  
4 October 2010  
00:58  
Reuters News  
LBA  
English  
(c) 2010 Reuters Limited

- \* Diesel cracks seen capped at \$11-\$12/bbl until Feb 2011
- \* Q4 Asian refinery maintenance seen sharply lower vs Q3
- \* New capacity in China, India coming online by year-end
- \* Backwardated Europe market cuts East-West arbitrage

By Jennifer Tan

SINGAPORE, Oct 1 (Reuters) - Asian refiners and traders could grapple with thin diesel margins this winter and early next year, weighed down by heavy supplies from new plants and fleeting European appetite for eastern barrels.

Winter heating demand is traditionally the key driver for the distillates market, and weak margins during this period could hit refiners hard.

Poor margins for middle distillates, which contribute 40 percent of a refinery's total capacity, may put more pressure on global oil majors in Asia as domestic firms further boost their refining capacities.

China and India, Asia's two top oil consumers, are together estimated to add over 900,000 barrels per day (bpd) of refining capacity this year to feed growing fuel demand as sustained economic growth boosts car sales and manufacturing activity.

European markets, the other key outlet for barrels from Asia, may also be out of reach, as the arbitrage window can swing shut fairly quickly. "We feel there's little upside for gas oil cracks, and they're likely to stay around \$12 a barrel for the rest of the year, perhaps until February," said Alex Yap, an analyst with energy consultancy FACTS Global Energy.

<^^

Graphic on Asian gas oil cracks vs Dubai crude:

<http://link.reuters.com/puq46p>

Graphic on the ICE gas oil backwardation/contango:

<http://link.reuters.com/xeq46p>



Indonesia's Pertamina has raised its fourth-quarter term gas oil imports, but India, a heavy importer of low-sulphur Asian diesel, will buy significantly less as its plants complete upgrades to produce clean fuels by October. Devastating floods have reduced Pakistan's consumption. [ID:nSGE67M04M]

Vietnam's top fuel importer Petrolimex has also scrapped its fourth-quarter tender due to high domestic inventories. [ID:nSGE68R0GZ]

#### ARBITRAGE WINDOW SHUTS, THEN OPENS

East-West arbitrage opportunities had thinned earlier this week, after brief European pre-winter heating demand had drawn an estimated 5.5 million barrels of Asian gas oil to the West.

The 5.5 million barrels of arbitrage gas oil represent the highest volumes to be shipped West since November. At that time, 7.35 million barrels of Asian distillates were provisionally booked to be stored offshore the United Kingdom as demand slid in the wake of the slowdown.

In Europe, prompt prices have risen enough to spur the release of gas oil stored in tanks and drawdowns from floating storage anchored mostly off the U.K. coast, with Goldman Sachs citing shipbrokers' estimates of 4-13 million barrels of distillates held on tankers that were unloaded in September. [ID:nLDE68S2E9]

On Friday, the Oct/Nov ICE gas oil spread traded at a premium of \$2.00 a tonne <LGO-1=R>. The spread has flipped between backwardation and a small contango over two sessions this week, signalling that demand could weaken.

On Friday, expectations of tighter supplies after the French port strike cracked open the arbitrage window.

"The East-West arb is currently increasingly viable, but high stock levels in the West may cap volumes," added Yap at FACTS.

Lawrence Eagles, global head of oil research with JPMorgan in New York, noted that Europe's high supplies are bearish.

"Heating oil stocks in the Atlantic Basin alone are already at the level needed to meet peak winter demand. There's no need for barrels from Asia," he said.

"The stocks are a very key barometer of the net supply situation, and we think they are net bearish. That underscores the negative trend in prices."

Gas oil stocks in the Amsterdam-Rotterdam-Antwerp area <STK-GO-ARA> have fallen for the third-straight week, and down marginally on a year ago, while U.S. heating oil stocks rose slightly from week-ago and year-ago levels. [ARA/] [EIA/S]

Oil products held in floating storage worldwide remain hefty at 34.2 million barrels in September, although this was down 4.4 million barrels from August and was the lowest since June 2009. [ID:nLDE68F19M]

Last year's unusually cold winter is also unlikely to be repeated, resulting in lower heating demand, analysts said.

A developing La Nina climate cycle, which could be one of the strongest on record, could lead to warmer winter in parts of Europe, easing the draw on heating oil stocks, forecasters said.

#### CAPPED MARGINS

Trading opportunities could turn out to be pretty dismal for the rest of the year.

Lower volatility has hurt traders' ability to profit from middle distillates, while higher supplies and thinning arbitrage opportunities have dented physical market sentiment.

For traders, the contango and storage plays that had helped maximise trading margins last year, after the economic crunch stymied demand, will likely be absent this year.

"It's been a tough year, much harder than last year," said a trader at a Western firm. "Physical trades are tougher this year with the lack of contango to cover storage costs, while for paper trades, volatility has fallen, which in turn has eroded margins."

Another derivatives trader with a bank agreed. "There are fewer obvious opportunities this year. So far, it's been possible for some players to make money with the arb play in September, but we're not sure if this will last much longer." (Editing by Ramthan Hussain and Manash Goswami)

GASOIL-ASIA/OUTLOOK (ANALYSIS)|LANGEN|ABN|O|OIL|SNI|Z|E|RBN|J|IF|SI

Reuters Limited