S&P Global
Platts

TOP FACTORS TO LOOK OUT FOR IN 2019

PLATTS ANALYTICS SPECIAL FEATURE

December, 2018

Oil, Natural Gas Liquids, and Agriculture

1) **NGL supply growth will strain the North American energy system:** Midstream infrastructure with struggle to transport and fractionate the 5.7 MMB/D of NGLs expected to come to the North American market over 2019, resulting in opportunistic ethane rejection to free up capacity for higher value LPG and natural gasoline. Ethane prices will experience upward price pressure, particularly in the first half of the year, given the lower supply and higher demand from three new crackers in the US.

2) **Export capacity growth vital to prevent a blowout in LPG spreads:** With the US LPG export terminals operating at capacity, any delays in new capacity along the USGC or prolonged outages at existing facilities will place downward pressure on Mont Belvieu LPG prices in order to clear the market, widening spreads between cavern product and LPG stranded at the dock. Stranded US LPG will need compete against ethane in US crackers and naphtha in Asia and Europe, where margins will be pressured due to naphtha market tightness in anticipation of IMO 2020.

3) **Volatility in NGLs will extend to the downstream petrochemical markets:** Feedstock price volatility will carry over to downstream markets as petrochemical companies optimize their feedslates to take cheaper LPG and new mega refineries come online in Asia flooding the aromatics markets. The polymer-grade propylene market, in particular, could rapidly lengthen in 2019 as steam crackers and PDH plants run maximum LPG volumes this summer.

4) **Saudi Arabia will need to continue to be nimble to balance 2019 oil supply:** After overcompensating ahead of Iranian sanctions in November 2018, Saudi Arabia will be curtailing oil supply over 1H19. However, as markets are expected to tighten on slower US shale output and tighter sanctions on Iran come early May, the Kingdom will likely have to reverse course over 2H19.

5) **Geopolitical events present downside risk to Libya, Iraq, Venezuela, and Nigeria oil supply:** Watch for risks to oil assets ahead of and after elections in Nigeria (February 2019) and Libya (Spring 2019). The resumption of northern Iraqi flows through Kurdistan still faces political risk as well, while economic turmoil remains troublesome for Venezuela.

6) **A rising inventory of drilled but uncompleted wells (DUCs) in the Permian risk a potential surge in US supply at year-end:** Infrastructure constraints will limit growth in the Permian for the first half of the year and result in a slow build-up in DUCs through 2019. But higher prices and relief in takeaway capacity constraints in 4Q may lead to a surge in well completion and production activity, just ahead of the IMO specification change.

7) **Slowing industrial growth and trade tariff disputes subdues demand growth:** After three years well above trend, in 2019 we expect to see oil demand growth slow down (to 1.51 MMB/D) while still managing to stay slightly above trend. US, China and India will continue to be the three key growth markets, but US will not grow as fast as in 2018. Light-ends and middle distillates will grow at a very similar pace.

8) **Weaker sugar prices could lower ethanol consumption in Brazil:** The price relationship between world sugar prices and domestic ethanol prices in Brazil will be of high importance to balancing both markets in 2019. If sugar becomes more attractive than ethanol for Brazilian millers, sugar production could rise by an extra 2 million mt at the expense of ethanol (an oversupplied market) drastically changing the sentiment and dynamics for both sugar and ethanol.

9) **Global crude distillation units (CDU) additions will reach a multi-decade-high:** CDU additions of 2.0 MMB/D, will far outpace expected growth in crude demand in 2019 (~1.15 MMB/D), and may put refinery margins under pressure and reduce refining utilization, although 2019 refining maintenance should turn-out to be heavier than usual as refineries get ready for the IMO spec change. In particular, the Rongsheng Petrochemical Refinery in China will have a yield heavily skewed towards petchem feedstock and could put Aromatics market under pressure. On the other hand, Jizan in Saudi Arabia and Rapid-Johor in Malaysia are expected to yield primarily distillates with high level of destruction of fuel oil.

10) **China's product exports to reach new high**: As two refineries of 400 MB/D each will be added in 2019, China will hike its crude runs, particularly in 2H19. Coupled with increased product export quotas granted by the government, China's gasoline, jet fuel, and gasoil exports are likely to reach new highs.

11) **Mini IMO in China hits one year early**. China's new emissions control area (ECA) rules take effect on January 1, 2019, where vessels entering any port in China or entering internal waters are mandated to use bunker fuels with a sulfur content of no more than 0.5%. This

is similar to the broader IMO specification change set to go into force in 2020. Pent up demand for MGO (marine gasoil) will be released in early 2019 while more LSFO demand will emerge toward the end of the year. This will be aided by refineries running low-sulfur domestic crudes.

12) **New restrictions on plastics are coming:** Final text of the EU's Single-Use Plastics Directive is expected in 2019. This policy, along with their Strategy for Plastics in a Circular Economy efforts, will likely prompt others to regulate this space but unlikely to impact demand in the short term.

13) **Refinery capacity ramp-ups and lighter crude weigh on refinery margins into 2019:** Refinery margins and light product markets will be under pressure going into 2019 with gasoline oversupply and new refinery capacity ramping-up taking the edge off of middle distillate strength. The incentive to fill conversion capacity will remain lower (due to narrow light product vs. feedstock/ fuel oil spreads) leading refiners to not push their conversion units as hard which will help rebalance gasoline yields lower and relieve some of the pressure on resid supplies. The gasoline season will offer some support, but it will not be as strong as in recent years.

14) **IMO bunker spec change to disrupt markets as 2020 approaches:** Product pricing will shift as 2020 approaches as IMO 2020 will be very disruptive to markets with much stronger middle distillates and weaker HSFO pricing needed to balance supply and demand. That shift will not take full hold until sometime in 2020 (e.g., after the HS bunker carriage ban goes into effect on March 1st 2020), but some pricing effects will begin earlier, particularly with HSFO weakening and diesel strengthening later in 2019.

Natural Gas, Electricity, and Coal

15) **2019 LNG Supply additions largest since the Qatari Mega-trains:** There will be upwards of 42 billion cubic meters (1.5 trillion cubic feet) of LNG capacity added in 2019, primarily from new US projects and final capacity additions in Australia. End-user backed LNG demand will struggle to cope with the speed and force of this new supply, with Europe looking to become a liquid market where LNG suppliers, portfolio players and traders are able to market surplus LNG.

16) **Nord Stream 2 will give more leverage to Russia in its dispute with Ukraine:** Significant progress with the development of the new gas pipeline between Russia and Germany during 2019 will coincide with the expiry of Gazprom's current transit arrangements with Ukraine's Naftogaz at the end of 2019. This will give Russia more flexibility to deliver gas into Europe and provide a stronger position against Ukraine as geopolitical tensions remain high.

17) **China's Coal Imports will decline on Fundamentals, not policy:** In late 2018, the Chinese government banned the import of thermal coal over November and December. However, slowing electricity demand growth, growing nuclear and renewable generation and robust domestic coal production has boosted power plant stockpiles. These trends will continue in 2019, depressing imports even without the continuation of policy.

18) **US Gas supply growth to exceed demand growth even with LNG Exports:** Despite demand growth in all sectors (especially LNG exports) US natural gas supply growth will be even larger, which should depress pricing. Much is riding on weather-related demand in 1Q19 however, as sustained below-normal temperatures could alter this trajectory.

19) **The UK is due to leave the European Union in late-1Q19, but uncertainty around the terms of its departure persist.** The UK is due to leave the European Union in late-1Q19, but uncertainty around the terms of its departure persist. A deal negotiated by the UK Government with the EU was finalised in November, although a December vote to approve the Withdrawal Bill in the UK parliament was pulled at the last minute in the face of certain defeat. Regardless of whether the UK now leaves the EU without a deal, successfully renegotiates the deal on the table, or holds a further referendum on EU membership, the UK Government has committed to maintaining a long-term carbon price signal "at least as effective" as the EU ETS. As such, there do not appear to be any meaningful impacts on power or gas trade with the Continent from a carbon perspective due to Brexit.

20) **Global solar growth to stall:** Weaker policy support for solar additions in China, tariffs on solar panel imports in the US and India, and near saturation in some areas, could see the global installation rate of solar photovoltaics to hold flat Y/Y with notable uncertainties. Despite this slowdown, solar is likely to remain the largest source of global electricity capacity additions.

21) **Timing of US midstream growth sits at center of US gas price volatility:** A sizable amount of midstream capacity is slated to come online beginning in the second half 2019, which will unlock substantial supply growth from shale basins in West Texas. The timing of the new Gulf Coast Express and Permian Highway natural gas pipelines in 2019 and 2020, offer a vast number of pricing scenarios regarding the spread between Waha and Henry Hub prices. The threat of renewed periods of absolute prices at Waha under $1/MMBtu remain feasible, though, ahead of, and after, the planned new gas pipeline additions.

22) **Elections in Canada could bring to power more fossil-fuel friendly governments:** Elections in Alberta before June and federal elections before November could lead to the rollback of aggressive carbon pricing plans, and facilitate additional solutions to address supply bottlenecks.