

Energy Weekly: Euro Gas Bulls Get A Wake Up Call From Russia

Russian Oil Flows May Warrant An Added Risk Premium, But Meaningful Sanctions On Oil Exports Are Simply Not An Option

- **Warm weather and comfortable balances had lulled the European gas market into complacency. The Russian occupation of the Crimea was a rude awakening for market participants whom were clearly short and asleep at the wheel as prices on NBP continued to fall last week, even as tensions in Ukraine were on the rise.** Monday's 10% jump in prompt NBP prices reflects a re-rating of the risk premium accruing to Russian volumes, which made up over 30% of total European gas supplies in 2013 and Citi forecasts this level of reliance on Russian flows to persist for the next few years.
- **Depending on how the ongoing negotiations proceed, the impact on gas delivery volumes could be limited:** (1) Gas storage is high after a mild winter, so that gas demand for storage injection should be lower y/y, especially with spring and summer being low demand seasons; (2) Russia may try to neutralize complaints from Europe by keeping gas flowing (but just to Europe); (3) Gas flow on Nord Stream could rise. About 80-mcm/d of Russian gas has been flowing through Ukraine in recent months, Nord Stream has about 60 mcm/d of spare capacity, so most of the gap could be filled by re-routing gas, but that would still leave S Europe short.
- **However, next winter's prices could stay bid as the risk of disruption remains high.** Gazprom may reduce gas deliveries inside Ukraine because of what's deemed to be insufficient payment from Ukraine to Gazprom. But since gas has to go through the country, it might siphon off gas destined for Europe as happened in 2009, affecting onward flow to Europe. Pipeline sabotage could pose added transit risks, potentially exacerbated by a further escalation of hostilities. Ukraine has very limited leverage against Russia; in the event of an escalation of hostilities Ukraine may feel it has to use every lever available.
- **On oil, there is much talk at present of possible sanctions on exports. This looks unworkable as Russia is simply too big to sanction.** It is the biggest oil producer in the world and the second biggest crude exporter (4.7-m b/d in 2013, with another world beating 2.1-m b/d of product exports) after Saudi Arabia (7.5-m b/d of crude in 2013). Not only is Russia key to global oil supplies, but it is a key source of imports into Brent's home turf of NW Europe. The loss of Russian flows to Europe as more is sucked eastwards to China has already been a key support for Brent. As this dispute now puts a question mark over ~50% of NW Europe's crude imports, a rise in the risk premium is justified, but Russia is such a critical supplier of oil and gas to Europe and the world that the odds of sanctions impacting these flows remains small as it would exact such a severe price from the countries imposing the sanctions.

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Energy Market Outlook

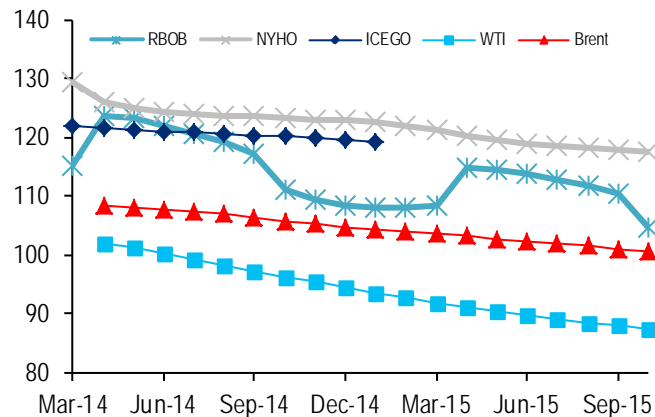
Figure 1. Citi Energy Market Outlook Summary

Factor	Bull/Bear/Neutral	Short Term View
Macro	Neutral →	Markets are reeling from the Ukraine crisis but as long as it stays contained the overall macro environment remains constructive.
Geopolitics	Bullish ↑	Geopolitical risk is running high with Ukraine and Venezuela both on the market's radar.
Positioning	Neutral →	Speculative net length in WTI continues to climb to new highs whilst managed money net length in Brent contracts has picked up in recent weeks.
Brent-linked Crudes	Bearish-Neutral ↘	N Sea crude diffs weakened last week but crude availability in the Atlantic Basin looks tight for now. March loadings are higher m/m in Nigeria and broadly unchanged for Russia loadings to Europe yet BTC and CPC loading schedules both dropped. Crude diffs in the MED remain firm as Libya remains heavily disrupted whilst KRG exports are failing to materialize, Basrah loadings are also set to drop 3% in March.
US Crudes	Bearish-Neutral ↘	Despite PADD III refinery turnarounds currently totalling ~900-k b/d, the US Gulf Coast (USGC) crude market remains tight. Weather related supply disruptions in North Dakota, which saw production drop 50-k b/d m/m in December, and Canada have reduced crude flows to the USGC. The start-up of the Keystone Gulf Coast pipeline is also bringing meaningful crude volumes to the USGC, flows averaged 265-k b/d last week. This is drawing Cushing at an impressive rate; last week's DOE data show a 1.7-m bbl w/w draw after a 2.7-m bbl w/w draw the week before. All the crude heading to the USGC is finding a home however as refiners are running as hard as they can, with PADD III refinery runs of 7.9-m b/d up 0.8-m b/d y/y.
Product Markets	Neutral →	Gasoline cracks remain firm as stronger US demand, 60c RIN prices and a stock draw in PADD I should keep the crack supported. US heating oil cracks depressed as several cargoes arrived from Europe/Russia which narrowly closed the arb. A return of the polar vortex could help heating demand and cracks, especially given the low stocks.
US Natural Gas	Neutral-Bullish ↗	Citi is revising its 2014 US daily Henry Hub natural gas price forecast from \$3.7/MMBtu (set in Nov'13) to \$5.0/MMBtu. \$5 gas would be needed to both cut demand and perhaps incentivize more production. A much colder than normal winter sharply drew down gas inventories, pushing the expected end-of-March storage below 1-Tcf, which was last seen in 2003 when March prices spiked to \$9.5.
European Gas	Bullish ↑	The Ukrainian crisis poses a major risk to gas flows from Russia, which continue to account for over 30% of total European supply.
Global Gas	Neutral →	LNG markets remain tight as Asian demand continues to be robust whilst droughts in Brazil are generating an increased bid for LNG.
International Coal	Bearish-Neutral ↘	The market has rallied on the Ukraine crisis, but with weak Chinese macro data and the confirmation of Drummond's return in 3 weeks, the outlook remains bearish as long as the Ukraine situation remains contained.

Source: Citi Research

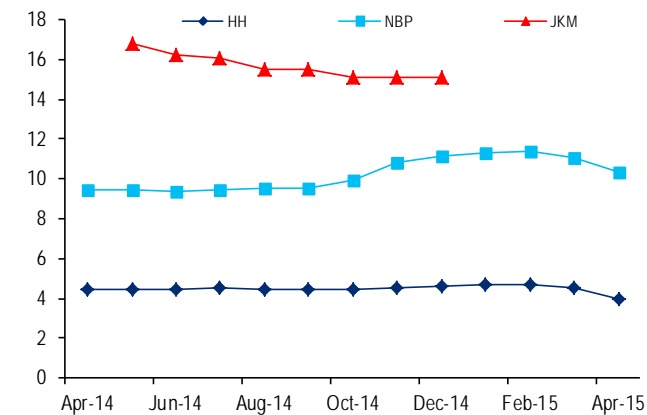
Market Charts

Figure 2. Petroleum Futures Curves (\$/bbl, 2014-15)



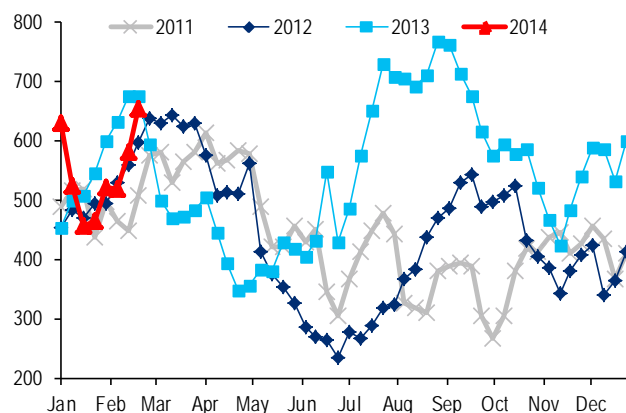
Source: Bloomberg, Citi Research

Figure 3. Natural Gas Futures Curves (\$/MMBtu, 2014-15)



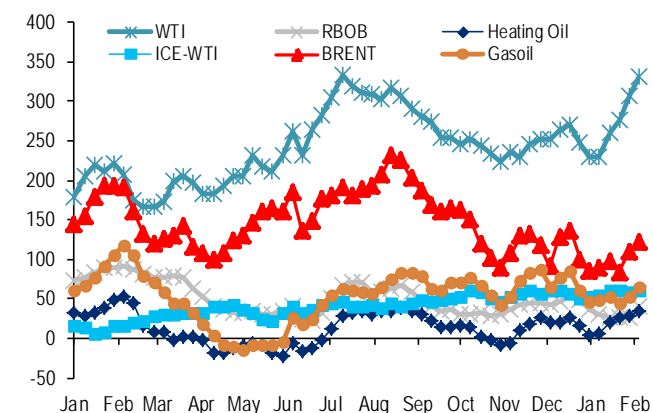
Source: Bloomberg, Citi Research

Figure 4. Combined Petroleum Contracts Speculative Net Length (k contracts, 2011-14)



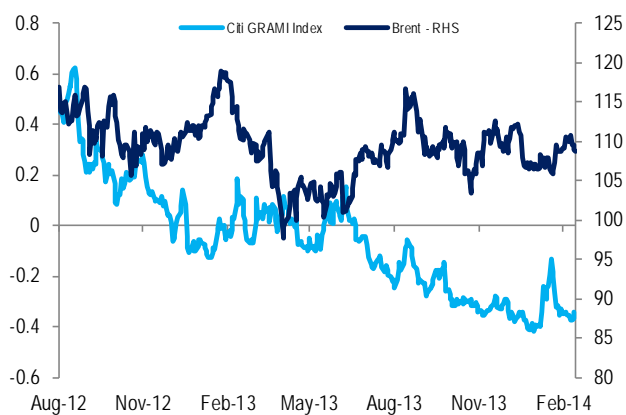
Source: ICE, NYMEX, Citi Research

Figure 5. Petroleum Contracts Speculative Net Length (k contracts, 2013-14)



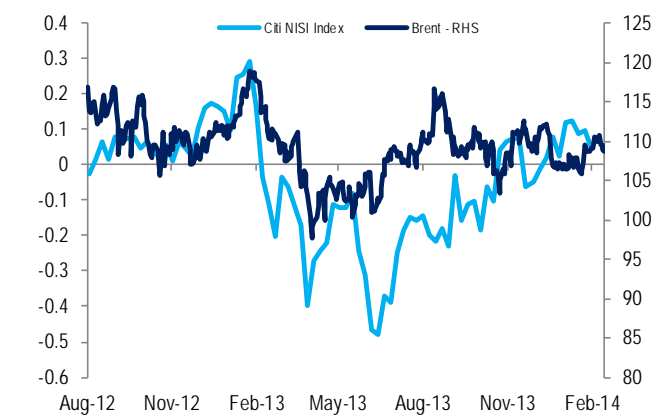
Source: ICE, NYMEX, Citi Research

Figure 6. Citi Risk Aversion Index vs. Brent Flat Price (2012-14)



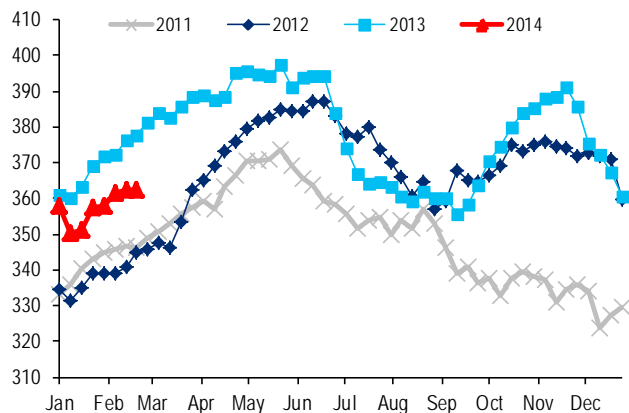
Source: Bloomberg, Citi Research

Figure 7. Citi News Sentiment Indicator vs. Brent Flat Price (2012,14)



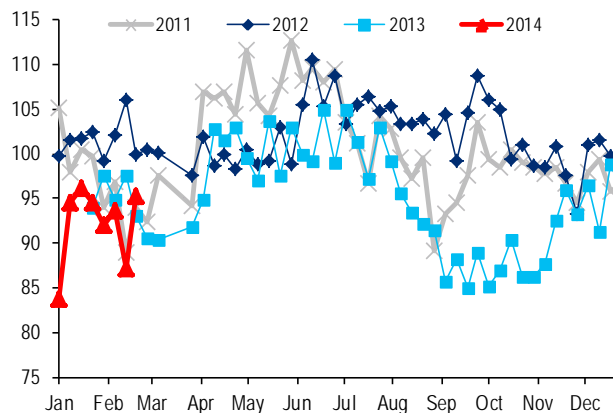
Source: Bloomberg, Citi Research

Figure 8. US Commercial Crude Stocks (m bbls, 2011-14)



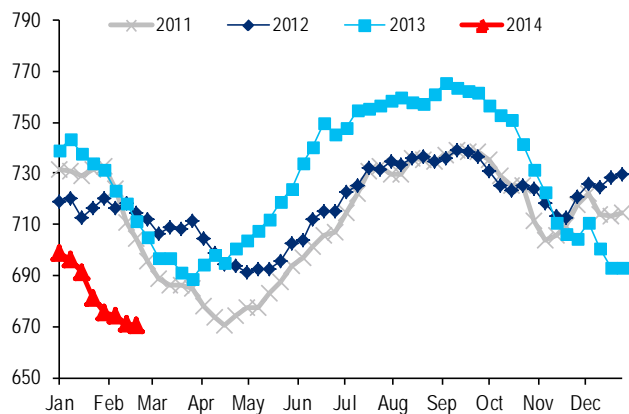
Source: EIA, Citi Research

Figure 9. Japanese Crude Stocks (m bbls, 2011-14)



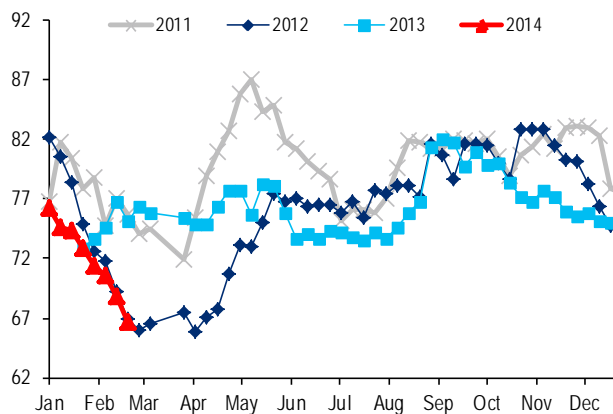
Source: PAJ, Citi Research

Figure 10. US Total Product Stocks (m bbls, 2011-14)



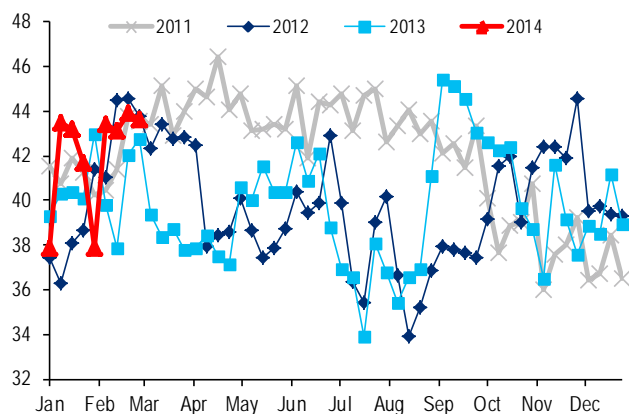
Source: EIA, Citi Research

Figure 11. Japanese Total Product Stocks (m bbls, 2011-14)



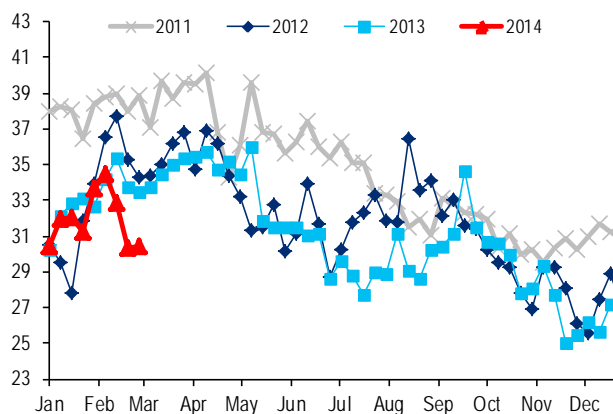
Source: PAJ, Citi Research

Figure 12. Singapore Total Product Stocks (m bbls, 2011-14)



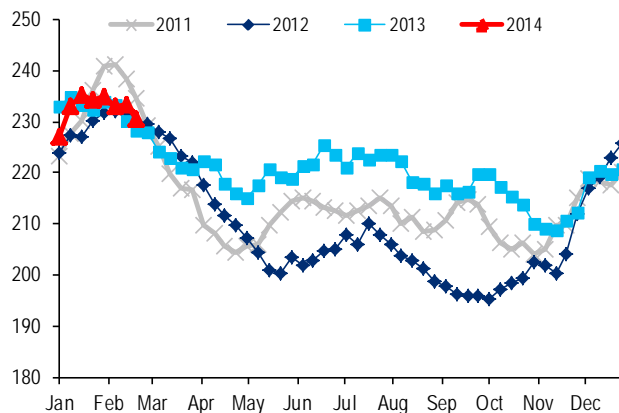
Source: International Enterprise, Citi Research

Figure 13. ARA Total Product Stocks (m bbls, 2011-14)



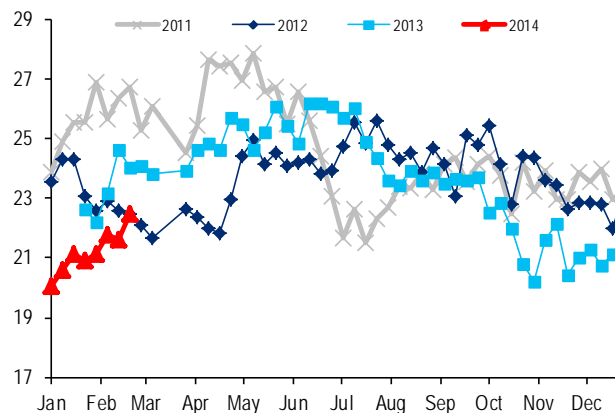
Source: PJK, Citi Research

Figure 14. US Gasoline Stocks (m bbls, 2011-14)



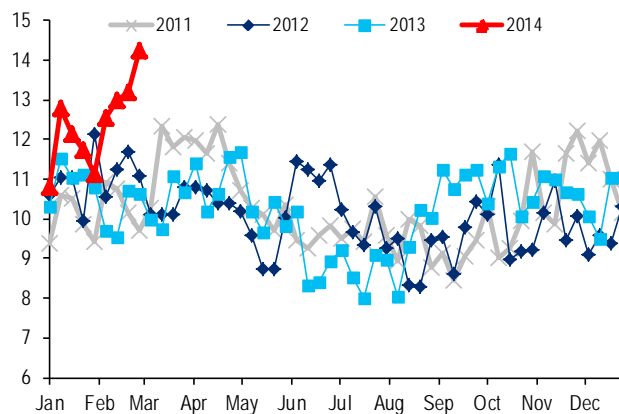
Source: EIA, Citi Research

Figure 15. Japanese Light End Stocks (m bbls, 2011-14)



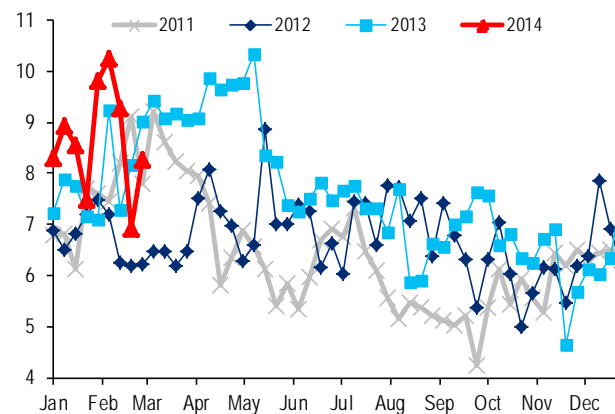
Source: PAJ, Citi Research

Figure 16. Singapore Light End Stocks (m bbls, 2011-14)



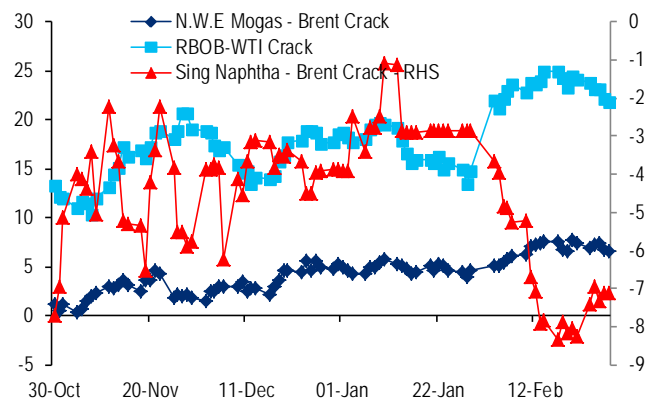
Source: International Enterprise, Citi Research

Figure 17. ARA Light End Stocks (m bbls, 2011-14)



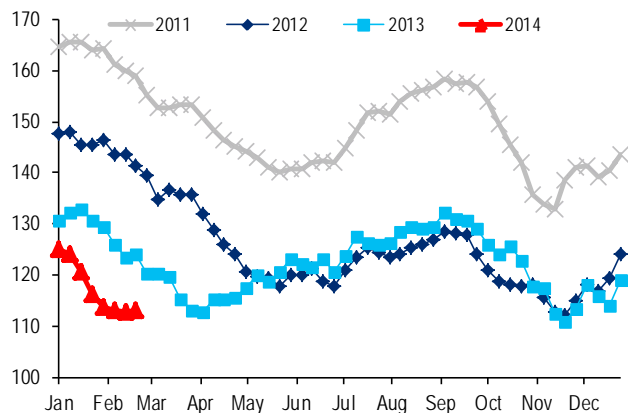
Source: PJK, Citi Research

Figure 18. Global Light End Cracks (\$/bbl, 2013-14)



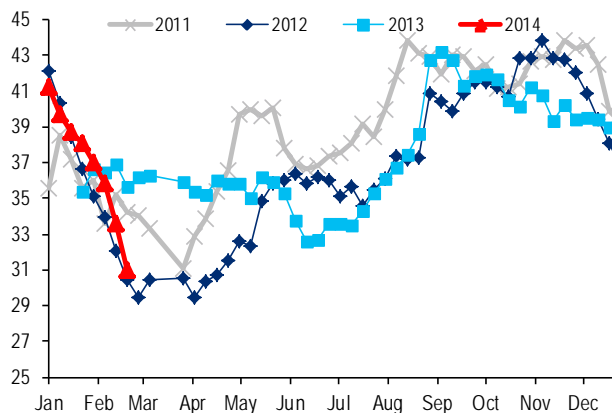
Source: Bloomberg, Citi Research

Figure 19. US Distillate Stocks (m bbls, 2011-14)



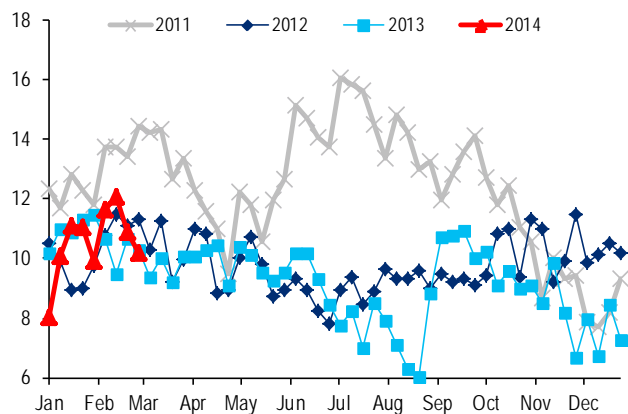
Source: EIA, Citi Research

Figure 20. Japanese Distillate Stocks (m bbls, 2011-14)



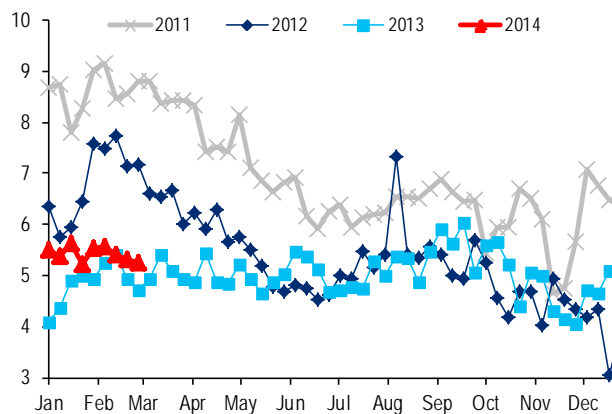
Source: PAJ, Citi Research

Figure 21. Singapore Distillate Stocks (m bbls, 2011-14)



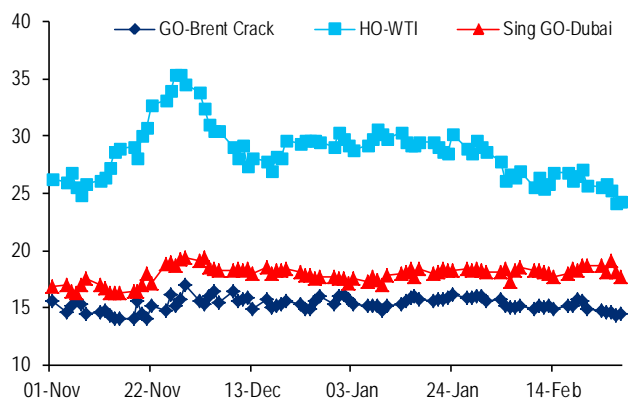
Source: International Enterprise, Citi Research

Figure 22. ARA Distillate Stocks (m bbls, 2011-14)



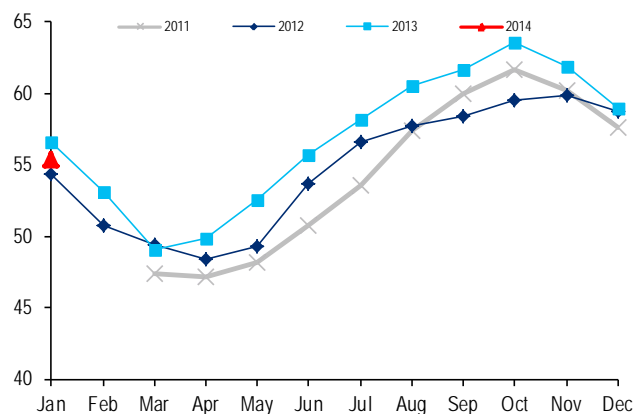
Source: PJK, Citi Research

Figure 23. Global Distillate Cracks (\$/bbl, 2013-14)



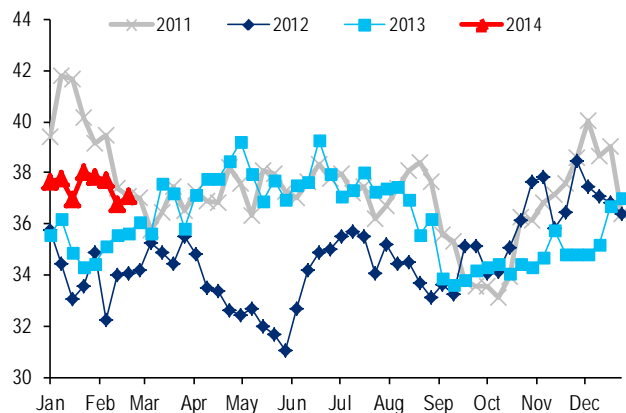
Source: Bloomberg, Citi Research

Figure 24. German Private Housing Heating Oil Stocks (% , 2011-14)



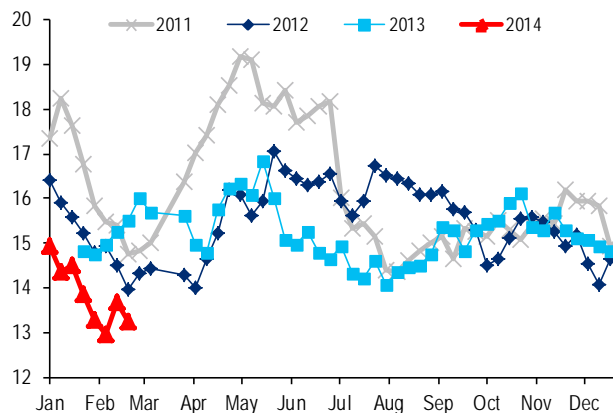
Source: Bloomberg, Citi Research

Figure 25. US Residual Fuel Oil Stocks (m bbls, 2011-14)



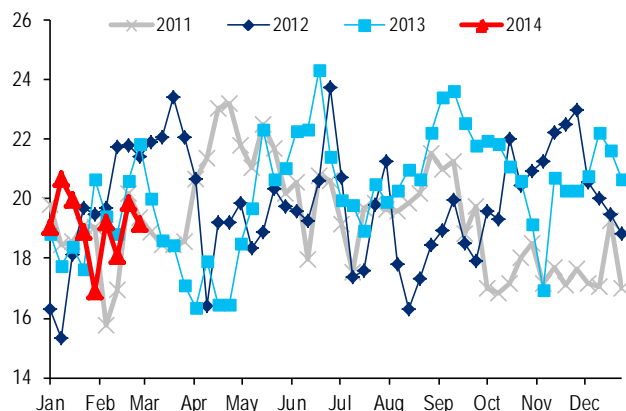
Source: EIA, Citi Research

Figure 26. Japanese Residual Fuel Oil Stocks (m bbls, 2011-14)



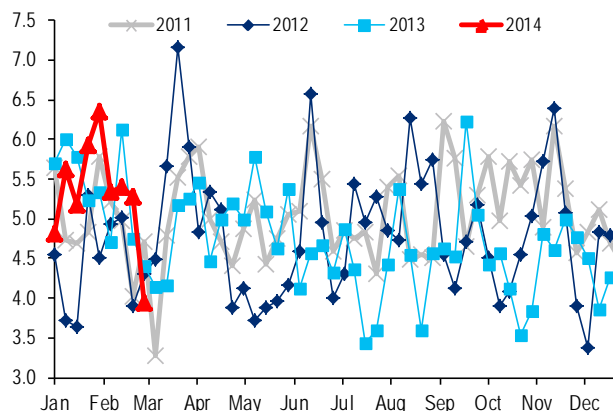
Source: PAJ, Citi Research

Figure 27. Singapore Residual Fuel Oil Stocks (m bbls, 2011-14)



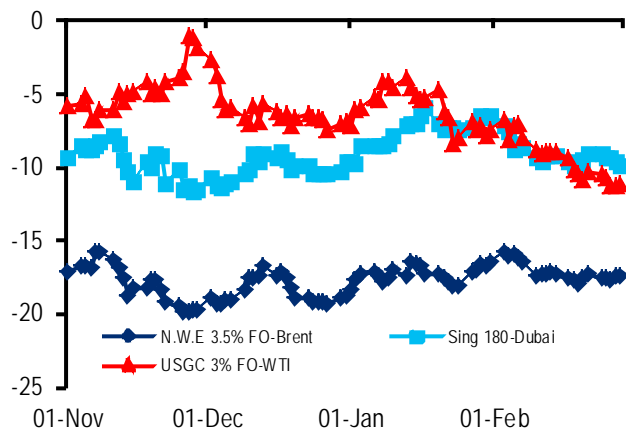
Source: International Enterprise, Citi Research

Figure 28. ARA Residual Fuel Oil Stocks (m bbls, 2011-14)



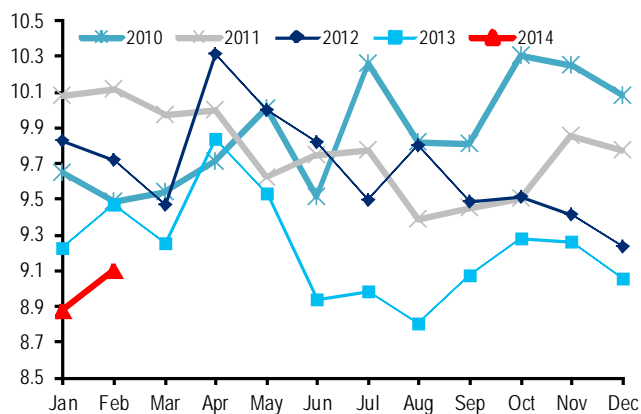
Source: PJK, Citi Research

Figure 29. Global Residual Fuel Oil Cracks (\$/bbl, 2013-14)



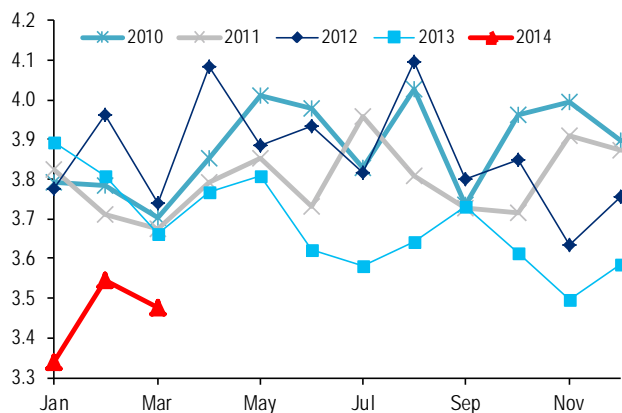
Source: Bloomberg, Citi Research

Figure 30. N Sea, Angola, Nigeria, Russia – ESPO, BTC & CPC Crude Loadings (m b/d, 2010-14)



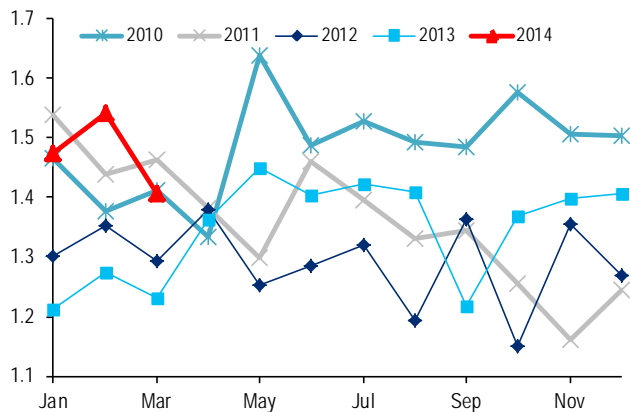
Source: Bloomberg, Citi Research

Figure 32. Angola & Nigeria Crude Loadings (m b/d, 2010-14)



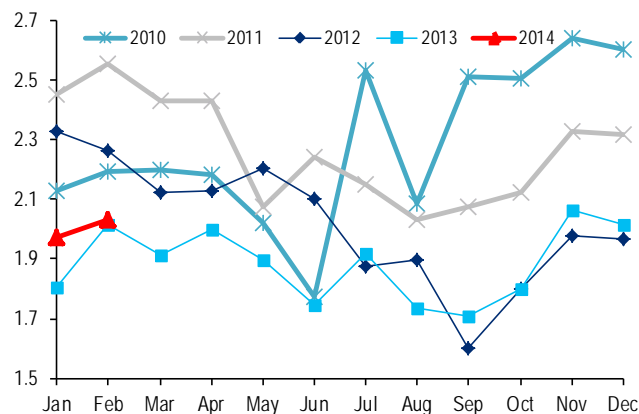
Source: Bloomberg, Citi Research

Figure 34. CPC + BTC Crude Loadings (m b/d, 2010-14)



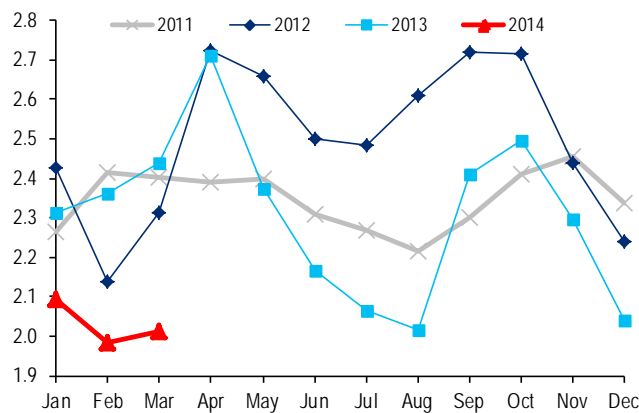
Source: Bloomberg, Citi Research

Figure 31. North Sea Crude Loadings (m b/d, 2010-14)



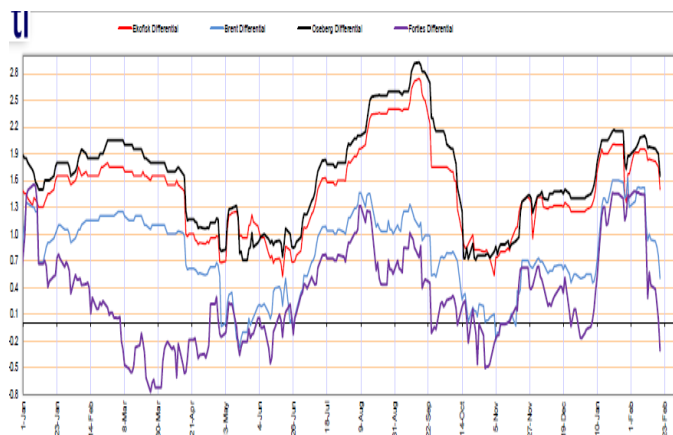
Source: Bloomberg, Citi Research

Figure 33. Russian Crude Loadings to Europe (m b/d, 2011-14)



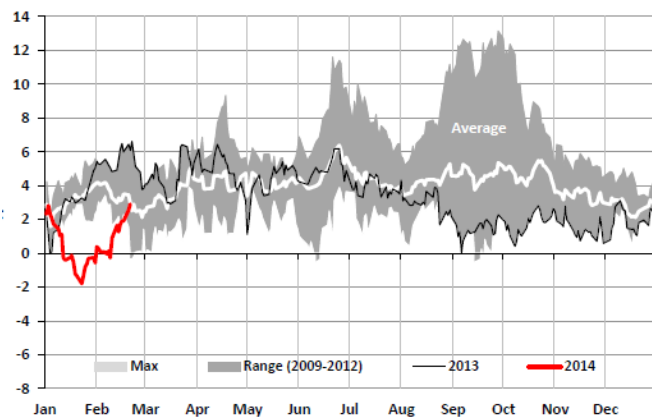
Source: Bloomberg, Citi Research

Figure 35. N Sea Crude Differentials (\$/bbl, 2013-14)



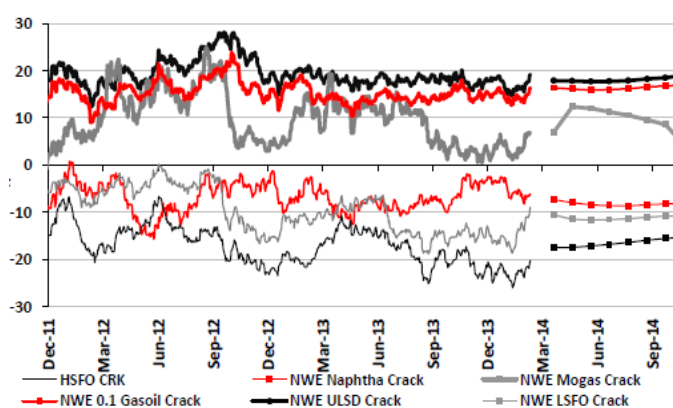
Source: Citi Research

Figure 36. NWE Refinery Margins (\$/bbl, 2009-14)



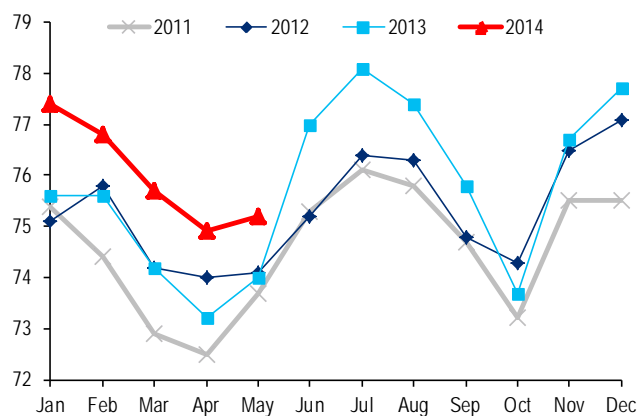
Source: Citi Research

Figure 37. NWE Product Cracks (\$/bbl, 2012-14)



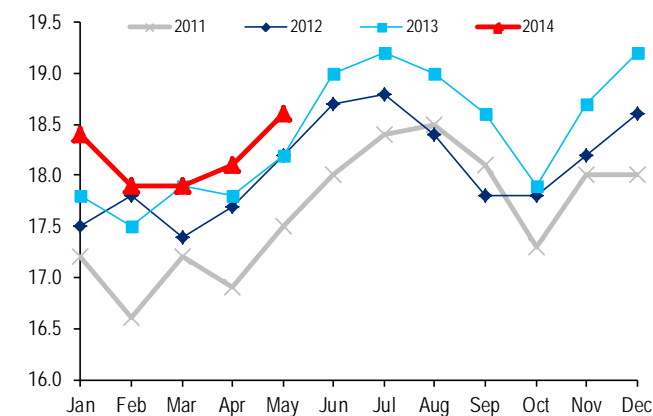
Source: Citi Research

Figure 38. Global Refinery Runs (m b/d, 2011-14)



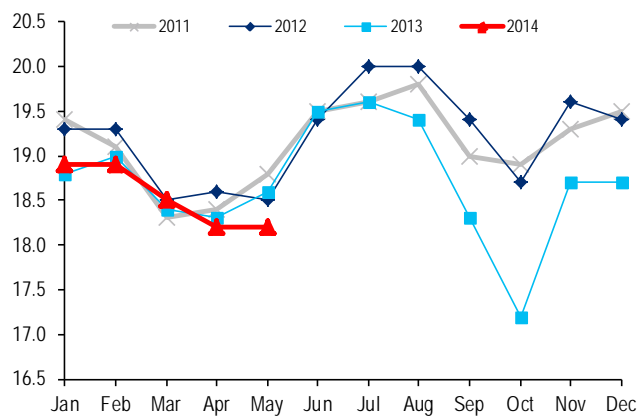
Source: IEA, Citi Research

Figure 39. North American Refinery Runs (m b/d, 2011-14)



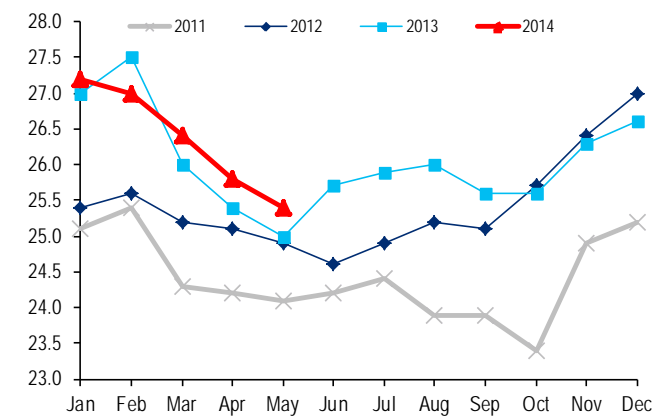
Source: IEA, Citi Research

Figure 40. Europe & FSU Refinery Runs (m b/d, 2011-14)



Source: IEA, Citi Research

Figure 41. Asian Refinery Runs (m b/d, 2011-14)



Source: IEA, Citi Research

Appendix A-1

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