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## Outlook for European Tank Terminal Sector



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Global oil markets are changing rapidly. Markets are specifically dynamic for European players where competitive pressures are highest. In what way will tank storage markets in the Northwest Europe and the important ARA-region be influenced and how profitability will be impacted for tank terminals operating in the oil product segments gasoline, middle distillates and fuel oil are subject of this article.

ARA oil tank storage markets can be divided into three segments: low-flashpoint products, middle distillates and fuel oil.

Low-flashpoint products consist out of naphtha and gasoline. Naphtha is an intermediate and is used as a feedstock for petrochemical crackers and as a gasoline blend component. The port of Amsterdam plays a central role in the gasoline segment. Because Europe has a structural surplus of gasoline there is a continuous flow being exported out of Europe to gasoline outlets. Gasoline traders collect the abundant gasoline components, blend them together into finished product and ship it to export markets. These gasoline blenders are mostly located in the Port of Amsterdam where they rent tanks to blend and make bulk. Terminals geared to importing naphtha to feed the petro-chemical crackers in ARA and West-Germany are mostly located in Rotterdam and the mouth of the Scheldt (Antwerp, Ghent, Terneuzen). From these terminals, naphtha is transported by pipeline or barge to the olefin plants.

European middle distillate markets are somewhat the opposite of the gasoline market. Europe has a structural deficit of diesel and jet-kerosene and needs to import large volumes of these products. Diesel is mostly imported from the USA, Middle East and Russia. Large volumes are discharged into tank terminals in ARA and distributed across Europe from these terminals. Jet-kerosene is imported from the Middle East and Far East.

Fuel oil markets can be divided into two main businesses: (1) the marine bunker market and (2) the Russian / Far-East transit arbitrage business. The ARA-region is one of the busiest port areas in the world and has a large marine bunker market. Tank storage capacity is needed to supply fuel oil to ships. Another lucrative business is the facilitation of the Russia / Far-East fuel oil transit flow. Russia has a structural surplus and the Far East has a structural deficit of fuel oil. Fuel oil is currently shipped from the Baltic Sea via Rotterdam to Singapore. The stop in Rotterdam is needed because of draft limitations during the voyage from Baltic ports to the North Sea.

There are six main themes that are likely to impact European oil and ARA tank storage markets in the medium term:

- Climate policy & renewables
- IMO marine fuel specification changes
- The outlook of the European refining sector

- The US refinery and petrochemical renaissance: current status and outlook
- Changes in the Russian / Far East fuel oil flow
- Oil futures forward curves: when will the contango switch to backwardation?

In the text below each theme is highlighted.

Except for jet-kerosene, consumption rates for oil products are in decline in Europe. Policies to limit GHG-emissions have increased fuel efficiency. Furthermore, increasing penetration of electric vehicles is expected to eat into market shares in the long term. The only exception is jet-kerosene, where the growth in passengers and demand for aviation travel is expected to outpace advances in fuel efficiency.

Another big policy-induced change is expected to result from the IMO bunker fuel specification change. The maximum sulphur content in marine fuels is mandated to be lowered to 0.5% from the current 3.5% as of 2020. Fuel oil demand is expected to take a hit and demand for marine gasoil is expected to rise. Alternative marine fuels such as LNG might profit in the long run and eat into market shares of petroleum products.

Due to global competition refinery margins were under pressure. Especially in Europe, where refineries are relatively old and there is a strong mismatch between fuel consumption and refinery output, margins were very low or even negative. Recently refining margins in Europe recovered due to the oil price collapse but many believe this to be a short-term relieve. Depending on the view on future refining output in Europe, imbalances might change. Refiners from the US, Russia and the Middle East have been squeezing out European competitors that were unable to compete.

One of the reasons that US refiners have been performing better than European peers is the US shale gas and tight oil revolution. This gave US refiners a double competitive advantage. Also the abundance of US NGL output creates a good feedstock market for olefin plants. This revolution has been considered a global game-changer. The massive investments in petrochemical crackers in the US are a lasting impact of this new situation. This development limits petrochemical sector growth in Europe.

The supply of Russian fuel oil via Baltic ports into Rotterdam may be reduced because of two factors. The first factor is planned Russian refinery upgrades. These upgrades focus on increasing gasoline and middle distillate yields at the expense of low value fuel oil yields. The second factor is the gradual increase in fuel oil export taxes in Russia. This tax regime change will most likely lead to closing of small inefficient Russian refineries. These refineries produce relatively much fuel oil. Already we see reduced volumes of fuel oil coming out of Baltic ports.

Apart from supply chain considerations the tank storage market is also very much dependent on prices on oil derivatives markets. Especially the shape of the forward curve influences demand for tank storage capacity: a contango stimulates demand whereas a backwardation reduces demand for tank storage capacity. In 2011 the market has turned from contango to backwardation and as a result trader's profits were under pressure and there was less demand for tanks storage capacity. However, with the unexpected drop in oil prices at the end of 2014 the market has shifted back into contango again, which has supported the market. However, the landmark OPEC-Russia deals have the aim to reduce oversupply on oil markets. According to forecasts at the end of 2017 global oil markets might become balanced or a slight shortage might develop that will result in decreasing stocks and a possible end to the contango. We already see a flat forward curve some months further out along the curve. This is likely to put pressure on storage rates as 'playing the contango' by traders is no longer a profitable option.

The general outlook for the ARA tank terminal market in the **medium term** is that profitability will decline somewhat. This is mostly the result of a change in the shape of the oil price forward curve. Storage rates are likely to decline because of the expectation that the contango will switch back into backwardation in 2017/2018 and will stay in backwardation for a couple of years. Imbalances are likely to increase however, which will support demand for storage tanks. The deficit of LPG will increase slightly. The surplus of gasoline and the deficit of middle distillates are likely to increase significantly, which will support occupancy rates in the CPP-segments. Demand for fuel oil tanks is likely to decrease as a result of the IMO bunker fuel spec change. This legislation is likely to increase demand for gasoil but decrease demand for fuel oil. Furthermore, the fuel oil transit flow, that goes from Russia via Rotterdam to Singapore, is likely to marginalize. Russian fuel oil export volumes are already declining, and it is expected that this decline will continue because of investments in conversion capacity and because of changes in the fuel oil export tax structure. Also the Far-East bunker demand will also likely shift from fuel oil to gasoil following the implementation of the IMO legislation in 2020.

The shape of the forward curve is less relevant for the **long-term** outlook because the average effect is zero (backwardation period is cancelled out by contango period). Long term profitability is mainly driven by developments in product supply, demand and trade flows (logistics). Demand for oil products is expected to decline significantly in the long run (till 2035). In this case refinery capacity is likely to be closed down. Even though refinery output will be reduced total imbalances will increase relative to 2015 levels. Normally increased imbalances are supportive for tank storage markets but if this is really the case is uncertain. The reduced refining activity can have a negative effect on trade flows and tank demand. Also closed down refineries might be converted to tank terminals. The exact location of any closed down refineries is of vital importance. If refineries are closed outside ARA, this will increase demand for tanks in ARA, whereas if refineries are closed

down in ARA this will lower demand for tank capacity. A clear view for long term profitability of the tank terminal sector in ARA is therefore not available.

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