Europe Refining Landscape: Boom to Bust in 2013

CRAIG BROWN

On the heels of steep refinery rationalisation in the Atlantic Basin, 2012 was a year of significant rebound for Europe's ailing refining sector. Simple refining margins improved to 5-year highs supported by strong gasoline exports to the northeast United States and abrupt capacity shut-ins at home. The rebound continued strongly into 1Q 2013, with refinery crack spreads showing a further 24 percent quarter-on-quarter improvement on 2012 figures (Figure 1).

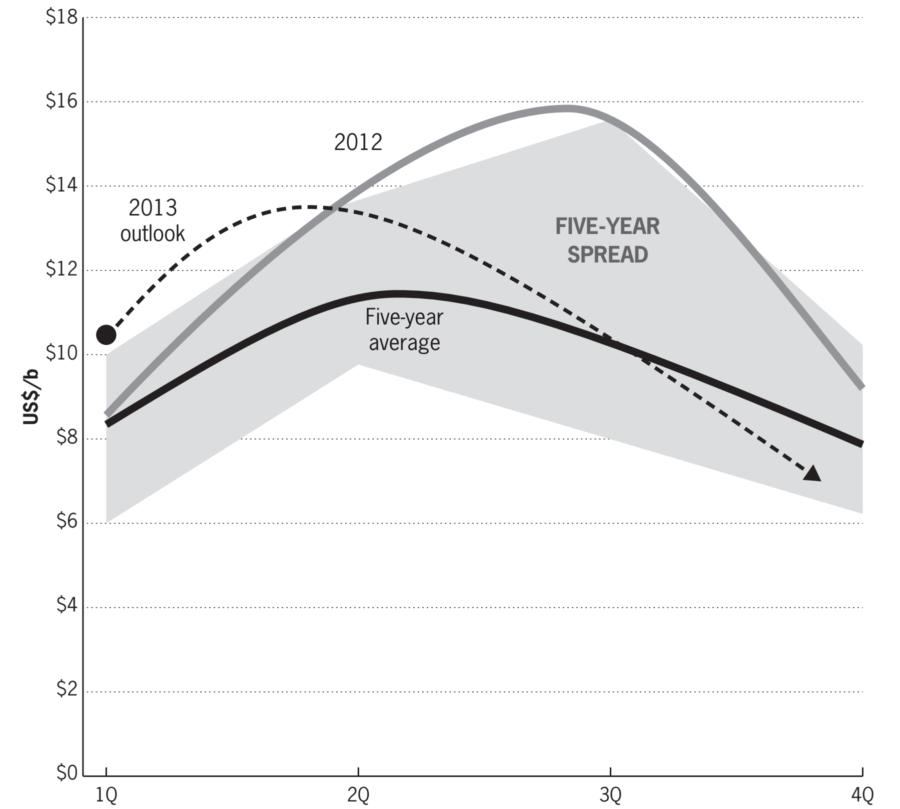
However, a number of structural factors that provided a brief respite to Europe's refining sector in 2012 will evaporate, eroding the atypically healthy margins enjoyed in 2012.

The restoration of capacity utilisation rates in the northeast United States' refining sector in 2H 2012, along with ongoing projects to debottleneck gasoline flows from the Gulf Coast refining complex to northeast product markets will gradually displace Europe's gasoline export opportunities through 2013. As refining conditions progressively deteriorate and margins retreat, another round of European capacity rationalisation looms on the horizon.

Atlantic Basin Refinery Shut-in provided a brief Respite in 2012

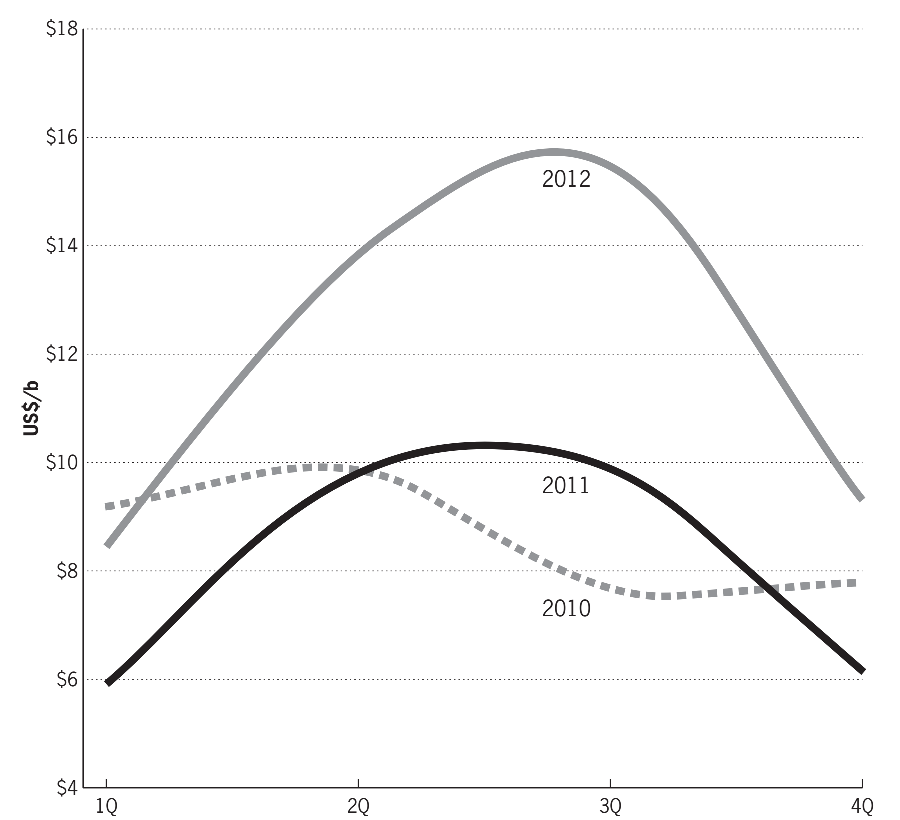
A total of 681 kb/d of capacity was shut-in

Figure 1: Five-year 3-2-1 crack spread comparison



Source: PFC Energy

Figure 2: Europe 3-2-1 crack spread comparison



Source: PFC Energy

across Europe over the course of 2012, with an additional 585 kb/d of capacity permanently removed from the US side of the Atlantic Basin. Capacity shut-ins were led by the abrupt idling of Petroplus's five refineries throughout Europe in early 2012, with three sites indefinitely idled and two sites only partially utilised from April 2012. While three of these sites would eventually be purchased and restarted within the year, the permanent closure of the UK's Coryton refinery and the prolonged idling of France's Petit Couronne rendered some 313 kb/d of capacity offline in Northwest Europe in 2012. Across the Atlantic, some 360 kb/d of capacity remained idled in the Northeast United States moving into 2012 (Trainer and Marcus Hook refineries), while the 350 kb/d Hovensa site and 235 kb/d Aruba site were permanently mothballed in February and April 2012. Although the 185 kb/d Trainer site would be restarted later in the year under the banner of Delta Airlines, 2012 saw some 1.4 mb/d of capacity idled or eliminated across Western Europe and the Atlantic Basin, providing abnormally strong support for European refining margins.

Refinery Margins see strong Recovery in 2012

On the heels of steep capacity rationalisation, 2012 became a year of recovery for European refining margins. Over 700 kb/d of shut-in and idled capacity in the US Atlantic Basin alone, combined with logistical bottlenecks between the US Gulf Coast refining complex and the northeast US product markets, supported high gasoline spot prices on the East Coast. Robust gasoline export opportunities and the ease in domestic refining overcapacity aligned to support relatively buoyant European refinery margins throughout 2012, with simple 3-2-1 crack spreads averaging $11.78/b in 2012 against $7.93/b in 2011 (Figure 2).

Favorable Scenario will be short-lived

Nevertheless, the confluence of factors lending support to European refining margins is poised to evaporate over the coming months. The restarting of idled capacity in the northeast United States in the second half of 2012 facilitated a sharp deterioration in simple margins for

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EU refiners that was visible by 3Q 2012. While the announced closure of Hess's 70 kb/d Port Reading/New Jersey refinery in January 2013 provided temporary respite, a number of developments within the USA will gradually ease US gasoline imports going forward, eroding the export opportunities enjoyed by European refiners in 2012.

The restart of the 185 kb/d Trainer site in late-2012 will continue to cut into PADD 1 import volumes through 2013 and marginally offset the shut-in of the Port Reading site. Meanwhile, completion of a major refinery overhaul in Port Arthur, Texas and the 125 kb/d capacity expansion of Colonial pipeline capacity through 2013–14 (a main product conduit between the Gulf Coast refining complex and the US East Coast product market) will facilitate increasing USGC gasoline transfers to PADD 1, applying further downward pressure on European gasoline imports. Combined with the ongoing deterioration of demand in the US East Coast gasoline market, USEC net gasoline imports will continue to trend downward through 2013. Europe's gasoline exports to the USA could be even further depressed by US ethanol blending mandates in 2013, which will increase compliance costs for gasoline exports to the USA and further erode the favorable margin landscape enjoyed in 2012.

Meanwhile, improving capacity utilisation in the USA is poised to apply significant import competition to Europe's gasoil/diesel markets. Already under pressure from complex refineries in the Middle East and India, European refiners will increasingly find themselves at a competitive disadvantage to gasoil-exporting refineries in the United States benefiting from cheaper crude feedstock options and significantly lower priced natural gas to fuel their refineries. The confluence of these factors in the context of weakening gasoil demand across Europe (down -1.2 percent year-on-year in 2012) will put even more downward pressure on the domestic market landscape.

Further Refinery Rationalisation will be delayed

Despite the deteriorating conditions facing Europe's refining sector in 2013, however, refining capacity is likely to remain relatively static through the year. Temporary shut-ins in 2012 across Italy and France are expected to remain in place through 2013 and will likely persist into 2014 given the unfavorable market. In April it was announced that Petroplus's Petit Couronne site in France, offline since Q1 2012, had failed to find an acceptable buyer after successive bidding rounds, and the site will remain permanently offline. Moving into 2014, however, labour union agreements in France and Italy designed to buffer against further job losses will presumably delay additional rationalisation. While French labour union strikes advocated government intervention (even nationalisation) of Petit Couronne, they ultimately failed to save the facility, Europe's largest refiner Total (with some 1.8 mb/d of Europe-wide equity refining capacity) has publicly pledged no rationalisation before 2015, a move that will temporarily offset the potential wave of immediate closures looming in France. Italian oil giant ENI, on the other hand, has similarly agreed to labour union requests through at least end-2014, pledging no permanent closures over the next two years.

While the deteriorating refining environment exerts further downward pressure on Europe's refining margins, further refinery rationalisation is anticipated to be kept relatively at bay. Although various factors are offsetting permanent closures through 2013–14, the playing field will be open for steep rationalisation as labour union agreements expire in 2015. ■