

Global Demand Means Less Supply for U.S.

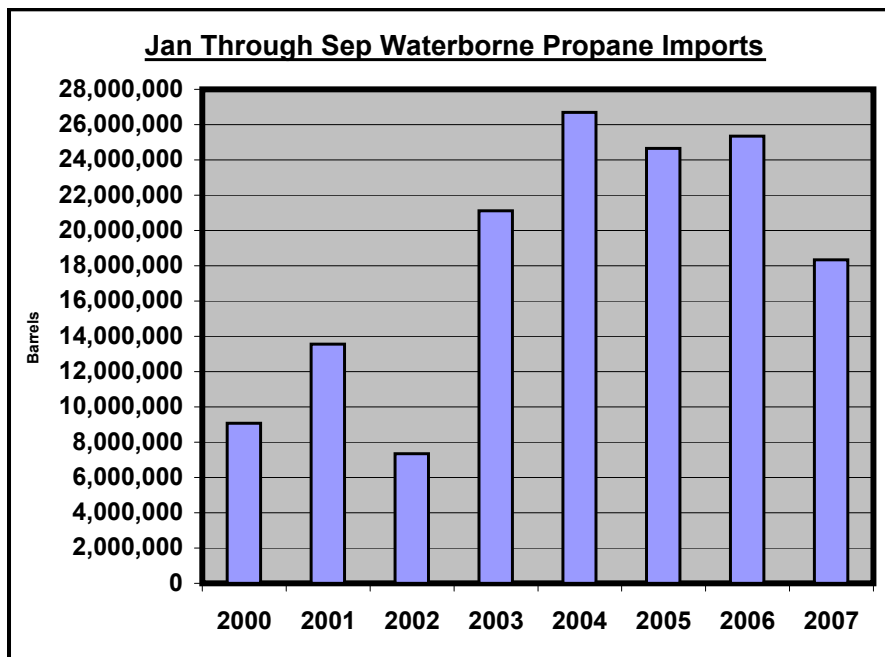
By Scott Gray

The current state of affairs in the U.S. propane market—specifically the less-than-desirable propane inventory situation—can be traced back to the beginning of the year, and the story begins in South America.

Typically the U.S. builds its propane stocks during the summertime when residential/wholesale demand is at its weakest point, and when offshore suppliers have fewer global destination options other than the U.S. Since the capacity of the Mont Belvieu storage system is so vast (265 MMbbl of gaseous storage at last count), the U.S. is generally ready, able, and willing to accept the world's summertime surplus. In other words, the U.S. gets in the summertime what the world doesn't want.

This year has been a bit different, and the inventories reflect those differences. The Energy Information Administration (EIA) reported that domestic U.S. propane stocks totaled 57.440 MMbbl as of Sept. 7. Generally speaking, the accepted rule of thumb is that propane stocks in the U.S. should be right around the 65 MMbbl level during the first week of October.

From mid-September, this conservatively translates to mean that inventories will need to grow on a weekly basis by about 2.5 MMbbl, or five big-ship (VLGC) propane deliveries per week for



the next three weeks. Put rather bluntly, this will not be happening.

But the lack of imports this summer cannot be entirely blamed as the reason stock levels have not built. The petrochemical industry has been consuming extremely high levels of liquids this summer, and that trend is likely to continue through at least the balance of the year. Current consumption rates remain at around the 400,000 bbl/d (12 MMbbl per month) level. And even though the market generally agrees that petchem usage will decline as the second-half of the year progresses, at this point most

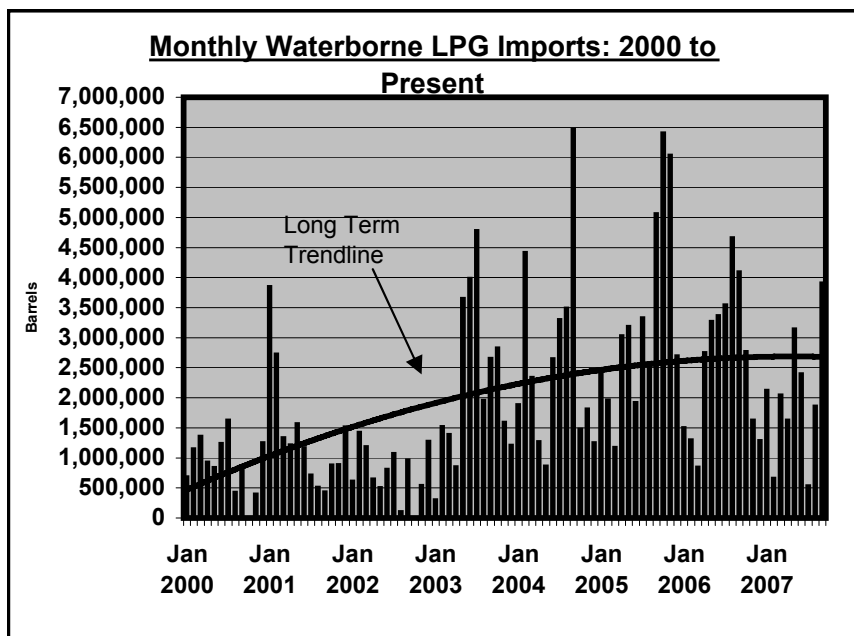
observers have pinned their hopes on the import market.

Turning back the clock a bit and taking a look from a loftier view, the import situation itself came about as a result of a series of events that occurred in South America. Earlier this year during the first quarter there were refinery re-start problems in Brazil. Those problems caused Brazilian domestic supplies to fall short of Brazil's own weather-related requirements, which generally peak during the Southern Hemisphere's July winter. The situation was exacerbated by production disruptions that followed in Argentina. Some of the Argentine production feeds the Brazilian market and is, in part, controlled by Petrobras itself. This essentially amounted to "strike two."

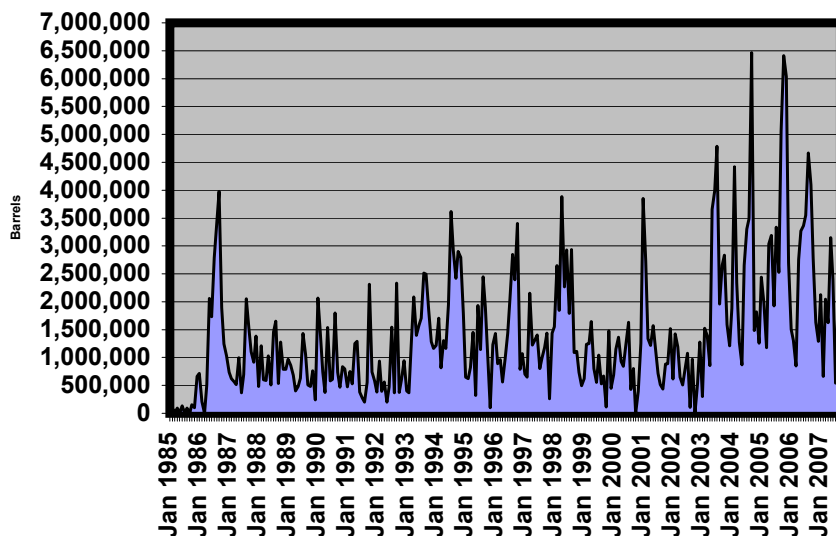
Strike three came in the form of an extremely cold and unusually long winter in South America; in fact it snowed this year in Buenos Aires for the first time in many years. And the winter was not confined to just the southeastern portions of South America, but was ultimately rather widespread.

All of those conspiring factors then pushed Latin American buyers into the open market, and over the course of the summer many of the cargoes that might otherwise have "defaulted" to the U.S. instead went to Brazil, Chile, Ecuador, and the like.

Predictably, many of the cargoes were purchased from Atlantic Basin sup-



Long Term Waterborne U.S. Propane Imports



ply sources, i.e., West Africa, Nigeria, and the North Sea. The situation became sufficiently severe, however, that additional cargoes were sourced from as far away as the Middle East. Several cargoes moved from Yanbu in the Red Sea, from Ruwais in Abu Dhabi, and from the As-suleyah terminal in Iran. We estimate that from the beginning of this year to date, as many as 10 MMbbl have been delivered to Brazil alone, versus the same period in 2006 when around 7 MMbbl were delivered to Brazil.

Likewise, Ecuadorian demand jumped from around 5 MMbbl in the first nine months of 2006 to about 7.5 MMbbl during the same period in 2007.

When combined, those two destinations alone account for 5.5 MMbbl, and does not include improved demand that was seen in Chile, which ran about a million barrels higher in 2007 than in 2006. That, then, roughly brings the total demand increase in South America from 2006 to 2007 to the 6.5 MMbbl level.

If the bulk of that volume were to have been delivered to the U.S.—say, 5 MMbbl—the situation as it stands in the domestic U.S. market would be quite a bit different since overall inventories would be nearer to the 62 MMbbl mark at this point, and would then be only 3 MMbbl away from the rule-of-thumb 65 MMbbl level. That, in turn, would mean that a weekly build of just 1 MMbbl between mid-September and early October would be required to achieve the collective goal.

It has not turned out that way, how-

ever, and the U.S. now appears strapped for propane. But there's another problem. It's called \$80/bbl crude, and there are only a few brave souls prepared to take a length position in the propane market at that price—no matter the percentage relationship between the two.

The good news from the standpoint of the inventory situation is, however, that there is now a warmer-than-average Q4 being forecast, and only a "normal" January prognosis. While this may not bode so well for those whose livelihood depends on sales volumes, it is likely welcome news for those who supply that sector of the market.

With all of that said, the words of a well-respected industry friend come to mind, and that is in the end, the price will cure all of the market's woes, whether it's the price at Mont Belvieu, for example, or the price in the Northwest European market, or in the Middle Eastern market. In some form or fashion, the price will solve everything. In fact, the precise quote from said friend is that "the best cure for high prices is high prices." And in this case it applies, though the question remains as to the timing.

Scott Gray is one of two principals at Waterborne Energy, a privately-held Houston-based publishing and consulting firm that is engaged in the shipping side of the LPG and LNG markets. The firm recently marked its 25th anniversary. Gray has been with Waterborne Energy for 15 years and oversees the LPG operations.