Is ‘styrene monomer party’ over or is round two set to begin?

June 2015
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**IS ‘STYRENE MONOMER PARTY’ OVER OR IS ROUND TWO SET TO BEGIN?**

- SM prices nosedive, then surge heading into H2 2015
- China manufacturing sector drives demand for Asian aromatics

The Asian styrene monomer party kicked off ahead of the massive turnaround season in main producing country South Korea and historically low inventories in China in the first-half of the year, but stepping into the second-half, is it all over as prices headed south from the start of June, only to recover slightly on June 10?

Opinions are divided on the outlook for the third quarter. Is the SM party over or is round two of the party set to begin?

**THE RALLY: ASIA SM LEADS THE WAY IN Q1, Q2 SURGE**

The FOB Korea SM marker led the surge in Asian aromatics prices in the first and second quarters of this year.

It soared 33.4% since January 2 to $1,257.50/mt on May 29, followed by FOB Korea toluene rising 26% over the same period, FOB Korea isomer-grade mixed xylenes jumping 24%, FOB Korea benzene 14.6% higher and FOB Korea paraxylene up 5.8%. Comparing with the all-year high level of SM at $1,454.50/mt FOB Korea on May 15, the SM marker had even surged 54.24% since early this year.

What made the SM rally overtake that of all other aromatics?

**ASIAN SM SEES NEW RESURGENCE**

Asian SM was one of the most lackluster aromatics markets last year, as it struggled with tight credit policies in China, plunging crude, non-performance among traders and weakening downstream demand.

The FOB Korea SM marker was on a downtrend throughout last year, plummeting 44.6% from January 2 to $937.50/mt December 31, 2014, according to Platts data. FOB Korea benzene plunged 50.5% over the same period to $663/mt, FOB Korea toluene tumbled 49% to 597.50/mt, isomer-MX slid 46.3% and PX dropped 41%.

The massive turnaround season in South Korea and returning demand from the downstream expandable polystyrene market during March-May, triggered the surge in the SM price.

As many as seven out of eight SM plants in South Korea, around 76% if the country’s total SM production capacity, had been shut for maintenance over March-May.

South Korea supplied around 40% of China’s SM imports in 2014, according to Chinese customs data.

These shutdowns made the SM forward curve flip into backwardation on February 27 from the prolonged contango structure – the FOB Korea SM marker soared 80.7% from the six-year low of $805/mt on January 13 to a seven-month high of $1,454.50/mt on May 15 this year.

Unprecedented low SM inventory levels in east China were a powerful spur to the skyrocketing SM market as well.

The weekly SM inventory level in east China hit a two-year and eight-month low at 37,000 mt on May 22 this year, according to Platts data. East China’s SM inventory in May averaged 43,250 mt, which is around 51% lower than the five-year average of 89,110 mt.

The low SM inventory in east China widened the China domestic import parity/CFR China price spread to as high as $107.95/mt on May 11, 2015, a level not typically seen in a normal market situation. Looking back at historical data since 2009, the spread averages at minus $30/mt, Platts data shows.

Further boosting the rally was tight US-origin SM supply to Asia this year. The US-Asia SM arbitrage had been shut for most of H1 2015, as a bullish European SM market due to tight supply amid turnarounds and unexpected outages in the Middle East lured US cargoes to Europe.

Demand-wise, returning SM demand from the downstream EPS market, with the approaching spring construction peak season, was another bullish factor supporting the SM market.

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**Massive turnarounds in Mar-May in South Korea supported SM in Q1 (’000 mt/year)**

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<thead>
<tr>
<th>Company</th>
<th>Location</th>
<th>Capacity</th>
<th>Timing</th>
<th>Estimated loss</th>
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<td>580</td>
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<td>Yeosu</td>
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<td>Apr, 30-45 days</td>
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<tr>
<td>SKGC</td>
<td>Ulsan</td>
<td>350</td>
<td>Idled since 2014</td>
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</table>

**Total estimated loss** 223.62-262.25

Almost 76% of total annual capacity in S. Korea affected

Source: Platts
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NOSE-DIVING SM TURNS TO A SUDDEN SURGE

The bullishness in the Asian SM market is, however, likely to come to an end, with prices taking a dive over the last two weeks of May. On May 29, FOB Korea SM was flat day on day but tumbled 8.4% or $116/mt week on week to $1,257.50/mt, according to Platts data. This is the sharpest weekly drop in 2015.

The inter-month June/July FOB Korea spread has gradually narrowed from $40/mt in February to $30/mt as of June 2, reflecting easing tightness.

However, SM prices have rebounded since early June, on the back of active short-covering and unexpected outages of SM plants in the region.

Asian styrene monomer prices surged $40/mt on day to $1,354.50/mt FOB Korea and $1,378.50/mt CFR China June 10 on flurry of short-covering by traders squeezed by earlier short-selling despite major exporter South Korea’s heavier-than-usual turnaround season drawing to an end.

The price surge came despite major South Korean producer Yeochun Naphtha Cracking Center restarting its 290,000 mt/year SM plant at Yeosu on June 10 after month-long maintenance, marking the end of the country’s unusually heavy turnaround season.

The fluctuating SM prices in late Q2 have been adding to the uncertainties faced by market participants, who are wondering whether the ‘SM party is over’ or ‘the second phase of the party is set to begin?’.

There are two contradictory interpretations on the market outlook, which reflects the escalating uncertainties.

BEAR MARKET BELIEVERS

Market players who expect a ‘bear market’ are saying that increasing SM supplies from out of Asia are signaling an oversupplied market in late Q2-early Q3.

China’s SM imports from the US almost tripled in April, surging 32,138 mt or 199.9% month on month to 48,213 mt, data released by the country’s General Administration of Customs showed.

The re-opening of the US-Asia SM arbitrage on paper from April 13 to May 21 and plumpethylene-benzene fed SM production margins are adding downward pressure.

“At least 55,000-60,000 mt of US-origin SM, including delayed cargoes, may be arriving in Asia over July-August, and the US suppliers may keep offering SM to Asia on the back of lower production costs in the US [which make US SM more attractive to Asian buyers] and outperformed SM in Asia,” a trader based in Singapore said.

Market sources are expecting the supply tightness in Asia to ease with the arrival of US SM in late June and July, which is likely to be double the 2014 volume from the US to South Korea/China that averaged at 25,327 mt/month, based on Korean and Chinese customs data.

SM production margins using ethylene-benzene as feedstock widened to a historical high of $312.60/mt FOB Korea on May 15. It was last at a similar level on July 31, 2013, at $311.15/mt, Platts data showed. This would be a reason to boost run rates, eventually leading to higher supply that will put downward pressure on prices?

In downstream markets, lower run rates by polystyrene producers on the back of prolonged negative production margins due to the H1 feedstock SM rally, would dampen demand in the third quarter?

BULL MARKET BELIEVERS

Market players who expect a ‘bull market’ are saying that many traders had short-sold in recent weeks, expecting supply would rise after the end of South Korea’s turnaround season, pressuring down prices and enabling them to buy at lower prices to cover their shortages. But with delays in the arrival of US-origin deepsea cargoes, plants in the region running below capacity and end-users raising run rates, the same traders are now actively short-covering.

“Approximately 20,000-30,000 mt of SM was heard over-sold by the short sellers,” a market source said.

“The lower run rates of a major South Korean producer at 80-90% capacity, trouble at one of Japan’s naphtha-fed steam crackers lowering runs at an SM unit and end-users restocking on better margins amid a rebounding crude price – all this is supporting the price of SM,” a trader in Singapore said.

A market source in Seoul said: “Active short-covering by short-sellers who had anticipated a falling SM market after the turnaround season ended amid delays in US-origin SM arrivals in Asia has triggered the uptick in prices.”

FEEDSTOCK BENZENE FACES SUPPLY PRESSURE AFTER RECENT PLANT START-UPS

From a benzene perspective, SM margins for non-integrated producers have been mostly healthy this year, with the weakness in benzene allowing for widening SM-benzene spreads in the face of strong styrene demand.
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Heading into the second-half of the year, the spread is starting to taper off. However, due to the wide spread earlier, the narrowing spread has some way to go before veering into unprofitable levels.

The FOB Korea SM-benzene spread hit an all-time high of $704/mt on May 15 this year, the highest since Platts started assessing the FOB Korea styrene price in January 2004. Non-integrated styrene monomer producers typically target a spread higher than $250/mt for profitable production.

Since 2004, the SM-benzene spread has averaged above $250/mt in most years. Since the start of 2015 up till May, the spread has averaged at $407.02/mt -- the highest level seen so far.

The spread has been narrowing since peaking at more than $700/mt mid-May, and closed the month at $487.50/mt on May 30. However, the level is still close to double the target spread for non-integrated styrene producers.

The narrowing spread comes as styrene prices lose steam in the face of softer Chinese demand, outpacing the drop in benzene prices which was due to market length.

Benzene prices recovered slightly at the start of 2015 since plunging late 2014 as crude prices sank. FOB Korea benzene started off the year below $700/mt, at $673.50/mt, and crept up shakily over the months to an intra-year high of $870.50/mt on April 21 amid a resurgence in demand from China.

In March, China’s imports of benzene peaked at close to 200,000 mt (196,687 mt), a high not seen in the previous few years. Demand for benzene in China was so strong that up to 30,000 mt of benzene was originally said to have been fixed into China late April, shipped from the US Gulf Coast in late February and early March. This would represent a rare reversal of the typical arbitrage flow for the material between Asia and the US, market sources in both regions previously told Platts.

“The arbitrage was open, traders are trying to make money,” a US-based trader had said.

“In January and February, US benzene was oversupplied. But the Asia price [was] up and up,” said a trader in China.

Benzene typically flows from Asia to the US in relatively large quantities, but this dynamic changed in late February after Chinese domestic prices firmed enough to support a reversal of the cargo flow.

“The arbitrage window was open last month. No risk,” said a Singapore-based trader in March.

Since then, however, demand has cooled. A source noted that the volumes slated for China from the US Gulf may have been redirected.
China and the US are two key buyers of Asian benzene. With China demand flagging and the arbitrage to the US closed for the bulk of 2015, demand has been weak. The strong supply of benzene, especially with the start-up of the new production capacities, also exacerbated the situation.

The FOB Korea benzene average price in April, at $826.60/mt, was an intra-year high. Since then however, prices have come off with the May average coming in at around $777.50/mt.

The May benzene drop triggered falls across most aromatics. While the FOB Korea benzene marker fell $68.50/mt, or 8%, from the start of May till the end of the month, the ICE Brent crude settlement price fell $0.90/b or 1.4% over the same period.

Upstream toluene edged down $37.50/mt, or 4.7%, on an FOB Korea basis, while downstream styrene fell 7.8%, or $106/mt, on an FOB Korea basis. Co-product PX fell 7.1%, or $67.50/mt, on an FOB Korea basis.

Going forward, demand from both China and Taiwan is likely to be a key factor in FOB Korea benzene, with both showing a strong appetite for the product recently, on the back of demand from end-users.

Strong toluene demand and firm prices may also be supportive for benzene, especially because producers using toluene to produce benzene may reduce rates in the current price environment -- where toluene prices can be higher than benzene on an FOB Korea basis. The average toluene price in May was $781.65/mt, above that of benzene.

Meanwhile, South Korea’s Ulsan Aromatics, a joint venture between South Korea’s SK Global Chemical and Japan’s JX Nippon Oil and Energy, has reduced the operating rate of its toluene disproportionation unit and PX plant to around 70% on May 29, from 90% due to technical problems at the TDP unit.

It was not clear how long the plants would need to run at the lower rate. The PX plant can produce 1 million mt/year of PX and 500,000 mt/year of benzene. The production capacity of the TDP unit, which uses toluene and C9 to make isomer-grade mixed xylene and benzene, was not disclosed.

**CHINA HAS AN INSATIABLE APPETITE?**

The market is divided about whether SM prices will fall further in the third quarter or rebound. Some were expecting a collapse after South Korea’s turnaround season ends early June and as the US cargoes arrive in Asia.

“The supply tightness is easing now, so, Asia SM market is seen to be on a downtrend,” a market source from a Western trading company said.

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Total Benzene start up in 2015: 700,000 mt
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But others expect seasonal demand from downstream PS makers to absorb the additional supply.

“There will be another turnaround season in Asia from autumn and ABS operation rates will keep at full capacity, thus, the Asia SM price may be at a high level [going forward],” a Japan-based trader said.

However, there is a general consensus about the rising importance of SM demand from downstream markets in China.

“From January to April this year, the supply of SM, including domestic and import, was increasing compared to 2014, but the price was increased sharply, so I think it’s the demand [not a supply] which pulled the uptrend of SM,” a trader based in China said.

However, there is a general consensus about the rising importance of SM demand from downstream markets in China.

In April, China imported 331,935 mt of SM, up 55% year on year and 33.9% higher than the four-year average for April, according to Chinese customs data.

China’s general-purpose polystyrene and acrylonitrile-butadiene-styrene imports in April were similar to the five-year average at 80,695 mt and 151,822 mt, respectively, while high-impact polystyrene imports were up 20.7% from 2014 and up 45.9% from the five-year average at 32,963 mt.

But market participants are cautious after seeing a slowdown in China’s macroeconomic data, which could signal weaker downstream markets and lower demand from the manufacturing sector for EPS, GPPS, HIPS and ABS.

The country’s property and construction sectors are showing weak growth. China’s real estate investment in April rose a marginal 0.5% year on year to Yuan 702 billion, according to data released by China’s National Bureau of Statistics. Q1 sales of cement fell 3.2% year on year to 426 mt.

Tight credit in China is another concern on the Asia aromatics market. Shanghai Interbank Offered Rate has been rising since early this year and it is likely curbing Chinese buyers’ purchasing power and will likely press down the commodities market prices.

A slowdown in China’s GDP growth rate in recent years and a lower purchasing manager’s index in recent months also indicate that the country's manufacturing sector has been hit.
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China’s economy recorded its weakest growth in 24 years in 2014, with its GDP expanding at 7.4% amid a sluggish domestic market and fluctuating exports.

But, this year, the GDP growth rate will likely slow further.

With expectations of a slowdown in China’s GDP growth rates, SM annual demand growth rates are also expected to be hit.

China’s Purchasing Managers Index in April was 49.2, which is a 12-month low and also below the 50 level.