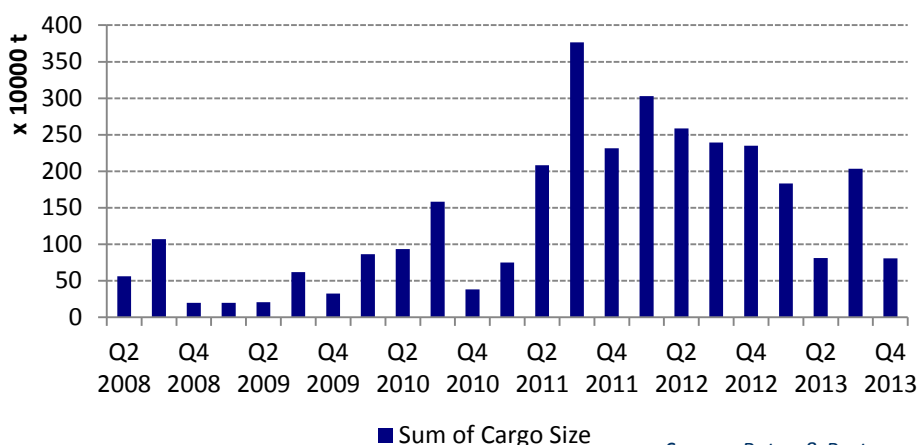


Removal of Brazilian Subsidies to Back Out Clean Product Imports?

Gasoline and diesel prices were subsidized in Brazil, but this may end soon.

Brazilian transportation fuels subsidies have reduced costs for consumers, who have enjoyed longstanding market discount for gasoline and diesel. Currently the cost of the subsidy is borne by the state run oil company, Petrobras. As the cost of these imports is rising, the company is pushing for an end to price controls, a move which could reduce demand for clean product imports. Historically, until around 2010, Brazil faced a narrow gap between domestic demand and refining capacity, resulting in a modest amount of clean product exports. However, a trend of increasing miles driven per light duty vehicle has started rising quickly: 9,000 km/year in 2010, with forecasts of 13,000 km/year in 2015. The resulting increase in domestic demand was met by clean product imports, which peaked in 2011.

Reported Spot Fixtures Discharging Brazil
Quarterly, 2008-present



Source: Poten & Partners

Imports have been trending down since 2011 peak.

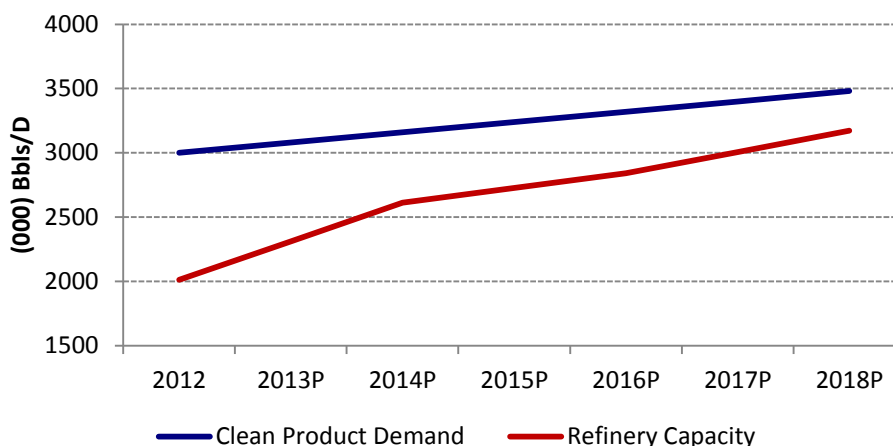
Since 2011, the country's imports have been slowly trending downward, for two main reasons: currency devaluation and price increases for consumers. The Brazilian currency was at its strongest in 2011, when 1.6 Real's equalled one US Dollar, reducing costs for importers. However, the currency has steadily weakened since then, and it currently takes 2.2 Real's to equal one dollar. This has led to an estimated loss of 20% on each barrel of gasoline/diesel that is imported into the country for consumption. The government allowed a 7.8% increase for gasoline in June, while diesel prices were allowed to rise by 9.9% in June and July. Prices are

roughly pegged at \$6.90 per gallon of gasoline after the last price increases and further hikes may contribute to demand destruction for transportation fuels.

Ethanol usage backing out some demand, but production is not constant.

Another bearish factor in clean product imports into Brazil has been the use of domestically produced biofuels. Ethanol blending for gasoline motor fuels increased to 25%, up from 20%, in May of this year, which marginally reduced demand for imported gasoline. More importantly, some consumers have switched to 100% hydrous ethanol, which is priced at a discount to gasoline due to a robust sugar cane harvest in the country. In the past, consumers returned to gasoline and diesel as price advantages melted away after depletion of the harvest.

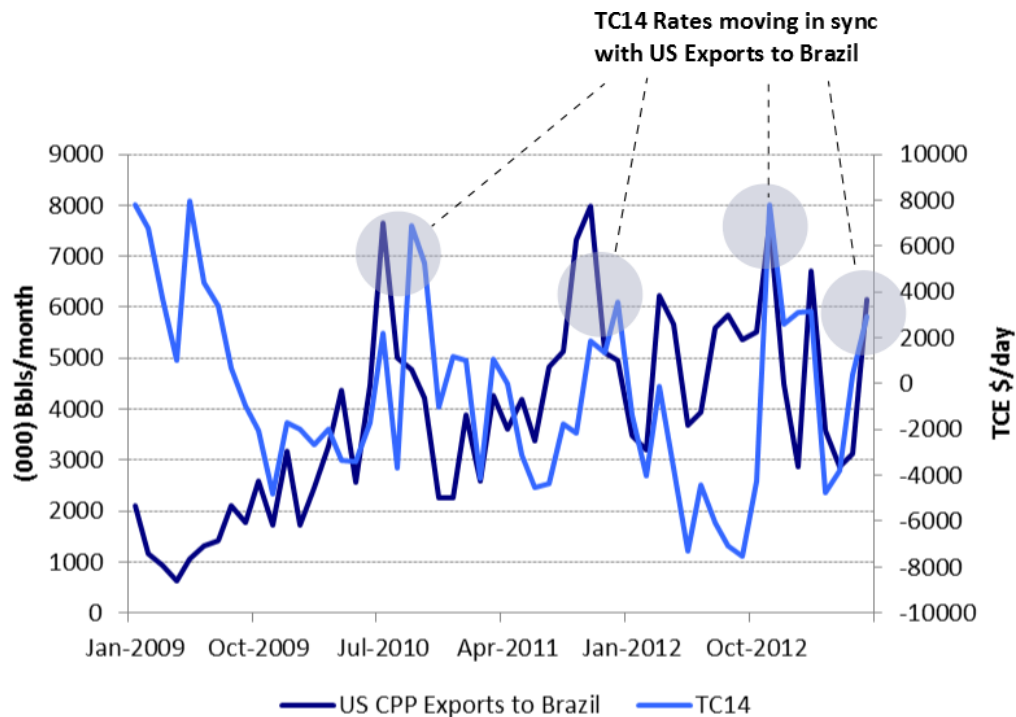
Clean product demand may continue to rise, but refinery capacity forecast not guaranteed.



Source: IEA

At least one factor, however, may be driving Brazil back to imports. Projected product demand and the production capacity of domestic refineries are converging on paper. But many of the longer term refinery projects, particularly those in 2017 and 2018 are uncertain, and the supply of clean product may not be as optimistic as the graph leads one to believe. Not all projects are fully funded, and many delays are predicted, particularly those beyond 2015.

US Gulf export rates correlating more closely with cargo movements to Brazil.



Source: Poten & Partners, EIA

Despite the recent drop off in overall Brazilian imports, US product exports to the country have been steadily rising. As seen in the graph above, rates for TC14, a benchmark for US Gulf clean product tanker rates, has been increasingly correlated with Brazilian imports. This does not imply that Brazil alone is helping drive up rates in the US Gulf, but it does indicate that during the increasingly strong US Gulf diesel export arbitrages, Brazil appears to be taking advantage of buying opportunities.

The end of gasoline subsidies for the Brazilian consumer will add negative pressure to clean product demand. Imports have been decreasing already, and this could help the downward trend continue.