DEMAND

Summary

- **Global oil demand** has been revised down in both 2008 and 2009, given a much starker contraction in the OECD than expected, and early signs of weakness in non-OECD countries, notably in Asia. World oil demand is forecast to average 85.8 mb/d in 2008 (-0.2% or -0.2 mb/d versus 2007 and roughly 350 kb/d lower than previously estimated) and 86.3 mb/d in 2009 (+0.5% or +0.4 mb/d versus 2008 and 260 kb/d lower when compared with our last report). The global demand contraction expected in 2008 will be the first since 1983.

- **Oil demand in the OECD** is seen averaging 47.5 mb/d in 2008 (-3.3% or -1.6 mb/d versus 2007) and 46.9 mb/d in 2009 (-1.4% or -0.7 mb/d on a yearly basis), about 290 kb/d and 210 kb/d lower, respectively, than previously estimated. Once again, 3Q08 and 4Q08 revisions to preliminary demand data in both North America (United States) and the Pacific (Japan) were significant, reflecting much weaker economic performance, and were carried through to 2009. It should be noted that this forecast assumes that OECD demand destruction will bottom out next year and that demand will begin to gradually recover in 2H09, in line with current IMF economic assumptions.

Global Oil Demand (2007-2009)
(million barrels per day)

	1Q07	2Q07	3Q07	4Q07	2007	1Q08	2Q08	3Q08	4Q08	2008	1Q09	2Q09	3Q09	4Q09	2009
Africa	3.1	3.1	3.0	3.1	3.1	3.1	3.2	3.0	3.1	3.1	3.2	3.2	3.1	3.2	3.2
Americas	31.1	31.0	31.3	31.2	31.1	30.5	30.4	29.8	29.6	30.1	29.8	30.0	30.0	29.9	29.9
Asia/Pacific	25.5	24.9	24.5	25.7	25.1	26.4	25.4	24.7	25.5	25.5	26.6	25.6	24.9	26.1	25.8
Europe	16.0	15.7	16.1	16.4	16.0	16.0	15.6	16.1	16.3	16.0	15.8	15.4	15.9	16.0	15.8
FSU	4.1	3.9	4.2	4.3	4.1	4.1	4.1	4.4	4.4	4.2	4.2	4.2	4.4	4.5	4.3
Middle East	6.4	6.5	6.7	6.4	6.5	6.7	7.0	7.3	6.8	6.9	7.0	7.3	7.6	7.1	7.2
World	**86.2**	**85.1**	**85.7**	**87.2**	**86.0**	**86.8**	**85.7**	**85.2**	**85.6**	**85.8**	**86.6**	**85.7**	**86.0**	**86.8**	**86.3**
Annual Chg (%)	0.4	1.5	1.1	1.5	1.1	0.8	0.7	-0.6	-1.8	-0.2	-0.2	0.0	0.9	1.3	0.5
Annual Chg (mb/d)	0.3	1.2	0.9	1.3	0.9	0.7	0.6	-0.5	-1.6	-0.2	-0.2	0.0	0.8	1.2	0.4
Changes from last OMR (mb/d)	-0.06	-0.03	0.00	0.01	-0.02	-0.02	-0.07	-0.29	-0.99	-0.35	-0.43	-0.26	0.14	-0.50	-0.26

- **Non-OECD oil demand** is now expected to average 38.3 mb/d in 2008 (+3.9% or +1.4 mb/d above 2007 and 60 kb/d lower than previously estimated) and 39.4 mb/d in 2009 (+2.9% or +1.1 mb/d compared with 2008 and 50 kb/d lower than in our last report). These revisions are related to both the economic slowdown and data reappraisals in several Asian countries, notably Malaysia, Taiwan and Thailand. Although demand in both China and India appears to be holding so far, non-OECD demand growth in 2008 will fail to offset the severe demand contraction in the OECD.

- **The fall in international oil prices has resulted in downward retail price adjustments in several Asian countries, which may help cushion the effects of the global financial turmoil upon their domestic economies.** Subsidies have not only become more affordable but are also politically expedient, as suggested by the recent end-user price cuts in India, Indonesia and Malaysia. Only China is seemingly taking advantage of the current low oil price environment to move towards market-based end-user prices – although the price reform proposal unveiled in early December hints that domestic caps will prevail if international oil prices rebound above $80/bbl.

OECD

OECD inland deliveries (oil products supplied by refineries, pipelines and terminals) plunged by 6.0% year-on-year in October, according to preliminary data. All three regions recorded losses, providing further evidence of the worsening economic situation. In **OECD North America** (which includes US Territories), oil product demand contracted by 8.3% on an annual basis given a persistent weakness across all product categories, particularly transportation fuels. Demand in **OECD Europe** shrank by 0.9%, despite the continued strength of heating oil deliveries, also on the back of declining transportation fuel deliveries. In **OECD Pacific**, demand plummeted by 9.1%, dragged down by very feeble Japanese and Korean deliveries in virtually all product categories.

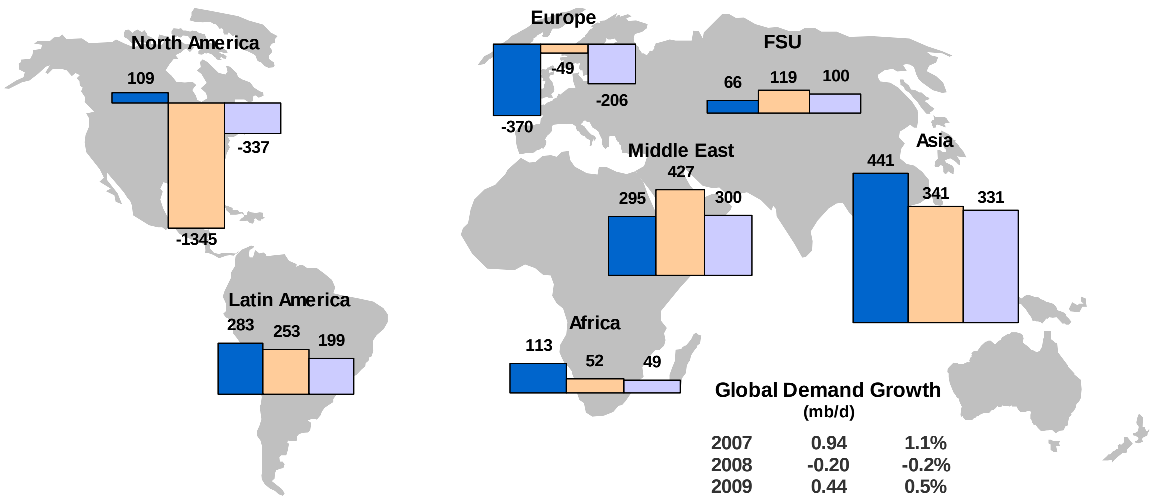
OECD Demand based on Adjusted Preliminary Submissions - October 2008
(million barrels per day)

	Gasoline		Jet/Kerosene		Diesel		Other Gasoil		RFO		Other		Total Products	
	mb/d	% pa	mb/d	% pa	mb/d	% pa	mb/d	% pa	mb/d	% pa	mb/d	% pa	mb/d	% pa
OECD North America*	**10.29**	**-5.0**	**1.69**	**-11.5**	**4.14**	**-1.3**	**0.88**	**-22.8**	**0.82**	**-27.4**	**5.49**	**-11.77**	**23.31**	**-8.3**
US50	8.70	-5.8	1.45	-12.7	3.57	-3.5	0.32	-36.7	0.40	-35.5	4.06	-14.3	18.51	-9.6
Canada	0.73	-1.6	0.12	-0.5	0.19	-4.1	0.39	-3.4	0.11	-1.7	0.76	-3.0	2.30	-2.5
Mexico	0.77	1.8	0.06	-11.5	0.31	5.7	0.13	5.7	0.19	-31.8	0.59	-5.4	2.05	-4.3
OECD Europe	**2.41**	**-5.1**	**1.34**	**-3.0**	**4.48**	**-1.4**	**2.35**	**8.9**	**1.67**	**-4.6**	**3.72**	**-0.5**	**15.96**	**-0.9**
Germany	0.49	-4.9	0.20	-1.7	0.71	1.9	0.70	57.4	0.20	13.9	0.60	-3.3	2.90	9.2
United Kingdom	0.37	-6.1	0.37	-2.9	0.40	-1.6	0.13	-4.0	0.08	-1.1	0.35	2.8	1.70	-2.2
France	0.21	-9.1	0.16	3.0	0.71	-1.6	0.38	-7.1	0.12	-15.6	0.48	-2.3	2.05	-4.2
Italy	0.30	-4.8	0.08	-13.2	0.58	-1.7	0.12	-4.6	0.22	-6.1	0.37	-7.6	1.68	-5.0
Spain	0.15	-7.8	0.12	-11.4	0.50	-8.6	0.22	-6.8	0.21	-6.8	0.33	-3.0	1.53	-7.1
OECD Pacific	**1.49**	**-5.6**	**0.65**	**-24.0**	**1.22**	**-7.5**	**0.44**	**-18.1**	**0.79**	**-19.4**	**2.87**	**-2.3**	**7.46**	**-9.1**
Japan	0.94	-7.0	0.38	-28.9	0.57	-8.0	0.30	-23.5	0.43	-22.8	1.65	-3.5	4.27	-11.5
Korea	0.16	-9.0	0.14	-26.4	0.25	-20.3	0.12	-4.3	0.31	-17.7	1.03	0.3	2.02	-9.0
Australia	0.33	-0.8	0.11	1.1	0.34	4.4	0.02	-1.2	0.04	-1.2	0.17	-3.3	1.01	0.6
OECD Total	**14.19**	**-5.1**	**3.68**	**-11.2**	**9.83**	**-2.2**	**3.67**	**-4.3**	**3.28**	**-15.0**	**12.09**	**-6.3**	**46.73**	**-6.0**

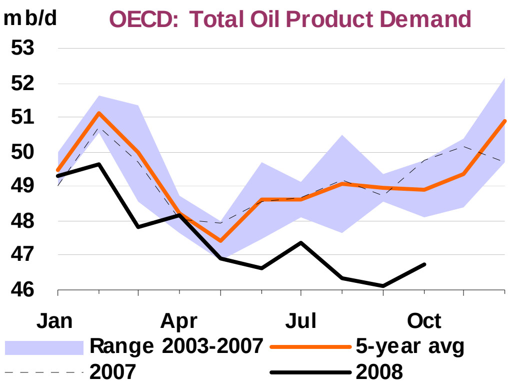
* Including US territories

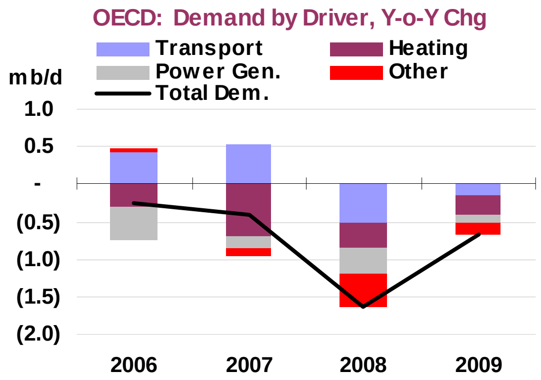
Once again, revisions to preliminary figures were huge, with September demand adjusted down by 1.1 mb/d, mostly on changes in North American figures. According to revised data, OECD demand fell by 5.4% during that month, instead of shrinking by 3.1%. This translates into a 380 kb/d downward adjustment for 3Q08, of which 370 kb/d came from OECD North America (mostly from the US). Moreover, the much weaker-than-expected preliminary data for October, notably for the US, Japan and Korea, has resulted in a 760 kb/d downward revision in 4Q08 (of which -440 kb/d in North America and -310 kb/d in the Pacific). This adjustment has been partially carried through to 2009 (not only in 4Q09 but in 1H09 as well, given the expected demand weakness by the end of 2008).

Global Demand Growth 2007/2008/2009
thousand barrels per day



Overall, OECD demand is now expected to average 47.5 mb/d in 2008 (-3.3% or -1.6 mb/d versus 2007 and 290 kb/d lower than in our last report). The OECD contraction will in fact offset non-OECD growth, and as such global demand should contract by about 0.2 mb/d in 2008, for the first time since 1983. In 2009, OECD demand is seen contracting by only 1.4% on a yearly basis (roughly -0.7 mb/d) to 46.9 mb/d (210 kb/d lower on average when compared with our previous assessment), and global oil demand growth should thus shift back to positive territory (+0.4 mb/d) next year. It is important to note that our 2009 forecast is based on two key assertions: 1) that OECD demand destruction will bottom out next year, and 2) that demand will begin to gradually recover in 2H09, on the basis of current IMF economic assumptions. Therefore, should the recession prove to be more prolonged than expected, this prognosis could be further revised down.





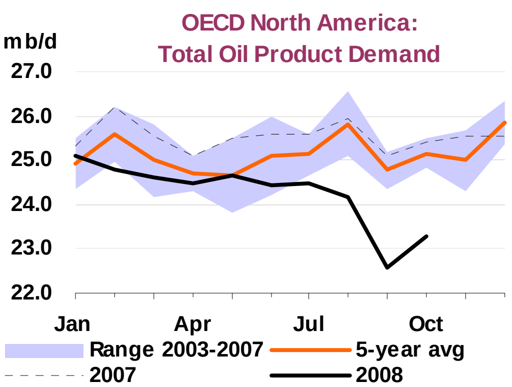
Total OECD Demand by Product
(million barrels per day)

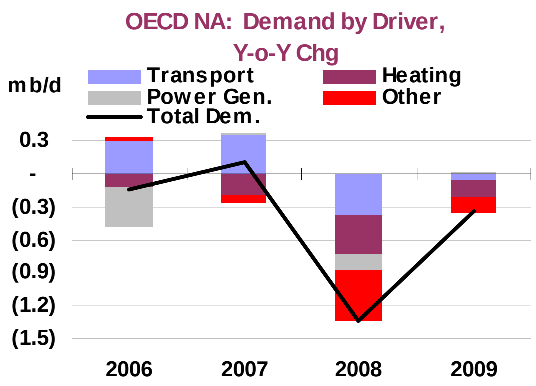
	2007	2008	3Q07	4Q07	1Q08	2Q08	Jul 08	Aug 08	Sep 08*	Latest month vs. Aug 08	Latest month vs. Sep 07
LPG & Ethane	4.82	4.68	4.45	4.93	5.16	4.58	4.52	4.42	4.02	-0.40	-0.33
Naphtha	3.24	3.15	3.18	3.27	3.28	3.00	3.01	3.10	2.92	-0.17	-0.23
Motor Gasoline	14.92	14.41	15.32	14.84	14.23	14.73	14.73	14.59	14.03	-0.56	-0.90
Jet & Kerosene	4.12	3.98	3.98	4.24	4.34	3.87	3.87	3.83	3.74	-0.09	-0.20
Gas/Diesel Oil	13.13	12.98	12.85	13.60	13.39	12.61	12.49	12.03	13.25	1.22	0.00
Residual Fuel Oil	3.96	3.65	3.83	3.95	3.87	3.61	3.68	3.45	3.41	-0.04	-0.42
Other Products	4.97	4.69	5.25	5.01	4.63	4.82	5.06	4.90	4.71	-0.19	-0.55
Total Products	**49.17**	**47.54**	**48.85**	**49.86**	**48.91**	**47.22**	**47.37**	**46.32**	**46.09**	**-0.23**	**-2.62**

* Latest official OECD submissions (MOS)

North America

Oil product demand in North America (including US Territories) tumbled by 8.3% year-on-year in October, according to preliminary data, falling for the tenth month in a row. Although this demand weakness continued to be mostly centred in the United States (-9.4% year-on-year), Canada and Mexico also posted losses (-2.7% and -4.3%, respectively). Revisions to September preliminary data, also largely driven by the US, were significant (-1.1 mb/d): demand in OECD North America actually contracted by 10.0% year-on-year during that month, almost twice as much as previously estimated. Regional oil demand is now projected at 24.2 mb/d in 2008 (-5.3% or -1.3 mb/d on a yearly basis and 200 kb/d lower when compared with our last assessment) and 23.8 mb/d in 2009 (-1.4% or -0.3 mb/d), 110 kb/d below our previous assessment.



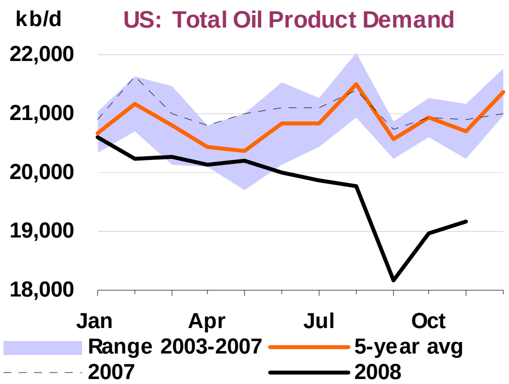


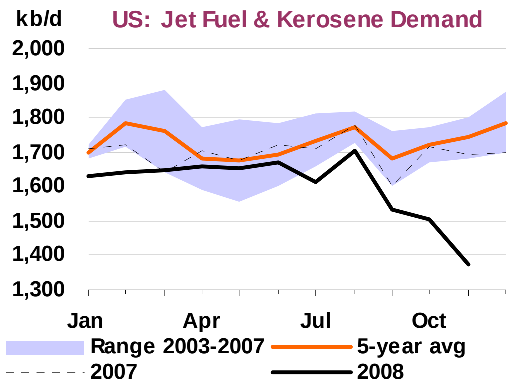
OECD North America Demand by Product
(million barrels per day)

	2007	2008	3Q07	4Q07	1Q08	2Q08	Jul 08	Aug 08	Sep 08*	Latest month vs. Aug 08	Latest month vs. Sep 07
LPG & Ethane	2.92	2.74	2.70	2.97	3.10	2.63	2.70	2.70	2.20	-0.50	-0.50
Naphtha	0.41	0.38	0.42	0.41	0.36	0.37	0.41	0.30	0.31	0.01	-0.11
Motor Gasoline	10.84	10.52	11.07	10.84	10.47	10.74	10.74	10.72	10.05	-0.67	-0.73
Jet & Kerosene	1.89	1.78	1.91	1.90	1.84	1.84	1.84	1.89	1.71	-0.18	-0.09
Gas/Diesel Oil	5.24	5.01	5.13	5.24	5.29	4.96	4.76	4.71	4.84	0.13	-0.34
Residual Fuel Oil	1.25	1.11	1.21	1.18	1.14	1.22	1.22	1.07	0.90	-0.17	-0.26
Other Products	2.97	2.64	3.11	2.95	2.63	2.77	2.81	2.78	2.57	-0.21	-0.48
Total Products	**25.53**	**24.18**	**25.54**	**25.49**	**24.84**	**24.52**	**24.47**	**24.17**	**22.59**	**-1.58**	**-2.51**

* Latest official OECD submissions (MOS)

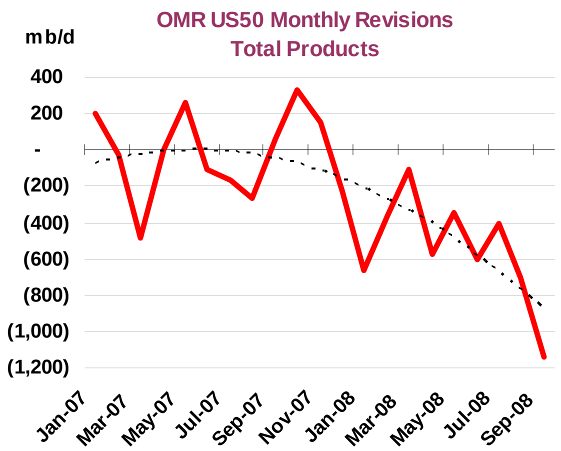
Adjusted preliminary data in the continental **United States** continue to depict an extremely gloomy picture of oil demand, which since last year has suffered successive blows: a financial crisis, high oil prices, devastating hurricanes and, to cap it all, an officially recognised economic recession – since December 2007, according to the National Bureau of Economic Research (NBER) – as consumer spending continues to contract in order to pay off debts and rebuild private savings. Inland deliveries– a proxy of oil product demand – fell by 8.6% year-on-year in November, with all product categories bar naphtha and diesel registering significant contractions. For example, jet fuel/kerosene deliveries plummeted by an unprecedented 19.3% year-on-year, while gasoline demand shrank by 5.3%. Residual fuel oil, meanwhile, plunged by 20.1% on an annual basis – this product, however, is once again becoming competitive vis-à-vis natural gas on a price basis and, as such, the month-on-month rebound reported in November could conceivably continue in the months ahead.

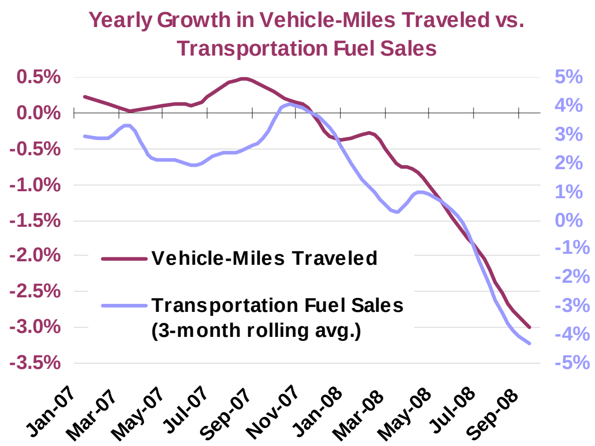




If that were not enough, preliminary weekly data were corrected down – for the twentieth month in a row – in September. The adjustment totalled an unprecedented 1.1 mb/d, implying an annual decline of 12.6% or -2.6 mb/d, almost twice as much as previously estimated. The revisions centred mostly on LPG, 'other products' and gasoline, in that order. Arguably, the weekly assessments had failed to capture some of the negative effects of both Hurricanes Gustav and Ike, while counting some gasoline volumes as 'supply' (a proxy of demand) rather than as exports. Moreover, the size of the weekly to monthly revisions to total US50 demand had tended to increase since mid-2007, despite this report's efforts to anticipate both monthly and annual EIA adjustments. Our current estimate of future revisions going forward, based on a three-month average, stands at roughly -800 kb/d.

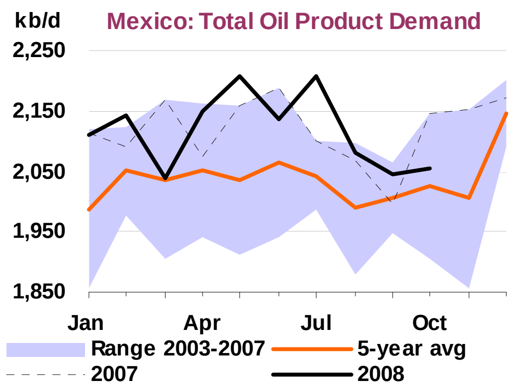
The weakness in gasoline demand was corroborated by low vehicle-miles travelled (VMT) readings. VMT, which are strongly correlated to transportation fuels (gasoline and diesel), fell by 3.0% year-on-year in September, a drop not seen since May 1980. Total average oil demand was the lowest since September 1996, while the year-on-year percentage decline was the largest since 1980. On the basis of these revisions, and assuming that demand destruction will bottom out in 2009, US oil demand is now expected to contract by 6.3% year-on-year in 2008 to 19.4 mb/d (some 180 kb/d less than our previous report) and by 1.4% in 2009 to 19.1 mb/d (about 60 kb/d less than previously anticipated).

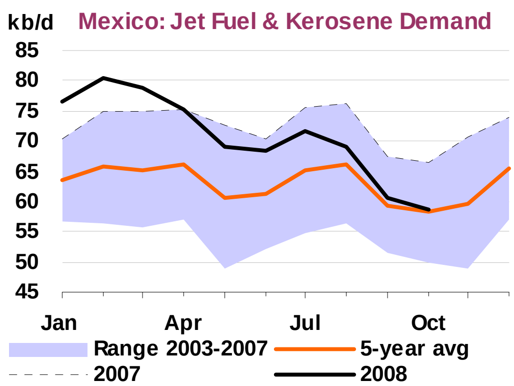




Sources: US FHWA, EIA

As noted earlier, **Mexican** oil product demand – which had so far proved more resilient than that of its North American peers – fell sharply (-4.3% year-on-year) in October, according to preliminary data. The contraction is largely driven by the structural decline in residual fuel oil use (-31.8% year-on-year), which is increasingly being replaced by natural gas. Nonetheless, there is some evidence that the economy has begun to slow down as a result of the woes in the US, thus denting consumer confidence. Indeed, gasoline demand grew by a paltry 1.8% in October, well below the monthly average from January to September (+5.2%). More significantly, perhaps, jet fuel/kerosene demand has fallen uninterruptedly since May, suggesting that air travel is weakening significantly. On these trends, total oil demand is set to stagnate in 2008 (-0.1% year-on-year), and contract by 2.1% to 2.1 mb/d in 2009, as the structural decline in LPG and residual fuel oil use is compounded by weaker transportation fuel demand.

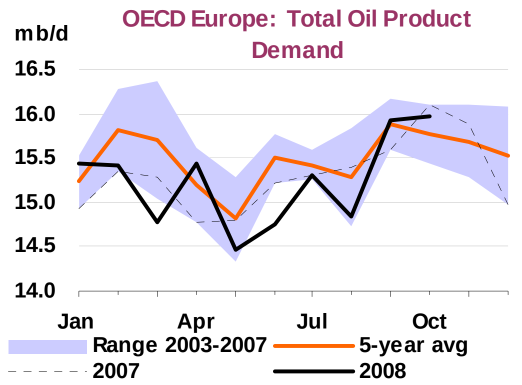


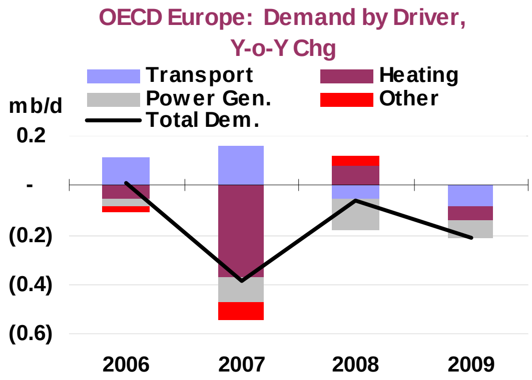


Looking further ahead, in mid December state-owned Pemex announced plans to introduce ethanol-blended gasoline in the country's three largest metropolitan areas – Guadalajara, Mexico City and Monterrey – over the next four years. Ethanol, to be purchased from domestic sugar cane producers, is intended to replace MTBE as a gasoline oxygenate. Pilot tests of the E6 fuel (containing 6% of ethanol) are set to begin in January 2009. Nevertheless, the volumes will be relatively modest. According to company estimates, ethanol demand in Mexico could average between 38 million and 180 million gallons/year by 2012 (roughly 2.5 kb/d and 11.7 kb/d, respectively).

Europe

Oil product demand in Europe fell by 0.9% year-on-year in October, according to preliminary inland delivery data. Continuous buoyant deliveries of heating oil (+8.9%) failed to offset losses in other product categories, notably gasoline (-5.1%), diesel (-1.4%), jet fuel/kerosene (-3.0%) and residual fuel oil (-4.6%). Revisions to September annual submissions, meanwhile, were negligible (-4 kb/d). Forecast demand in OECD Europe is thus largely unchanged at 15.2 mb/d in 2008 and 15.0 mb/d in 2009, implying a year-on-year decline of 0.4% and 1.4%, respectively, as the continent's economic recession deepens.



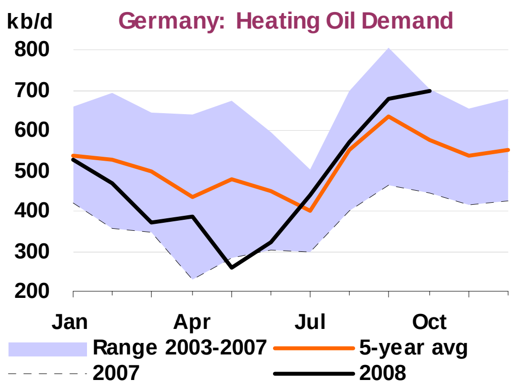


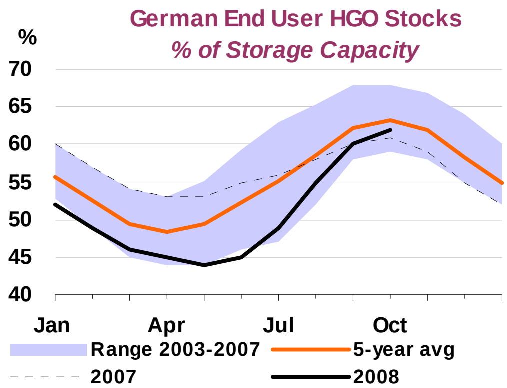
OECD Europe Demand by Product
(million barrels per day)

	2007	2008	3Q07	4Q07	1Q08	2Q08	Jul 08	Aug 08	Sep 08*	Latest month vs. Aug 08	Latest month vs. Sep 07
LPG & Ethane	0.95	0.97	0.85	0.98	1.06	0.98	0.89	0.82	0.89	0.07	0.07
Naphtha	1.17	1.14	1.13	1.20	1.23	1.07	0.99	1.17	1.06	-0.12	-0.07
Motor Gasoline	2.50	2.38	2.61	2.43	2.29	2.44	2.49	2.38	2.46	0.07	-0.06
Jet & Kerosene	1.31	1.31	1.42	1.30	1.25	1.31	1.42	1.39	1.40	0.00	0.00
Gas/Diesel Oil	6.10	6.25	6.04	6.49	6.30	5.93	6.14	5.85	6.75	0.90	0.44
Residual Fuel Oil	1.75	1.61	1.70	1.76	1.67	1.51	1.60	1.54	1.65	0.11	-0.07
Other Products	1.52	1.57	1.68	1.50	1.41	1.63	1.77	1.68	1.72	0.05	0.04
Total Products	**15.30**	**15.23**	**15.42**	**15.65**	**15.20**	**14.88**	**15.30**	**14.84**	**15.93**	**1.09**	**0.34**

* Latest official OECD submissions (MOS)

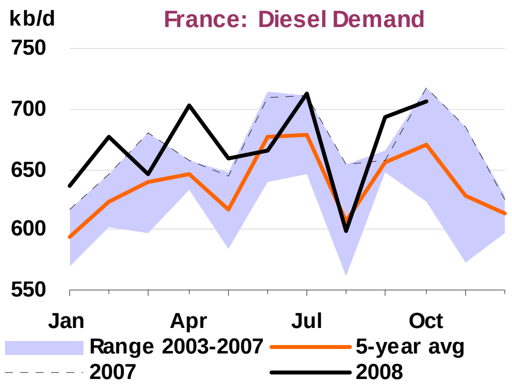
Inland deliveries in **Germany** soared by 9.2% year-on-year in October, according to preliminary estimates, given the continued firmness of heating oil (+57.4%) and diesel (+1.9%) deliveries. Heating oil consumer stocks averaged 62% of capacity by end-October, slightly higher when compared with both the previous month (60%) and the previous year (61% in October 2007). The heating oil stock build began in July, possibly on the realisation that household inventories had dwindled to levels that could prove insufficient to withstand a cold winter. More significantly, the trend accelerated sharply over the past three months, given the dramatic fall in German heating oil prices (about -35% from their July peak). It should be noted, though, that Germany is already in recession (if defined as a GDP contraction over two successive quarters), and as such oil demand excluding heating oil is bound to stagnate or even weaken in the months ahead.

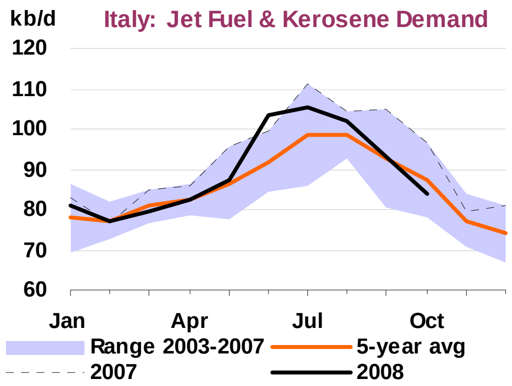




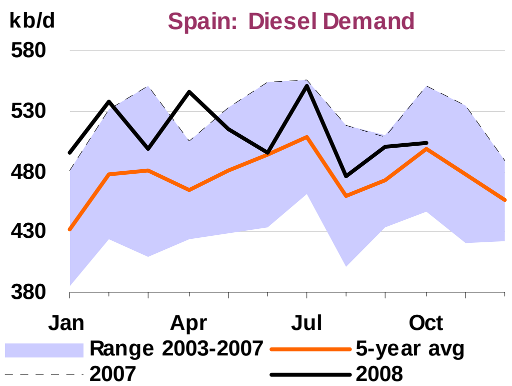
In **France**, by contrast, total oil demand fell by 4.2% year-on-year in October, weighed down by weaker deliveries of gasoline (-9.1%) and distillates (-3.6%). In particular, the contraction in diesel demand

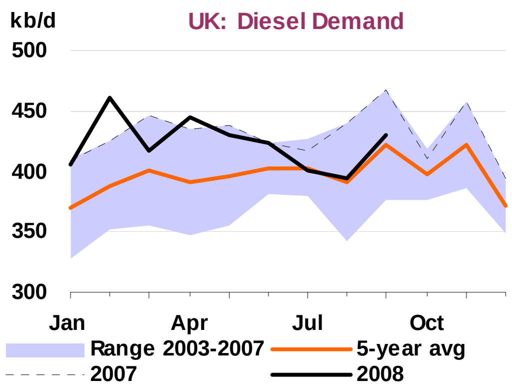
(-1.6%) may be indicative of gradually slowing economic activity (even though in 3Q08 France technically escaped recession, contrary to Europe's other large economies). In **Italy**, indeed, the economic contraction is well underway, with total oil product deliveries plummeting by 5.0% year-on-year in October. Diesel demand, which accounts for roughly 35% of the total, shrank by 1.7%. It is also worth noting that Italian jet fuel/kerosene deliveries dived by 13.2%, possibly reflecting the woes of state-owned carrier Alitalia, which is on the brink of bankruptcy.





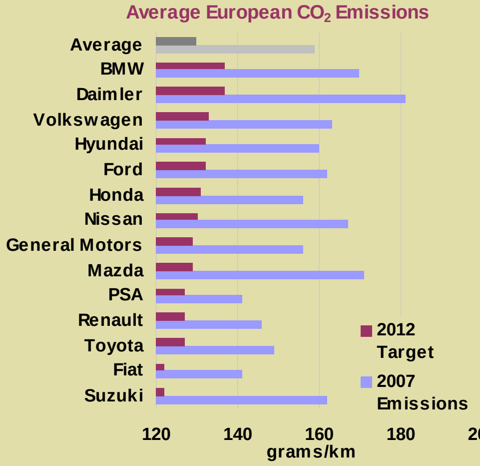
In **Spain**, which is also already in recession, oil demand plummeted by 7.1% year-on-year in October. All product categories declined sharply, most notably jet fuel/kerosene (-11.4%) and diesel (-8.6%). In the **United Kingdom** the oil demand picture is broadly similar (i.e., falling amid a contracting economy). However, deliveries only fell by 0.6% year-on-year in September, the last month for which data are available – after plunging by 10.2% in August. As elsewhere, diesel demand deliveries – a barometer of economic activity – shrank by 7.8% in September, but remain slightly above the five-year average.

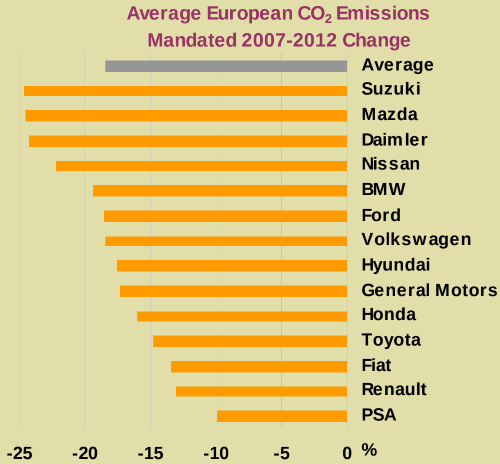




Europe's Car Industry: Fewer Emissions … and Lower Sales?

In early December, the European Union's authorities reached an agreement on the new legislation governing the amount of allowed CO_2 emissions from vehicles. The new text – formally approved by the representatives of the 27 countries on 3 December and due to be passed by the Euro deputies on 17 December – aims at reducing European emissions to 130 grams/kilometre by 2012, from 158 g/km in 2007, and sets sliding penalties for those manufacturers that fail to meet their target.

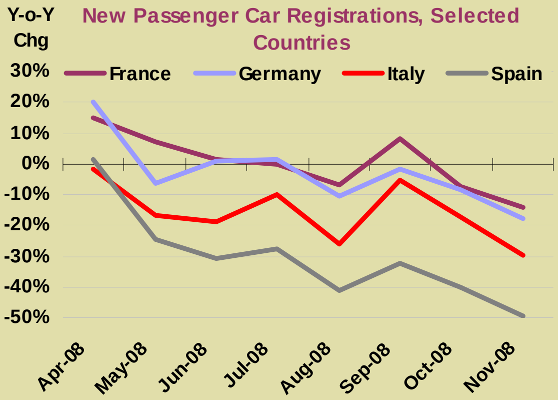




There are, however, several important caveats to the new legislation. First, in order to make the collective effort more palatable, the 2012 targets will be applied to only 65% of new vehicle production; this share will gradually increase over the following three years (75% in 2013, 80% in 2014 and 100% in 2015). Second, even though the targets for CO_2 emission reductions seem particularly ambitious in the case of manufacturers of larger vehicles, the brunt of the adjustment will actually fall upon those specialised in smaller cars, which will be required to achieve further emission reductions in order to attain a European *average* of 130 g/km.

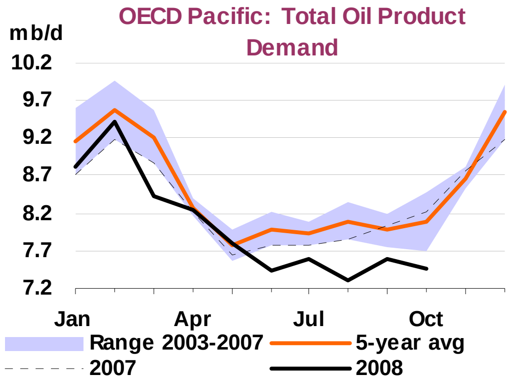
Nevertheless, the overall European vehicle fleet is poised to gradually become more efficient, so growth in transportation fuels demand should further slow in the medium to long term, even as the region's economy recovers. In addition, barring a major technological improvement, these efficiency gains will probably be met by diesel engines, which emit less CO_2 than gasoline engines – i.e., the 'dieselisation' of the European vehicle fleet should continue, despite the saturation in some large markets, posing significant challenges to refiners.

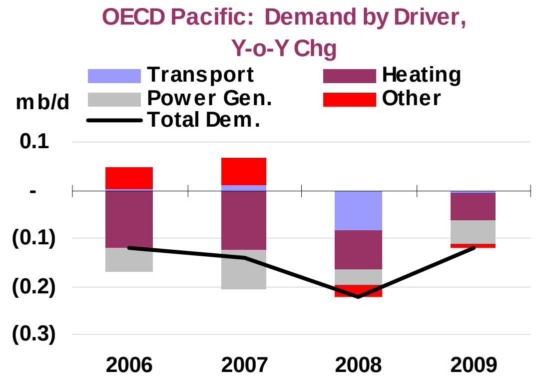
A most pressing question in the short term is whether European car manufacturers (as their US peers) can endure the current economic downturn. Sales of new vehicles in key domestic markets have declined since 2Q08, aside from a brief rebound in July and September. Being exposed to virtually every facet of the unfolding financial and economic crisis – from less access to credit to falling consumer confidence – all European carmakers have been forced to implement temporary plant closures, and some have even begun to cut jobs. The downturn has become a serious political issue, since job losses could cascade down through the supply chain, from the manufacturing sites to parts suppliers and dealerships. According to some estimates, the European car industry accounts for 27% of global vehicle production, with 2.3 million direct jobs and 10 million indirect jobs in related industries. As such, several countries, such as France, are working on rescue packages for the industry. In others, such as Belgium, dealers are attempting to dispose of costly stocks by offering two vehicles for the price of one.



Pacific

According to preliminary data, oil product demand in the OECD Pacific plunged by 9.1% year-on-year in October, given continued weakness in Japanese demand, compounded by a larger-than-expected contraction in Korea. Contrary to previous months, downward revisions to September preliminary data were minimal (-30 kb/d). Oil demand in the Pacific is now seen averaging 8.1 mb/d in 2008 (-2.7% or -220 kb/d on a yearly basis) and 8.0 mb/d in 2009 (-1.5% or -120 kb/d). These prognoses are down in both years by about 90 kb/d on average when compared with our last report, given the worsening outlook for the regional economies, notably Japan.



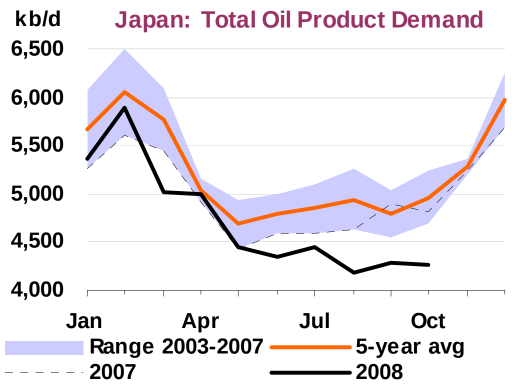


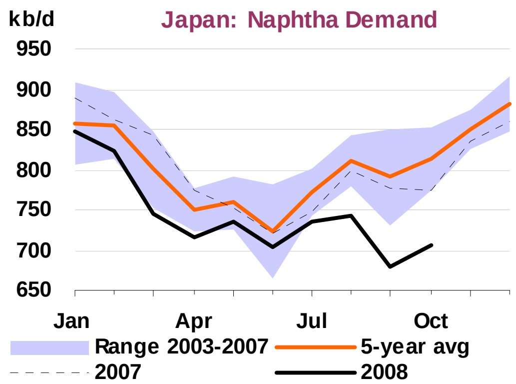
OECD Pacific Demand by Product
(million barrels per day)

	2007	2008	3Q07	4Q07	1Q08	2Q08	Jul 08	Aug 08	Sep 08*	Latest month vs. Aug 08	Latest month vs. Sep 07
LPG & Ethane	0.96	0.97	0.89	0.99	1.01	0.97	0.93	0.90	0.93	0.03	0.11
Naphtha	1.65	1.62	1.63	1.66	1.69	1.55	1.61	1.62	1.55	-0.07	-0.05
Motor Gasoline	1.57	1.52	1.64	1.57	1.48	1.55	1.51	1.49	1.53	0.04	-0.11
Jet & Kerosene	0.93	0.89	0.66	1.04	1.24	0.72	0.62	0.55	0.63	0.09	-0.10
Gas/Diesel Oil	1.80	1.72	1.68	1.87	1.80	1.72	1.59	1.47	1.66	0.19	-0.10
Residual Fuel Oil	0.96	0.92	0.92	1.01	1.06	0.89	0.86	0.83	0.86	0.02	-0.09
Other Products	0.48	0.49	0.46	0.56	0.59	0.42	0.48	0.45	0.42	-0.03	-0.11
Total Products	**8.35**	**8.12**	**7.89**	**8.72**	**8.87**	**7.82**	**7.60**	**7.31**	**7.58**	**0.27**	**-0.46**

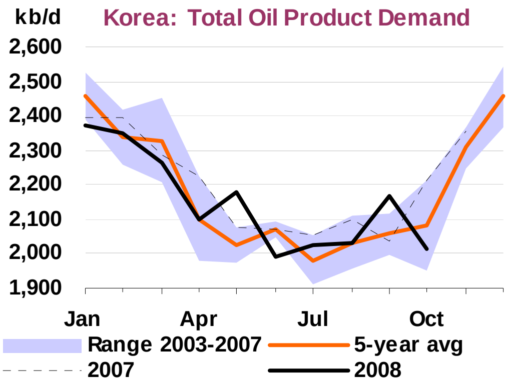
* Latest official OECD submissions (MOS)

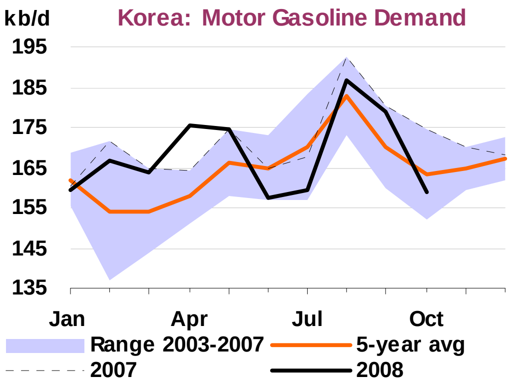
For the second month in a row, oil demand in **Japan** tumbled by double-digit figures (-11.5% year-on-year in October, after -12.3% in September). Demand has declined uninterruptedly since June, with deliveries falling across all product categories bar LPG in October, according to preliminary figures. The woes of the Japanese economy are indeed compounding the country's structural oil demand decline. Since the summer, demand for those products that are closely related to economic activity has been subdued, particularly naphtha (-8.8% year-on-year) and diesel (-8.0%). Oil demand is thus expected to contract by 4.2% to 4.8 mb/d in 2008, and by 2.8% to 4.7 mb/d in 2009.





Preliminary data indicate that oil demand in **Korea** contracted by 9.0% year-on-year in October, with lower deliveries for all product categories bar naphtha. As elsewhere in the OECD, the financial panic that gripped the markets that month took a toll on economic activity and consumer confidence. Gasoline demand, for example, had been relatively buoyant during the previous two months, before diving in October (-9.0%). Only demand for naphtha, roughly 40% of total demand, recorded strong growth (+9.0%), as the fall in international oil prices helped offset the effects of the won depreciation versus the dollar (which since early 2008 had rendered feedstock naphtha relatively expensive). Nevertheless, Korea's solid fiscal position, abundant foreign reserves (sufficient to cover short-term liabilities, despite their recent fall) and relatively limited export exposure suggest that the country is better equipped to weather the financial turmoil than most of its OECD and Asian peers. As such, oil demand should contract by only 1.0% in 2008, and remain flat in 2009 at 2.2 mb/d.

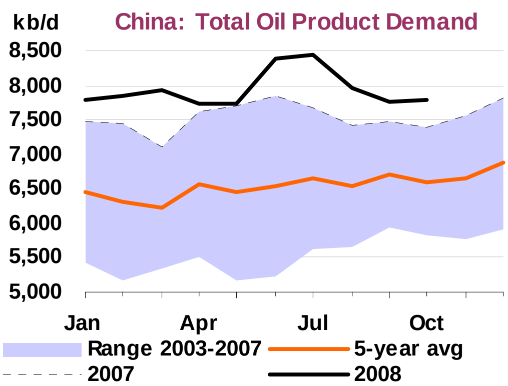


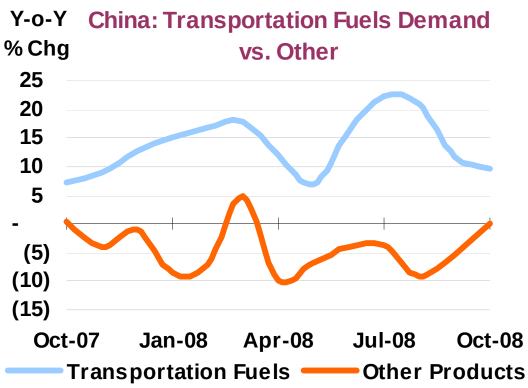


Non-OECD

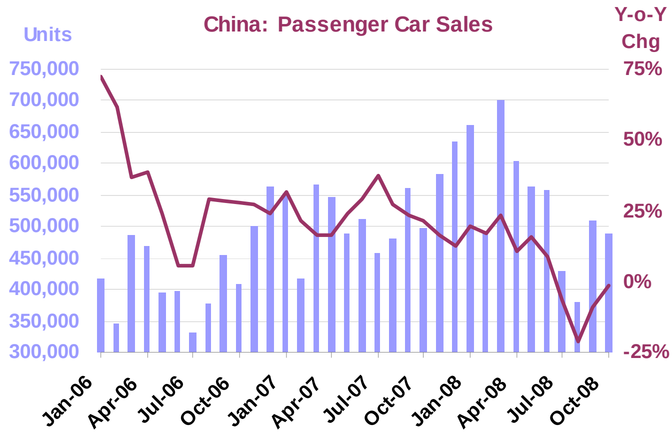
China

Preliminary data indicate that China's apparent demand (refinery output plus net oil product imports, adjusted for fuel oil, direct crude burning and stock changes) rose by an estimated 5.4% year-on-year in October. Despite the often-repeated claims that Chinese oil product demand was inevitably bound to plunge after the Olympics, given the global economic deceleration and allegedly plentiful stocks, growth was notably higher than in September (+4.1%). Moreover, even though net oil product imports have continued to fall (-34.4% month-on-month), both net crude imports and refinery output actually increased when compared with September (+6.1% and +1.7%, respectively). Deliveries of two key products – gasoline and gasoil – also rose (+7.7% and +12.2%), suggesting that industrial activity, freight and road travel are holding despite concerns about the country's economic outlook.





Yet the Chinese economy is indeed slowing down, according to diverse indicators on manufacturing, power generation, retail sales and trade. For example, growth in passenger car sales has virtually stalled since last summer, after rising at double-digit rates for several years in a row. Jet fuel/kerosene deliveries, meanwhile, fell by 4.2% in October, despite a week-long holiday (when coastal migrant workers traditionally return home). Moreover, the pace of growth of both gasoline and gasoil demand has slowed, although the relative weakness in domestic distillate demand could also be partially related to smuggling from Hong Kong. Over the past two months, as international prices have fallen, the so-called 'red diesel' available to local industrial and shipping users in the island has become cheaper than in mainland China (where retail prices are currently about $0.77 per litre), thus reportedly triggering a wave of smuggling into southern China.



Aside from jet fuel/kerosene, only two other products showed year-on-year contractions in October: LPG (-8.6%), which is structurally declining as natural gas makes further inroads in urban areas with the development of pipeline networks, and residual fuel oil (-22.9%), partly because of lower electricity generation and limited use by 'teapot' refineries. Power generation has fallen on a yearly basis for the second month in a row, suggesting that manufacturing and industrial activity is indeed slowing. Moreover, the price of imported Russian M-100 fuel oil – the feedstock of choice for the teapots – was still too high in October relative to domestic wholesale prices. The slide in international oil prices over the past several weeks could thus augur a rebound in fuel oil use if the economics of teapot refineries becomes attractive again – provided, of course, that domestic retail prices remain high enough (see text box below) and that domestic demand does not plunge. Most teapots are based in two provinces – Shandong and Guangdong – where industrial and export-oriented activities are reportedly slowing down. However, Shandong teapots are arguably better equipped to respond to weaker oil product demand, having access to crude, featuring more sophisticated refining capacity and enjoying local government support. By contrast, their peers in Guangdong typically have simple refining units, are heavily dependent on residue and are virtually ignored by the provincial authorities.

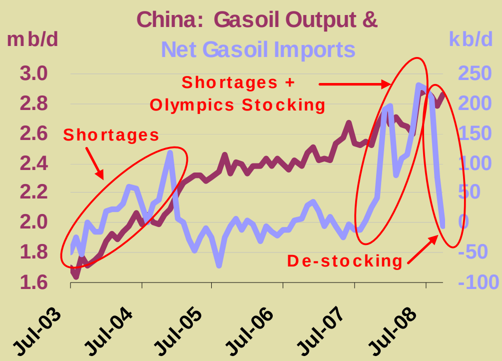
China: Demand by Product
(thousand barrels per day)

	Demand			Annual Chg (kb/d)		Annual Chg (%)	
	2007	2008	2009	2008	2009	2008	2009
LPG & Ethane	669	615	625	-54	10	-8.0	1.6
Naphtha	812	806	870	-6	64	-0.7	7.9
Motor Gasoline	1,257	1,453	1,515	196	62	15.6	4.3
Jet & Kerosene	280	296	314	16	18	5.8	6.1
Gas/Diesel Oil	2,576	2,907	3,000	331	92	12.8	3.2
Residual Fuel Oil	744	600	639	-144	39	-19.4	6.6
Other Products	1,204	1,266	1,262	62	-4	5.2	-0.3
Total Products	**7,542**	**7,943**	**8,225**	**402**	**282**	**5.3**	**3.5**

Overall, our Chinese oil demand prognoses are broadly unchanged versus the previous report (which featured significant downward revisions on the back of lower IMF assumptions). Oil demand is expected to rise by 5.3% to 7.9 mb/d in 2008 and by 3.5% to 8.2 mb/d in 2009. Nevertheless, we will continue to monitor China's economic and pricing policy developments. If the country's slowdown is more pronounced than currently anticipated, this could eventually prompt further downward revisions to our oil demand forecast.

A Price Reform on the Cards?

China's policy of capping domestic gasoline and gasoil retail prices helped insulate domestic users as international oil prices skyrocketed over the first half of this year. It also created supply shortages by rendering refining and marketing operations unprofitable, thus obliging the government to subsidise state-owned refiners in order to guarantee sufficient supplies, notably in the run-up to last summer's Olympics. Given the recent fall in international oil prices, this situation has been reversed: average domestic retail prices are now much higher than international benchmarks (about $0.70/litre for gasoline and $0.73/litre for gasoil). This helps explain the rise in both refining activity and in reported product smuggling into the country.



The fall in international oil prices also prompted a renewed wave of talk about an impending reform to China's administered price regime. According to some observers, such rumours actually contributed to the fall in gasoline and gasoil imports over the past two months, as refiners increased crude runs and curbed product stocks in anticipation of a retail price cut of as much as 20%. In the meantime, some consumers have loudly protested against the stickiness of domestic prices (for example, taxi drivers in Sichuan province's Chongqing, one the country's largest and most populous municipalities).

Although changes have often been anticipated in the past, this time around such expectations are arguably better grounded. On 5 December, the government released a joint reform proposal that will serve as a basis for public hearings, to be conducted until 12 December; the finalised proposal is to be implemented on 1 January 2009.

The draft proposal is sketchy, but the reform should broadly maintain the state's oversight. Price adjustments may become more frequent (the last one occurred in June), possibly monthly – especially if a 'refinery gate' price is established, based on a basket of crudes (Brent, Dubai and Minas) to which transportation costs and a 'reasonable' margin (around 4%) would be added. This would replace the current mechanism for setting the so-called domestic 'guidance' retail prices, which are theoretically based on product prices prevailing in New York, Rotterdam and Singapore. It is unclear, though, whether the retail tolerance band around guidance prices (currently +/-8%) may be broadened, or whether these may vary according to market conditions. Indeed, if the basket were to exceed a certain level (reportedly $80/bbl), the government will exercise 'appropriate control' over domestic prices – i.e., reimpose a cap.

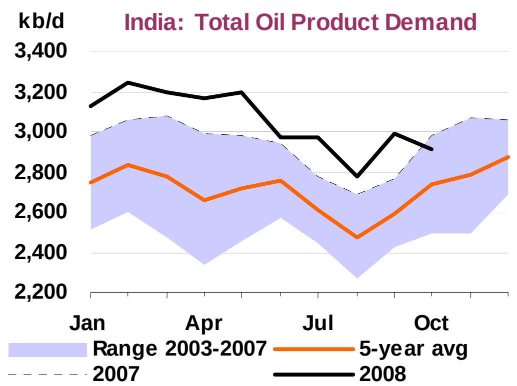
In addition, a much-touted fuel tax, which would be collected by the central government and replace the road tolls may finally be introduced. The fuel tax, by definition, would be levied on all fuel users (not just road users). However, it remains to be seen whether Chinese farmers and the military – two key constituencies currently exempted from paying road tolls – would accept the new tax (expected at roughly $0.13/litre on average). Their objections could be overcome if they were to be subsidised, which seems likely (other sectors will also allegedly qualify for subsidies). Furthermore, provincial governments, which collect the road tolls, would lose a sizable income stream, unless the central government were to share fuel tax revenues – a possibility that is reportedly being considered.

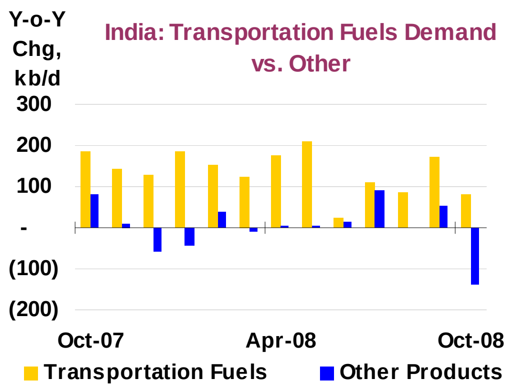
A reform based on international benchmarks would probably engineer an overall domestic price cut, even if a fuel tax is levied, given the extent to which international crude prices have fallen. This could conceivably unleash pent-up demand, notably for transportation fuels. Paradoxically, however, if the reform were to be delayed (and assuming that the government succeeded in stabilising GDP growth at around 8-8.5% in 2009 with the help of fiscal and monetary measures), the current price differential could also boost demand. Expectations of sustained economic growth would arguably help relaunch vehicle sales, while high domestic prices would boost supplies. Some answers to this Chinese riddle are likely to come over the next few weeks; we may then re-examine our outlook for the country's oil demand.

Other Non-OECD

According to preliminary data, **India's** oil product sales – a proxy of demand – contracted by 2.0% year-on-year in October, for the first time since December 2005. Although it would be tempting to ascribe the fall to the global financial turmoil and to slowing industrial output, as some observers have claimed, a closer examination suggests that the picture is less clear cut. The fall is largely related to a contraction in four product categories: 'other products', residual fuel, naphtha and LPG, in that order. The first category is notoriously volatile, and is often significantly revised; the latter three, meanwhile, are certainly related to economic activity but also to interfuel substitution and seasonal factors. Natural gas can replace fuel oil for power generation, as well as naphtha and LPG for fertiliser and petrochemical production. In fact, naphtha has reportedly become less available despite falling prices, since refiners have been diverting it to the export market, obliging petrochemical companies to purchase more LNG.

By contrast, both gasoline and gasoil, which account for over half of Indian oil demand, continue to post significant gains (+10.6% and +6.3% year-on-year, respectively). It should be noted that gasoil's relatively modest growth in October (compared with +17.2% in September) was largely due to a shift of the Diwali holidays (which fell in November last year). Overall, the outlook for India's oil demand is marginally lowered compared with our last report. Total demand is expected to average 3.1 mb/d in 2008 (+4.2% on a yearly basis) and 3.2 mb/d in 2009 (+4.0%).





The Indian government decided to lower domestic end-user prices on 5 December – with gasoline and gasoil prices falling by roughly 10% and 6%, respectively. The measure was somewhat surprising, given the government's earlier reluctance to implement a cut despite falling oil prices – presumably to allow state-owned oil companies to recoup some of the substantial losses they had incurred up until 3Q08 as a result of domestic retail caps amid rising international oil prices. Indeed, previous announcements that retail prices would be slashed if oil prices fell below a certain level had been ignored. When oil reached $67/bbl (the initial threshold), the rupee's depreciation (about 25% since early 2008) was invoked to postpone a cut. When oil fell below $61/bbl (the revised threshold), the government-cited regulations forbidding the introduction of policies that could influence voters after an election date has been set. As such, any adjustment to domestic retail prices would not be implemented before 25 December (a series of state polls that began early this month will be completed the day before).

The government presented the cuts as part of a fiscal and monetary package aimed at stimulating the country's economy amid the ongoing global financial turmoil. Moreover, India's Electoral Commission ruled in early December that the government had not violated campaign laws by announcing forthcoming price reductions, as the opposition Bharatiya Janata Party (BJP) had contented. Therefore, the new retail prices will stand (fuel prices are a particularly sensitive issue in India, and as such can have a substantial influence upon electoral results). In terms of oil demand, however, the retail price cuts are unlikely to have a substantial impact, since India's gasoline and gasoil demand is largely price-inelastic.

Another side-effect of the plunge of international oil prices has been the resumption of retailing operations by India's three private oil companies. Reliance Industries, which had closed all of its 1,432 service stations in March 2008 as the combination of rising crude prices and capped domestic product prices led to huge losses, has reportedly sought government approval to reopen most of them. Essar Oil, which had restricted operations to only 100 out of its 1,250 outlets, is also intent to reactivate its entire network by early 2009. Finally, Shell India, which has abandoned its expansion plans, may seek to increase its retail network beyond the 50 stations it currently owns.

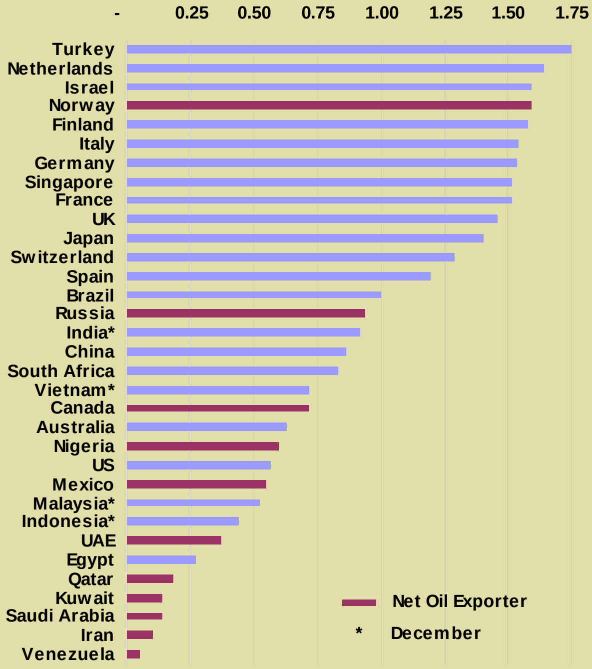
Renewed Signs of Life in Administered Price Regimes?

The upward retail price adjustments several Asian countries in the run-up of international oil prices during the first half of this year led many observers to conclude that administered price regimes were bound to become a relic of the past. Subsidising end-user prices was not only inefficient – fuelling excessive oil demand and thus further feeding the price rise – but also extremely costly – the fiscal burden had indeed become untenable for most governments in the region earlier this year, forcing them to hike domestic end-user prices despite inflationary concerns.

However, the dramatic decline in oil prices over the past few months has not given way to fully market-based price movements, as many had hoped. In fact, several governments in the region have taken advantage of lower oil prices to reintroduce some degree of price controls – as these have not only become more affordable but also present undeniable political advantages. Malaysia and Indonesia, two of the region's largest consumers after China and India, are a case in point. The retail price cuts will arguably help to temper the negative effects of the global financial turmoil upon their domestic economies, but will also entail a significant fiscal cost.

Malaysia has gradually cut the price of gasoline since last summer (-5.6% in August, -3.1% in September, -6.1% in October, -7.0% in November and -5.0% in early December). This has partially reversed the massive June hike (+41%), which resulted in mass street protests and widespread calls for the government's resignation. The country's gasoline price currently stands on the low side of the international spectrum, at about $0.52/litre. Nevertheless, the government is actually collecting fuel sales taxes for the first time in many months, but these revenues will arguably be insufficient to recoup the massive subsidy cost incurred in 1H08 (estimated at about $15 billion, equivalent to over a third of the government's budget).

Retail Gasoline Prices, October/November 2008
Selected Countries (US$/litre)



Indonesia, meanwhile, has gone a step further. In early December, the government cut the retail price of gasoline to $0.44/litre (from $0.55/bbl in early November), finally bowing to political pressure – Indonesia is due to hold a presidential election in 2009. With such a move, the government has partially reversed May's 28% hike, which had sparked street protests; Indonesia features once again the lowest gasoline price in Asia (the prices of subsidised diesel and kerosene remain unchanged, but they are likely to be lowered as well). Furthermore, contrary to Malaysia, Indonesia is still footing a substantial subsidy cost despite lower international prices; the subsidy for this year, which covers gasoline, gasoil and cooking kerosene, is estimated to total some $14 billion.