

OIL AND GAS SECTOR

CURRENT SITUATION

The price of Brent crude oil rose in the first half of 2019 and reached its highest annual level in the middle of May 74.69 USD/bbl. However, prices fell in the second half of 2019, both due to the weakening of the global economy and the oil demand decrease as an outcome of the trade tensions between the USA and China. Due to the decision of OPEC and non-OPEC countries to balance the global market by adjusting production, oil prices continued to rise in December. Following the interim trade agreement between the US and China, prices rose further in the second half of December 2019. The average price of crude oil compared to the annual average fell in 2019, so Brent oil ended the year with an average price of 64.20 USD/bbl, which is 7.10 USD lower compared to 2018.

According to the data of the Energy Agency of the Republic of Serbia, the total consumption of crude oil and semi-finished products from domestic production, imports and stocks in 2019 was about 3.373 million tons, which is about 12% less than in 2018. In 2019, about 0.859 million tons of crude oil was produced (25.47% of total consumption), and about 2.514 million tons (74.53%) was provided from imports.

The total consumption of motor fuels in 2019 was about 2.46 million tons, which is 4.6% more than in the previous 2018. In the structure of motor fuel consumption, gasoline participated with 17.4%, gas oils with 75.6%, and LPG - with 7.0%. Total gasoline consumption was increased by 2%, compared to 2018, consumption of gas oils - Euro diesel and gas oil 0.1 is higher by 6.5%, consumption of extra light Euro L gas oil is higher by 2.2%, while LPG consumption, including autogas, decreased by as much as 6.6%.

The increase in the consumption of motor fuels was also influenced by the decline in the unintended import of base oils and its illegal blending with diesel fuel, which was practically eliminated in 2019.

It should be noted that LPG is still under pressure from fiscal duties, which are among the highest in the region - with the exception of Austria and Hungary.

In 2018, the construction of a deep processing plant with delayed coking technology began at the Oil Refinery in Pancevo, which continued in 2019 as well. After the completion of the construction and commissioning of this

plant, the share of oil derivatives that are better valorized on the market will be higher, reaching the quality of all produced motor and energy fuels in accordance with Directive (EU) 2016/802 on reduction in the Sulphur content of certain liquid fuels.

The total annual production of natural gas, delivered to the country's transport distribution system in 2019 was 293 million m³, which is 12.5% less than the production in the previous year. In 2019, a total of 2,609 million m³ was available from import, domestic production and underground storage, and 2,325 million m³ of natural gas was consumed, 8% less than in 2018. Most of the natural gas was provided by imports from the Russian Federation in the amount of 2,197 million m³, while domestic production of 293 million m³ could meet only 12.6% of needs.

The Ministry of Trade, Tourism and Telecommunications announced that in 2019, the Market Inspection performed 4,059 controls at energy entities and 10,547 samples were taken, of which 6,872 for marking and 3,675 samples for monitoring the quality of oil products. 132 samples with reduced marker concentration and 51 samples deviating in quality parameters were identified. Trade of 43,701 liters of Euro diesel, 6,218 liters of BMB 95 and 6,258 liters of LPG with a total value of 8,943,876.00 dinars was prohibited.

By April 30, 2020, the Market Inspection also performed 464 controls at energy companies and took 1,796 samples (of which 1,054 for marking and 742 samples for monitoring) of the quality of oil products. There were 18 samples with reduced marker concentration, while 20 samples deviated in quality parameters. Trade of 27,253 liters of Euro diesel in the value of 4,451,978.00 dinars was prohibited.

COVID-19

The outbreak and spread of the COVID-19 pandemic, as well as the restrictions on movement that followed, contributed to a sharp drop in oil demand. Total demand fell by almost 5 percent in the first quarter of 2020, and the decline in the second quarter of 2020 is projected to be about 20 percent. The International Energy Agency has estimated global demand in 2020 at 91.7 million barrels per day (MMb/d), but this estimate is subject to further change due to market uncertainty and the possible economic consequences of the COVID-19 pandemic. Restrictive measures by the states affected the flow of both people and goods, which resulted in a reduction in all modes of transport (which accounts for

about two-thirds of the demand for oil), and thus the need for all types of oil products.

The unsuccessful meeting between OPEC and Russia in early March 2020 on the topic of reducing crude oil production is also one of the causes of the drop in the prices, due to a following sharp increase in production in some OPEC countries. With oil demand drop, world oil stocks rose sharply and storage capacities were insufficient. In March, oil prices recorded the biggest one-month drop. The price of European Brent oil fell by 79% between January 22, when the first human-to-human transmission of the COVID-19 virus was registered, and its lowest threshold on April 21 - 13.24 USD/bbl. Since then, the price of Brent oil has gradually risen, but for now not exceeding the price of about \$ 45 per barrel. The economic consequences of the pandemic could be long-lasting, which would be a particular problem for energy exporters, but initiatives in the form of OPEC + agreement have made a major contribution to restoring stability to the market. In order to further accelerate the balancing of the market, OPEC+ decided in early June to extend the production reduction of almost 10 MMB/d until the end of July. If trends in production continue and demand recovers, the market will have a much more stable basis.

Global developments have inevitably affected the domestic oil market. The big drop in oil prices, as well as the drastic reduction in consumption, and thus the drop in income, had a big impact on oil companies. Energy entities have been brought into an unenviable situation and faced a number of challenges, and among them the greatest was redistribution of funds and focus on activities that are crucial for business - maintaining stable production, processing and distribution of oil products, while preserving the interests of all stakeholders.

According to available data, consumption of motor fuels in Republic of Serbia decreased in the first half of 2020 by -9.7% when compared with the same time period of previous year, being 111,239 tons lower. Partial decrease in consumption of -0.9% was registered in the first quarter, while it further declined by -17.3% in the second quarter due to the imposed restrictions on movement. Main decrease in absolute quantities was registered in the consumption of diesel fuels – during the first half of 2020 it was 67,610 tons lower, while the consumption of gasoline fell by 23,367 tons. Since the restrictive measures on movement were lifted in the second quarter, a gradual recovery of the market is expected in the upcoming period.

POSITIVE DEVELOPMENTS

During 2019, the Government of the Republic of Serbia adopted a new Action Plan for the implementation of the National Program for the Suppression of the Gray Economy for the period 2019-2020, which confirmed the interest of state authorities in continuing to improve the control of the system of illegal trade, which is of importance for business in the Oil and gas sector. In addition, the state authorities continued to effectively control the non-purpose import and blending of base oils with diesel fuel in accordance with the adopted Flowchart for inspection control of this area, and in this way continuously controlling this market segment.

In addition, the Directorate for Administration of Seized Assets has actively started to resolve the status of confiscated oil products stored with energy entities.

REMAINING ISSUES

Even if the control of illegal trade in oil products in the country is maintained at a satisfactory level, it is necessary to keep in mind that the relaxation of control measures can increase the scope of illegal activities in a relatively short time.

Systematic control of oil products imported for re-export has not been established, even though the state authorities have considered this issue in the past period.

Systematic resolution of the issue of storage of temporarily seized derivatives is necessary in order to free up the resources of inspection bodies in order to increase the scope and efficiency of market control.

The process of forming operational reserves of oil products has also not started, due to the lack of by-laws.

Obtaining energy licenses for legalized energy facilities is still a complex procedure due to non-harmonized Law on Legalization of Facilities and the Energy Law.

New regulations on the production and trade of explosives and other hazardous substances have also not been adopted in the past period.

It is possible to accelerate the process of modernization of business activities in the sector by more agile adoption of solutions in the field of digitalization.

FIC RECOMMENDATIONS

- DIGITALIZATION - prescribe the possibility of digitalization of fiscal receipts and their electronic delivery to customers buying goods and services, which would abolish the obligation of physical printing and delivery, and subsequent storage of fiscal receipts for control. (3)
- Timely conclude agreements between the Directorate for Administration of Seized Assets and energy entities on storage of confiscated oil products, by establishing and implementing an adequate procedure in the short term. (3)
- Enact by-laws necessary for the creation of operational reserves, in accordance with the Energy Law. (2)
- It is necessary to introduce control of oil products imported into the country for re-export through coordinated activities of relevant authorities, in view of abuses to which such goods declared for this purpose are subject. (1)
- Resolve the discrepancies in the Law on Legalization of Facilities and the Energy Law related to the documentation needed for the acquisition of energy licenses for legalized energy facilities. (1)
- Enact the Law on Explosive Substances, supported by related by-laws, all of which would define activities in the area of the manufacturing and trade of explosives and other hazardous substances. (1)