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IMO 2020: Preparing for Changing Demand and Slimmer Margins

by Michael Hinton

IMO 2020 is set to radically change the ecosystem of the world's refined products with dramatic effects for both marine fuel suppliers and consumers. Unprecedented shifts in supply and demand and logistical challenges will upend the oil and gas value chain's status quo when the International Maritime Organization's (IMO) planned bunker fuel regulation goes into effect on Jan. 1, 2020.

The maritime sector consumes 5 percent of the global demand for diesel and gas and accounts for 3 percent of global emissions. Ultimately, the IMO regulation plans to cut the industry's emissions in half by 2050. One of the first steps in meeting that goal is to reduce sulfur emissions by 80 percent by 2020.

Currently, the maritime sector accounts for 50 percent of the global fuel oil demand, totaling 4.3 million b/d. High-sulfur fuel oil currently comprises 3.1 million b/d of this demand. To date, the industry relies on only 1.2 million b/d of low-sulfur marine gas fuel and other distillates to fill the remaining gap.

Wood Mackenzie analysts recently predicted there isn't enough refining capacity for low-sulfur fuel to offset the 3.1 million barrels per day of dirtier fuel the marine industry will need to replace by the January 1 deadline. This lack of available supply will most certainly drive up prices for low-sulfur diesel and other distillates, while also increasing pressure for LNG use in shipping and demand for new scrubber installations.

THE IMPACT ON MARINE FUEL SUPPLIERS

With oil refineries unable to produce enough low-sulfur fuel to meet the increase in demand by 2020, the cost of diesel and other low-sulfur distillates like heating oil and jet fuel are already spiking. Higher gasoline prices could be another side effect of higher demand for light crude oil from shippers.

At the same time, demand for alternative bunker fuels will drive higher utilization of existing refining capacity, impacting costs and margins. Eventually, refineries will need to supplement the market by increasing refinery capacity for low-sulfur fuel oils further constricting margins.

An unprecedented crash in the value of high-sulfur fuel in the coming months will have significant effects. The International Energy Agency expects that demand will fall from 3.5 million to 1.4 million b/d leaving a 2 million b/d gap in demand and supply in a shrinking market.

As refiners and suppliers evaluate how to navigate volatility and constrained supplies, suppliers will need tools like commodity trading and risk management software with advanced analytics to understand the pricing implications for feedstock, plant, and capital investments.

THE IMPACT ON THE MARITIME INDUSTRY

While the IMO first announced the regulation in 2008, companies are just now scrambling to comply in the remaining eight months before they go into effect. While they'll face the same pricing volatility as suppliers, consumers looking to find alternatives to the increasingly expensive bunker fuel will likely install scrubbers to sustain the consumption of the cheaper high sulfur. However, scrubbers pose challenges due to limitation factors like high costs, manufacturing capacity, and a dearth of dry-dock space for installation over the next eight months.

This uncertainty and change may also force renegotiations of fuel oil contracts driving companies to evaluate their exposure to risk. The only way for consumers to adequately plan and understand their market position amid this volatility is to fully understand their bunker fuel optionality — the key to maintaining fuel costs in a competitive market.

PLANNING FOR CHANGE

While some debate whether or not IMO 2020 will be delayed, it will happen eventually. For both consumers and refiners to successfully navigate the coming changes, they'll need clear insights and enhanced portfolio visibility. This is where enterprise commodity trading and risk management (CTRM) software and advanced analytics can help companies mitigate risk.

Both refiners and consumers will need to rethink their fuel management strategy, which requires extensive analysis of complex data. While uncertainty during this market shift is inevitable, CTRM solutions, such as Allegro Horizon, can provide position visibility, risk management, controls, regulatory compliance, accounting, and clarity when buying, selling, and accounting for fuel oil in a changing market.

Volatility is inevitable, but advanced technology platforms can help protect margins, no matter how volatile the market becomes.

About the author: Michael Hinton is the Chief Strategy and Customer Officer for Allegro Development Corp. Michael is responsible for assisting the Executive team in defining overall corporate strategy while ensuring the corporate execution supports and remains aligned with that strategy. Also, Allegro's customer advocate throughout all aspects of the customer life-cycle.