

The IMO 2020 Scramble and beyond: tactical hurdles, strategic considerations

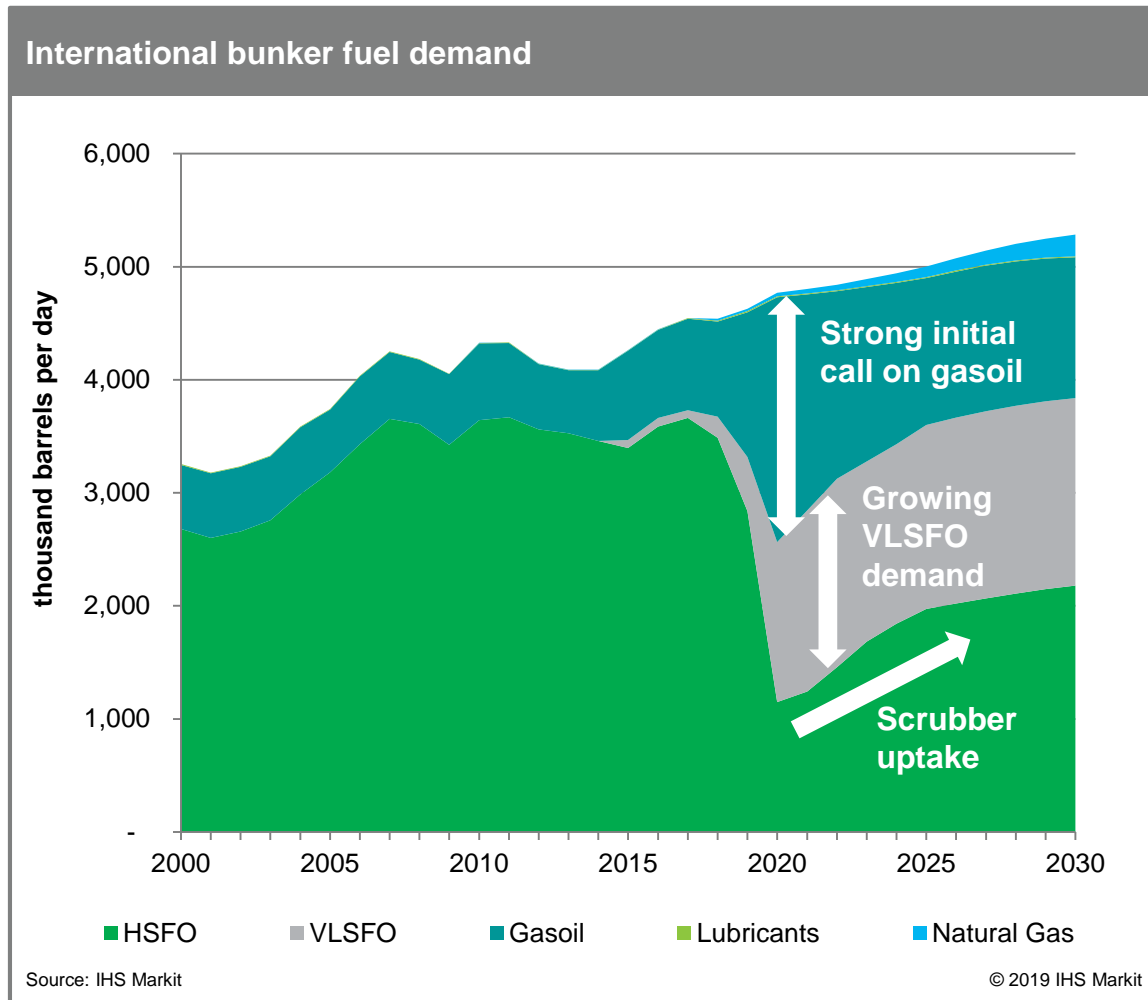
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The global ship fleet will need to adopt new fuel quality rules resulting in major disruption to the “bottom” of oil markets



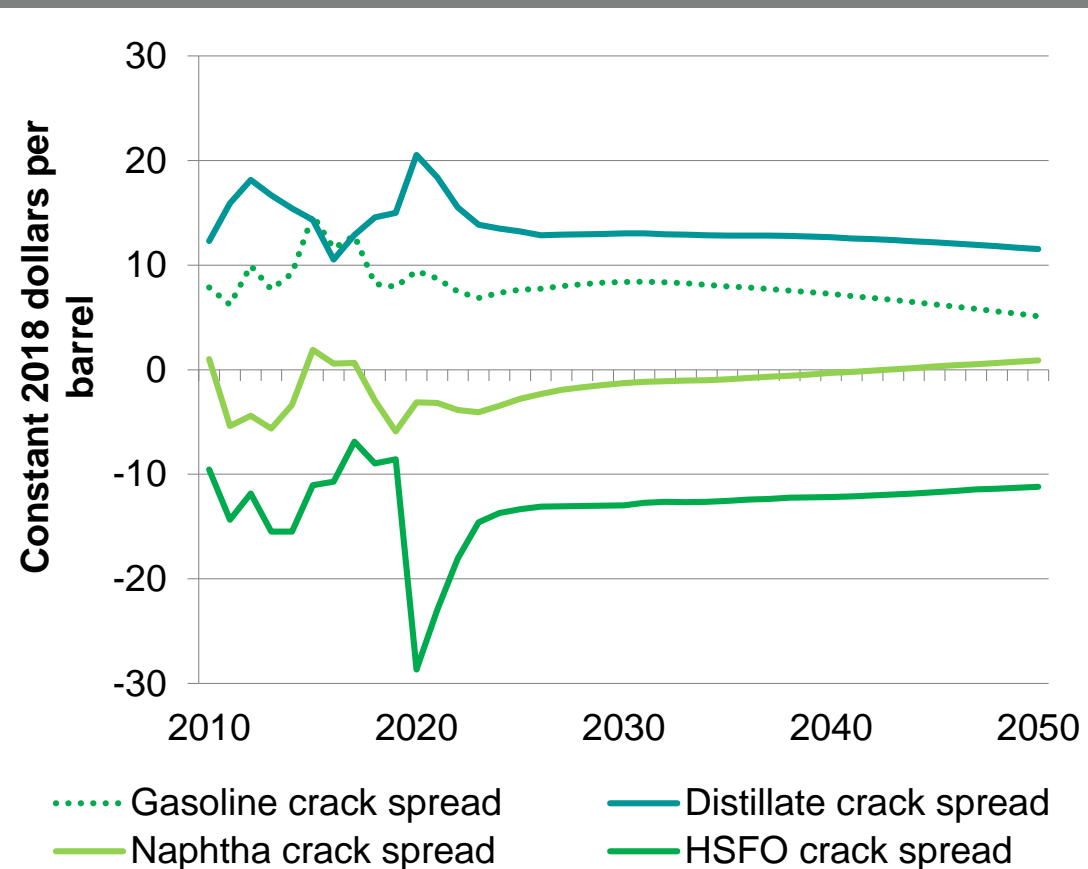
New 0.5%S formulations – straight-run, treated or blended VLSFOs – are projected to account for about 30% of total bunker fuel consumption in 2020



- The long-held status of 3.5%S fuel oil (HSFO) as the most consumed fuel in international bunker markets is ending
- Following the implementation of the global 0.5%S cap in January 2020 there will initially be a strong call on gasoil and MGO-type fuels
- However, gasoil supply constraints and inevitable price spikes mean that there is a need for a cheaper, alternative bunker fuel
- This will result in a heavy reliance on new, currently unknown and sometimes unproven 0.5%S bunker fuel formulations – Very Low Sulfur Fuel Oils (VLSFOs)
- IHSM projects that VLSFO will account for a ~30% share of bunker fuel consumption worldwide in 2020.

Distillate cracks to get an “IMO” boost while heavy products are penalised – but refinery additions should return spreads to historical levels by 2022

Global product crack spreads (Dated Brent Basis)

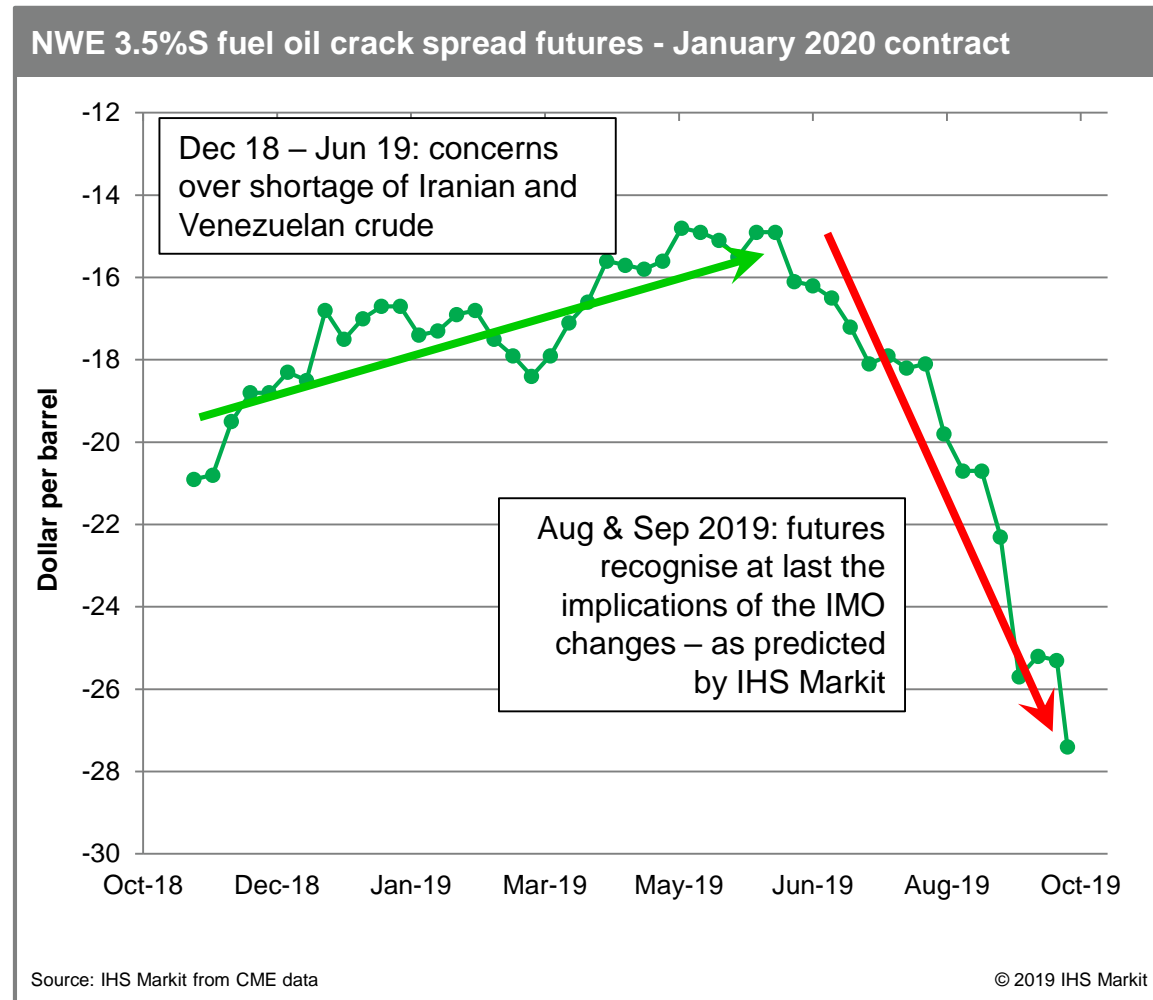


Source: IHS Markit

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- **Fuel oil cracks** will decline significantly in 2020 as the market struggles to clear. In subsequent years fuel oil cracks will recover with higher usage as bunker fuel following greater adoption of scrubbers by the shipping industry
- Additional support is likely to come from 0.9 MMb/d of coking and residue hydrocracking capacity additions in 2021-23
- **Gasoil/diesel cracks** will be boosted in 2020 by an estimated 1.2-MMb/d increase in marine gasoil demand during the implementation of IMO bunker fuel regulations
- These are likely to decline rapidly as a result of greater adoption of scrubbers and alternative VLSFO fuels by the shipping industry as well as refinery capacity additions – including 2 MMb/d of catalytic and hydrocracking in 2021-23 alone
- Longer term, gasoil cracks are expected to be broadly flat until the mid 2030s and experience a soft decline in the last decade of the forecast over declining demand. Naptha spreads are expected to benefit from steady petrochemical demand.

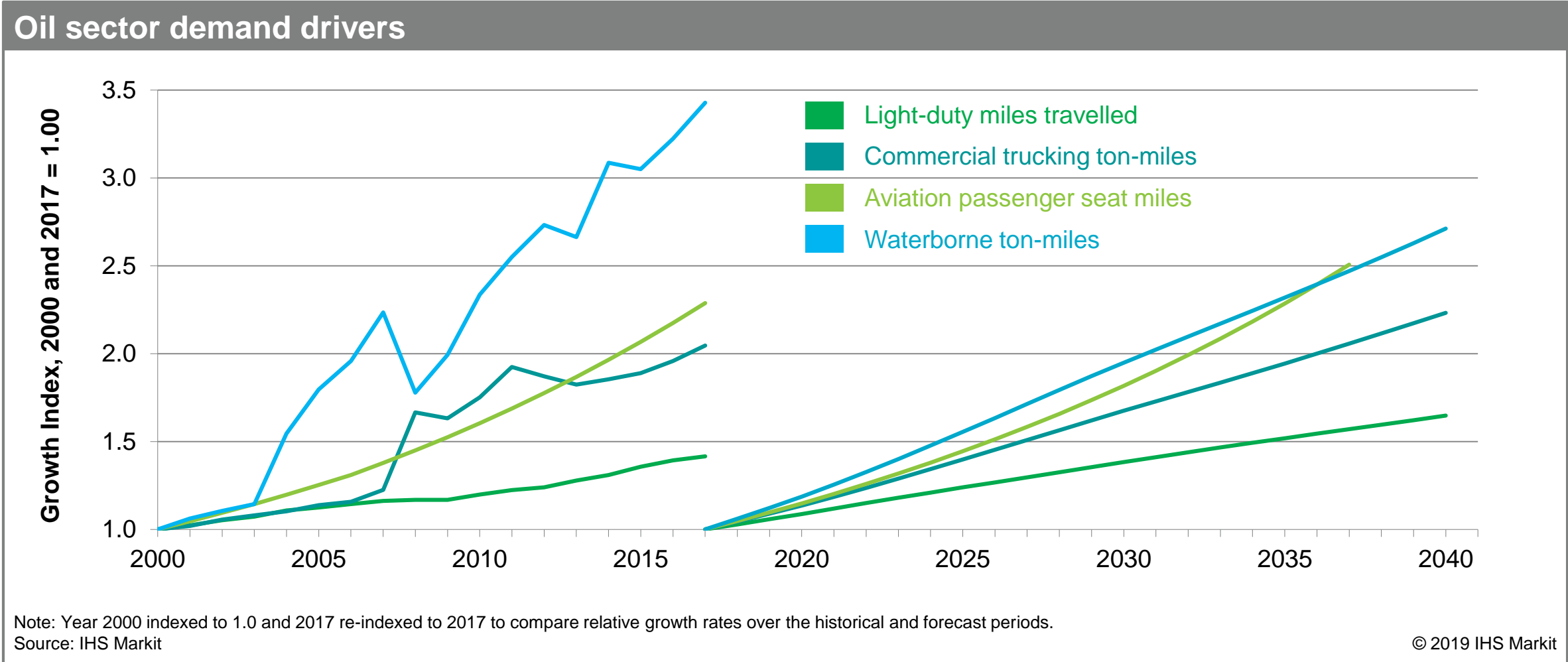
High-sulphur fuel oil futures prices have begun to 'price in' notably an 'IMO 2020 impact' from the current quarter



- In contrast to the volatility in HSFO physical markets, futures have exhibited a fairly consistent downward trend in recent months.
- The notable downward shift in HSFO crack spread futures prices for January 2020 in late-3Q2019 would seem to demonstrate growing market negativity about HSFO prices post- 'IMO 2020' – a reversal of the trend that persisted for much of the past year.
- HSFO futures crack spreads for January 2020 had narrowed considerably from mid-2018 to mid-2019 as market participants became more confident about scrubber uptake levels and retained major concerns over the effectiveness of enforcement mechanisms – as well as reflecting then-current concerns over high-sulphur crude oil supplies.
- IHS Markit expects that HSFO crack spread futures for 2020 will continue to fall as the January 2020 deadline approaches.

While the NWE 3.5%S HSFO futures crackspread for January 2020 as of late-September 2019 has widened significantly, to US\$(27)/bbl, IHS Markit is projecting for January 2020 a wider physical CIF cargo differential, of US\$(30)/bbl

Shipping volumes are set to outstrip other modes of transport in the long term – which raises questions over its sustainability





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