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Argus Marine Fuels Outlook:

Executive Summary

Whatever fundamentals have been at work in global bunker markets, they have been completely overshadowed by what has been going in the wider crude and refined products markets. A 20mn b/d year-on-year drop in global demand cratered global crude prices and refined product crack spreads, forced refiners everywhere to drop utilisation to traumatically low levels and produced from the Opec+ producers group the largest and most extensive agreement to cut production ever seen.

It is far too soon to call an end to the Covid-19 situation and the impact of the pandemic will linger on for a good while yet. But in terms of the impact on crude and refined products prices, the immediate fallout is probably over. Crude prices bottomed out in mid April — at just $13/bl for North Sea Dated — and have recovered steadily since. The contract is now trading at over $40/bl and we expect further increases ahead. Product crack spreads hit rock bottom in May but have recovered slightly since, although the recovery in product values has been much less impressive than in crude. But some sense of stability has returned to the market.

Underpinning this recovery is an impressive performance by Opec+ to deliver 9mn b/d of production cuts in May, 10mn b/d in June and potentially as much as 12mn b/d in July — with an ongoing commitment to cut output right through to early 2022 if necessary. This has certainly encouraged the market to buy into the idea of a rebalancing market. What has also helped is the easing of lockdowns in many countries and signs that oil demand is on the road to recovery. Meanwhile, the recent low prices have hit high-cost crude oil producers hard — US production for instance fell by around 3mn b/d in the second quarter. So the market is rebalancing organically. The Opec+ cuts are just speeding up the process.

Unless there is an unexpected flare-up in Covid-19, or the global economic recovery fails, the market will rebalance steadily over the remainder of 2020 and into next year. This will support a steady increase in crude prices, and with it higher prices for bunker fuels.

But other factors are at work. High-sulphur fuel oil (HSFO) prices are currently strong because of reduced refinery runs and the loss of heavier crude owing to the Opec+ cuts. This is not likely to change in the very short term. But moving into 2021, runs will increase as demand levels recover and once the market is rebalanced, producers will be able to increase production again. In this environment, expect HSFO prices to weaken relative to crude and other bunker products.

As global demand recovers, gasoil and gasoline crack spreads will start to move back to more normal levels. But we do not expect that they will recover to the levels seen in 2019 and before. Global demand is not forecast to return to pre-coronavirus levels until 2023, and products markets will remain structurally long for the foreseeable future. This will cap distillate crack spreads going forward, with weak gasoil pricing leading to relatively weak marine gasoil (MGO) prices. And with gasoline also structurally oversupplied, fluid catalytic cracker (FCC) utilisation will remain depressed, as a result leaving more vacuum gasoil (VGO) available to the very-low sulphur fuel oil (VLSFO) bunker pool and this portion of the market well supplied.

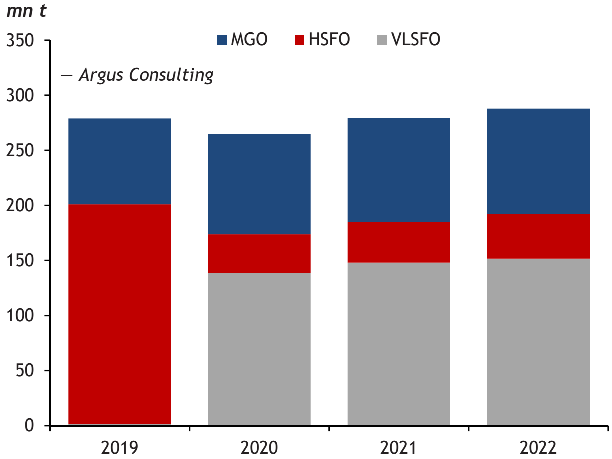
We expect the VLSFO-HSFO spread to remain narrow in the short term but widen in 2021 and afterwards. The currently tight spread between 0.1pc MGO and VLSFO should revert to more normal levels once gasoil crack spreads recover.

Petroleum
illuminating the markets

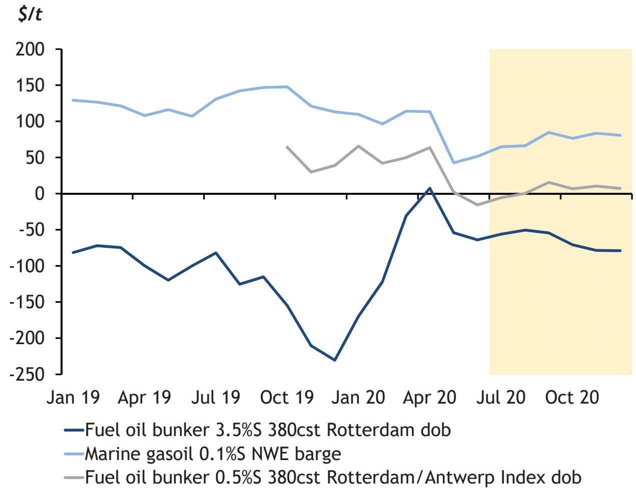
Despite the economic impact of Covid-19 and reports of lower seaborne trade, so far there is little evidence of any serious decline in bunker sales. Data for Singapore and Panama through May show sales down on December 2019, by 12pc and 24pc respectively. Data for Rotterdam for April report almost no change on December. The data also show that VLSFO sales are averaging a consistent 70pc share of the overall market, confirming again how well the industry has transitioned from last year — another factor behind the steady drop in VLSFO prices this year.

The impact of Covid-19 on refinery operations has enhanced the ability of refiners to supply VLSFO. Low gasoline demand means low FCC utilisation and this has freed up VGO feedstock for use in the VLSFO bunker pool. Refiners are also turning to low-sulphur crude to help produce VLSFO. This is particularly the case in Asia with large imports of sweet, heavy Brazilian crude. More recently, several cargoes of heavy, sweet North Sea Kraken crude have headed to Asia. The crude normally sells into the US Gulf Coast but this year has started to head to Asia on a regular basis. Previous fears of shortages are now firmly behind us and the bunker market seems to have firmly embraced its low-sulphur future.

Bunker demand



Bunker price forecasts - cracks vs North Sea Dated



To learn more about the **Argus Marine Fuels Outlook**, and to get access to the full report from which this executive summary was taken, you can request more information; **https://view.argusmedia.com/marine-fuels-outlook-2020**

For more information:

contact@argusmedia.com +44 20 7780 4200 www.argusmedia.com @argusmedia