

# bunkerworld

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## The end of an era?

**With predictions putting future oil prices over \$100 per barrel, comparisons to marine fuel costs suggest that a return to cheaper bunkers is unlikely.**

This year has seen surging prices in key bunkering ports, with prices rising to all-time record levels. In Singapore, IFO380 hit \$760 per metric tonne (pmt) in mid-July. By comparison, the highest price in 2007 was \$515 and in 2006 it was \$360 pmt, according to Bunkerworld price information.

While prices have come down in recent weeks, 2008 levels since the middle of April have been consistently higher than for all of 2007. Prices for the entirety of this year have been over \$420 pmt, which was reached only in late September in 2007; prior, prices for that year were mostly in the range of \$260-400 pmt.

The average price of Singapore's IFO380 in 2007 was \$370 pmt. Over the last eight months it has been closer to \$570 pmt, an increase of 55%. From 2005 to 2006, prices increased 20%; from 2006 to 2007, the increase was also 20%.

Clearly, this year has seen dramatically larger price rises. The most recent increase in prices that has even approximated the per-

centage change seen this year was between 2004 and 2005 when the average price of IFO380 in Singapore climbed by 45%.

### Oil and bunkers

The driver for the increase in bunker prices has been the extraordinary bull run that has dominated crude markets this year.

Since 2006, the price of WTI futures has been over \$50 per barrel. The end of 2007 saw the start of the run with pushing past \$80, but then came 2008 with the price closing over \$100 on February 20, \$120 on May 6, then hitting a peak of \$145 per barrel on July 3.

There has been much discussion and analysis of this dramatic price increase with some pointing to the role of speculation on futures markets while others have pointed to a variety of supply and demand factors. What is clear, though, is that the price increase in oil has not been temporary with prices having stayed over \$100 since the end of February.

Bunker prices, using Singapore as the example, have

generally followed the trend set by crude this year (see comparison graph). There is not a direct correlation between the price of crude and bunkers, due to local and regional supply and demand conditions in bunker markets. Bunkerworld price information shows, for example, that in 2007 the differential between the two ranged between \$100 and \$200 pmt, averaging at around \$150. The differential was greater in 2007 as the price of crude increased and bunker prices were slower to respond to firmer fundamentals.

As the graph for 2008 shows, this was indeed the trend so far this year. The difference between prices was around \$200 pmt through January and February. As crude prices surged, Singapore IFO380 increased at a slower rate, with the differential widening - around \$300 in March and April, then widening to \$350 pmt in May and June.

As crude prices fell in July through August, bunker prices also moved lower, but not to the

same extent. The average difference in cost in July was \$260 but in August it was only \$180 pmt as tight fuel oil supplies in Singapore due to delays in cargo arrivals kept bunker prices higher.

This suggests that while general trends in oil prices have a strong effect on bunker prices, other factors also come into play that can have a profound implications for bunker prices in a particular port. These factors appear to have been exacerbated this year as the correlation coefficient for the comparative prices in 2007 was 0.98 but in 2008 to August was 0.85, which has implications for using WTI to hedge against bunker price changes. One can, however, draw certain conclusions from historical pricing to project forward to speculate on how bunker prices might move in the future.

### Supply constraints

There has been much discussion on the record high prices for oil this year, whether to attribute the rise to supply and demand



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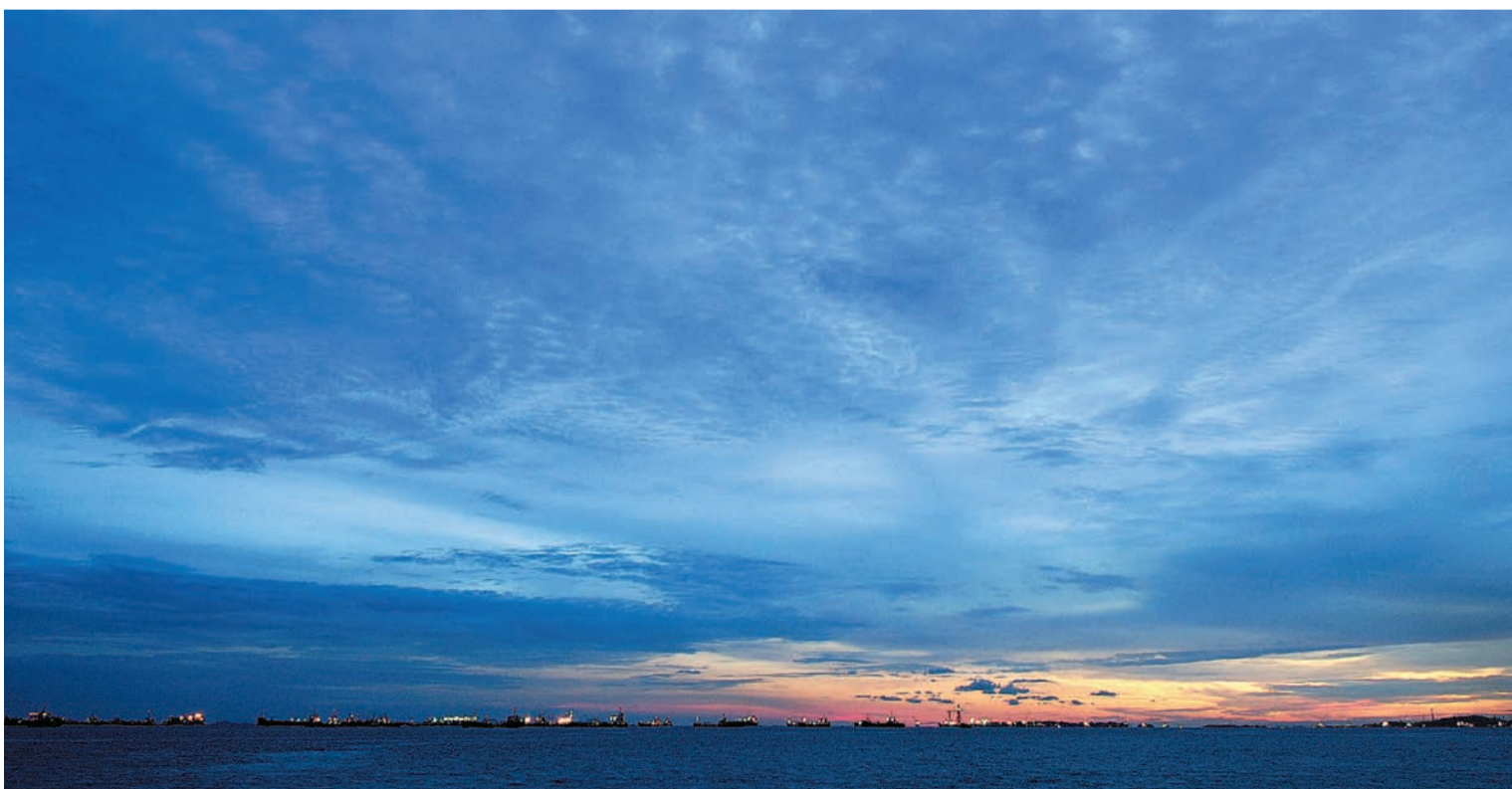
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*A new dawn for bunker prices in Singapore and other global ports.*

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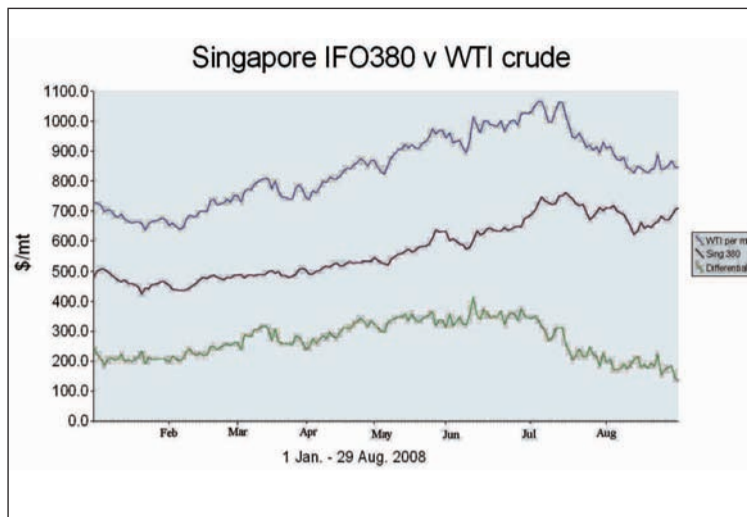
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factors or to market speculation on futures markets.

"Speculators are moving enormous amounts of money into commodity markets for the obvious purpose of making more money," Senator Joe Lieberman told a US Senate hearing in July. "But in doing so they are artificially inflating the price of fuel futures."

Other analysts, though, have attributed the rise in prices to market factors and have pointed to supply constraints, such as OPEC maintaining limited excess capacity, lower growth in production from non-OPEC producers, and increasing demand from developing countries.

The International Energy Agency (IEA), in a mid-year report, said there was a "backdrop of supply constraints" but that "there may be some price effect from investors moving into commodities". The IEA had concerns over supply issues, and its presentation pointed to its forecast for supply growth in coming years: 1.5 million barrels per day (bpd) this year in growth, rising to 2.5 million bpd in 2009, but then falling to under 0.5 million bpd by 2011. Global demand increases are expected to average 1.45 million bpd over the 2008-2013 period.

The IEA has predicted that demand growth will be initially weak, but then move higher closer to 2013, while supply will see surplus capacity in 2009 but some tightening just as demand starts to increase. The onus will be principally on producers such as Saudi Arabia and Iraq to continue to invest in production capacity to meet higher levels of demand.

But concerns over the supply picture have been expressed, particularly with many agencies now seeing little or no growth in oil supply from non-OPEC producers.

"The industry has now accepted that non-OPEC oil is close to its plateau and that underlying decline of existing fields in production is offsetting much of the growth from new discoveries and developments," according to a report from the Clingendael International Energy Programme in the Netherlands. "New

supply...has been constantly disappointing."

"At best, non-OPEC oil output could slowly increase with just of couple of million bpd, but to expect that it will increase with another double-digit percentage number in the coming decade is not realistic," they said.

According to OPEC figures, the cartel will need to produce an additional 12 million bpd across all products (including NGLs and non-conventional supplies) by 2030, an increase of around 38%, to meet expected demand. This is the same rate of increase in production seen between 1975 and 2007, according to US Energy Information Administration (EIA) numbers. In the last ten years, however, the rate has been only around 10%.

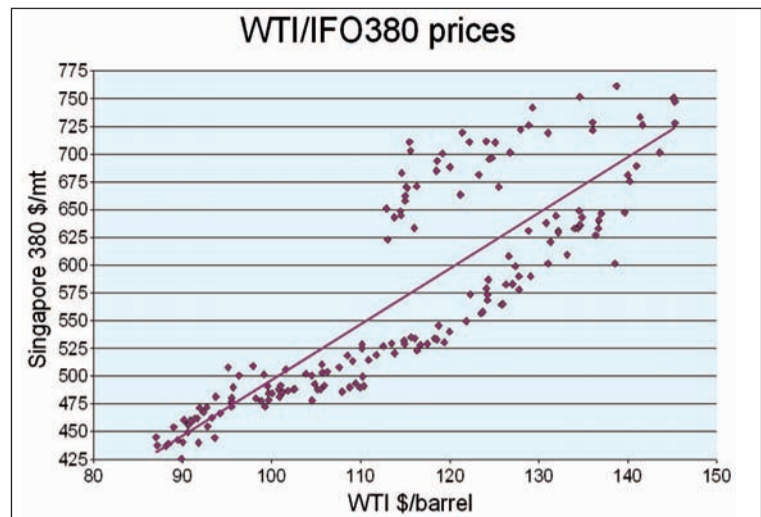
"The industry still has to bring twice as much new oil and liquids onto the market in the next 22 years than what they have done over the past 22 years," according to the authors of the Clingendael International Energy Programme report. "We have to assume that oil supply constraints will last most of the next decade."

"Realistically, things will become worse before getting any better," they concluded.

## Future prices

These supply factors have fed into macro-level analysis of future oil prices and the general consensus is that a return to \$40 - or even \$60 - for a barrel of oil is unlikely in the future. "The crude outlook remains relatively tight with little supply or demand relief in the very short term," said a report from the EIA in July.

According to the Clingendael report, "until recently the oil price was largely underpinned by the marginal cost of the last barrel needed to match demand, with some political economic conjuncture mark-ups or -downs... this currently puts a structural floor of \$110 a barrel under the oil price" for WTI on the NYMEX. "The largest part of the \$110 a barrel floor is determined by the marginal cost of supply, currently around \$80. The remaining \$30 a barrel is determined by supply-



demand fundamentals, a short-term risk premium, and long term scarcity and policy."

While investment analysts have forecast \$150 or even \$200 price levels in the near term, government agencies such as the EIA in the US have been more conservative.

"The combination of slower US and global oil consumption growth, increased production capacity for crude oil and natural gas liquids in the OPEC countries beginning in the third quarter 2008 and continuing through 2009, and higher non-OPEC supply, raises the prospect for a drop in demand for OPEC crude oil and an increase in surplus capacity," it said in its August monthly report.

In the same report, the agency revised its prediction for the average price of crude for 2009 down from \$132 to \$123 per barrel. The previous month, in a detailed report, it set the bounds of future prices between \$100 and \$150, based on supply and demand scenarios. Analysts in early September, as crude prices weakened, also suggested that OPEC would move to constrain supply if futures prices fell below \$100 per barrel.

If the floor, therefore, of crude prices is \$100, for the sake of analysis, and the upper range is \$150 per barrel in the near-term, conclusions can be drawn from recent price movements as to bunker prices over this period as well.

The difficulty with predicting future bunker prices based on crude prices, however, is the substantial differential between the two products that has already been discussed above. As noted, Singapore IFO380 prices have been, on monthly averages, anywhere from \$180 to \$350 lower per metric tonne than WTI.

Based on the data at hand so far this year, though, a simple linear regression suggests that with WTI crude at \$100-150 the range of Singapore IFO380 would be approximately \$490 to \$750

pmt - a \$260 range.

This calculation establishes a possible range for prices, but given the differential between the two products, there is much room for variation. In early September, for example, outside the range of figures presented here, oil sunk to nearly \$105 per barrel but fuel oil tightness in Singapore kept IFO380 in the \$640-650 pmt range for a time - the level that might be expected from crude over \$130. Clearly, predictions are a difficult business.

## A new era

Oil prices in the range of \$100 to \$150 per barrel represent a range of around \$370 per metric tonne, a substantial figure. Using a comparison between WTI crude and Singapore IFO380, this article has proposed a narrower spread of bunker prices in the \$490-750 pmt range, based on the conclusion from the numbers seen so far this year that bunkers did not follow crude to the same relative high prices.

While there is a strong relationship between the price of crude and bunker prices in a particular location, there are still regional and local factors that affect prices, primarily around fuel oil supply. The relationship between the price of the two products was weaker this year than 2007 with wider differentials in prices, making future predictions further complicated.

What is clear, however, is that bunker markets have entered a new era. If, as predictions have it, oil remains above \$100 per barrel in the foreseeable future, bunker prices for key grade IFO380 in Singapore will likely be above \$500 pmt, if not closer to the average price of \$570 pmt seen so far this year.

The era of sub-\$400 bunkers seems, therefore, to be well and truly at an end. ■

*Guy Wilson-Roberts*

*In September the US EIA revised its estimates for WTI crude down to \$116 per barrel for 2008 and up to \$127 for 2009. At the time of publication, WTI in New York had fallen close to \$90 per barrel before reversing course and heading upward again.*