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Where to now for bunker prices?

After a rollercoaster 2008 of price highs and lows, oil predictions for 2009 will give some solace to marine fuel buyers.

By now, the story of bunker prices in 2008 is a familiar one. In the fourth quarter of 2007, marine fuel markets started to firm in line with rising crude oil. Singapore saw key indicator grade IFO380 pass \$400 per metric tonne (pmt), then average between \$400 and \$500 for each month of the quarter.

Other major world bunkering ports saw price increases of a similar magnitude.

But more price increases were to come in the first half of 2008. The trend was decidedly bullish and bunker prices continued to rise across the board. Singapore's IFO380 averaged \$522 pmt in April, \$582 in May, \$629 in June, then topped out at \$720 in July – an increase of nearly 55% in the first six months of the year.

Around the world, ports posted all-time record high daily prices in July, including \$730 pmt in Rotterdam. Distillate prices were also at record levels with marine gasoil (MGO) sold at over \$1,300 pmt in Singapore and Rotterdam.

These bunker price rises were buttressed by the ascendancy of the bulls on crude oil futures markets. Index grade WTI on the NYMEX started 2008 at \$99 then, after a brief decline, kept heading higher, adding \$10 a month until it finally topped out at \$145 per barrel in July.

There appeared in mind-2008 to be no relief in sight from higher prices. Investment banks were predicting that prices could go as high as \$200 per barrel for crude. Even more sober assessments by think-tanks suggested a floor of \$110, or a range of prices between \$100-150 per barrel in the near future.

In September the US government agency, the Energy Information Administration (EIA), predicted that 2009 oil prices would average \$127 per barrel. This level for oil would have likely kept IFO380 in Singapore over \$500 pmt, according to Bunkerworld's price analysis.

Bear markets

But then came the crash. As the financial collapse on Wall Street



Short-term price swings predicted.

spread to the global economic system, markets revised their expectations for oil demand substantially downward and oil prices headed quickly south.

During August, oil prices slipped from the highs seen in July but remained over \$100 per barrel. Prices were still over \$90 in September but October saw WTI levels drop to \$60; November and December saw another drop to the \$40-50 range with the low closing price for the year reported on December 19 at \$33.87 per barrel – the lowest since 2004.

Bunker prices followed this bearish trend. In Singapore, IFO380 averaged just over \$600 pmt in September but lost \$200 to average \$410 in October. By November and December, however, average prices were closer to \$240 pmt, levels more commensurate with 2005. This equated to a 70% drop in prices over a 6-month period.

Interestingly, on a comparative basis, bunker prices did not reach the same highs as crude oil when the latter was so bullish. From 2005

to 2007, WTI on a per metric tonne basis, was on average \$170-190 more expensive than IFO380 in Singapore. In July 2008, when crude was at its peak, the differential was closer to \$350 or \$400, which suggested that bunkers were at least \$150 pmt undervalued.

Conversely, at the end of 2008, the differential had closed to \$80 on average – on some days much lower – making bunker prices overvalued relative to crude. At the time, though, fuel oil supplies were tight in Singapore, highlighting the importance of regional cargo markets in determining bunker prices.

The future of oil

The IEA released its World Energy Outlook last year with its projections of oil demand and production through to 2030. In light of the economic downturn, the agency revised its demand figures downward but still expected that demand would grow by 1.6% per year until 2030, from 85 million barrels per day (bpd) to 106 million bpd with the

latter figure down by 10 million bpd from its prediction last year.

It remained concerned, however, at the impact of its projected supply and demand balance on oil prices. "Current trends in energy supply and consumption are patently unsustainable," it said. "Rising imports of oil and gas into OECD regions and developing Asia, together with the growing concentration of production in a small number of countries, would increase our susceptibility to supply disruptions and sharp price hikes."

Upstream investment will need to be around \$8.4 trillion, the IEA said, or \$350 billion per year to bring 30 million bpd online by 2015 and more by 2030. "The era of cheap oil is over," it said. "There remains a real risk that underinvestment will cause an oil-supply crunch in that timeframe."

Based on its assumptions, the IEA predicted that crude would average \$100 per barrel from 2008 to 2015 before rising to \$120 in 2030 (or \$200 in nominal terms). "Prices are likely to remain highly

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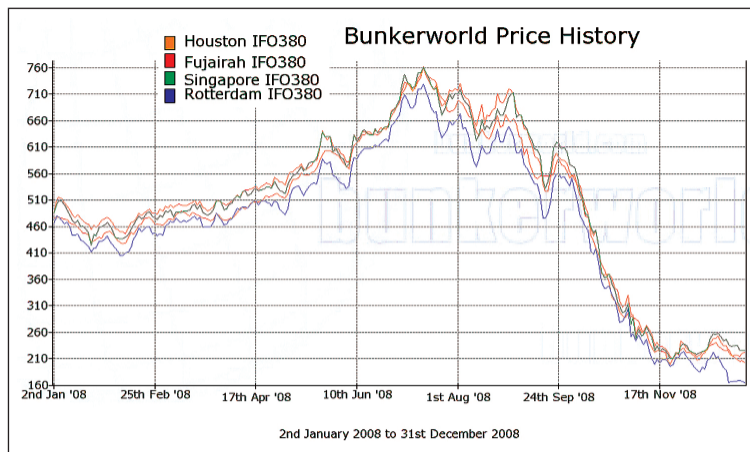
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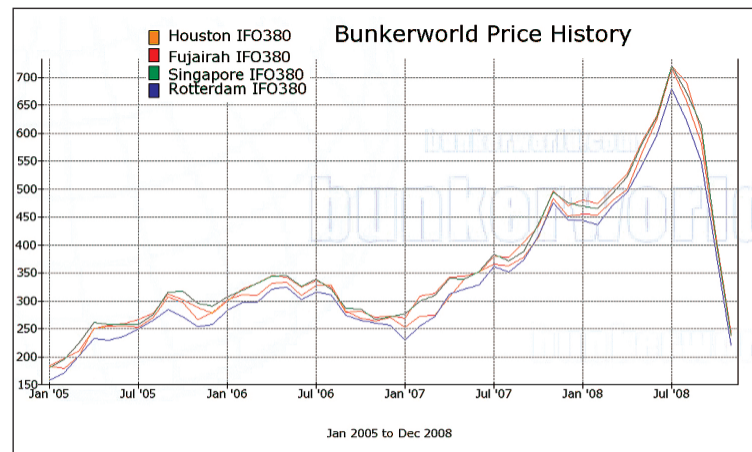
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2008 in review.



Four years of prices.

volatile," it said. "However, pronounced short-term swings in prices are likely to remain the norm and temporary price spikes or sharp falls cannot be ruled out."

In line with the IEA's figures, WTI averaged \$99.64 per barrel for 2008. Forecasts by others, however, have been much more bearish.

The United States' EIA predicted in December that crude prices will average \$51 in 2009. By January this year it had revised its prediction to \$43 for 2009 and \$55 per barrel in 2010, "under current economic assumptions and assuming no major crude oil supply disruptions". The agency had already revised its numbers down from its November price report. "The current global economic slowdown is now projected to be more severe and longer... leading to further reductions of global energy demand and additional declines in crude oil and other energy prices," it noted. In August it was predicting \$120-130 per barrel for 2009.

Goldman Sachs, notable for its call of \$200 oil, late last year abandoned its estimates for 2008 price levels, citing market volatility. For 2009 prices, its predictions have come steadily downward: \$140 in the middle of 2008 to \$110 per

barrel by September. In December 2008 it forecast an average of \$45 in 2009 - averaging \$35 during the first half of 2009, before rebounding to \$50-60 per barrel in the second half of the year.

It did foresee much higher numbers in the future, however, and said that positive demand growth and shrinking non-OPEC supply would lift oil prices to \$70 by 2010 with a big jump to \$195 in 2012.

Bunker prices

As the examples above of oil price predictions have shown, gazing into the crystal ball to forecast markets is a fraught process. Government agencies, investment banks, and think-tanks were broad-sided by the extent of last year's financial collapse and forced to radically revise their future oil price numbers. Talk of floors of \$80 or even \$100 proved to be illusory.

Regional market conditions have proved to be an important factor in bunker prices. In December 2008 and early January 2009, as has been noted, the differential between IFO380 in Singapore and WTI narrowed noticeably (just \$9 on a per metric tonne basis on January 15, for example). Supply issues will therefore be a price determinant. Oil

prices provide a high degree of correlation with bunker prices, but there are local conditions that come into play with marine fuel pricing.

Over time, though, there has been a strong correlation between oil and bunker prices. Bunkerworld data show this correlation to be 0.96 in statistical terms when looking at the period 2005-2008 (it was only 0.78, however, across the first three quarters of 2008 when prices were volatile).

Graphing oil and bunker prices enables the plotting of a simple linear regression (see graph 'Singapore IFO380 v WTI'), which yields a correlation coefficient of 0.92 (a 1.0 result is the 'best fit'). On the basis of historical pricing, therefore, it is possible to draw some conclusions about future bunker prices based on predictions of the price of oil.

Taking the lowest and highest figures from the Goldman Sachs predictions as an example, which also encompasses the average prices estimated by the EIA, gives a range of average oil prices in 2009 of \$35-60 per barrel. Based on the linear regression results, this would suggest that the average price for IFO380 in Singapore would be between around \$150 and \$300 pmt.

Using the EIA's average of \$43

gives a figure of \$200 for the average price of IFO380 in Singapore. The EIA has not made any suggestion as to the volatility of expected prices in 2009 that contributed to its average figure, which could still mean large swings in oil (and bunker) prices.

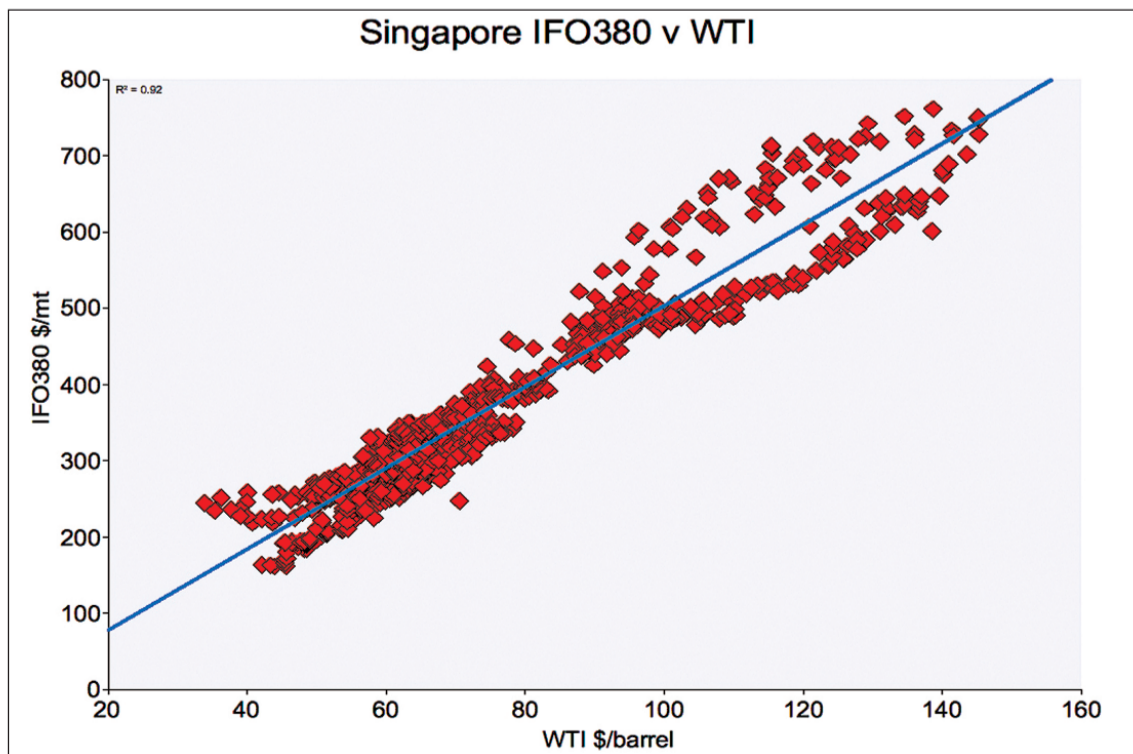
If the average price of oil proves to be more bullish than the bearish estimates of the EIA and Goldman Sachs, bunker prices could average at a higher level. According to this analysis, an average price of \$100 per barrel for oil, in line with the IEA, would suggest an average price of Singapore IFO380 of \$500 pmt in 2009. This would be a similar result to this year, where WTI averaged \$99 per barrel and bunkers were \$505 pmt.

Future costs

If oil prices confirm to the low-end expectations of the firms and agencies repeated here, then average bunker costs will be significantly lower - perhaps even as much as 40% - this year when compared to last year and at levels not seen in the last four years.

This will certainly be good news for shipowners who faced dramatically escalating fuel costs in 2008. On a quarterly, or even daily, basis the cost of buying bunkers this year, though, could vary substantially. If the IEA is correct in its forecast then markets could see sharp rises and falls in oil prices, which will impact bunker prices. Oil prices at \$80 per barrel would be expected to take Singapore bunker levels back over \$400 pmt, while oil at \$25 could take bunkers as low as \$100.

Predictions on future oil prices made six months ago proved to be wrong by a large order of magnitude. Whether forecasters have better luck this year will be subject to the vagaries of product supply and demand, and market perceptions - and speculative investment may also play a role. Unless oil markets find the stability they lacked last year, bunker prices seem likely to be in for another roller-coaster ride in 2009. ■



Bunker prices tracking oil prices.

Guy Wilson-Roberts