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# Market Insights: Can Maritime Fuel take its rightful place at the Oil table?

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## Can Maritime Fuel take its rightful place at the Oil table?

The nature of bunker supply and procurement is changing fast. As the market grapples with the imminent fragmentation of the maritime fuel mix, an increasingly vocal debate has emerged around the benchmarks used to price and hedge maritime fuels. Two major developments are coalescing; on one side, the market seeks answers on how to evaluate IMO-compliant fuels, and price them into charterparties and supply agreements into 2020 and beyond. On the other side, additional complexity in production, supply and distribution has prompted concerns about price dislocations between wholesale cargo markets and delivered bunker fuels. PRAs, exchanges and other stakeholders are scrambling to find consensus in what could be a disruptive transition period, and at the same time open up opportunities for risk management and trading.

There are two major challenges for suppliers and end users of maritime fuels that relate to the use of benchmarks. The most apparent is basis risk, or the risk of a physical exposure being benchmarked or hedged using an index or instrument that does not correspond to the price of your underlying asset. Using proxies such as cargo indices, or even futures prices from markets such as gasoil or crude to hedge delivered bunkers is prevalent but leaves large cash flow risks if correlations weaken. A second major topic is flat price risk, which occurs when leaving exposures unhedged, especially in the period between acquiring an asset and locking in the selling price. The inability to hedge buy- or sell-side appropriately leaves price risks that can potentially erode profit margins, and drastically impact the P&L.

The market for bunker fuel is significant, as every month more than 4 million tonnes of fuel oil enters the maritime fuel oil value chain in Singapore. Translated to bunker distribution, this equates to more than 100 individual stems transferred to seagoing vessels on a daily basis, from a large group of licensed suppliers who operate in the retail market. In contrast, the wholesale market for fuel oil counts at most 4-5 cargos per day and is dominated by a few large players. Different parcel sizes and time horizons underlying the assessments means that local supply issues, as experienced this week in Singapore, can lead the delivery premiums reaching more than \$34 per metric tonne. For a ship owner hedging with cargo futures and selling spot, this could potentially mean losses of more than 50,000 USD on a 1,500 metric tonne bunker delivery.

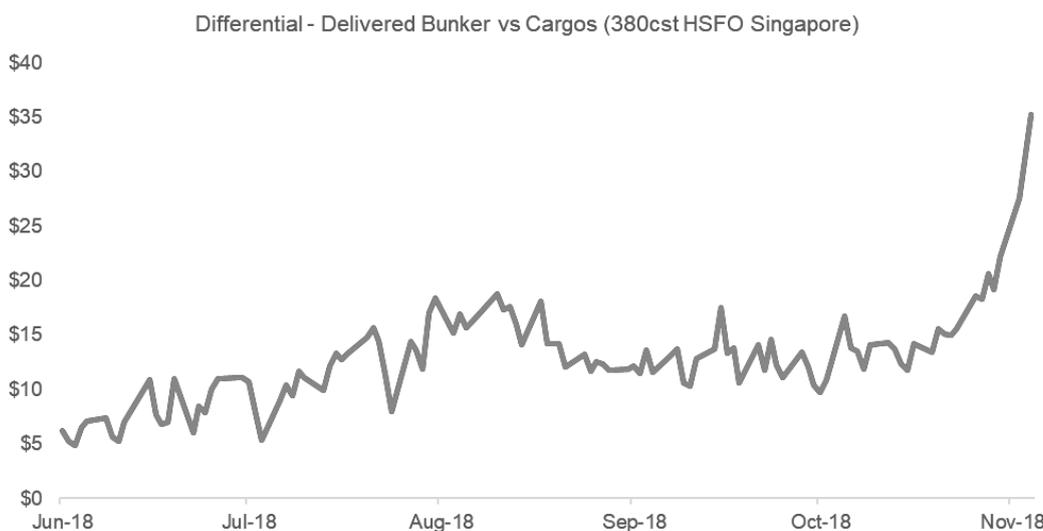


Fig. 1: Fuel oil differential (delivered vs cargo). Source: Argus

The implementation of sulphur regulations in 2020 creates new complexities for both suppliers as well as end users. From being a comparatively straightforward market with a relatively homogenous commodity, suppliers now need to cater to a variety of demands and upgrade their infrastructure accordingly. According to research house Wood Mackenzie, an estimated 2mmbbl/day of high sulphur fuel oil demand will be displaced from the bunker market, which will need to either be further refined, blended into lower sulphur distillates, or disposed of in the power generation fuels market. Wood Mackenzie also estimate an additional demand of 1mmbd for marine gasoil, further adding pressure on blending, logistics and storage.

Traditionally, most of the price discovery, and by extension liquidity in fuel oil derivatives has remained in the cargo market indices, taking cues from global refinery margins and incorporating local differentials between the main hubs of Rotterdam and Singapore. Cross-hedging in a fairly homogenous and singular use market has been reasonably effective but is becoming progressively difficult due to the complexity downstream, and the influencing factors of distillate markets, which among other things will be influenced by road diesel and jet fuel demand as the distillate component increases.

The combination of these factors suggests that the merits for delivered bunker assessments are more relevant than ever. First, the compulsory use of mass flow meters has dramatically improved the ability to accurately assess bunker prices and flows in ports like Singapore. Due to the large and diverse market, it is possible to gather data points from a variety of suppliers and buyers. A delivered assessment will also reflect the real value of fuel, regardless of its origin as straight-run cargos or blended materials.

Adoption of delivered assessments in the fuel oil market can significantly benefit the supplier and user markets for bunkers. The ability to reference a more appropriate index would enhance suppliers' capacity to protect margins and alleviate stresses on working capital due to higher product costs. For ship owners, it would mean referencing accurate market prices both in term purchasing agreements, as well as bunker adjustment factors. For traders, the development of a liquid derivatives market in bunker fuel derivatives can enable compelling spread trading opportunities and further enhance the liquidity of this important market.

EEX Asia is working closely with industry players and stakeholders to cater to the needs of the maritime industry. The Cleartech Portal™ offers an electronic marketplace for companies wishing to hedge their forward exposure to fuel prices.