Center for Global & Strategic Studies
Islamabad

IMO 2020: Implications for Global Oil and Shipping Industry

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Published on 01st February 2020

As a specialized agency of the United Nations, the International Maritime Organization (IMO) is the global standard-setting authority for the safety, security, and environmental performance of international shipping. Its main role is to create a regulatory framework for the shipping industry that is fair and effective, universally adopted and universally implemented. IMO through its working also supports the UN Sustainable Development Goals (SDGs). From 1st January 2020,

international bunker fuels have needed to meet a much tighter maximum sulphur specification of 0.5 percent, versus 3.5 percent earlier, due to the new regulations implemented by the IMO. These regulations are commonly called IMO 2020, and expected to effectively eliminate one of the largest sources of Sulphur emissions, accounting for roughly 10 percent of the global total from all sources. In fact in the Emission Control Areas (ECAs) i.e. in the North America, Canada and the U.S. Caribbean Sea Areas, the sulphur discharge limits have been restricted up to 0.1 percent or less.

According to estimates, the shipping sector consumes 3.5 million b/d of High-Sulphur Fuel Oil (HSFO) in which the sulphur content capped at 3.5%. In order to meet the current demand, globally, Crude Oil Refiners will only be able to produce 1.5 million b/d of Very-Low Sulphur Fuel Oil (VLSFO) which capped at 0.5%. It will significantly improve air quality, reduce climate change effects and limit the environmental impact of the oil and shipping industry.

Restrictions for shipping companies to comply with IMO 2020 will affect other industries as well. It' s not just the bunker prices and refinery industry due to which global trade will likely to experience instability in freight rates for quite some time. The increased competition for low-sulphur crude oil will drive up the competition between shippers, global Steel, and Aluminium industry as well. Needless to say that shipping freight rates will also increase because of higher fuel costs, pushing up prices of all goods transported by sea. Almost 90 percent of global trade is carried

through sea transport. About 55,000 ships are plying the global waters at any point. According to some researches, the global fleet has almost 10,000 tankers.

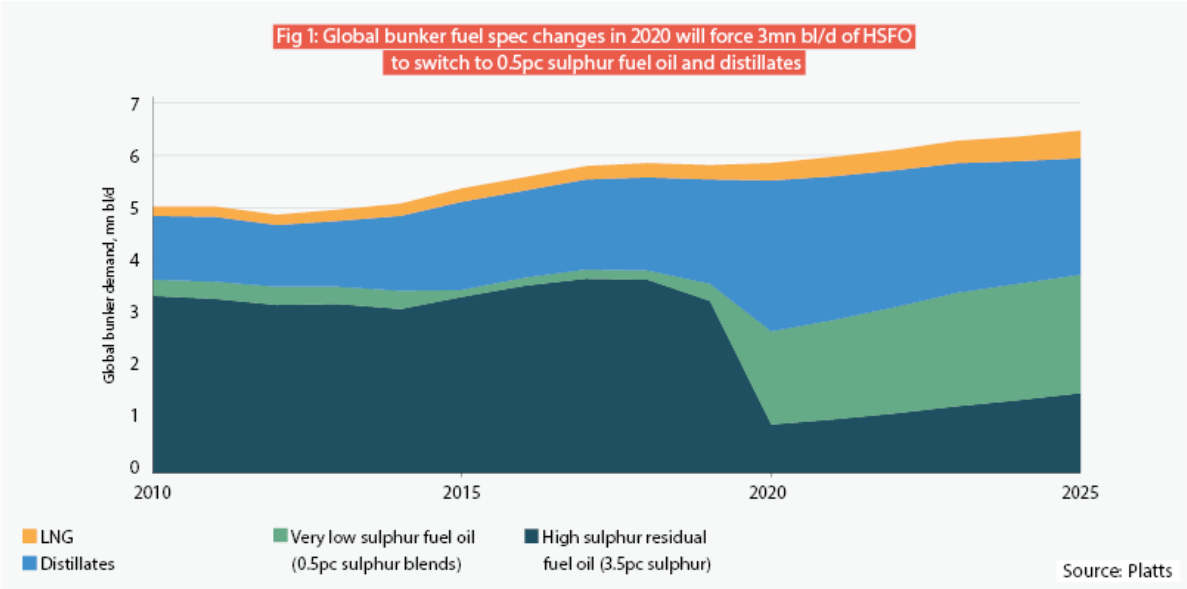
An increase in freight rates for transport of raw materials, such as iron ore and coal, will defiantly be a triggering factor to increase costs for the steel production. As Needle Coke would play a significant role in nurturing the trend for these industries. In addition to steel and aluminium manufacturing, the electric vehicles production will also be affected due to increased shippers demand for low sulphur fuel.

The share of fuel used for bunkering only accounts for 4 – 7% of global oil demands, but their importance for refiners as the world's largest sink for the hard oil; or simply known as the law quality remains at the bottom of the petroleum barrel with high impurities and Sulphur content, enhanced its significance as well as economic share in the global market. Argus Media, which is a specialized energy communications and analysis firm, states that maritime shippers/ bunkers alone account for 47 percent of the global demand for this end funnel product.

The experts have already raised concerns over the stability of supply of low sulphur fuel due to the new IMO 2020 restrictions. It may seem a simple environment-friendly ruling, but the ramifications of this change ripple across the shipping industry, shipping, trading, environment, and freight rates. Its implications will also go down to crude oil producers, refiners and other consumers.

Another factor that will trigger the freight rates will be the expected rise in use of marine gasoline and Liquefied Natural Gas which is also an expensive fuel choice.

The statistics of 2018 countries that there were about 122 ships fuelled by LNG, compared to a total oceangoing fleet estimated at 55,000 vessels. That number is expected to go beyond 220 marks by 2022. Graph one (Source Platts) shows the past pattern about the consumption of various types of fuels and the future anticipation of the shippers for bunkering.

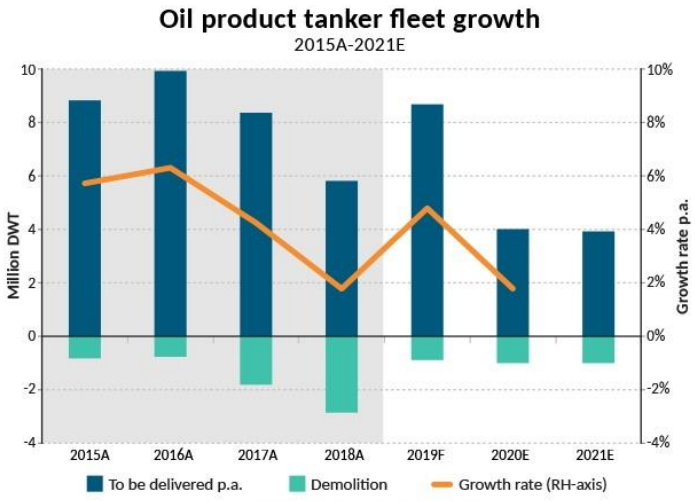


The projected forecast is expected to have a greater share of Very Low Sulphur Fuel Oil (VLSFO) and Distillates. However modern ships will go for LNG due to for being an extremely environmentally compatible option. IMO 2020 will lead to about 2 million b/d increase in marine gas oil (MGO) shipments. But price differentials, between distillates and LNG for shipping business, will also implicate the trading pattern. HSFO demand will be sustained by non-compliant vessels which account for about 10% of the global fleet (an estimated figure for the year 2020). It is believed that some ships may be due to incompatibility or unavailability of low sulphur fuel, will continue to follow use traditional oil.

In the past two years, tanker freight rates have been increased and they were fund to be at times less than half break-even levels. From an economic perspective, when we look at implications of IMO 2020, particularly for ECAs, some key strategic questions are also significant; will there be an adequate number of oil tankers available to meet the trading requirements of these areas? And what would be the expected charter cost these ships will have? Thirdly and most importantly; because it will have a direct bearing on the consumers that how much will be a rise in the price of trade goods that a common man has to bear?

According to the critiques, the prices of petroleum products have been very volatile due to the recent global political and strategic scenarios so the increase in freight rates should not be attributed to IMO 2020 alone. The global flow of oil from the Middle East will likely to be affected by this in the emerging scenarios because they produce heavy crudes with rich Sulphur contents, on the other hand, producers of light crude will enjoy a good flow of money in coming years for against increased demand.

Non-compliant ships with these fuel regulations will also put for demolished. Therefore, the crude oil tanker has been witnessed to have the highest growth in the past few years as compared to the main shipping fleets with a growth rate of 6.3% in 2019. BIMCO is currently forecasting that the crude oil tanker fleet will grow by around 1.5% in 2020 and 2021. Thus the effects of IMO 2020 have also been witnessed, in terms of rising global shipping and breaking industry.



(Source: BIMCO estimates on Clarkson's Raw Data)

Demand for oil shipments in 2020 also anticipated to increase as sophisticated refineries would improve their output to meet energy needs. Thus, IMO 2020 will also increase global refinery throughputs by 1.6 million b/d from January 2020.

By choice, or by regulatory restrictions, quality of fuel has become a key concern of consumers. Battery-powered and hybrid ships; their prospects are brightening but they are still infancy. Upcoming LNG-fuelled vessels are expected to remain dedicated to specific routes on ECAs. Adapting to the energy transition by improving refining technology is the most import way out to deal with this changing scenario. Further, to meet the current and future demand, the refiners also have to invest in modern technology so the sulphur can be extracted from the hard crude at the source.