IMO 2020 impacting Asian base oils

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IMO 2020 is a regulation that has the potential to impact the base oils market in both the long and the short term. Moving away from high-sulphur marine fuels with the aim to reduce emissions is altering how producers look at the marine market – with many moving away from producing Group I base oils.

Asia is a market that utilises shipping in a big way to transport goods, thus the region could be set for subtler changes to how its industry operates. However, with Asia being home to a number of key producers of higher-viscosity base oils already, could this shift to low-sulphur be a boon for producers already investing in Groups II and III?

To find out how the regional market is responding, I spoke to Matthew Chong, Senior Editor at ICIS. He shared a variety of insights into the sentiment he has garnered from his industry contacts, as well as some predictions for how IMO 2020 could impact base oil prices in the long run.

SEISMIC SHIFT

Chong gave an overview of how the legislation is currently impacting the market. Though still in the early phases of implementation, the Asia region has already had to shift its focus somewhat.

"From January this year, the refiners of Group I in southeast Asia are cutting their Group I production in favour of producing more low-sulphur fuels. This is because the low sulphur fuel prices have shot up since December 2019, the prices increasing to over $700 per tonne early this year from around $500 just a few months ago.

Matthew Chong
Senior Editor
ICIS
"I cover northeast and southeast Asian base oil markets, including India. We track base oil group prices in the region on a daily basis to get insights into how the Asian market is developing."

"The tighter supply in Group I is being balanced by stable prices, but if more and more refineries start to cut production in favour of low-sulphur fuel oils then the prices may start to increase as supply dwindles.

"However, I do think that cutting production could be a good thing for the base oils industry in the long run because it could solve the oversupply issue we are currently facing."

A significant move away from Group I could exacerbate a pre-existing market trend in favouring Group II, meaning the base oils industry could see global shifts in production in the short term. While the market as a whole will have to shift gears, Chong highlights how increasing freight costs could be an underlying cost of IMO 2020 coming into force.

"Up until the end of 2019 we didn't see a large impact on the base oils market. I think this is because of the aforementioned oversupply, especially when we are talking about Group II.

"However, what we have noticed is that, since November 2019, freight costs have started to increase in the region. Say you're planning a long-distance transport, from South Korea to India for example, then the freight rates can increase to as much as $10-$15 per tonne. If we are talking about shipping shorter distances, from Taiwan to China for example, the price is more like $3."

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SENTIMENTALITY

Now that the industry has a clearer view on what the new regulation means for them, the question will be how companies ensure they are compliant in the long term.

Chong details how restrictive current solutions to being compliant are – and how they could have a wider impact on how producers view the production of marine fuels.

"There are two ways that vessels can comply to IMO 2020: install scrubbers and use higher-sulphur fuels; or to purchase low-sulphur fuel oils.

"Apart from these options there's really no way of getting around the regulations, therefore I think that the marine sector will see a spike in demand for low-sulphur fuel oil."

Once again looking on the bright side, Chong does point out that widespread panic regarding IMO 2020 is not present in Asia. Rather that companies are approaching it pragmatically – with long-term goals in mind.

"The sense that I get is that many companies are not overly concerned by the regulations. There are so many factors involved and it's relatively early in implementation, so I think the policy most players are adopting is to take things one step at a time."

FUTURE OF IMO

Predicting the full scale of IMO 2020 is a nigh-on impossible task, however, Chong focussed on how political concerns may play a large part in how quickly the industry is able to tackle IMO 2020. Specifically the US/China trade war easing off and relations improving between the two nations were encouraging signs.

"The next few years will bring a lot of uncertainty – what with the US/China trade war and other geopolitical concerns exacerbating base oil challenges caused by the new regulations.

"The relationship between US/China is improving which will probably lead to a boost in the economy for China, which could help it out of its slump that it's currently experiencing."

Update on the Coronavirus

Disruption in China caused by the coronavirus is hitting domestic chemical production as the Lunar New Year break was extended amid restrictions on movement of goods and people.

As the government battles to contain the spread of the virus, there are reports that logistical problems, staffing shortages and rising inventories are forcing chemical companies to cut production.

Demand is also being hit as economic activity is curtailed in some areas and downstream industries delay post-holiday restarts.