

WHY DIESEL PRICES ARE SET TO SOAR?*

The world is ticking down to a deadline that promises to have major ramifications in the global fuel markets. On January 1, 2020, the International Maritime Organization (IMO) will require the sulfur content in marine fuel to drop from a maximum of 3.5% down to 0.5%.

The rule is meant to curb pollution from ships. Combustion of high-sulfur fuels leads to the production of compounds like sulfur dioxide, which causes respiratory problems and produces acid rain.

This rule continues a trend of limiting the sulfur content in fuels (which originates from the sulfur contained in crude oil). Europe began tightening sulfur specifications in the 1990s, and the U.S. began to phase in ultra-low-sulfur diesel (ULSD) in 2006.

Prior to implementation of the ULSD standard in the U.S., gasoline often traded at a premium to diesel. But meeting the ULSD standards required refineries to invest billions of dollars into equipment to remove the sulfur. This drove up diesel prices in two ways.

First, the cost to produce diesel was simply higher due to additional capital and operating costs. Second, this meant that refiners had to be more selective about purchasing high-sulfur ("sour") crude oils. This drove down the demand for sour crudes and drove up the demand for lower sulfur ("sweet") crudes, increasing the price differential between the two grades.

So, refiners had to pay more for sweet crudes, or invest heavily into new equipment that could remove the sulfur from the sour crudes.

It has been estimated that the new IMO rules will apply to 3.5 million barrels per day of high-sulfur fuel oil, although post combustion gas scrubbers may allow some vessels to continue using the high-sulfur fuel. Most marine vessels will have to switch to cleaner distillate fuels like low-sulfur diesel, which will increase demand significantly.

As with the previous USLD switch, the new regulations will increase the cost to produce marine fuel, and it will again put upward pressure on the price of sweet crudes and downward pressure on sour crudes.

In any case, it seems certain that diesel prices are set to rise, and perhaps significantly.

History suggests that discount won't last.