Oil Market Report: Feb 2024

In last month's report, we pointed out that increasing tensions in the Red Sea – centred on Yemen's Houthi rebels – could be one of the factors that send oil prices significantly northwards in 2024. Since writing that report, conflict levels have further intensified with ongoing drone attacks against passing maritime traffic and "preventative" military strikes from the US Navy and Britain's RAF in return. The aim of the US / UK strikes has been to nullify the Houthi threat and protect international trade, but with major shipping lines such as AP Moeller saying that the counter-strikes are actually making the security situation worse, should we now expect a prolonged crisis and resultant increases in the price of fuel?

The strife-riven Southern Arabian Peninsula has a long history connecting it to the oil industry. Historically part of the British Empire (Federation of Southern Arabia), the port of Aden was a key coaling (refuelling) station for ships voyaging between Europe and India, via the Suez Canal (built in 1869). Fuel oil took over from coal as the "bunker" of choice for ships from 1900 onwards, but Aden's role as a key fuelling station continued. By 1950, it had become one of the busiest ship-bunkering ports in the world, fuelling over 7,000 ships per annum (20 ships per day) and to meet this demand, BP opened the 170,000 barrel per day (bpd) Aden refinery in 1954.

For the next 20 years, the Aden refinery was one of BP's most profitable, taking cheap crude oil from inland Yemen and converting it into heavy fuel oil for shipping. However, in 1977 the refinery was nationalised by the newly formed People's Republic of Yemen and soon became embroiled in a spectacularly complicated civil war that rages to this day and has claimed hundreds of thousands of lives. The current "stage" of the conflict pits the "officially" recognised government of Yemen (Presidential Leadership Council) against both the secessionist and socialist southern Yemen (including the Aden Governorate), and the Houthi led Supreme Political Council that controls the North Western part of the country. In addition, there are a long string of other regional and religious combatant groups.

The impact of interminable hostilities on the country's oil industry has been predictably dire. The Aden refinery ceased production in 2015 and crude oil production has declined from 500,000 bpd to less than 10,000 bpd today. It has also resulted in some bizarre and worrying outcomes, not least the stranded 1m barrel super-tanker "FSO Safer" (ahem...), that has lain lay at anchor since 2015. With nowhere to discharge its cargo and the ownership of the oil disputed by rival factions, this slowly rusting hulk of iron presented an environmental time-bomb as well as bargaining collateral for anyone who could lay claim (legally or otherwise) to its contents. In 2023, the United Nations launched a(n ongoing) salvage operation.

With no refinery, major security concerns and ships that can sail much further without refuelling, bunker activity around Aden is now virtually non-existent. Nonetheless, the flow of maritime traffic sailing past the port has not diminished. In 2023, 24,000 vessels took the Red Sea passage, of which 25% were transporting oil products (around 3.5m barrels per day). Overall, 12% of global trade and 15% of all European imports sail this route. Since the Houthi rebels began their campaign of attacking maritime vessels deemed as "friendly" to Israel, international ship owners have faced a daunting logistical choice. Carry on as normal and face the prospect of attack or divert cargoes 4,000 nautical miles around the other side of Africa. This extra distance adds somewhere between 10 to 15 days of sailing time and costs around $1m in extra fuel for a Suezmax vessel (ie, the maximum size of ship able to travel through the Suez Canal). Furthermore, that same type of ship will typically emit a further 3,000 tonnes of CO_2 by taking the route around the Cape of Good Hope.

Unsurprisingly, Crude Tanker rates have increased significantly. Those tankers still using the Suez route between the Middle East and Europe have seen rates increase by 65% to $4.30 per barrel (~2.15ppl = pence per litre), largely reflecting increased insurance premiums. For those vessels avoiding the Red Sea, rates are a further $2.40 per barrel higher (~1.15ppl) and for refined products, rate increases are steeper still. "Clean" tanker rates (ie, carrying refined products) have almost doubled to $13 per barrel (~6.50ppl), whilst biodiesel cargoes imported from Asia via Suez have increased from around $18 per barrel to $25 (up by circa 3.25ppl).

These freight increases are particularly acute for European markets, as since Indian diesel replaced Russian diesel (post-Ukraine), Europe has been dependent on product travelling via the Suez Canal. The same is true when it comes to biodiesel, where half of the EU's Used Cooking Oil (UCO) is imported from Asia (via the Suez route). Overall crude prices however, have been largely unmoved. Global demand for oil still looks pretty shaky and markets generally are actually still over-supplied. Furthermore, the important geographic fact remains that however circuitous, there are still available shipping routes that bypass the Red Sea. This means that irrespective of increased freight costs, product shortages (the real driver of price spikes) are unlikely. Some comfort then to hard-pressed consumers, but they shouldn't relax too much. In a hypothetical situation whereby the current crisis was to spill over into the Northern Arabian Peninsular, then over 20% of global oil production (Iran, Iraq, Kuwait, Bahrain, Qatar and the UAE) would be affected. With no maritime route other than the Straits of Hormuz to get in or out of the area, an escalation here, really would have a seismic effect on prices.