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Truckers Asleep at the Wheel as Diesel Price Shock Creeps Closer

- Erin Douglas, Bloomberg News

(Bloomberg) -- Every time Chuck Paar makes the over 500-mile round trip from his home in Mt. Jewett, Pennsylvania, to Buffalo and Syracuse, New York, his 18-wheel tractor trailer carries 25 tons of sand or cement and burns about $265 of diesel in one day. That's up from as little as $166 for the same route two years ago, and the increased cost of fuel is squeezing already thin industry profit margins.

It's about to get worse.

In 16 months, new standards will descend on a corner of the global oil market that may disrupt fuel supplies crucial to transportation industries like trucking, airlines, railroads and ships. While the goal of the change is to reduce sulfur emissions, which cause acid rain, the rules could boost diesel prices by 20 percent to 30 percent, according to the International Energy Agency. That means Paar could be shelling out more than $344 on fuel for each New York trip.

"We bleed diesel," said Paar, 62, whose brothers, wife and son are all truckers. Diesel accounts for around 20 percent of the operating costs at his company, Sandman Services. His four trucks log a combined 28,000 road miles a month, but get just six miles per gallon, compared with 30 mpg for many new passenger cars.

While truckers can negotiate a fuel surcharge on their customers, those don't take effect until weeks after pump prices rise, Paar said, so it's uncommon to recoup the full cost. "I can't afford to eat a chunk like that."

The last time diesel prices shot up as much as the IEA is predicting was mid-2008, according to data from AAA. At that time, crude oil hit a record high of $145 a barrel. This time, the culprit isn't the raw material, which is around $70, but new rules from the International Maritime Organization. The group is requiring the world's ocean-going vessels to cut the sulfur content in fuel to 0.5 percent from 3.5 percent.

The IEA estimates 3 million barrels a day of high-sulfur bunker fuel is used by the global shipping industry, which handles about 90 percent of the world's trade. Some ships may keep using the fuel after 2020 by installing scrubbers to clean up emissions, or just ignore the rule and take the chance on heavy fines. A few may switch to new ships that run on liquefied natural gas.

But those options may be too expensive, so the IEA expects many ship owners to upgrade the fuel they use. That would spark a rush on existing supplies of middle distillates like diesel and jet fuel. When the standards kick in at the start of 2020, global demand for diesel could jump by about 1 million barrels a day, to 29.7 million, the IEA estimates. That's more than the combined gains of the past four years.

“The consensus is that it will be expensive as hell," said John Butler, president and CEO of the World Shipping Council. “It will dwarf anything we've seen as an external cost on the industry."

Refiners in some parts of the world may struggle to add enough extra supply, at least initially. Without expensive upgrades, it would be difficult for refineries to drastically change the mix of products they create from each barrel of crude. That poses a potentially big problem for industries that need diesel, though few are doing much to prepare and many small operators don't even know it's coming.

“Everybody missed this in our industry,” said Glen Kedzie, vice president of energy and environmental affairs for the American Trucking Association. The organization began alerting trucking company owners a few months ago, and found that most had never heard of IMO and didn't know about the risk to fuel markets. “No one knows about this,” Kedzie said.

Among the truckers, airlines and railroads that are aware, many hope they can simply pass along the increased cost in the form of fuel surcharges or higher ticket prices. However, smaller operators may have less flexibility to charge customers more or the financial resources to withstand a prolonged increase in fuel costs, Kedzie said.

“They'll be wondering why all of a sudden their fuel prices went skyrocketing,” said Paar, who is a member of Owner-Operator Independent Drivers Association. “They will very likely be the ones who sell or go out of business.”

Trucking companies already are getting squeezed by higher labor costs, reflecting a shortage of drivers. The average hourly wage was $24.14 in June, up 23 percent since June 2009, according to the Bureau of Labor Statistics.

For the airline industry, where fuel is expected to account for a quarter of operating expenses this year, companies are more likely to pass along the costs to passengers and adjust flight plans or plane loads, according to Macquarie Group Ltd., which conducted a survey of 27 airlines about the impact of the IMO regulations.

"It's not like overnight you're going to see a huge jump in fares," said Susan Donofrio, a Macquarie analyst. It may take three to six months after fuel costs rise, she said. While all nine of the U.S.-based airlines in the survey have IMO on their radar, according to the survey, the majority of respondents remain committed to their existing hedging strategies, or else aren't sure how they'll respond.

Delta Air Lines Inc. saw second-quarter fuel costs jump by a third, and the company said it's looking to increase fares this year to offset that pressure. In addition, Delta has spent "a lot of time" working on IMO, Chief Financial Officer Paul Jacobson said at a conference in June.

IMO Standards

The IMO said when it announced the new emission standards in October 2016 that it would work to develop consistent guidelines for implementation to prevent market disruption. A working group assembled July 9-13, which is scheduled to submit draft guidance to a new committee in October for consideration and approval.

"IMO members framed the regulation based on health and environmental grounds," Lee Adamson, head of public information services for IMO, said in an email. "The effect, if any, on oil prices is not within IMO's remit and we cannot comment on it."

Some are less concerned about the IMO's impact and more worried about global supply and demand disruptions.

"If oil prices start to erode in 2020, this will not be a big deal," said Michelle Foss, chief energy economist at the Bureau of Economic Geology at University of Texas in Austin.

But, at least one economist, Philip Verleger at PK Verleger LLC, said the impact of the IMO rules could be even more far-reaching than just transportation industries, especially if the rush boosts demand for crude and sends oil up to between $85 and $100 a barrel.

"It's actions like this that cause big recessions," said Verleger, who has been studying energy markets since 1971. "It's not like it's regulating one industry, it's a whole series of industries."

--With assistance from Mary Schlangenstein, Justin Bachman and Robert Tuttle.

To contact the reporter on this story: Erin Douglas in New York at edouglas16@bloomberg.net

To contact the editors responsible for this story: David Marino at dmarino4@bloomberg.net, Steve Stroth