IN CONFERENCE

Developments in the World Tanker Market: The View from Energy Shipping Ltd.

This issue's "In Conference" is based on a speech (with updates) by Nigel J. Dean at the World Fuel Oil Summit in Athens on May 19-21, 2016 in Athens. Mr. Dean is a senior shipbroker with Energy Shipping Ltd. The summit was hosted by the Public Power Corporation of Greece and organized by Axelrod Energy Projects.

This "In Conference" explores developments in the world tanker market since the oil price collapse of 2014-15. In addition to assessing factors affecting the overall tanker market, the analysis takes into account some of the factors affecting different classes of tankers.

While cheaper oil may be of benefit to many sectors of the global economy, the world tanker industry has another perspective. With the oil price collapse, there was an expectation in some tanker industry quarters that the credit lines of trading companies would be extended and allow the trading of more barrels, resulting in more deals and more fixing. But that is not what has occurred. It appears that the same inelasticity that drives consumers of energy to buy when oil prices are high does not encourage them to consume more energy when prices fall to today's levels. In other words, there has not been a return to conspicuous oil consumption.

In an environment of high bunker prices before the oil price collapse, there was talk of building less fuel-hungry eco ships and how they might create a two-tier tanker market. Under current market conditions, eco ships are not even mentioned when chartering vessels on the spot market. With bunkers at under $200 per metric ton, bunker fuel is no longer a top priority for tanker owners or charterers but it has encouraged operators and time charterers to return to the market after almost three years of redelivering.

The collapse of oil prices did initially encourage speculators to take VLCCs and Suezmaxes on time-charter for use as floating storage and these classes of tankers enjoyed a few months of boom. The boom disappeared as it became obvious that the time scale for the low prices may be longer than expected and after due consideration of all the longer term price-depressing factors. These factors included the ongoing relatively high levels of Saudi crude production and the slow pace of declines in US shale oil production.

For shipowners, the peculiarities of the tanker market have caused substantial imbalances as the Worldscale flat rates are calculated some four months in advance of the new year. As such, falling crude and bunker prices continually undermined the printed scales. The net result was to establish 2015 as a very good year for tanker owners with some publicly-quoted shipping companies reporting record profits. This was not surprising since the Worldscale flat rates were based on heavy bunker fuel prices above $500 while in fact owners were enjoying prices half of that for most of the year.

The Worldscale book is reissued at the end of every year and, as the year roles over, charterers try to revise the fixing rates to maintain the freights at similar levels to the previous year. The trouble is the markets tend to firm in the pre-Christmas/New Year holiday rush, and so there is always a rollover time into January when the owner/charterer conflict gets resolved. Throughout 2015 the owners had the best of it with bunkers cheaper than the Worldscale book assumptions. With the 2016 Worldscale book, the flat rates have been substantially revised and for this reason 2016 has been very different as reflected in time charter equivalent earnings which have been halved between May and September 2016.

The positive results for many tanker companies in 2015 (which saved some larger tanker companies from disaster) pushed up owners' expectations of time-charter rates. In 2014 one could have chartered an MR for 12 months at $14,500 per day. In 2015 owners' MR ideas inflated to as much as $17,000, but today owners of modern MR tonnage are asking $14,500 (about $1,000 a day away from the rates offered by potential operators.) Since 2009, tanker time-charter rates jumped at the first signs of marginal earnings had moved above running costs. These rate increases have been gradually eroded during 2016. With newbuilds being delivered on an almost daily basis, returns to shipowners are on the wain (despite an increase in tanker tonnage miles) because there are just too many ships available across all tanker sectors.

The problem for tanker shipping is undoubtedly overbuilding in all sectors. It is not that the world needs to move less oil; on the contrary, there is substantially more oil that needs to be moved but there are just too many ships to allow anything more than the odd market spike where tonnage has chosen to leave weak market areas. Today an MR 45,000 dwt tanker can be chartered for 12 months at $14,000 a day (similar to the rates of 2014), and it is rumored that some profit-sharing deals are being done below $12,000 per day.

Although crude shipments to China have increased, a lot of that oil is coming across Siberia in pipelines. It may be noted that Chinese companies are quietly using their own tonnage in many areas of the world, especially east of Singapore. In Europe, the damage to oil export prices has forced the Russians to increase production to try to maintain hard currency income. There have been some serious spikes in the Black Sea market for both clean and dirty tankers but the oversupply of tonnage always eventually balances the shortage. Many of the tankers trading the Mediterranean never want to leave the general area.

In the aftermath of the oil price collapse, the boom in tanker building has undermined global freight structures. This year the last sector (namely, Medium Range) to enjoy steady returns has been undermined by some 200-plus newbuilds entering the market. Nowadays famous shipyards in South Korea (such as Hyundai) are in serious financial difficulty (despite a good 10 years or so of feverish activity) with empty order books. It seems the Greek shipowners have finally run out of ideas as to which sector to build and the finance with which to do so. Frontline, the John Fredericksen tanker arm, recently signed an order for a new VLCC at $76 million, some $40 million less than the prices in 2012.

VLCCs looked like dinosaurs in 2010 but things have changed and the last 18 months have restored confidence in the big ships ability to make profits in the future. At the same time the sources of crude for VLCC cargoes have multiplied. These ships are no longer restricted to carrying crude from the Mideast Gulf and West Africa to Japan, Europe, and the United Sates. Today VLCCs are loading cargoes in northern Europe, the Caribbean, West Africa, the Mideast Gulf, and India with diverse destinations, including old homes such as Rotterdam and the USGC, but now also new homes in South America and Asia.

Certainly the world's tanker industry has become more global. On the back of US shale oil production, US product exports have grown dramatically, giving rise to regular trades in Panamax and MR tonnage from the USGC to the Caribbean. These MRs transit the Panama Canal on their way to Colombia, Peru, and Chile. While 20 years ago the trades were always Caribbean (mostly Venezuela) to the USGC or USAC, these days one observes regular tenders for product supply to Latin American countries and nowadays some tankers rarely venture east to the old world of the European continent or the Mediterranean.

West Africa is growing as a destination with the Continent-West Africa trade rising in significance as an increasing employer of Medium Range tonnage. Port restrictions have denied oil traders the economies of scale which have become the bread and butter of the East-West clean products trade. Inter-West African business was very exciting until first quarter 2016, after which it faded somewhat with the stronger dollar undermining the economics of gasoline imports to Nigeria. Nigeria has certainly been welcomed into the global economy and West Africa is now a significant destination for oil tankers, not just for lifting crude oil but also supplying refined products. The Continent-Mediterranean clean and dirty tanker markets are now benchmarked against the Continent-West African market.

With the new Red Sea, Mideast Gulf, and Indian refineries, the considerable expectations for the LR2 market did not materialize into much greater earnings.

AVERAGE DAILY EARNINGS IN THE SPOT TANKER MARKET, BY SHIP SIZE

Ship Class	MR	LR1	LR2	Aframax	Aframax	Suezmax	VLCC
Date	**Atl Combi**	**AG/Japan**	**AG/Japan**	**X UKC**	**AG/Spore**	**WAfr/UKC**	**AG/Japan**
Average 3rd Quarter 16	5,776	10,759	13,452	6,811	8,291	11,572	16,858
Average Sept 16	4,925	8,139	9,496	11,094	3,827	17,706	13,029
Average Aug 16	4,812	13,143	17,533	-1,180	8,261	3,129	15,829
Average Jul 16	7,592	10,995	13,327	10,519	12,784	13,882	21,716
Average 2nd Quarter 16	11,890	11,311	13,743	24,184	16,906	22,713	40,159
Average Jun 16	7,918	10,172	11,735	23,722	14,283	22,159	32,499
Average May 16	13,296	11,506	13,629	20,293	13,495	18,306	41,750
Average Apr 16	14,457	12,255	15,864	28,537	22,940	27,673	46,229
Average 1st Quarter 16	17,735	16,604	22,089	22,953	25,663	29,782	52,355
Average Mar 16	15,539	15,566	17,585	19,778	26,996	23,403	52,855
Average Feb 16	17,247	13,657	18,857	19,122	21,678	27,980	43,122
Average Jan 16	20,418	20,590	29,825	29,959	28,316	37,963	61,088
Annual Average 2015	**25,987**	**22,504**	**27,368**	**34,574**	**28,370**	**39,635**	**60,864**
Average 4th Quarter 15	21,803	15,616	19,941	37,001	28,764	42,519	81,117
Average Dec 15	24,455	20,422	25,606	39,371	39,204	41,835	98,263
Average Nov 15	22,948	13,872	15,773	39,818	27,308	46,047	65,985
Average Oct 15	18,005	12,553	18,444	31,814	19,781	39,675	79,104
Average 3rd Quarter 15	27,879	30,097	39,644	23,652	27,544	32,855	50,482
Average Sept 15	24,146	20,332	23,301	20,938	20,948	30,462	51,558
Average Aug 15	24,753	34,364	49,685	24,528	25,269	30,918	29,635
Average Jul 15	34,739	35,595	45,946	25,490	36,415	37,185	70,253
Average 2nd Quarter 15	28,912	22,791	26,485	47,769	30,533	40,050	58,624
Average Jun 15	33,038	27,978	33,356	61,710	40,974	43,323	59,424
Average May 15	28,699	20,684	24,330	40,611	26,929	45,141	61,635
Average Apr 15	25,000	19,711	21,769	40,987	23,695	31,685	54,812
Average 1st Quarter 15	25,352	21,510	23,401	29,875	26,640	43,116	53,233
Average Mar 15	34,781	24,079	25,335	21,810	26,634	44,709	42,297
Average Feb 15	17,053	17,666	23,197	26,501	25,708	39,232	50,902
Average Jan 15	24,221	22,784	21,672	41,315	27,579	45,408	66,501
Annual Average 2014	**15,743**	**13,956**	**14,701**	**22,224**	**16,390**	**25,963**	**24,207**
Average 4th Quarter 14	27,456	19,694	24,564	26,180	24,854	39,385	43,833
Average Dec 14	38,159	20,137	23,188	30,264	29,940	42,725	62,609
Average Nov 14	27,378	20,524	27,126	29,506	27,397	46,569	42,081
Average Oct 14	16,830	18,422	23,377	18,769	17,226	28,860	26,808
Average 3rd Quarter 14	12,369	14,091	16,925	21,913	17,486	22,151	19,684
Average Sept 14	10,879	15,780	18,705	12,165	15,257	13,815	12,158
Average Aug 14	10,385	15,289	21,079	22,369	22,664	18,311	24,438
Average Jul 14	15,843	11,205	10,992	31,205	15,618	34,327	22,455
Average 2nd Quarter 14	9,106	12,358	10,605	11,618	9,733	15,250	7,004
Average Jun 14	9,463	13,195	7,267	12,903	9,963	20,451	7,797
Average May 14	8,240	13,980	12,428	9,648	10,118	12,397	2,466
Average Apr 14	9,616	9,900	12,121	12,303	9,118	12,901	10,749
Average 1st Quarter 14	14,041	9,680	6,709	29,186	13,486	27,067	26,308
Average Mar 14	12,391	13,190	10,181	8,933	9,404	15,356	14,174
Average Feb 14	14,267	11,085	7,150	13,860	12,956	14,137	34,398
Average Jan 14	15,466	4,766	2,796	64,764	18,097	51,709	30,352

Source: Tanker Projects, Braemar ACM.

There were more liftings but the newbuilding program made sure there was no shortage of the right size tankers, indeed the LR1 size has consistently failed to meet expectations through the post-millennium period. While a large number of these LR tankers are on long-term time charter (mostly to the major oil companies), it is the poor returns of tankers in the spot market that are being considered here. The LR1 and LR2 returns are the most disturbing of all the tanker sizes.

The momentum in the growth of oil tanker size slowed after handy size reached 35,000 dwt, making the MR size the most convenient for supplying product to the less developed countries. It is difficult to see the 60,000 dwt size ever replacing the 45,000 dwt MR as the workhorse of the product tanker industry. What seemed like the inevitable growth in tanker size since the 1970s, when the 20,000 dwt was called the "Handy" size, seems to have come to an end with the Medium Range tanker of 45,000 dwt in 2015.

In the Far East, Japanese economic stagnation did little to excite the tanker industry and China has eclipsed Japan as the larger economy. The liberalization in the Chinese oil industry has allowed the so called teapot refineries to import crude. This has substantially boosted requirements for Aframax and Suezmax carriers while the drop in naphtha shipments into Japan has undermined rate structures for LR clean tonnage.

With respect to tanker shipping finance, it seems that the days of US corporations and hedge funds seeking offshore shipping investments for the sake of pre-tax profits are coming to an end. Those that invested in tankers in the past five years enjoyed the returns of 2015, but they will not see that year repeated. Many have been burned in the dry cargo shipping industry and, with no sign of a recovery there, they will be less eager to repeat the experience. The world now has more modern oil tankers than the market requires.

Conclusion

Low oil prices and low shipping costs should help encourage the economic growth the world economy so desperately needs, but other factors still discourage global investment in the liberal economy. The British vote on Brexit and the Syrian civil war are among the myriad destabilizing factors which discourage investment and economic growth. The European Central Bank is doing what it can to stimulate investment, but private capital seeks protection rather than high risk high return investment. Governments can create the groundwork and the legal framework but only security and the expectation of profit can encourage private capital to take the plunge.

With all the newbuilds of the past six years it would seem that the world economy requires at least five years of sustained peaceful growth to swallow up the tanker surplus and generate a need for increased capacity. Hedge fund cash will have to find onshore corporations needing growth and development which will in turn create new jobs and more consumers before the tanker industry needs more tonnage. Only onshore growth will lead to sustainable employment for the offshore industry.

Given the lackluster shape of the world economy, it really does not look good for oil tanker demand in the years ahead. Tanker demand will likely only be sufficient to sustain the existing fleet with marginal returns for the next three years. Under such circumstances, however, traders should find themselves able to move fuel oil in all corners of the globe at very economical freights. ■