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POTEN TANKER OPINION



It Is A Balancing Act

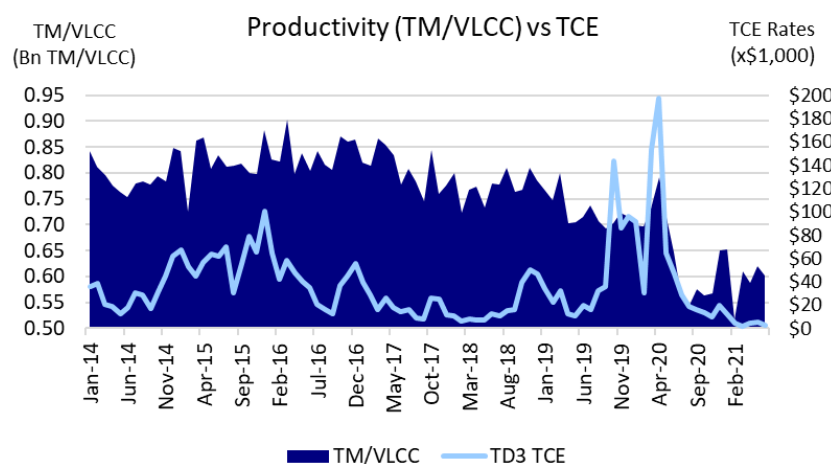
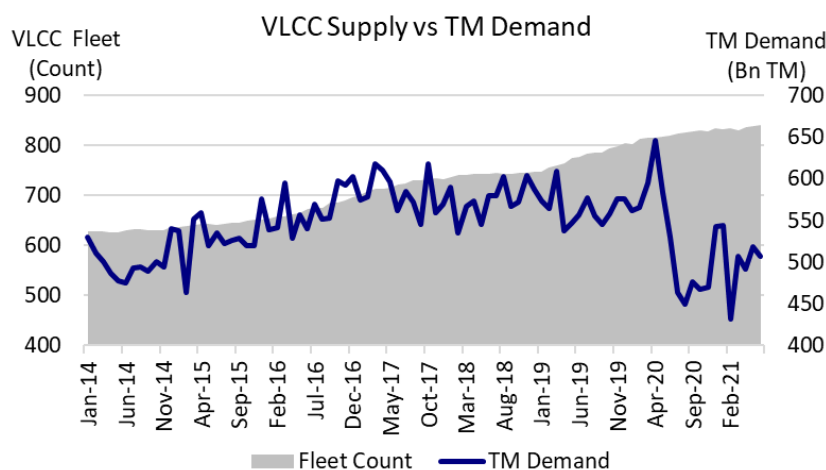
VLCC ton-mile demand remains below pre-pandemic levels

The tanker market, in particular the crude oil tanker market remains in the doldrums, despite widespread signs of improvements in oil demand amidst reopening economies. The dry bulk and container markets go from strength to strength, while VLCC rates, usually on of the bellwethers of global oil demand growth, struggle to remain in positive territory. The global economic boom seems to have no impact on the tanker market. Why is that the case? Is it temporary or is it a harbinger of things to come? In this Tanker Opinion, we'll take a look at VLCC supply, ton-mile demand and vessel productivity and determine how these factors, in combination with market psychology, have conspired to keep pressure on tanker rates.

The first chart on the right compares VLCC supply (number of vessels) with ton-mile demand from January 2014 until June 2021. Over this period, the VLCC fleet has increased by 33.7% (from 628 vessels in Jan 2014 to 841 today). However, during this 7-yr period, fleet growth was quite uneven. VLCC fleet expansion was subdued in 2014 (1.3%) and in 2018 (1.5%). In 2014, only 23 VLCC were delivered (the lowest delivery total since 2006), while 14 vessels were scrapped (on top of 21 removals in the previous year). This fleet rebalancing, combined with healthy demand growth (VLCC ton-miles expanded by 6.1% in 2015) led to a strong rate recovery in 2015.

The developments in 2019 are more difficult to explain as they involve factors that are outside of the market fundamentals. Supply growth was subdued in 2018. After several years of poor returns, owners decided to scrap underperforming assets and no less than 33 VLCC found their way to the breakers. However, deliveries were not particularly low in 2018 (41) and quite high in 2019 (66). On top of that, VLCC ton-mile demand declined in 2018 (-1.2%) and again in 2019 (-1.9%). Nevertheless, we saw a significant rate spike in towards the end of 2019. These high tanker rates were partially driven by market psychology created by geopolitical unrest in the Middle East and acerbated by a plethora of U.S. sanctions against Iran and Venezuela. The upcoming introduction of IMO 2020 sulphur rules also played a role. Uncertainty about fuel availability and vessels in drydock for scrubber installations created inefficiencies in the market and elevated tanker rates.

In February/March of 2020, it became clear that IMO 2020 was not creating the problems that some people expected, and the markets quickly came back to earth. That is, until Covid hit and the Saudi-Russian oil price war created another crisis. Rates spiked as tankers were used for floating storage. However, this boom was short-lived and tanker earnings fell rapidly when the OPEC+ countries cut production and ton-mile demand collapsed in the wake of widespread lockdowns and travel bans.



Source: Lloyd's List Intelligence; Poten

What was hidden behind all this volatility was a deteriorating supply/demand balance for VLCCs. From the beginning of 2016 through the middle of 2019, VLCC ton-mile demand was fairly stable, averaging around 575 Billion ton-miles per month. At the same time, the VLCC fleet continued to grow, from 653 vessels on 1 January 2016 to 783 units by the middle of 2019. As a result, the VLCC "productivity", defined as billions of ton-miles transported per vessel declined from a peak of 0.90 Bn TM/VLCC in March 2016 to 0.74 Bn TM/VLCC in June 2019. Since then, VLCC productivity has fallen further due to the combined effect of Covid-19 demand destruction and continued fleet growth. After the two event driven rate spikes in 2019 and 2020, VLCC earnings have fallen back to levels that reflect the poor supply demand balance.

Are VLCC's doomed? Not at all! The market can (and most likely will) bounce back, especially as oil demand growth translates into more tanker ton-miles. However, barring any unforeseen geopolitical triggers, it could take some time before the market balance swings back in owners' favor. It will require continued discipline on the ordering side as well as a pickup in the demolition of older tankers. If that happens, constrained fleet growth can set the stage for a freight market recovery, just like it did in 2014 and 2018.