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POTEN TANKER OPINION

Market Turm(Oil)

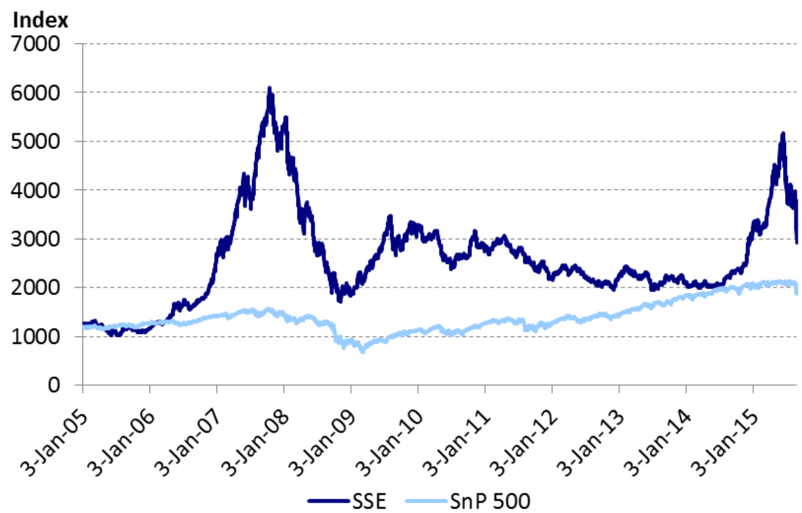
Impact of the volatility in the equity markets on tankers

Over the last two weeks, equity markets worldwide have sold off as investors ran for the exit. Over the last few days, many of the global stock indices have recovered some of their lost ground on the back of better economic news from China and the U.S. However, investors remain nervous. In the U.S., the stock market entered "correction" territory, i.e. stocks were down more than 10% from their highs. Shipping stocks suffered like everybody else. Most shipping stocks fell below Net Asset Value (NAV). Even companies with strong balance sheets and earnings were trading at a significant discount. It is too early to say whether the pullback will turn into a bear market (a 20% correction from peak to trough). But we should not look at the stock market in isolation. It is important to remember that the economy is not the same as the stock market. This is particularly true in countries like China where the stock markets are not as well developed. The key question is: what caused these stock market gyrations and will it spill over into the "real economy"?

The immediate trigger for the sell-off, which started in China, seems to have been the surprise devaluation of the Chinese Yuan. This was interpreted (and widely reported) as a signal that the Chinese economy was in serious trouble and in need of stimulation. Before the global stock market correction, equities in the U.S. were trading close to record highs as a result of a long term bull market. This was enabled by the cheap money policy of the U.S. Federal Reserve, which kept interest rates near zero since 2009. The uncertainty around the Chinese economy and the prospect of higher interest rates were the main reasons for the stock market jitters in the U.S. As wild as the recent swings in the S&P500 have been, they pale in comparison to the volatility in the Shanghai Composite Index (Figure 1).

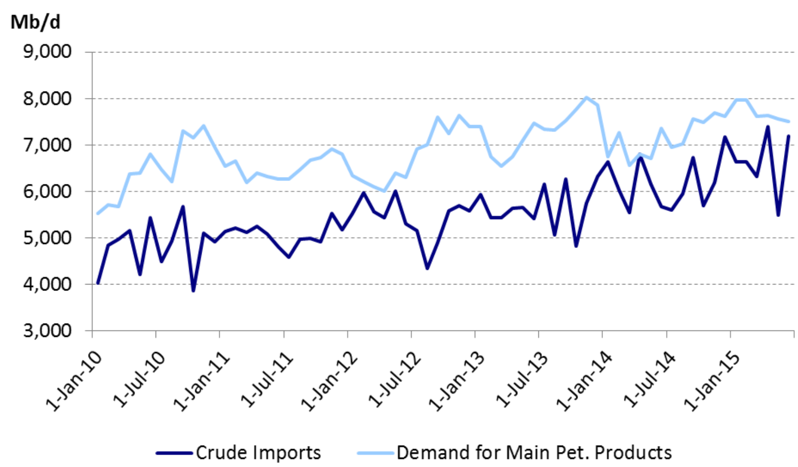
The Chinese economy is maturing and as a result, the Chinese economy is not growing as fast as it once was. However, this seems to have had more of an impact on the dry cargo markets than the tanker markets. The more limited impact on the tanker market can be explained by two factors. First of all, China's share of global oil demand is only 12% (as opposed to China's 73% share of global Iron Ore demand and 77% share of Thermal Coal demand, for example). Therefore, China's impact on the oil markets is more limited. Secondly, Chinese oil demand and imports have continued to increase throughout this year, stimulated by the drop in oil prices stimulates.

Fig 1. S&P 500 versus Shanghai Stock Exchange 2005-2015



Source: Bloomberg

Fig. 2: Chinese Oil Demand versus Demand for Main Refined Products



Source: JODI

The outlook for the U.S. economy remains healthy and the immediate impact of the stock market volatility on the real economy is limited. Over the longer term, a sustained bear market could have a negative influence on market psychology and trickle down to lower consumption and investments. However, economists generally consider the U.S. economy to be on solid footing and give that scenario a low probability.

While the dry bulk shipping markets have been heavily impacted by the developments in China, the tanker markets continued to perform well so far this year. A volatile stock market will not change that. What would change the outlook for the tanker market (and send chills down the spine of many shipowners) is a slowdown in Chinese oil imports. This has not happened so far as increased gasoline demand and continued stock-building have mostly compensated for reduced diesel consumption.