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LPG World Markets

Spot TCE earnings go below TC rates

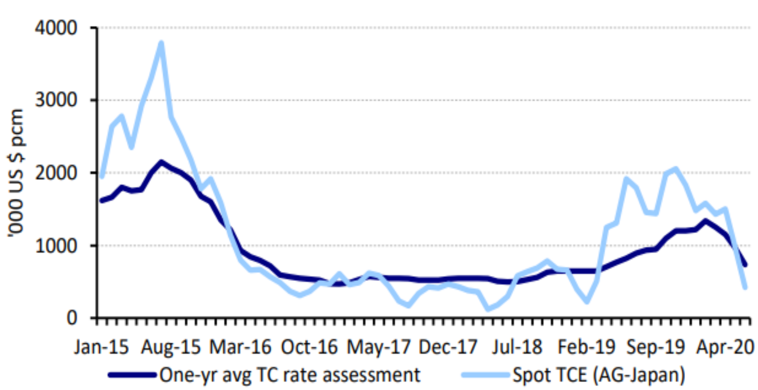
Unfavorable arbitrage economics, competitive naphtha and lower exports from the Middle East weighed on VLGC freight rates even though US exports were up year-on-year in 1H20. After a good start to the year, freight markets for VLGCs nosedived in the past two months. Although US exports registered robust year-on-year growth rates in the first half of 2020, export volumes declined in Apr and May from the highs registered in the first quarter. LPG exports from the Middle East registered a year-on-year decline in 1H20, largely due to OPEC+ decision to cut down approximately 10 MMb/d of crude oil production.

The oil price crash amid lockdowns in many nations due to the pandemic weighed on demand for refined products, including that for LPG. Although a few nations noted increases in seaborne LPG imports during the lockdown period, these increases have been unable to support freight markets for VLGCs.

Unfavorable arbitrage economics to ship US barrels to the East and to Europe/Med weighed on US exports creating a long list of available prompt vessel. Naphtha was the most competitive feedstock in Europe from the end of the first quarter of current year to mid-June edging out LPG, which weighed on transatlantic trade.

As a result, VLGC freight rates for AG-Japan voyages declined from a high of $81/t as of 22 Jan 2020 to $23.86/t on 22 Jun.

VLGC spot TCE rates vs 1-yr TC assessments



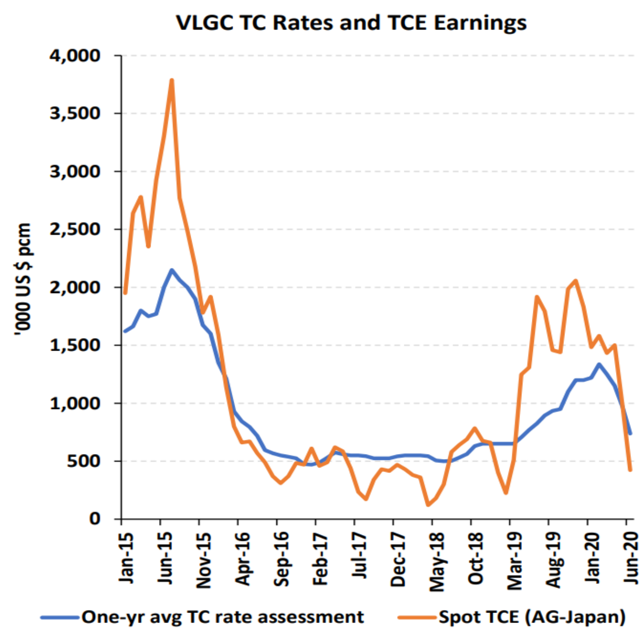
On a time charter equivalent (TCE) basis, VLGC spot rates for AG-Japan voyages declined below Poten's one-year average time charter rate assessment in June. The graph above plots a timeline of spot TCE rates and Poten's one-year VLGC time charter assessments since beginning of 2015. Between January and December 2015, spot rates on a TCE basis averaged just less than $2.6 million per calendar month (pcm), while average one- year time charter rate assessment averaged slightly more $1.8 million pcm. The scenario changed in 2016 with spot rates averaging around $660,000 pcm compared with $758,000 pcm for the TC rates due largely to increased VLGC fleet supply. A similar situation was observed in 2017 as earnings in the spot market averaged $439,000 pcm, while average TC rate was US $532,000 pcm.

In 2018, one-year TC rate assessments improved on firming sentiments towards the end of the year and averaged US $561,000 pcm for the year. Spot rates, on the other hand, also moved up year-on-year, however, was still below TC rates and averaged $483,000 pcm.

Apart from growing export volumes from major load regions and healthy demand from the main importing countries, some exogenous factors, such as, fog related delays followed by a tanker-barge collision in the Houston Ship Channel which blocked the traffic leading to loading delays in the US Gulf also contributed to the surge in VLGC freight rates since the second quarter of 2019. Discharge delays at a few Far Eastern ports, and at some Indian ports, were also reported intermittently.

Time charter rates remained stagnant at $650,000 pcm during the first quarter of 2019 but started heading north from the second quarter on firming sentiments and averaged around $1.2 million pcm in November and averaged $876,000 pcm for the year. On the other hand, spot rates surged from an average of $378,000 pcm for 1Q 2019 to slightly less than $2.1m pcm for November and averaged more than $1.3m pcm for the year.

Spot earnings as well as average one-year time charter rates carried the momentum they gathered in 2H19 to the first quarter of 2020. Although spot earnings for 1H20 averaged $1.2 million pcm, which was above the average TC rate at $1.1 million pcm, spot earnings went below TC rates in the second half of May. According to Poten's assessment, spot earnings for AG-Japan voyages stood at $417,000 pcm for the week ending 26 June against a TC rate of $700,000 pcm.



However, spot market activity increased during the last week of June and the benchmark Houston-Chiba route jumped from the high $40s/t to over $60/t in the space of just two days. Baltic rates also increased from $23.86/t on 22 June to $29.21/t on 30 June.

The recovery was largely weaved around encouraging macro signs with reduced threat of the second wave of lockdowns, as well as constructive data from US shale producers. On the vessel supply side, the impact of reduced ballast speeds to around 14 knots and VLGCs opting to take the longer Cape route to reposition vessels back to the US Gulf from Asia appears to have paid off. These factors combined with around 20 uncovered cargoes quoted to the market for July loading dates took the market up over 30% in just two days.

With the rebound in spot activity, many believed that the market has found a floor, at least for the time being.

Poten records show that a total of 17 short-term (ST) and four long-term (LT) time charter fixtures were concluded for VLGCs during 1H19 as against 14 ST and five LT deals concluded during the same period in 2020.

With spot TCEs sharply falling below average one-year TC assessment, it has resulted in a fairly typical standoff between owners and charterers, with owners reluctant to charter out vessels on term at a timing that they feel could be the bottom of the market, and charterers happy to enjoy the lower spot levels.

As a general rule, when the owners' TC ask level is significantly above the spot market earnings there is limited activity, and discussions often revert to those willing to consider a Baltic index linked deals to try and bridge the gap.

While some charterers have attempted to capitalize on the weaker market by looking at longer-term opportunities, bids and offers have been wide apart and the TC market has been quiet. Looking into near term expectations, if a second wave of lockdowns is avoided, TC activity and fixture hire levels are expected to slowly pick up as the market moves closer towards 2021.