Tanker Income Inequality

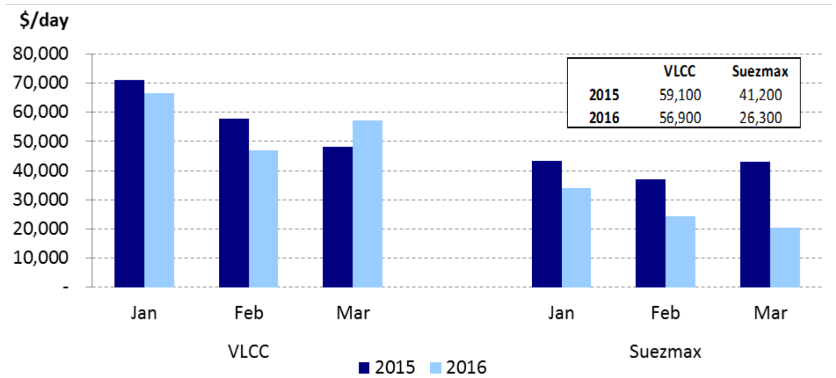
Divergent fortunes for Suezmaxes and VLCCs in Q1

Typically, the Suezmax and VLCC markets behave somewhat similarly over a period of time. However, in Q1 of 2016 we have experienced a significant divergence in rates between the two segments. The average VLCC rate on the benchmark Arabian Gulf to Japan route was $56,900 per day in the first quarter of 2016 compared to $59,100/day in the same period of 2015. This represents a modest reduction of 4% year over year. Suezmaxes, on the other hand, earned only $26,300/day in the first quarter of 2016 on the representative West Africa – Rotterdam route compared to $41,150/day in Q1 of 2015, a much more significant discount of 36%. What are the reasons that these segments performed so differently?

We will start with an analysis of the demand side using the volume of reported spot fixtures as a proxy. The total number of VLCC spot fixtures increased from 481 in Q1 2015 to 512 this year (+6.5%), driven mainly by strong Far Eastern imports from the Arabian Gulf. Imports from China in particular have been strong in the first three months of this year. Official statistics released this week by the General Administration of Chinese Customs showed that the country imported 13% more crude in the first quarter of this year than in the same period of 2015. A key driver of this growth seems to be robust demand from independent "teapot" refineries. These teapot refiners have picked up crude oil purchases in recent months, stimulated by higher refining margins and seasonally strong demand. Not only has this stimulated more VLCC fixtures, it has also exacerbated port congestion in eastern Shandong province, the main hub for the independent refiners. Unconfirmed reports have some 15 VLCCs waiting at Qingdao creating delays of three to four weeks. Another factor that has impacted VLCC availability and supported rates for the largest tankers has been loading delays in Basra, Iraq. Iraqi port infrastructure struggles to keep up with the country's rising production and exports and also gets hit with the occasional bad weather (sandstorms). Up to 30 VLCCs are currently waiting to load, creating delays of 2-3 weeks.

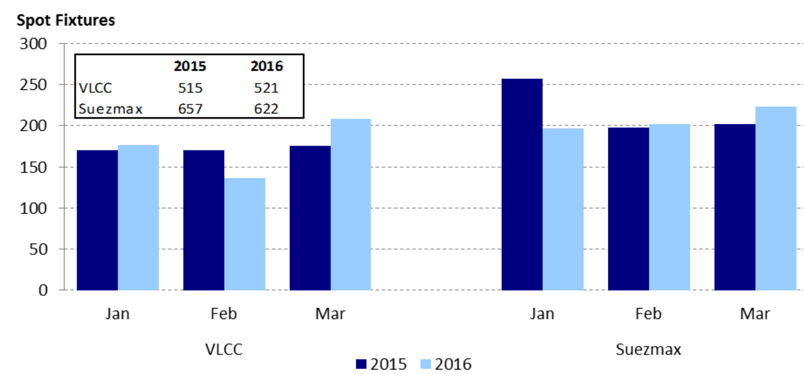
While the number of VLCC fixtures increased this year, total Suezmax fixtures declined from 657 in Q1 2015 to 614 (-6.5%) in the same period of 2016, mainly due to a reduced number of Suezmax fixtures bound for Europe. This reduction was partially offset by an increased number of Suezmax voyages from West Africa to the U.S. East Coast as reduced shale oil production in the U.S., in combination with a tightening Brent/WTI spread, have made imports more attractive than domestic crude for East Coast refiners. The Far East is gaining in popularity for Suezmaxes, in particular for trips originating in the Atlantic Basin.

Fig. 1: Suezmax and VLCC rates 2015Q1 vs 2016 Q1



Source: Poten & Partners

Fig. 2: Reported Spot Fixtures VLCC vs Suezmax (Q1)



Source: Poten & Partners

Are there any developments on the supply side of the equation that could explain the discrepancies between VLCC and Suezmax rates? Comparing the existing fleets of these segments for Q1 2016 with Q1 2015, shows little change in the Suezmax fleet: this segment grew by less than 1% from 436 to 439 vessels over the year. The VLCC fleet grew faster. In the year from March 2015 to March 2016, 17 vessels were added to the fleet, growing this segment from 640 to 657 units (+2.7%). This indicates that the explanation regarding the first quarter rate discrepancy between VLCCs and Suezmaxes is demand rather than supply driven.

In summary, it appears that the discrepancy between VLCC and Suezmax rates had to do with temporary factors, such as a spike in demand and congestion, driving up rates for the largest crude vessels, rather than indicating a structural shift. As China moves in into the seasonally lower second quarter, oil purchases will slow from the record pace of Q1. Crude inventories have started to build and, amidst growing port congestion in Qingdao, buying of the Chinese teapots will likely slow (at least temporarily). This will allow some of the backlog to ease, increasing the availability of VLCCs into the market. Congestion in Iraq will likely reduce over time and have a similar effect. We expect Suezmax rates to move closer to VLCC earnings in the coming months, more in line with their normal pattern.

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