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POTEN TANKER OPINION

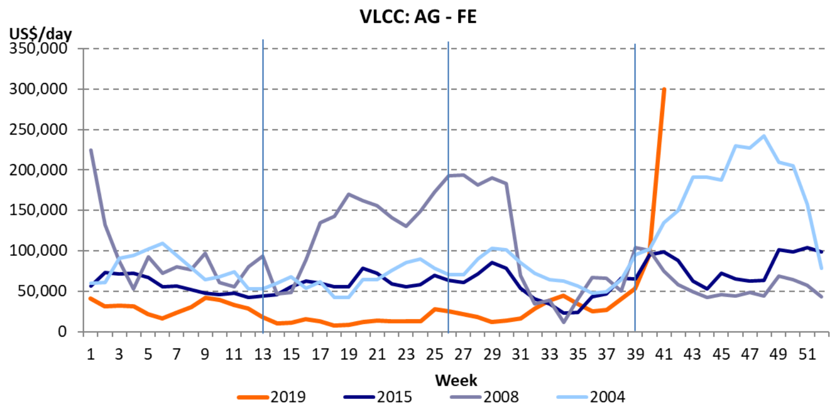
Uncharted Territory

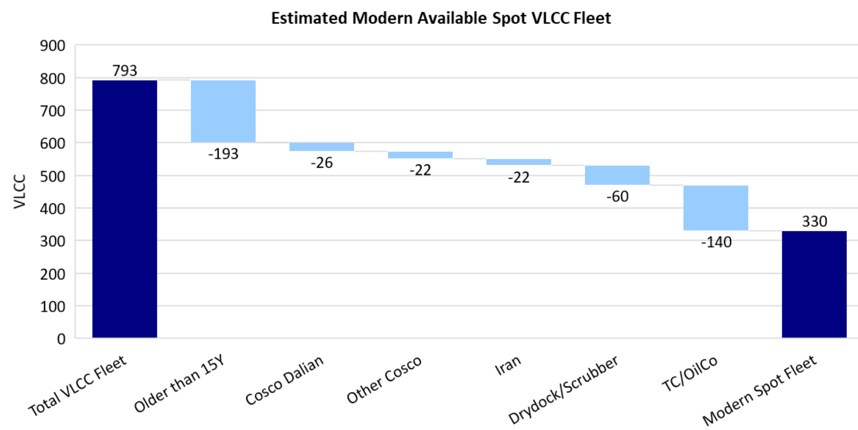
The recent surge in tanker earnings is unprecedented

Under normal circumstances, the Poten Weekly Tanker Opinion does not cover the same topic two weeks in a row. However, these are not normal circumstances. The rise in tanker rates started after the attack on the Saudi oil processing facilities in Abqaiq in Mid-September and accelerated when the Trump administration sanctioned a number of Chinese tanker companies, including COSCO (Dalian) on September 25. VLCC rates on the benchmark TD3 route from the Arabian Gulf to China, were assessed at $27,300/day four weeks ago. Two weeks later they doubled to around $53,000/day. One week after that they almost doubled again to $95,000/day. Today, rates are anywhere between $200,000 and $300,000/day. Last week, we were referencing the winter of 2015 as that was the last time VLCC rates reached above $100,000/day. To find a reference to today's skyrocketing rates, we must go back 15 years, almost to the beginning of the tanker super cycle. In the winter of 2004, rates also reached $250,000/day, but this came after VLCCs already earned more than $100,000 per day several times earlier in the year. As can be seen in the first chart, tanker earnings have been modest through the first three quarters of 2019 but have increased ten-fold in the span of one month. The questions on everybody's mind are: what caused this and is it sustainable, i.e. how long will it last?

There is not one major reason why the market has increased so rapidly. A lot of different factors have contributed, and they are reinforcing each other. First of all, after several years of dismal earnings, the market was probably more closely balanced than people expected. Export cutbacks from Middle East OPEC replaced by long-haul movements from the U.S. have helped. On top of that, sanctions on Iran and Venezuela have reduced spare production capacity and increased geopolitical uncertainty. In addition, both the refining and the tanker industry have started to prepare for IMO 2020 bunker fuel regulations. Refiners are running flat out to produce compliant fuels and (some) tanker owners are scheduling drydocks to install exhaust scrubbers.

In addition to these fundamental factors, we have seen a quick succession of unrelated incidents and these unpredictable events have pushed the market up. The Abqaiq attacks and COSCO sanctions were followed by the announcement that several charterers have increased their scrutiny of tankers that called Venezuela in recent months. This has created additional uncertainty in an already tight market. A few days ago Ecuador declared force majeure on the majority of its crude oil exports as domestic unrest escalated. While the exports from this country are relatively small (around 350,000 b/d), it does create a problem for several refiners on the U.S. West Coast, which take about 50% of Ecuador's output. They will have to source replacement barrels from the Middle East. This will create more long-haul VLCC demand.





Source: Poten & Partners

This morning, an Iranian Suezmax tanker was reportedly attacked in the Red Sea. While details have been scant and the incident has not been independently verified, this was probably a significant driver behind todays rate increases.

Where do we go from here? As rates reach into the stratosphere, it seems that the market will take a breather sooner or later. Many of the tankers that have recently been fixed or put on subjects don't know their loading dates yet. The nominations for most of the Middle Eastern exporters come out in the coming week and then we will know if this market will continue to be strong or come back down to earth. As can be seen in the first chart, which shows a number of "strong" markets in recent years, rates at these levels are almost unprecedented. History also teaches us that earnings can come down as quickly as they go up. However, the major impact of IMO 2020 is still coming and there is no significant new shipping capacity in the pipeline. While there are almost 800 VLCCs in the world, tanker rates are driven by the modern vessels in the spot market, which is less than 50% of the total fleet. We expect that the market will remain robust, albeit volatile.