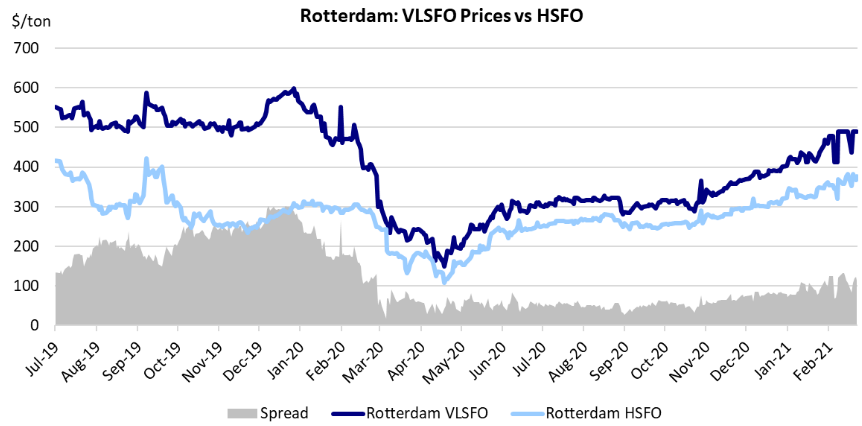
Not So Fast!

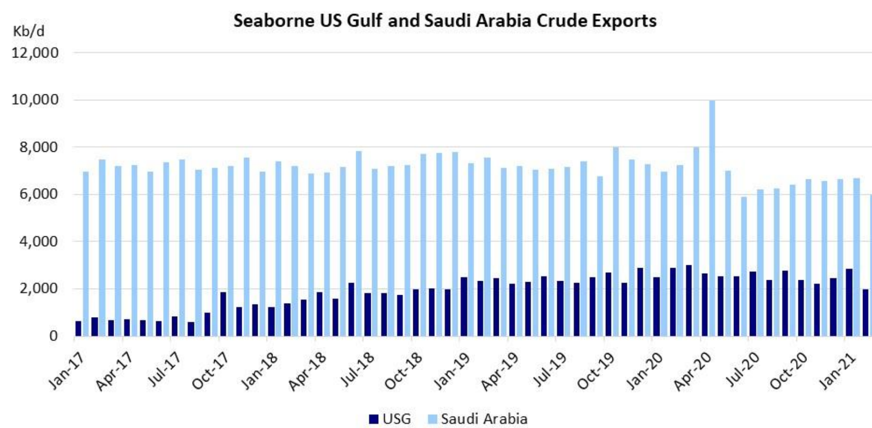
OPEC+ decision delays tanker market recovery

Like most analysts, we thought that the OPEC+ oil producers group would decide to increase production by up to 500,000 barrels per day and that Saudi Arabia would reduce their voluntary cutbacks, if not eliminate them entirely. That is not what OPEC+ decided. Except for small allowances for Russia (+130,000 b/d) and Kazakhstan (+20,000 b/d), output was held steady. OPEC is concerned about the global recovery from Covid, based on new variants of the virus and the relatively slow vaccine rollout. OPEC+ will convene again in April. Not surprisingly, oil prices moved up sharply. Brent prices have now recovered to the pre-pandemic levels of January 2020 and will face more upward pressure as long as the oil market is seen as undersupplied. What are the implications for the tanker market?

In the short term, it is bad news. Tanker rates have been depressed since the middle of 2020 and the market needs more transportation volumes for freight rates to recover to more sustainable levels. To add insult to injury, higher oil prices lead to more expensive bunkers. At the height of the global lockdowns (May/June 2020), when oil demand was down 20%, prices for Very Low Sulphur Fuel Oil (VLSFO) in Rotterdam bottomed at $164 per Metric Ton (MT), with the HFO prices at about $135/MT, a $29/MT discount (see chart 1). During a brief period, tanker owners benefited from extra-ordinary demand for tankers and low bunker prices, a potent mix that lead to supercharged earnings. Now they are facing the opposite situation. Bunker prices have tripled from their lows. Prices in Rotterdam are now $500/MT for VLSFO and $400/MT for HFO. Higher bunker prices have a detrimental effect on owners TCE's and with the market as oversupplied as it is today, it will not be easy to pass higher fuel prices on to charterers in the form of higher WorldScale rates. The only way to support earnings to some extent is to slow down. This will lower fuel consumption and increase the TCE's for individual vessels as well tighten tanker supply by reducing the productivity of the fleet.

The increase in bunker prices has also impacted the tanker market in another way: everything else being equal, vessels with scrubbers installed are earning significantly more than vessels that use VLSFO. Investments in scrubbers are paying off. As bunker prices have gone up, the differential between VLSFO and HFO has expanded again. From a low of $29/MT in April, it has now reached $120/MT. To illustrate the difference in the current market: Based on the current rate of WS 30.5 on the benchmark VLCC route TD3C (Ras Tanura – Ningbo), a VLCC with a scrubber earns around $2,100/day, while a vessel burning VLSFO has a TCE of -$5,800/day, a difference of almost $8,000/day. As of the start of 2021, we estimated that about 32% of the tanker fleet has scrubbers installed, with a higher penetration for larger vessels (VLCCs: 44%) than for smaller tankers (MRs: 27% and Handy's: 17%).





Source: Lloyd's List Intelligence

While the immediate impact of the OPEC+ decision is limited to higher oil prices and bunker costs, the longer-term impact could be more significant. Rising oil prices create an incentive for non-OPEC producers (in particular U.S. shale) to ramp up output and exports. If that happens, OPEC members will lose market share. This limits their ability to bring back output in the future, unless they are willing to (again) wage a price war to force shale companies to cut back. Under this scenario, the tanker market will benefit. A battle for market share will boost oil flows from both Middle East OPEC and the U.S. As a matter of fact, as can be seen from chart 2 above, seaborne U.S. crude oil exports were already growing again. After reaching a low of 2.2 Mb/d in November 2020, exports were back up to 2.8 Mb/d in January 2021, before the Texas storms knocked production offline in February. With prices recovering and the general economic outlook improving, we expect U.S. output and exports to come back strong. The OPEC decision to hold back may have given the U.S. producers a further boost by bolstering prices. If that happen, tanker owners will benefit as well. The recovery may be delayed but could be stronger when it comes.