POTEN TANKER OPINION

Living in "Interesting Times"

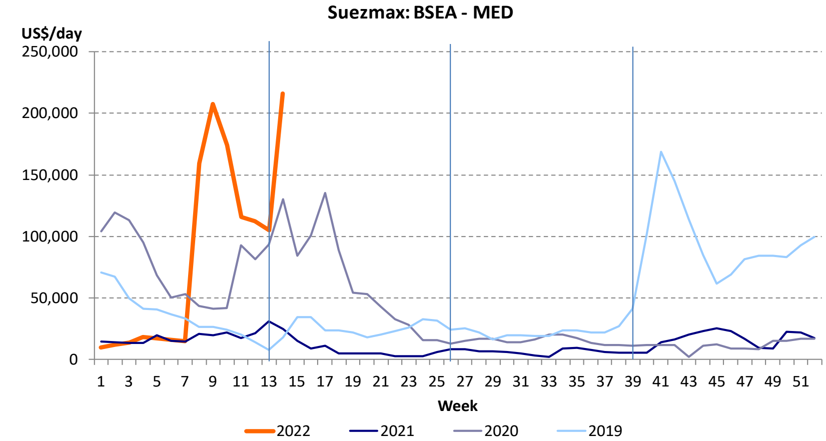
The tanker market is going through extraordinary turmoil

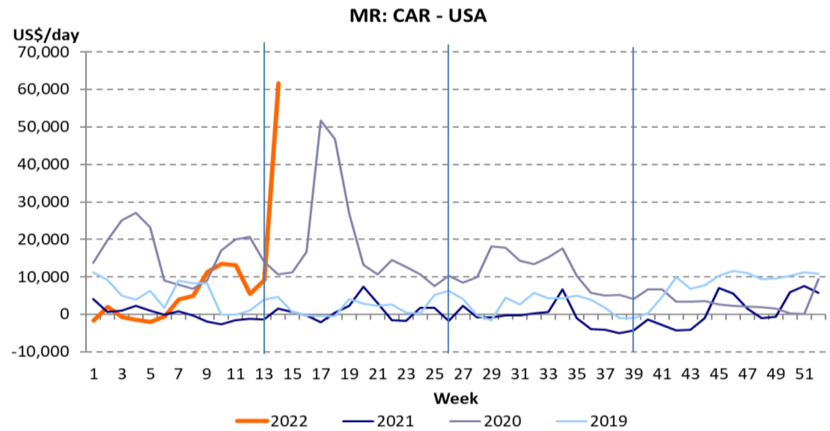
The English expression "May you live in interesting times", is claimed to be a translation of a Chinese curse, where "interesting times" are usually times of trouble. The tanker industry is indeed living in interesting times. It suffered from a high level of adversity and uncertainty with several supply and demand shocks in the oil markets in recent years and it does not appear that the situation will settle down any time soon. There are still significant challenges ahead, some of which will be overcome with time, while others are more structural. However, the industry is resilient, and owners are used to adapting to changing circumstances.

During the last four years, tanker freight rates have fluctuated wildly, ranging from the extraordinary highs in late 2019 and early 2020 to the (mostly) lows from the summer of 2020 onwards. The rate spikes for crude tankers in 2019 were driven by geopolitical events, in particular the attack on the Abqaiq oil facility in Saudi Arabia and the U.S. sanctions on certain COSCO companies. These events occurred in a tanker market that was already tight amid growing ton-mile demand and was dealing with the uncertainty around the implementation of IMO 2020. When the Covid-19 pandemic broke out in China, the initial reaction was understandably negative for the tanker market. However, the price war between Russia and Saudi Arabia in the face of falling oil demand turned the market on its head. The huge oversupply of crude oil needed to be stored in tankers, facilitating a short-term rate spike. Since then the market has been largely depressed, mainly as a result of the pandemics' negative impact on oil demand.

Although the pandemic is far from over, many (mostly Western) countries have vaccinated large portions of their population and are learning to live with the virus. Economies have started to open up and oil demand has almost recovered to 2019 levels. While 2021 was still a down year for tankers, the hope was that 2022 could be the year of recovery. This has not panned out so far for obvious reasons.

On 24 February 2022, Russia invaded Ukraine. This attack was followed by an avalanche of sanctions on Russia by the international community. While most countries initially avoided targeting Russian energy, the conflict did create a lot of turmoil in the oil markets. Tanker rates initially spiked, in particular for trades out of the Baltic and the Black Sea, two of the main export areas for Russian crude oil. Rates softened after a few weeks, until they moved up again last week as the dislocations in the crude oil and refined product markets are starting to have an impact. The sanctions on Sovcomflot, the largely state-owned Russian owner have also contributed to the rate increases. Initially, the Russia sanctions benefitted the Aframax





Source: Poten & Partners

and Suezmax tankers, which were most directly affected. However, product tankers have also moved up significantly and more recently, even VLCC-rates, which were lagging the market, have started to rise. The changes in Russian trade flows are likely permanent and should benefit future ton-mile demand.

The market would have probably improved more and faster if it wasn't for a new Covid-scare in China. China has a zero-Covid policy that aims to prevent the spread of the virus through border controls, mass testing, quarantines, and strict lockdowns. An increase in cases in the major commercial hub of Shanghai has caused officials to lockdown this city of more than 25 million people. This could shave up to 200,000 b/d off China's oil demand.

There are some possible short-and medium-term catalysts for the tanker market. A nuclear deal with Iran could quickly release more oil into the market. Fleet supply growth is set to moderate as scrapping has increased and new orders dried up because of low freight rates and high newbuilding prices. New regulations targeting maritime emissions have also made shipowners reluctant to commit to buy new vessels.

Over the long-term, the need to address climate change will reduce the use of fossil fuels and demand for tankers. The shipping industry has to address that transition. There is no consensus yet on what the best way forward is. Some owners go all in on certain new technology or fuels, while others keep their powder dry until they have a better feel for the winning strategy.