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POTEN TANKER OPINION

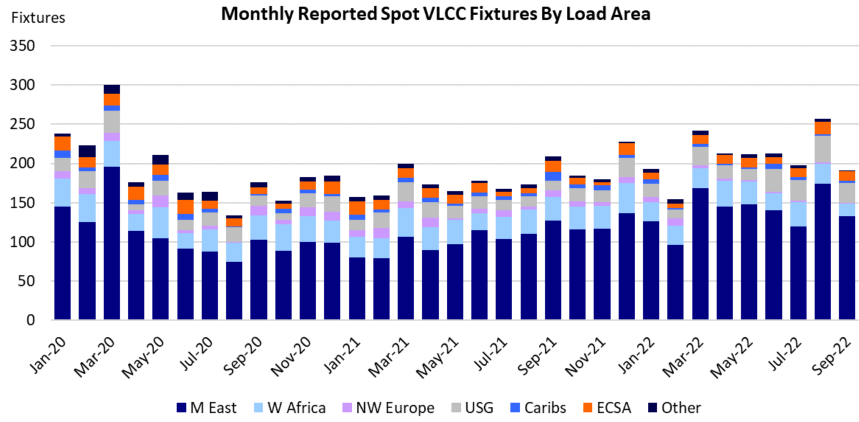
Wind In Their Sails

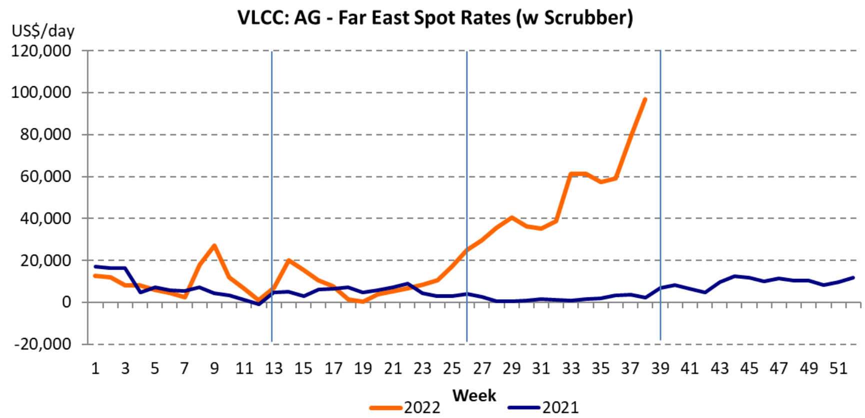
VLCCs are back in favor, but will it last?

The VLCC segment was one of the hardest hit after the massive OPEC+ production cut. This was not surprising given that most of the cutbacks came from long-haul crude oil exporters in the Middle East and West Africa, which are heavy users of VLCC tonnage. For parts of 2021 and into 2022, the earnings of older VLCCs without scrubbers were negative. These negative TCE's caught the headlines, just like the $250,000/day rates did when a Saudi-Russian price war coincided with a historical collapse in oil demand during the early stages of Covid-19. Even though OPEC members gradually brought production back, rates for the Very Large Crude Carriers failed to respond, despite many pundits predicting an imminent recovery: there was simply too much overcapacity in the market. Even when the Russian invasion of Ukraine wreaked havoc in global oil and tanker markets, it was initially the Aframax, Suezmax and product tanker markets that benefited, it did not seem to have any impact on the VLCCs. That is, until the end of June 2022. Suddenly, the market took off. Within two months, earnings for a standard VLCC equipped with an exhaust scrubber (allowing it to use cheaper HSFO as bunker fuel) went from $10,000/day to $100,000/day. What caused this sudden improvement, and, more importantly for tanker owners, are these higher rates sustainable?

As is often the case in the tanker market, there is not a single explanation for these developments. A combination of factors is at work, some related to ton-mile demand, others driven by supply side factors, fleet productivity, oil prices and last, but not least market psychology.

On the demand side, VLCC activity has picked up. Reported spot fixture activity shows that very clearly. In August 2022, Poten recorded 257 reported spot fixtures, which was the highest total since March 2020, when the aforementioned Saudi-Russian price war was in full swing. September is shaping up to be another good month. We have recorded 191 fixtures so far, with a week to go. There are two key areas that drive this increase: the Middle East and the U.S. Gulf. Some 174 spot fixtures out of the Middle East were reported in August 2022, up from 120 in July and an average of 140 for 2022 YTD. A record 33 U.S. Gulf fixtures were done in August as well, exceeding the 28 fixtures from March 2020. Since both regions tend to generate mostly long-haul voyages, the boost to VLCC earnings has been significant. China in particular seems to have picked up the pace, a welcome change from the lacklustre performance of the world's largest crude oil importer earlier in the year. The boost in U.S. exports can be partially attributed to the massive releases from the Strategic Petroleum Reserves from the Biden administration, in addition to a steady growth in U.S. domestic production. Pricing of U.S. crude has been competitive in Asia and even at current freight rates there still seems ample demand from refiners in China, South Korea and India.





Source: Poten & Partners

Other factors that may have contributed to the boost in VLCC rates are dislocations and inefficiencies. As the Europeans are looking at alternative sources of crude to wean themselves of Russian barrels, VLCC employment in the Atlantic Basin has increased. VLCCs were competitive in moving crude to Europe from the Middle East, West Africa and from the U.S. India and China imported more Russian oil, most of which came on Suezmaxes and Aframaxes. This trend has reversed recently and more demand in the Pacific means that Asian charterers need to pay up to draw these VLCCs away from the Atlantic Basin. As shipowners observe the tightening supply/demand balance, they gain confidence and boost their rate ideas, reinforcing the rising trend.

What do we expect for the next 6-12 months? That depends very much on the direction of the global economy and the developments in Ukraine. A successful implementation of the European ban on Russia seaborne oil imports, in combination with the G7 oil price cap could boost ton-mile demand and further increase freight rates. However, this positive momentum could be derailed by a global recession which will hurt oil demand.

VLCC fleet growth is limited, oil prices have come down, and owners are bullish on their prospects, giving the VLCC market positive momentum as we are getting closer to the seasonally strong winter months.