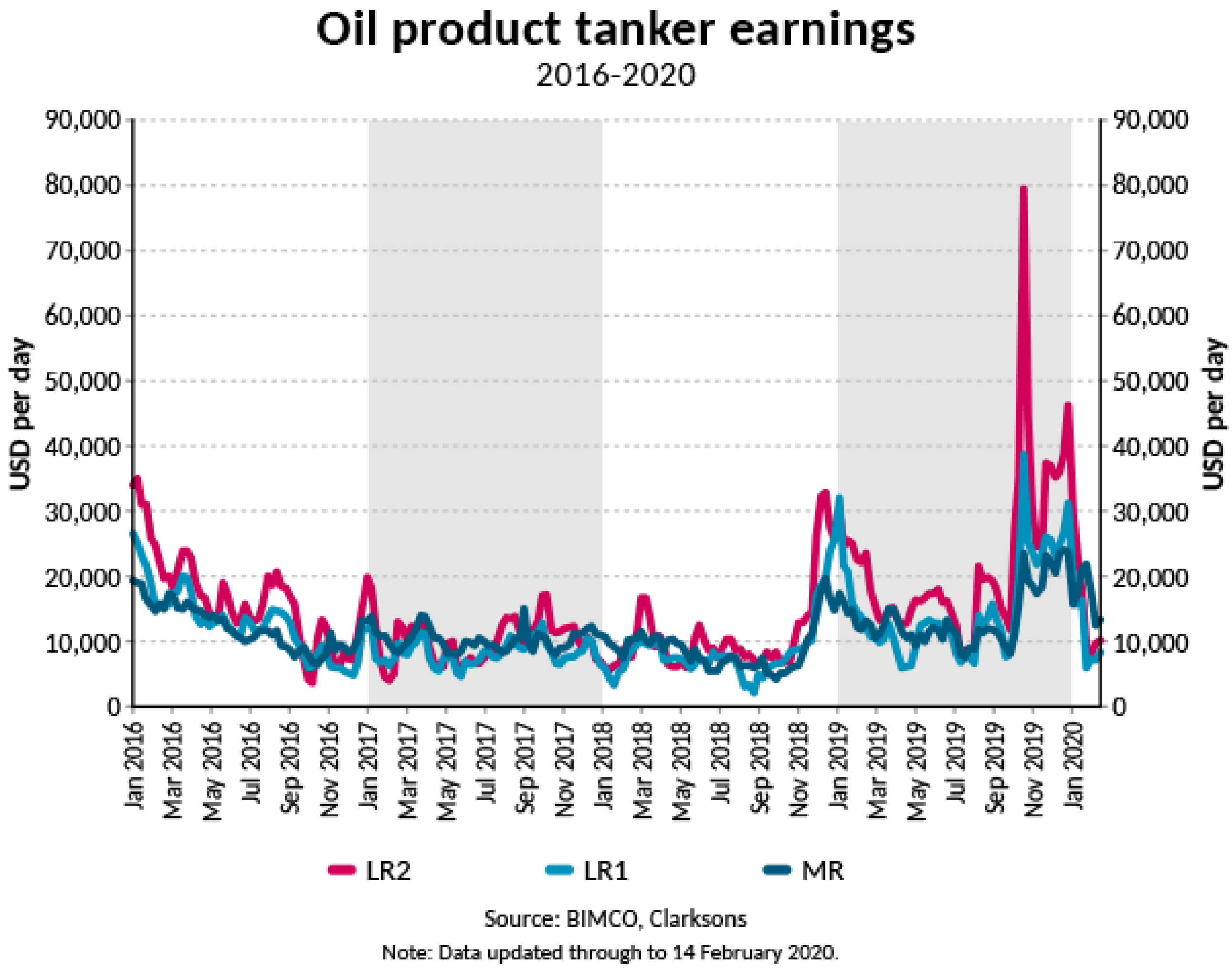
Tanker shipping: freight rates drop as strong seasonality fades and high fleet growth and coronavirus uncertainty hits

High fleet growth in 2019 and the coronavirus in China are clouding the outlook for 2020, despite the expected lower fleet growth.

Demand drivers and freight rates

Strong winter demand is fading away and has been reflected in falling freight rates. However, because charters are often fixed months in advance, ships with contracts from Q4 2019 are still earning high rates.

Moving into the new year, oil product tanker freight rates have fallen, with smaller vessel sizes earning more than larger ones. On 7 February, average earnings for an MR tanker stood at USD 12,531 per day and those for Handysize at USD 19,114 per day. At the other end of the scale, day rates for both LR1 and LR2 tankers have fallen to USD 7,154 and USD 9,573, respectively. Rates for both Long Range tankers peaked in the last week of 2019.



Inevitably, crude oil tanker earnings have fallen from the highs at the end of Q4 2019. Positive drivers have faded, including sanctions being lifted on certain Chinese-owned tankers, although rates remain seasonally high in January. Average daily earnings for very large crude carriers (VLCC) were at USD 23,797 per day on 7 February, having dropped from USD 94,286 per day at the start of January. By the beginning of February, Suezmax earnings stood at USD 33,756 per day and Aframax at USD 22,036 per day.

Falling rates at the start of the year is typical of the season-dependent oil tanker market. Demand is always strong in Q4, reflecting consumption patterns in the major markets. Demand only begins to fade during the first quarter of the next year, which explains the still-strong tanker freight rates.

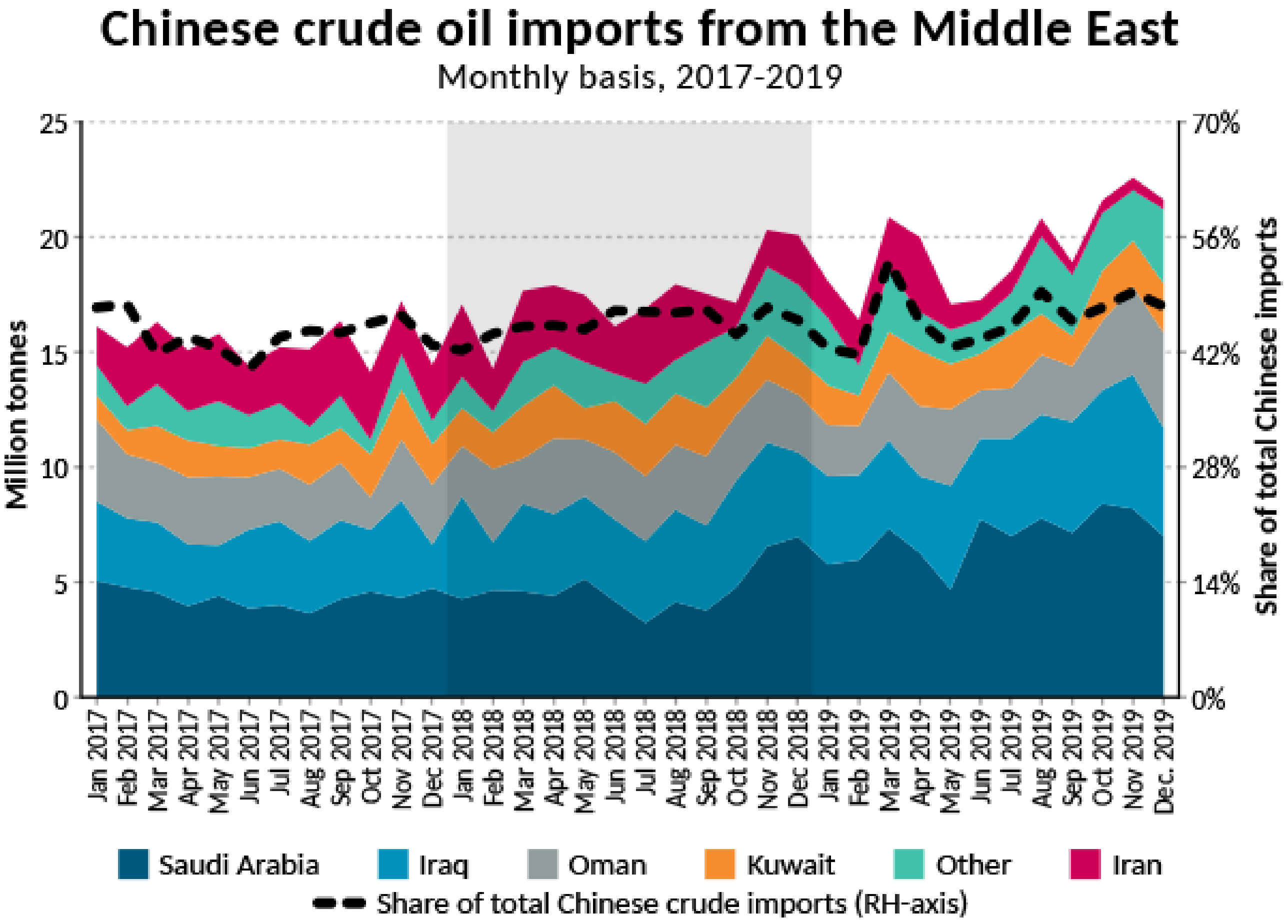
Another reason behind the decline in earnings is the higher cost of fuel caused by the implementation of the IMO 2020 sulphur cap. As average earnings are reported on a time charter equivalent (TCE) basis, they take fuel costs into account, and as these have risen for all non-scrubber fitted vessels, earnings reported for non-scrubber-fitted ships have dropped.

Comparing the difference in earnings between scrubber and non-scrubber fitted VLCCs illustrates this difference. In early January, a scrubber-fitted ship was earning USD 22,300 per day more than a non-scrubber fitted ship (Source: Clarksons), reflecting the savings from continuing to sail on cheaper high-sulphur fuel rather than a premium for the scrubber. Scrubber-fitted vessels have also seen their earnings fall over the course of January, with the difference in earnings between the two vessel types shrinking to USD 11,885 per day. This reflects the drop in the spread between low-sulphur and high-sulphur fuel oil since the start of the year.

Chinese crude oil imports continued the strong growth shown throughout 2019, setting a new record. Total imports hit 505.7 million tonnes – up from 461.9 million tonnes in 2018 – or an extra 146 VLCC loads (300,000 DWT).

Just under half of total Chinese crude oil imports (44% in 2019) are from the Middle East, with imports growing by 11% in 2019. This figure, however, hides large discrepancies between the Middle Eastern countries, partly because of the sanctions imposed.

Imports from Saudi Arabia, China's largest seaborne supplier were up 46.9% in 2019, an increase of 26.6 million tonnes. This brought total imports from Saudi Arabia up to 83.3 million tonnes. On the other hand, imports from Iran fell to 14.8 million tonnes, just under half the level reached in 2018.



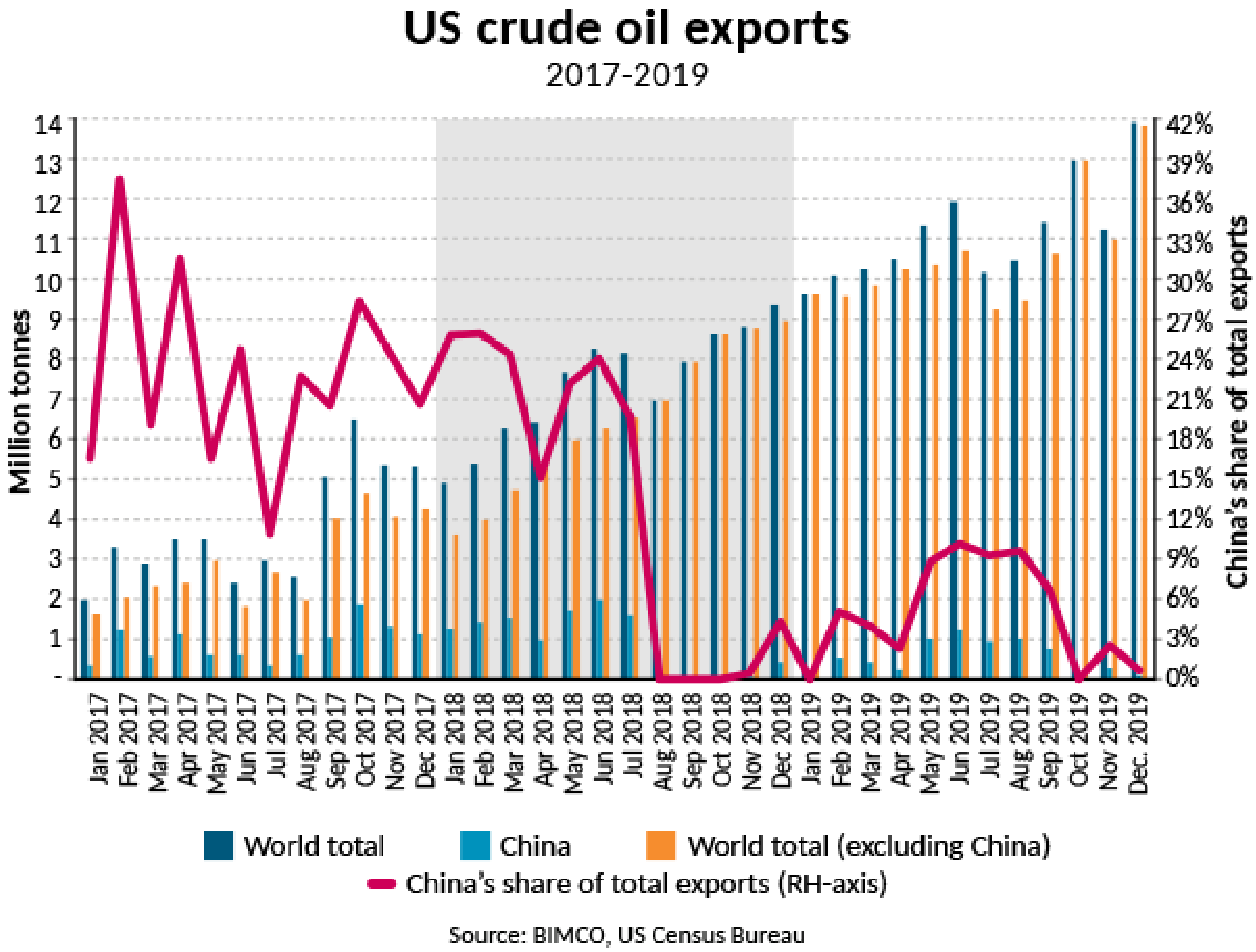
Source: BIMCO, GACC

China was originally granted waivers to the US sanctions, allowing it to continue importing crude oil from Iran between November 2018, when sanctions were imposed, and May 2019. Since then, under pressure from the US, China reduced its imports over the course of the second half of 2019. Of the total Chinese crude oil imports from Iran in 2019, 75% came in the first half of the year – an average monthly import of 1.8 million tonnes, compared with the 0.6 million tonne average in the second half.

US seaborne crude oil exports have also continued on their record-setting path; total exports reached 133.7 million tonnes, with Asia and Europe the biggest buyers. The boom in US shale oil production and the lifting of the ban on US crude oil exports in December 2015 provided some much-needed tonne miles to the crude oil tanker shipping industry. In 2019, US crude oil exports generated 1,086.6 billion tonne miles, accounting for 10.2% of total seaborne crude oil trade in tonne miles.

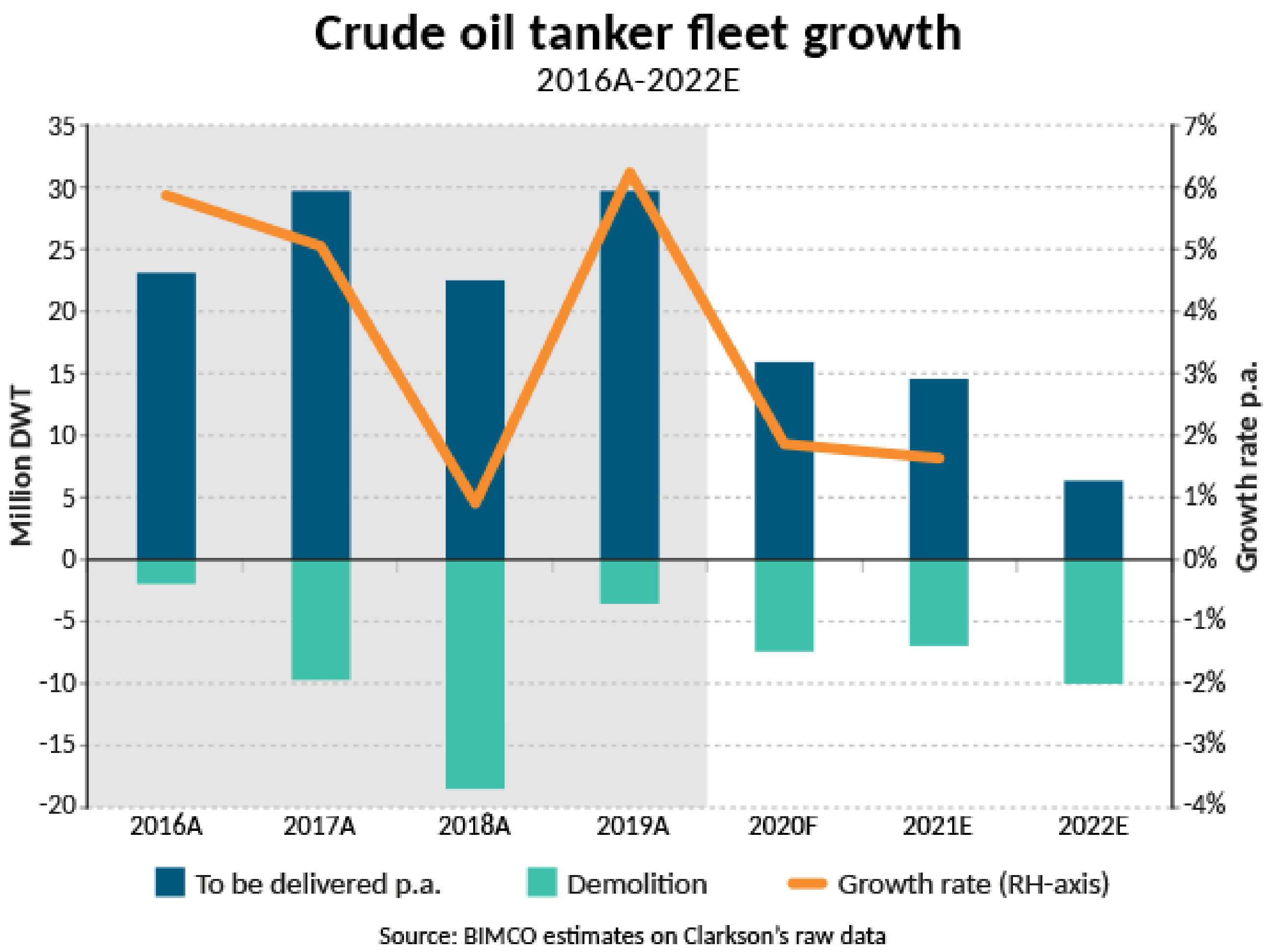
After facing severe disruption during the trade war, crude oil exports from the US to China may be set to recover this year as a result of the “Phase One” agreement. Taking 2017 as the base year, China has committed to buying an additional USD 18.5 billion of specific energy goods in 2020, with a further USD 33.9 billion over the baseline in 2021. As exports fell lower than the 2017 baseline in 2018 and 2019, the real increase in US exports will have to be higher than the headline figures. Furthermore, because of the lower oil price, volumes of exports will rise more than the value increase suggests.

Even if the agreed figures are not reached, any extra trade between the US and China – especially in high-volume energy goods – will bring additional tonne miles to the shipping industry. The higher US-to-China exports may be as a result of trade diversion rather than trade creation: total US exports not rising, but the share of exports to China increasing instead. It may be a similiar case for Chinese imports, with crude oil imports from the rest of the world replaced by imports from the US. This would be the opposite of what happened after the outbreak of the trade war, when US exports to China fell to zero for several months, whereas total exports continued to increase. In 2019, the share of total US exports to China was only 5%, down from 23.3% in 2017.



Fleet news

BIMCO projects 1.8% crude oil tanker fleet growth in 2020, considerably lower than the 6.2% growth in 2019. The market was awash with new ships in 2019, which had been ordered so that owners could profit from the overly anticipated demand boost from the IMO 2020 sulphur cap. Older ships, which might otherwise have been sent for demolition, were kept around for the same reason. Deliveries in 2019 totalled 29.7 million tonnes while only 3.5 million tonnes left the market.



A is actual. F is forecast. E is estimate which will change if new orders are placed. The supply growth for 2020-2022 contains existing orders only and is estimated under the assumptions that the scheduled deliveries fall short by 10% due to various reasons and 25% of the remaining vessels on order are delayed/postponed.

More than half the delivered tonnage during 2019 came from 68 VLCCs, with an average capacity of 310,000 DWT. The VLCC fleet grew by 8.5% in 2019 and, with a further 10 VLCCs delivered in January 2020, the global fleet now has 814 ships totalling 250.7 million DWT – the highest-ever in terms of capacity and number.

For oil product tankers, the largest ships' segment also experienced the highest growth in 2019; the LR2 fleet grew by 6.7%, whereas the overall oil product fleet rose by 4.6%. At the opposite end of the spectrum, 26 product tankers were sent to the scrapyards in 2019, the largest of which was a 47,000 DWT MR tanker.

BIMCO expects the product tanker fleet to grow by 2% in 2020, with 4.5 million DWT coming to the market and one million DWT leaving it.

Outlook

The optimism for a seasonally strong Q1 has been eroded by the effects of the coronavirus (COVID-19) and a warm winter in the northern hemisphere. Following the outbreak the International Energy Agency (IEA) has adjusted its forecast, and now expects global oil demand to fall by 435,000 barrels per day (bpd) in Q1, the first contraction in over ten years. Furthermore it has lowered its 2020 growth forecast to 825,000 barrels per day, down from 1.2m bpd before the outbreak.

US-imposed sanctions on certain Chinese-owned oil tankers, essentially removing them from the market and creating uncertainty, led to the high freight rates. But the sanctions were lifted on 31 January and around 40 tankers, more than half of which are VLCCs, have now returned to the market, adding to the pressure created by the 68 new VLCCs delivered in 2019. But this is not the only reason for unpredictability in the sector.

At the time of writing (mid-February), the full effect of the coronavirus outbreak is still impossible to predict. But because of China's size and importance to the tanker market, any disruptions to its oil trading caused by coronavirus will have a major impact on the tanker market.

Demand for oil products will be directly impacted by restrictions on travel – with air, road and rail transportation all affected in some way – as China shuts off cities in an attempt to stop the virus from spreading. Furthermore, the extended Chinese Lunar New Year holiday – which delayed the return to full work of many workplaces – has already lowered utilisation rates of Chinese refineries, thereby reducing its demand for crude throughput.

Government-owned Sinopec, Asia's largest oil refiner, has already announced a 600,000 barrel per day decrease in crude throughput and Bloomberg reports that Chinese crude oil demand has fallen by about 20% overall.

The EIA has lowered its forecast for Chinese oil demand in 2020 by 190,000 bdp in its February *Short Term Energy Outlook*, reflecting the potential fallout from the coronavirus on economic growth as well as the fall in energy demand from the transportation sector in China.

Lower Chinese demand and falling oil prices may lead to OPEC further lowering its oil output, having already agreed to trim production in December 2019.

The coronavirus outbreak is also likely to disrupt – at least in the short to medium term – China's attempts to boost sales of its own low sulphur fuel oil. The Chinese government announced in January that it would apply a tax waiver on exports of the fuel, with a particular focus on increasing sales to its own bunker market. The latter has previously relied heavily upon its neighbours to provide the fuel, given the previously high tax and consumption levies associated with producing and exporting the fuel in China.

The coronavirus spread could also derail the otherwise positive effects of "Phase One" of the trade agreement between the US and China. With only 12 months to increase its energy imports by USD 22.9 billion compared with 2019 levels, every month will count.

China has already halved tariffs on USD 75 billion of imports from the US – including on crude oil – from 5% to 2.5%, to support its economy and imports. Despite this move, in BIMCO's view, it is highly doubtful that China will meet its "Phase One" commitments if work and trade disruption is prolonged.