The Tanker Market, October 2011

Market Review

Tanker owners must certainly feel that they are pushing on a string. The more slow steaming we hear about, the lower the rates seem to go. Whereas in 2010 strong global oil and tanker demand largely mitigated the effects of rampant fleet growth, demand growth has dwindled in 2011, and tanker owners are feeling the pinch.

Rates plunge to new lows in 11Q3

The three largest importers of seaborne oil—the United States, China, and Europe—all experienced flat or declining oil imports in 11Q3, resulting in the fleet growing by more than double the pace of tanker demand. Moreover, bunker prices continued to rise in 11Q3, which has further eroded shipowners' margins. As a result, tanker earnings across the board fell precipitously. We estimate that a VLCC on our AG/East voyage earned on average $9,000 per day in 11Q3, down from $16,000 per day in 11Q2.

Moreover, the Suezmax and Aframax sectors have also been in the doldrums, as Far East liftings from West Africa and Med-Med trade declined in 11Q3. Specifically, average Suezmax rates on the West Africa/U.S. route fell to $6,000 per day in 11Q2 from $11,000 per day in 11Q2. Meanwhile, Aframax earnings for a Carib/U.S. voyage fell from $7,000 per day in 11Q2 to $6,000 per in 11Q3.

Even the product tankers were not entirely spared in 11Q3, as arbitrage windows closed, causing earnings on our benchmark Carib/U.S. voyage to dip to $11,000 per day from $14,000 per day in 11Q2.

Asset values plummet as well

Meanwhile, asset values began to come under considerable pressure in the third quarter, which has continued into October. Specifically, we estimate that the price of a 5-year-old VLCC declined by an astonishing 25% from 11Q2, hitting $61 million at present. In contrast, second-hand values of product tankers actually experienced a slight uptick in 11Q3, even though rates edged down.

NB prices dip, but remain relatively sticky

Although newbuilding prices edged down somewhat in 11Q3, higher steel plate prices and labor costs appear to be keeping contract prices from taking a plunge. Crude tanker newbuilding prices slipped by an average of 6% since 11Q2, with the contract price for our benchmark 305,000 dwt VLCC declining from $97 million in 11Q2 to $95 million more recently.

Rise in tonne-mile demand due to increases in average distances

Moving to demand-side developments, preliminary estimates show global oil trade increased by 0.5% in the third quarter of 2011, relative to year-earlier levels, with little distinction between crude and products trade. This growth is consistent with recent economic sluggishness in the OECD, as well as slower seaborne oil demand in China. Positive growth in our Asia/Pacific region was mostly offset by negative to low demand growth in North America, Europe, and China. As a result, we estimate that global tonne-mile demand saw a 2.5% rise in 11Q3, relative to year-earlier levels. Some of the tonne-mile demand growth was associated with increased average distances of oil imports into Europe and Japan relating to lost Libyan production and the effects of the March earthquake.

U.S. oil imports fall 9% yoy in 11Q3

Looking at regional developments, North American oil consumption slipped 3% yoy, with higher oil prices and rising domestic oil production cutting into oil imports over the past year. U.S. oil imports in 11Q3 fell by 9% yoy, with crude imports falling by 5% and product imports dropping by an astounding 21%.

Volumes were flat, but distances increased in Europe

Preliminary figures show that European oil imports were virtually flat compared to year-earlier levels, as a slight increase in product imports was offset by a small decline in crude imports. Adding to the weakness of import growth in Europe was an estimated 9 million barrel stock draw, partly related to the IEA's Strategic Petroleum Reserve (SPR) offering in June. Nonetheless, tonne-mile demand estimates associated with European oil imports point to a 5% yoy growth in 11Q3, as shorter-haul supplies from Libya had to be substituted with longer-haul supplies from the Middle East.

Japanese product imports surge in 11Q3

In Japan, demand for refined products for power generation has been on the rise. While Japanese crude imports were flat in 11Q3, product imports rose by 21% yoy. Not only did imports of fuel oil increase 70% yoy, but imports of gasoline rose by threefold over 2010 levels. The pattern of trade associated with Japanese crude imports has also shifted recently towards longer-haul trades, with crude imports from the Russian Far East being substituted with increased supplies from the Middle East, Africa, and Southeast Asia.

A 7% rise in Chinese oil consumption results in flat seaborne oil growth

In China, oil consumption grew 7% in 11Q3, compared to the same period of the previous year. But while Chinese oil consumption has been relatively robust, this has not translated into strong demand for seaborne oil imports. Compared to year-earlier levels, Chinese seaborne oil imports remained flat, with increases in domestic production and pipeline imports, as well as lower levels of stock builds, accounting for the majority of the decline. Moreover, China's crude supplies from the Middle East have increased over the past year, gaining market share at the expense of longer-haul supplies from West Africa and Latin America.

In the Asia/Pacific region (excluding China and Japan), preliminary estimates show oil consumption grew by 3% in 11Q3 relative to year-earlier levels, with marked increases in India, Indonesia, Thailand, and Korea. With a dip in domestic oil production, regional seaborne oil imports averaged 16.7 mbd in 11Q3, up 4% yoy.

OPEC crude output surges, but so does domestic demand

As a result of these developments, OPEC crude output reached 29.9 mbd in 11Q3, up from 29.2 mbd in 11Q2. While some of the incremental increases from the Middle East made it way to Europe, a large portion was also used as direct crude burn in power plants domestically, limiting the amount left for export. This has resulted in average crude oil prices falling slightly from $110 per barrel in 11Q2 to $103 per barrel in 11Q3, as lower WTI prices pushed the average down.

Moving to supply-side developments, the recent depressed market has virtually halted ordering in 2011, with only 2.4 million dwt contracted in

11Q3. This is compared to nearly 14 million dwt ordered in 10Q3. While renewed enthusiasm in the product tanker sector led to a modest surge in ordering in 11Q2, ordering activity has subsided in the tanker sector.

Initial estimates show tanker deliveries totaling 8.3 million dwt in the third quarter of 2011, 1.7 million dwt below the previous quarter and 2.3 million dwt below year-earlier levels. VLCCs accounted for over half of the new tonnage entering the fleet, while product tankers accounted for just 13%.

Despite the lower freight rates over the past several months, scrapping and removals continue to be relatively modest, with only 3.8 million dwt scrapped in 11Q3. It should be noted, however, that second-hand vessels have recently tumbled, which has placed 15-year-old VLCCs only $3 million above scrap levels.

Tanker fleet grows by 5% in 11Q3

As a result of these developments, the tanker fleet has expanded by 23 million dwt over the past year, registering 5% growth. Specifically, the crude tanker fleet grew by 5.5% and the product tanker fleet grew by 2.8%.

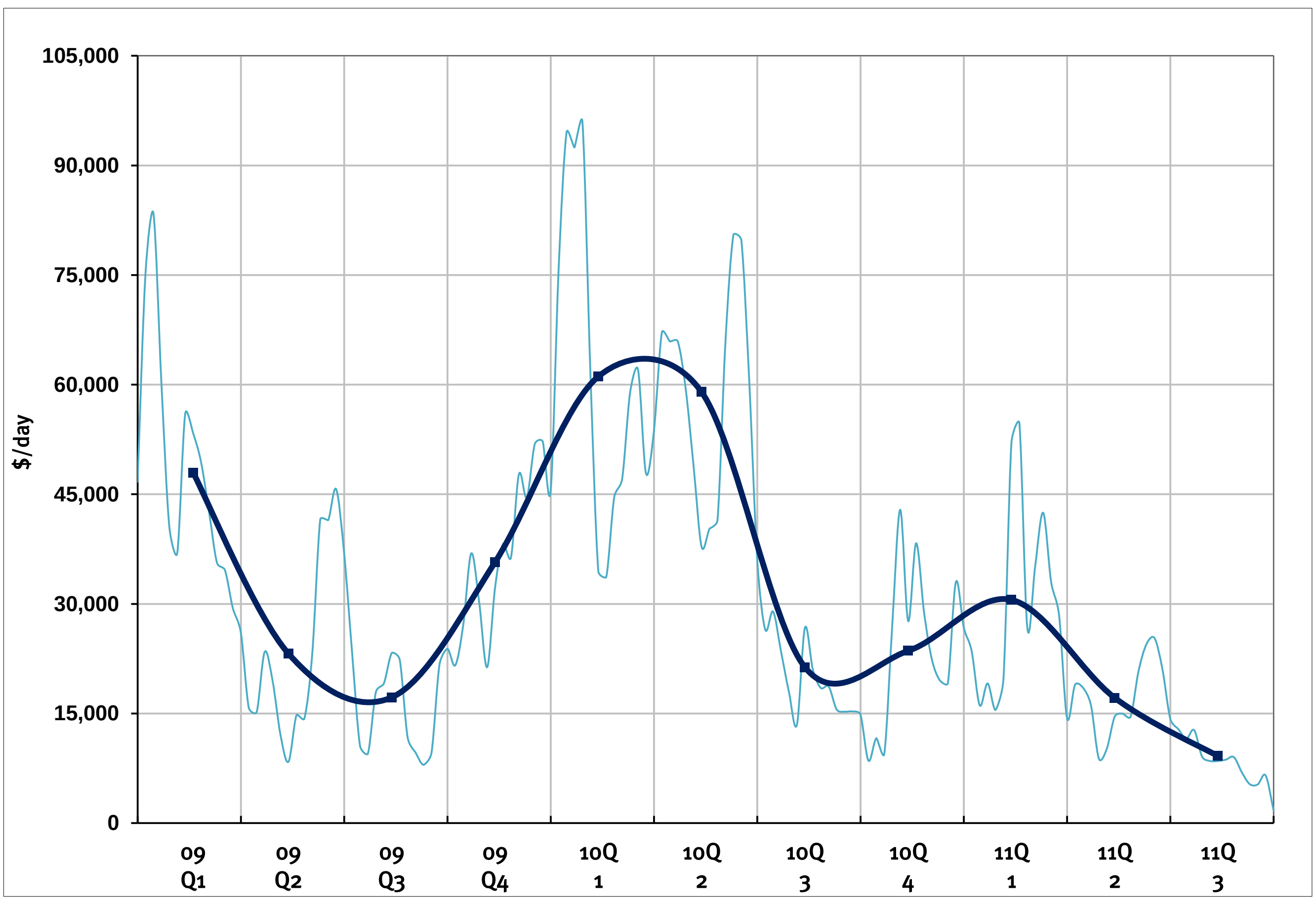

Figure 1. VLCC Spot Earnings. AG/East: Weekly Volatility vs. Quarterly Averages