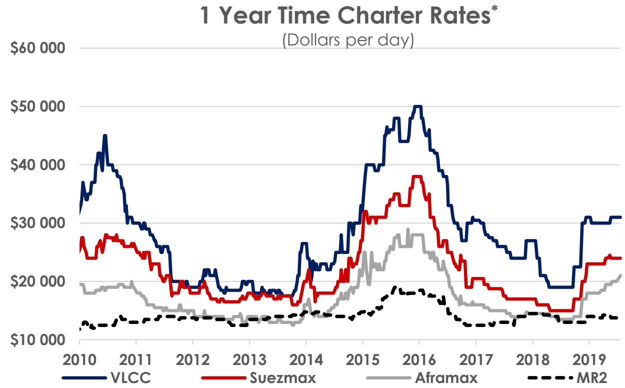
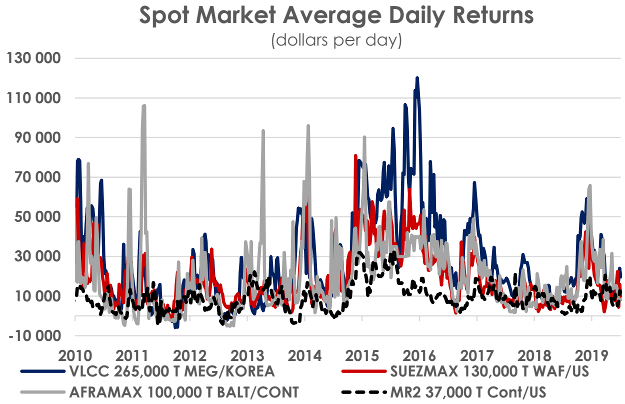
Closing the gap

One of the current curiosities of tanker markets is the extreme divergence between spot hire rates and those of time charters. This spread has steadily widened to almost unprecedented levels over the past few months as, while time charter rates have steadily strengthened, spot rates have been stuck in the doldrums. Since time charter rates are typically driven by the spot market, the current spread is unsustainable and thus has prompted tanker market participants to ask when will the gap close and will it be driven by firming spot rates or softening time charter rates? This week, we accordingly examine the drivers behind the current wide spread and suggest two scenarios which could play out in tanker markets over the second half of the year.



*basis non-eco, non-scrubber-equipped



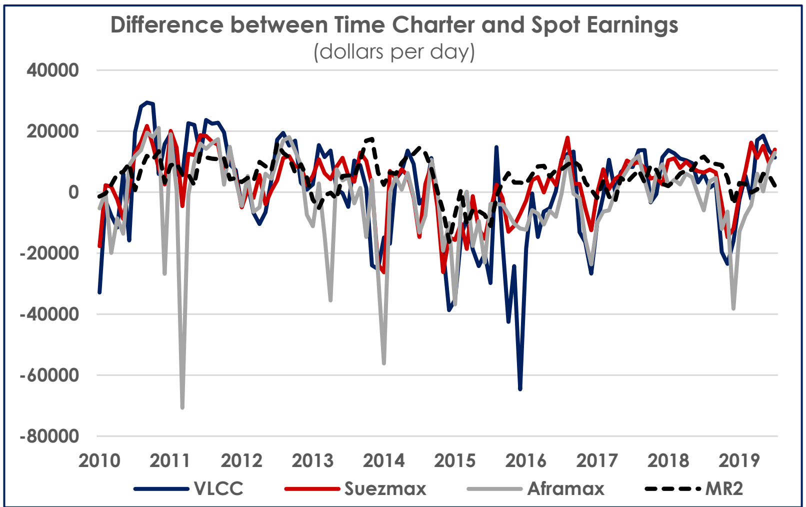
Steady demand for tanker time charters. The time charter market is a very illiquid market with long gaps between deals and a wide intra-segment variation in rates depending on vessel type (scrubber-equipped, eco etc), the delivery date (prompt versus future delivery), delivery location and the time charter length. However, what is clear is that demand for time charters has strengthened for many vessel types over the first half of this year. This publication has already discussed at length the factors influencing time charter demand (see 29 March 2019 issue of *Alphatanker Weekly Newsletter* for further details) but the main driving forces have been expectations for a strong 4Q19 with IMO2020 on the horizon. For example, the current BRS assessment of a one year time charter on a non-scrubber equipped, non-eco VLCC for prompt delivery stands at $31,000/day compared with $28,000/day in February 2019 and $19,000/day one year ago. It should also be noted that due to the differences in vessel types outlined above, a scrubber-equipped, eco VLCC for prompt delivery currently commands an approximate $4000/day premium versus the marginal (non-eco, non-scrubber equipped) vessel type.

Spot rates stuck in the doldrums. The spot tanker market has experienced a difficult first half of the year as there remain too many vessels chasing too few cargoes. Many segments, notably VLCCs and MR2s, have seen an avalanche of new buildings hit the market this year and in the absence of scrapping, fleet growth has remained strong and tonnage lists slack. Indeed, only 25 tankers of 34,000 Dwt or above have so far been demolished in 2019, a huge slowdown on 2018 when 140 units were scrapped over the course of the year. At the same time, both clean and dirty tanker demand have been stuck in the doldrums amid the ongoing OPEC crude production cuts and as refinery throughputs slipped below year-ago levels during 2Q19 amid high maintenance and economic run cuts which have both led to less oil being transported by sea compared with one year ago.

Holding pattern. As stated above, it is difficult to generalise with different levels in time charter activity across different tanker types and sizes, but in the dirty segment there is currently a disparity in sentiment across the three largest vessel classes. In the VLCC segment, charterers appear to be in a holding pattern with last week's failing of five VLCCs by a US charterer fuelling expectations that time charter rates, at least in that segment, are due for a downward correction. It is a similar story in the Aframax sector where rates have been propelled to…

...$21,000/day for a one year time charter (non-scrubber, non-eco vessel, prompt delivery). This has seen the delta in time charter rates for Aframaxes and Suezmaxes (currently $24,000/day for prompt delivery) narrow over recent months which has accordingly fuelled interest in the hiring of Suezmaxes under time charter. It should also be noted that the current strength in time charter rates has also helped to support current prices for second-hand tankers.

Scenario 1 – soaring bunker prices sees interest in scrubber-equipped tankers surge. As IMO2020 looms large and as prices for 0.5% compliant fuels soar compared to both current spot prices and those inferred from today's futures curves, the interest in securing scrubber-equipped and eco time charter tonnage would likely soar as these types of vessels would help charterers save money on their bunker expenses. Indeed, even a non-scrubber equipped eco tanker would burn approximately 30% less bunkers than the marginal vessel. Accordingly, it is likely that demand and thus time charter rates for non-scrubber equipped, non-eco vessels would drop while the rates for eco or scrubber-equipped vessels would be propelled higher. Therefore, under this scenario, only the gap between spot and time charter rates for the marginal vessel would narrow.



Scenario 2 – spot rates strengthen. As stated in sister publication *Alphatanker Oil Market Monthly Monitor*, we are cautiously optimistic on the outlook for spot rates during the second half of the year. Strengthening hire rates will be driven by slightly higher tanker demand as global crude demand rises strongly in 2H19. Analysis suggests that crude throughputs will climb by more than 3 mb/d between their May low point and December (when global throughputs are projected to hit their high for the year). We also project that ton mile demand will rise during the second half of the year as more oil 'leaks' from the Middle East Gulf as some OPEC producers open their taps. Notably, Saudi Arabia has some leeway to increase production towards its compliance ceiling within the framework of the OPEC+ deal. Meanwhile, we anticipate that Iraq will continue not to comply with the deal and thus produce above its ceiling. Elsewhere, we project that US crude exports will continue to extend records, especially as demand for low sulphur crudes rises ahead of IMO2020 and as Brazil continues to ramp up exports in line with its production increases. On the clean side, increased refinery activity will lead to more product being exported, especially from refineries located east of Suez. Finally, information suggests that shipowners will begin to bunker with compliant fuels from September onwards, this is likely to see spot rates rise as owners try to recover at least some of their increased bunker costs. However, all of the above does not suggest that there will be a repeat of end-2018 when OPEC's decision to open the taps saw tanker demand and thus spot hire rates soar. Rather this year, we suggest that rates will follow their normal seasonal patterns and rise modestly.

Conclusion. The above suggests that, on their own, it will be difficult for spot rates to bridge the currently-wide gap with time charter rates which suggests that time charter rates, at least for the marginal non-scrubber-equipped, non-eco vessel, are due for a downward correction. The timing of this narrowing is hard to pinpoint and will likely vary between tanker segments. However, it currently seems difficult to foresee a sustained strengthening of spot rates over the summer months, which suggests that the gap will only significantly narrow from September onwards.

This week's market pointers ↑↓

Benchmark crude prices continue to be volatile with prices regularly oscillating by $2/bbl on a daily basis. By the time of writing ICE Brent was trading at over $65/bbl in the wake of preliminary data suggesting inventory draws in the US and as the first major storm of the season approaches the Gulf of Mexico which has the potential to disrupt oil production and shipping in the region. In the US, NYMEX WTI was last trading at $59.50/bbl.

Saudi Aramco to recommence preparations for an initial public offering (IPO)? Newswire reports suggest that the Saudi Aramco IPO is back on the table after a number of investment banks have restarted their preparations to pitch for it. The reports also suggest that the Saudi energy minister and chairman of Aramco, Khalid al-Falih, has confirmed to the banks that the partial IPO will take place in 2020 or 2021 after the purchase of a 70% stake in SABIC and the bonds sale have been completed.

Mounting refinery problems in Venezuela. According to reports, PDVSA's near-1 mb/d Paraguana refining complex shut down on Sunday following an electricity blackout. Despite, crude exports experiencing a modest rebound over the past couple of weeks, the country is beset by power outages and gasoline shortages. Indeed, the uptick in crude shipments may have come in the wake of a drop in domestic refining activity.

Refinery roundup. Runs have been cut by approximately half at Vietnam's 200 kb/d Nghi Son refinery following a problem at a hydrodesulphurization unit. Korea's S-Oil has announced maintenance at its 580 kb/d Onsan refinery for September. In the Middle East, a CDU at KNPC's 265 kb/d Mina Abdullah refinery will undergo maintence as of 1 August. In the US, the 158 kb/d Citgo Corpus Christi plant has restarted a previously shut FCC. In Europe, refinery maintenance is now drawing to a close. Repsol's Cartagena plant has restarted after a brief shut down of its CDU. BP's Rotterdam has also brought back a 200 kb/d CDU after a seven-week stoppage. In France, Total's Donges and Feyzin refineries are now in the process of ramping up[after maintenance and an unplanned outage, respectively.

China raises the security alert for Strait of Malacca. Last week, China's transport ministry has raised the security level for its vessels transiting the Strait of Malacca possibly in reaction to a threat to attack its ships. The security level is now 'level three' which required Chinese-flagged vessels to put in place security plans and to report any suspicious activity when passing through the notorious chokepoint. By the time of writing, the Maritime and Port Authority of Singapore had stated that they had not received any information indicating an increased threat level.

Tanker scrapping remaining low. There continues to be low interest from tanker owners in scrapping their oldest units with BRS data indicating that only 25 tankers of 34,000 Dwt have been scrapped since the turn of the year. One of the contributing factors has undoubtedly been falling scrap metal prices with those on the Indian subcontinent softening by $50/ldt since the turn of the year. Demolition is not likely to increase over the short-term considering that summer is the monsoon season which typically disrupts activity in India, Pakistan and Bangladesh.

Preliminary data suggest that bunkering activity has dropped in Fujairah. Ship tracking data from *Alphatanker* suggest that, following the recent attacks on tankers off Fujairah and in the Sea of Oman, less vessels are now calling at the main regional bunkering hub of Fujairah. Also it appears that vessels' speeds have also increased slightly when passing through the region.

Japan begins trials of low sulphur fuel on coastal routes. Japan's Ministry of Land, Infrastructure, Transport and Tourism has announced that it has successfully trialed the use of 0.5% compliant fuels on a number of bulk carriers running in its territorial waters. Following the trial, the ministry has also announced that Japan will commence selling compliant fuels later this year.

Very low sulphur fuel oil (VLSFO) prices experience a pre-IMO2020 boost. The past couple of weeks have seen global prices for VLSFO blending components surge as stockpiling demand ramps up ahead of IMO2020. Indeed, price reporting agency Platts has reported that the spread between HSFO and VLSFO has surged from around $40/ton in January to around $130/ton in late-June. At the same time, Argus are reporting that 1% low sulphur fuel oil (LSFO) is trading at a 16-year high and approaching parity to Brent in Europe as demand for it as a blending stock increases and as refineries reduce production as they concentrate on producing 0.5% VLSFO.

Seaborne Crude Exports[1] for Selected Countries for week ending 5 July 2019 Million barrels per day				
	12-month rolling average	4-week rolling average	latest week (5 July)	change from previous week
Algeria	0.41	0.45	0.56	0.23
Angola	1.31	1.42	1.49	0.05
Gabon	0.20	0.19	0.22	0.08
Iran	1.06	0.11	0.42	0.42
Iraq	3.49	3.61	3.45	-0.45
Kuwait	1.93	1.91	1.92	0.30
Libya	0.79	1.05	1.04	-0.03
Nigeria	1.93	2.00	2.20	0.18
Qatar	0.66	0.68	0.61	-0.11
Saudi Arabia	7.17	6.95	6.63	-0.57
UAE	1.97	1.95	1.95	0.02
Venezuela	1.05	0.83	0.56	-0.44
Azerbaijan[2]	0.79	0.81	0.80	-0.04
Kazakhstan[3]	1.15	1.16	1.18	0.05
Russia[4]	3.41	3.30	3.45	0.27
Oman	0.80	0.72	0.52	-0.46
Sudan	0.12	0.11	0.11	0.00
Brazil	1.19	1.25	1.22	-0.02
Colombia	0.44	0.44	0.32	-0.08
Mexico	1.10	1.01	0.71	-0.28
Canada[5]	0.24	0.30	0.32	-0.05
US	2.35	3.11	2.88	0.13
North Sea[6]	1.05	1.08	1.05	0.02

Source: Alphatanker

[1] does not include pipeline flows

[2] adjusted for Turkmenistan re-exports

[3] does not include volumes exported via the Atasu - Alashankou pipeline, includes volumes exported via Russian ports

[4] does not include volumes exported via the Druzhba or Daqing ESPO Spur pipelines

[5] Does not include volumes re-exported via US ports

[5] Only includes volumes exported outside of UK or Norway

Oil counted as exported when a vessel exits national territorial waters, includes volumes built on vessels over previous weeks

Data are subject to revision

Latest Crude, Refined Product and Bunker Prices and Freight Rates