All Roads Lead To China

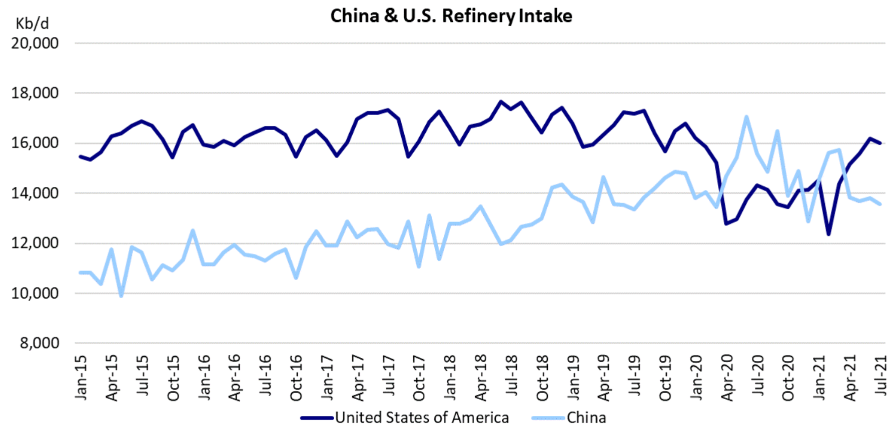
Tanker owners can no longer take Chinese growth for granted

Over the last two decades, China's oil demand growth has propelled the tanker market upwards and onwards. China's rapid economic development was largely responsible for the 2004-2008 "Super Cycle" in the shipping markets (not only in tankers, but in dry cargo and containers as well). China's oil demand grew from 4.7 million barrels per day (Mb/d) in 2000 to 13.8 Mb/d in 2020, an average annual growth rate of 5.5%. China rapidly expanded its refining sector to meet domestic demand. Since China's domestic oil production has been steady and fairly limited (approximately 4.0 Mb/d), the growth in oil demand translated almost 100% in additional crude oil imports. China has become by far the largest crude oil importer in the world. In recent years, however, we have seen several changes in China that cast doubt on whether the Middle Kingdom will be the same dominant force in the future as it was in the last two decades. Some of these changes may be temporary (such as the impact of the Coronavirus), but others are likely to be permanent. The impact of these developments on the tanker market could be significant.

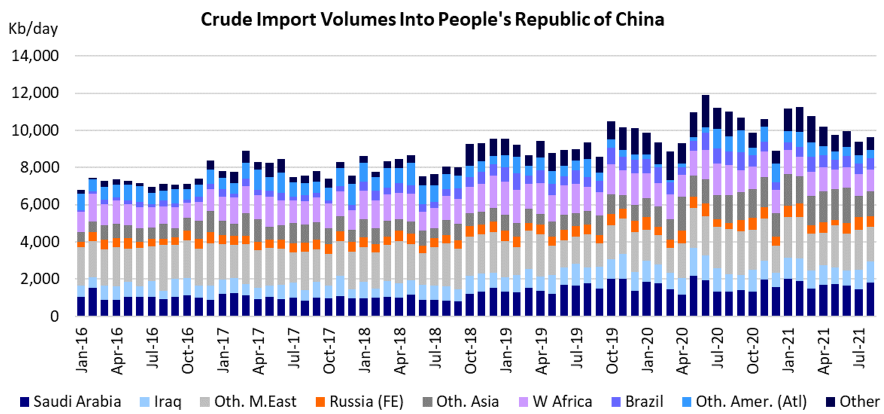
At a conference in Beijing this week, Ma Yongsheng, the acting chairman of China Petroleum & Chemical Corp. (Sinopec), China's largest oil conglomerate, said that China's oil consumption is likely to peak around 2026 at about 16 million barrels per day. This is only 1.0 Mb/d above the IEA's estimate of China's 2021 demand. The rapid adoption of electric cars is the main driver of this forecast, which also indicates that the focus of China's oil demand will shift from fuels to petrochemicals.

In addition to importing crude oil to fuel their domestic demand, China imported barrels to build up a sizeable strategic petroleum reserve. In particular during periods of low oil prices, China took advantage and scooped up excess supplies to build up its inventories. In a historic move, China released oil reserves from its massive SPR earlier this year. The government did not explain exactly when and why this was done, so the market is unclear whether this is a one-off or a new policy tool.

During the early part of the Covid-19 crisis, China overtook the U.S. as the world's largest oil refiner. For several months in 2020 China processed more crude oil than the U.S. While temporary factors (the Covid-19 pandemic and U.S. Gulf hurricanes) contributed to this change, other – more permanent - developments also played a role. U.S. refining capacity peaked at 19 Mb/d in early 2020 and several companies have announced the closure of less efficient plants. In contrast, China's refining sector is still growing with an additional 1.4 Mb/d of capacity coming online by 2024. However, if the Sinopec forecast proves to be correct, China's oil consumption may peak below U.S. oil demand, which is pegged at 20 Mb/d.



Source: JODI



Source: Lloyd's List Intelligence

Another recent development that is having an impact on Chinese crude oil flows is the government's tightening supervision of the independent refining sector (the "teapots"). Teapot refineries account for about 35% of China's total refining capacity. Unlike the large state-owned refiners, the teapots rely on government quotas to import crude oil. Beijing liberalized the independent refiners in 2015 to boost the overall competitiveness of the sector and since then, the teapots have been the largest contributor to China's crude oil import growth. Recently the government has limited quota allocations and increased taxation, which squeezed the margins of the teapots, forcing rationalization and consolidation. For tanker owners, this also means less import volumes.

For many years, China's crude oil imports will continue to be a key source of employment for large crude tankers. However, it appears that the days of rapid, unbridled growth are behind us. With the global focus on climate change creating a move away from fossil fuels, it is unlikely that there are many other countries waiting in the wings to step in and provide a boost to ton-mile demand and the tanker market needs to carefully manage vessel supply to enable the industry to return to profitability.