POTEN & PARTNERS

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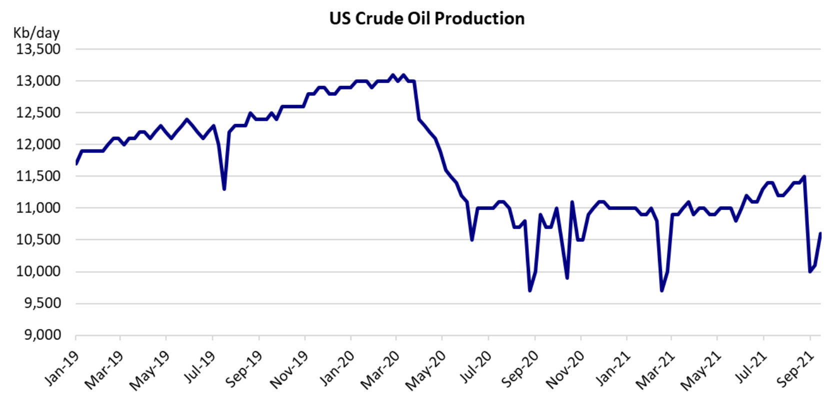
POTEN TANKER OPINION

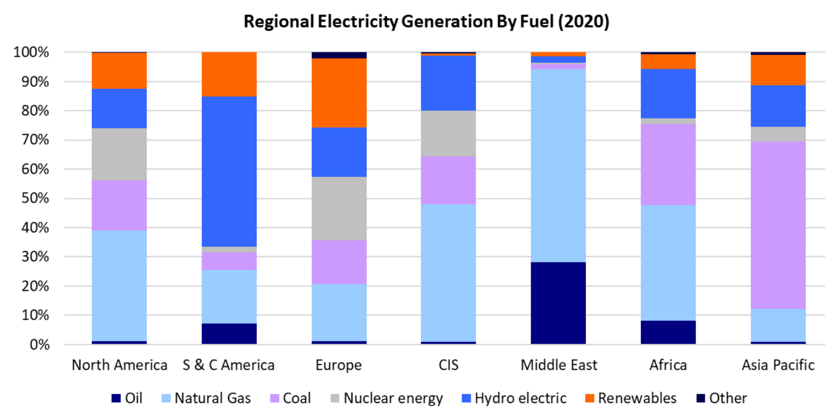
A Glimmer Of Hope

Combination of factors could increase oil and tanker demand

Over the long term, fundamental supply and demand factors, such as global oil demand and fleet size determine the direction of tanker freight rates. However, in the short- to medium term other factors, such as market psychology, geopolitics or weather events can have a significant impact on top of market fundamentals and seasonality. As we are approaching the 4th quarter of 2021, it seems that the combination of gradually improving oil demand fundamentals, in combination with seasonal factors and the impact of adverse weather events could propel oil demand higher during the winter season in the Northern Hemisphere. Exactly what that might mean for the tanker market we will try to discover in this week's Tanker Opinion.



Source: EIA



Source: BP

The fundamentals are pointing towards stronger oil demand in the 4th quarter. In their latest Oil Market Report, the IEA forecasts that 2021 Q4 global oil demand will reach 98.8 Mb/d, 1.6 Mb/d higher than 2021 Q3 and 4.6 Mb/d more than the 4th quarter of 2020. The IEA points to signs that the number of Covid cases are abating, which should lead to a sharp rebound in oil demand. There is an expectation that jet fuel demand could also make a comeback after the U.S. government decided to ease rules on vaccinated travelers from the U.K. and Europe. Global jet fuel demand, which is still lagging pre-pandemic levels could get a 400,000 b/d lift in 2021 Q4.

The projected increase in global oil demand seems to provide ample support to the OPEC+ group of oil producers to continue their 400,000 b/d monthly production increases, at least until the end of the year and maybe even into 2022.

Weather is playing an important role in the energy markets. The overall oil market tightened in 2021 Q3, primarily due to the sharp decline in U.S. crude oil production as a result of Hurricane Ida, which knocked 1.7 Mb/d offline (chart 1). This production has been slow to come back (some production will not return until 2022). Buyers of U.S. crude have been forced to look elsewhere for supplies. U.S. refiners have been turning to Iraqi and Canadian oil, while Asian buyers have been pursuing Middle Eastern and Russian grades. U.S. oil stocks have been declining as well. They are at their lowest level since 2018, while oil inventories in Europe are below average as well. This has contributed to a tightening of the global oil market.

The global commodity markets are highly inter-connected and the world's energy system has little margin of safety. As a result, the oil and tanker markets are directly affected by what is happening in the global gas market. Due to high demand and constrained supply, gas prices are at record highs. Compared to gas, oil is a relative bargain and High Sulphur Fuel Oil (HSFO) is now cheaper than LNG for power generation. This has led several analysts to project that more oil will be used for power generation during the upcoming winter period. Some of the most bullish pundits expect that fuel switching and additional diesel demand (due to increased use of generators) could lead to 1.8 – 2.0 Mb/d of additional oil demand over the next six months if the Northern Hemisphere has a cold winter. The low range of the estimates is 150-400,000 b/d in additional demand. We expect that actual switching from gas to oil will be fairly limited, i.e. closer to the lower end of the range, because most of the major power producing countries have limited oil fired power capacity (chart 2). Some of the few countries that have spare oil-fired power plants include Pakistan, Bangladesh, and Japan.

What does all this mean for the tanker market in the next six months or so? We expect it to be a positive catalyst. Oil demand is rising, the winter market is upon us, adverse weather events always create market inefficiencies. In a market that is inching closer to a balance, even 250,000 b/d additional demand can make a big difference. The tanker market is still weak but has shown some signs of life recently. A cold winter could tighten the market further and create a more bullish market sentiment. After a long period of depressed rates, tanker owners could experience a more traditional (i.e. profitable) winter market.