August 19
2022
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POTEN TANKER OPINION

Out of Favor

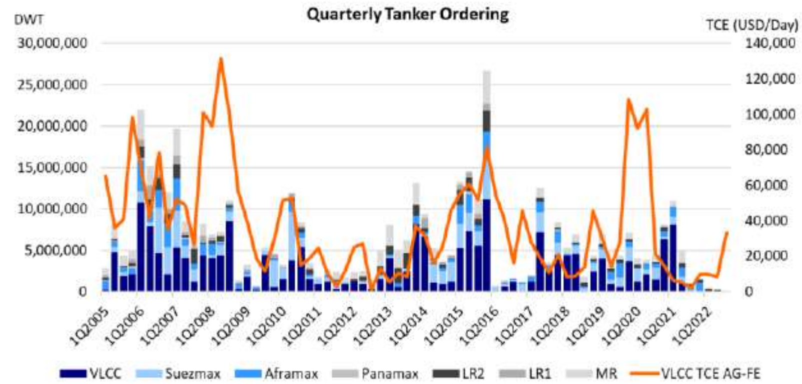
The tanker orderbook continues to shrink

Over the last several months, the tanker freight market has been quite volatile, as competing supply and demand factors drive the market up and down. Oil demand forecasts are mixed, the situation in Ukraine remains dire and the global economy faces headwinds in the form of high inflation and rising interest rates. However, compared to the challenging second half of 2020 and the disastrous year 2021, both crude oil and product tanker rates have staged a strong recovery. Even VLCCs have joined the party in recent weeks. What is remarkable against this backdrop of a recovering tanker market is the almost complete lack of ordering. The last time a shipowner placed an order for a VLCC was in June 2021, 14 months ago. One month later, in July 2021, the last Suezmaxes were contracted. Panamax/LR1? No orders since April 2020. The only tanker segments that have seen some contracting have been the Aframax/LR2s and, to a lesser extent, the MRs. According to our fleet data, 6 Aframax sized tankers and 7 MRs were ordered in 2022 YTD. Nothing was ordered in any of the other segments. Let's delve a little deeper into the why, or rather, why not.

A couple or reasons stand out that have been widely reported. First of all, with the tightening environmental regulations, tanker owners are uncertain what type of propulsion to choose for their newbuilding; fuel oil, LNG, ammonia, etc. That explanation seems to make sense. However, this uncertainty does not seem to faze the owners in other shipping segments. LNG carriers, container vessels and, to a lesser extent, bulk carriers are being ordered in large quantities.

High newbuilding prices are a factor as well. The last VLCC that was ordered 14 months ago cost $93 million. Now, we are assessing the contract price for the same vessel at $119 million, a 28% increase. Prices for newbuildings in the other tanker segments have appreciated significantly as well. The price increases are partly the result of higher labor and material costs. Another contributing factor is the strong newbuilding demand from other shipping sectors (in particular container vessels and LNG carriers) which increased the competition for yard slots and pushed delivery times out. Even if ordering slows in these competing segments, it will take some time for the shipyards to work through the existing orderbook. In the meantime, they have limited incentive to lower prices.

The biggest overarching factor keeping tanker owners away from the shipyards is uncertainty about the future. In previous cycles, owners could always feel comfortable that, as long as they could ride out the lean years, the market would eventually recover. Over the long-term, oil and ton-mile demand growth could be taken for granted and the market would always grow itself out of trouble. That is no longer the case. Regulations to reduce emissions in the shipping sector will have an impact on the efficiency of new and existing tonnage and the future profitability of the sector is more uncertain. On top of that there is the general expectation that global oil demand (and its transportation) will likely peak within the next 10-20 year. For a shipowner, that is not a strong incentive to invest in an asset that has a 25 year life. Especially, if (in the case of a VLCC) it is 28% more expensive than last year and you won't get it delivered for at least another 2 years.



Sources: Poten & Partners, Lloyd's List Intelligence

However, while shipowners are reluctant to sign up for newbuildings given the long-term uncertainties, they remain bullish about the prospects for the tanker market in the short- to medium-term. Freight rates are up significantly for both crude oil and product tankers. Global oil demand is recovering from the Covid-19 pandemic and trade routes are scrambled due to the sanctions imposed on Russia. As a result, many shipowners are looking at secondhand purchases.

Sale & purchase activity in the tanker market has been booming in recent months. A secondhand tanker is cheaper and can be employed in the rising market immediately. Greek and Chinese owners have been particularly active in the S&P markets, where both nationalities are willing buyers and sellers. Buyers want to expand or renew their fleet to take advantage of rising rates, while sellers see an opportunity to shed older assets at attractive prices and/or realize some gains on previously acquired tonnage.

At some point the newbuilding market will probably come back. Until that happens, the action seems to be in the secondhand market.