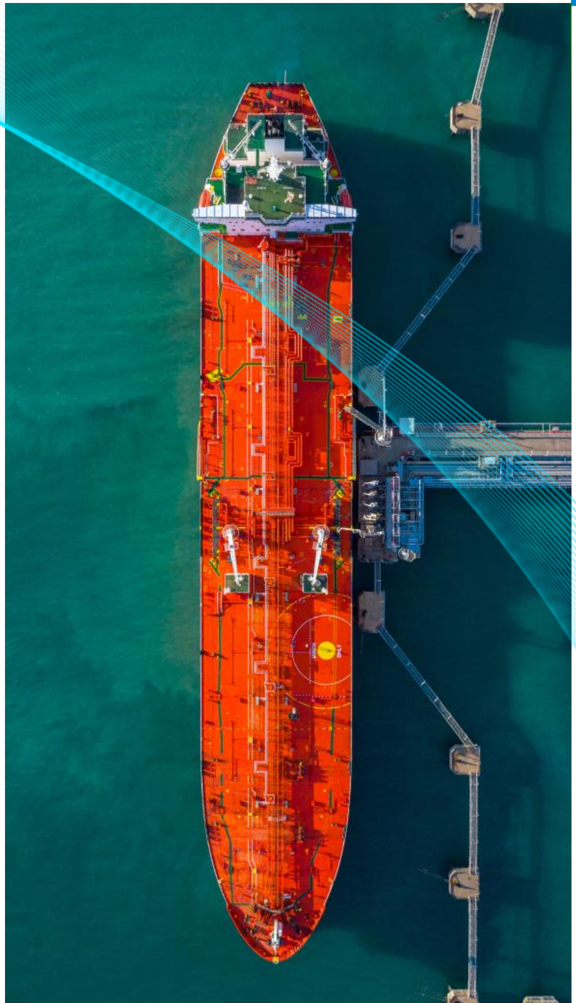
Tanker Fundamentals



Feature: Surging LR Rates to Trigger Crude Tanker Clean-Up

25 January 2024

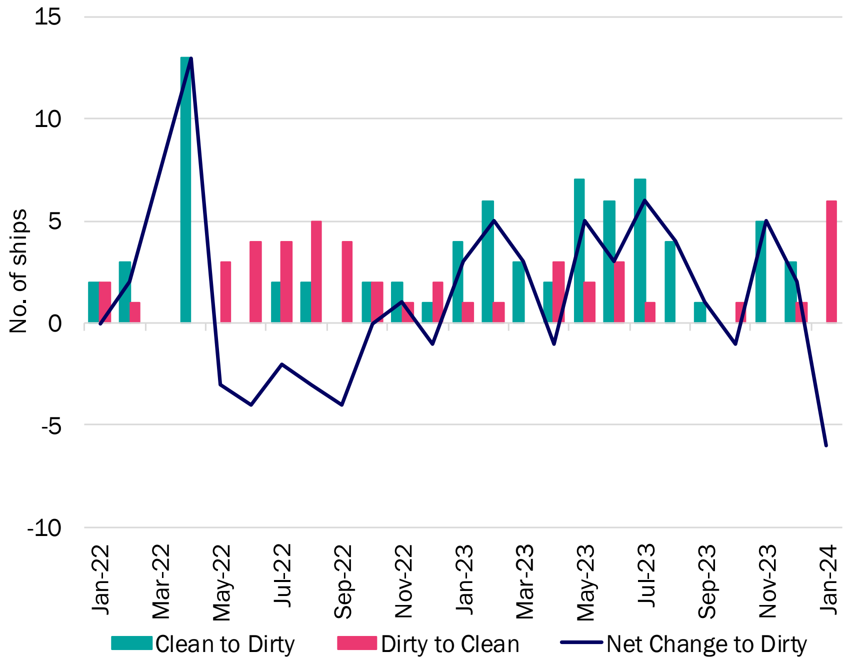
Surging LR Rates to Trigger Crude Tanker Clean-Up

East of Suez product tanker earnings climb amid Red Sea disruption

Escalating tension within the Red Sea has driven East of Suez LR tanker earnings higher since mid-December following a drastic reduction in the number of owners willing to transit via the Suez Canal. This has prompted a scramble for tonnage on certain voyages, particularly westbound runs, where hefty premiums have been required for diversions around the Cape of Good Hope. As such, earnings for benchmark voyages from the MEG to both Japan and the UKC surged to $100,000/day and $96,000/day respectively on 24 January, the highest since May 2020. While it has also been a firm start to the year for the Aframax sector, this strength has been largely driven by the USG and concentrated within the Atlantic Basin, while earnings in the MEG have come under relative pressure as some owners were willing to accept lower rates to move away from the region due to the situation in the Red Sea and with higher earnings available in the West. This divergence in earnings for crude tankers between the West of Suez and the East of Suez as well as the spike in clean rates has incentivised some Aframax owners to clean-up their vessels and switch to trading CPP, a shift against the trend of 2023.

SSY tracking of the LR2 fleet showed an increase in the number of vessels trading DPP in 2023, with a net change of 12 clean-dirty switches recorded. An average of four LR2s switched to trading DPP per month in 2023, compared to one per month cleaning up. This was due to increased demand for shorter-haul European replacement supplies as EU/G7 countries halted imports of Russian crude, as well as the introduction of premium Russian trade opportunities which pulled some of the fleet away from competing for non-Russian cargoes. As such, Aframax earnings (an average of UKC-UKC, Indo-Aus, USG-UKC) averaged roughly $24,000/day above the LR2 MEG-Japan benchmark in 2023, establishing the incentive for these vessels to have switched to trading DPP. But this trend flipped as of 2H January, with LR2 MEG-Japan earnings soaring to a premium of almost $41,000/day against the Aframax average on 24 January, compared to a discount of $45,000/day mid-month. Initial estimates for January indicate this has already led to six LR2s switching back to trading CPP, with other market participants also reportedly indicating intentions to follow suit.

LR2s Switching to Trade Clean or Dirty



Source: SSY

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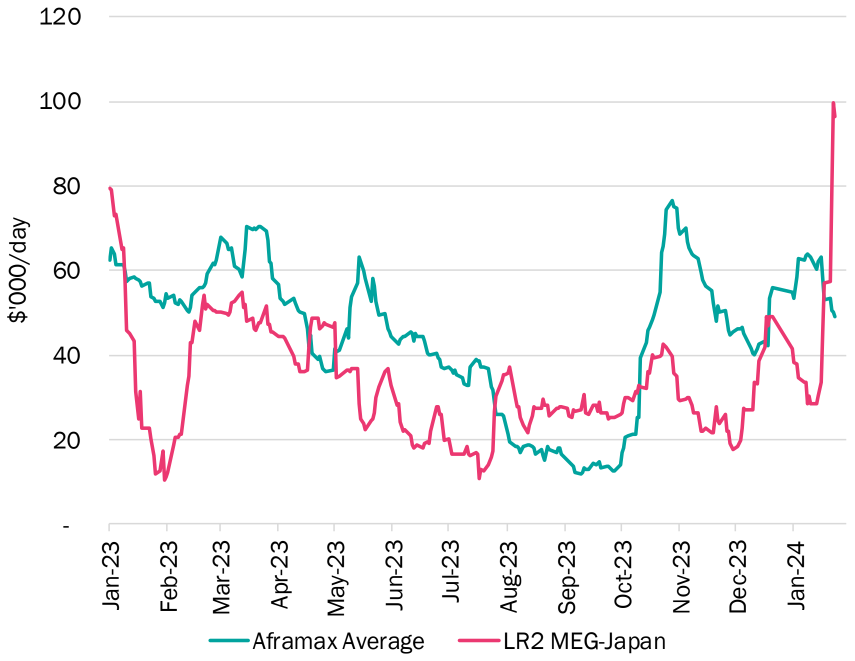
If maintained this would be supportive of the East of Suez Aframax tanker market as competition from LR tonnage trading DPP eases. In particular, this could help the Aframax sector regain market share of Australian condensate exports, where shipments have increasingly been taking place on LR vessels due to their more competitive freight. Refinitiv trade flow analysis shows the percentage of Australia's DPP loadings (including condensates) shipped on Aframaxes averaged 43% in 2023, down from 59% in 2022. In contrast, LR2 market share increased from 29% in 2022 to 51% last year.

There have also been reports of increased Asian chartering interest for ex-dry dock VLCCs and Suezmaxes for CPP trade. These sectors also recently came under pressure, so if LR earnings continue to escalate this may generate westbound trade opportunities via the Cape of Good Hope, particularly for the larger crude tankers. However, given the more considerable tanker cleaning fees for these larger vessels this would be a significant commitment for owners, while there are also a limited number of ex-dry dock vessels in place which would naturally limit the viability for these sectors. It is also worth noting that in previous years there has been a more readily available supply of newbuild VLCCs and Suezmaxes being delivered and able to load CPP on their maiden voyages. However, with just two VLCCs (the lowest on SSY records) and seven Suezmaxes (the lowest since 2014) scheduled to deliver this year there will be fewer ships available for such trades.

The crude clean-up will cap East of Suez product tanker rates, and if the larger crude sectors are called upon this would place further pressure. Still, a range of factors remain in place which should continue to support product tanker trade and keep earnings elevated, particularly with tonne mile demand being stretched by Red Sea transit issues. Longer-haul East to West demand is likely to be maintained given the expansion of refinery capacity east of Suez, the ongoing impact of the EU/G7 embargo on Russian imports, as well as limited European inventory levels (see Europe, FSU & Africa page) which will continue to support hand to mouth buying. A heavy scheduled European refinery maintenance period should also underpin demand, particularly with turnarounds scheduled in the US. Meanwhile, naphtha shipments from the west to the East of Suez are being delayed so nearby supplies are being sought from the MidEast and India, elevating regional rates.

LR2 vs Average Aframax Earnings



Source: SSY

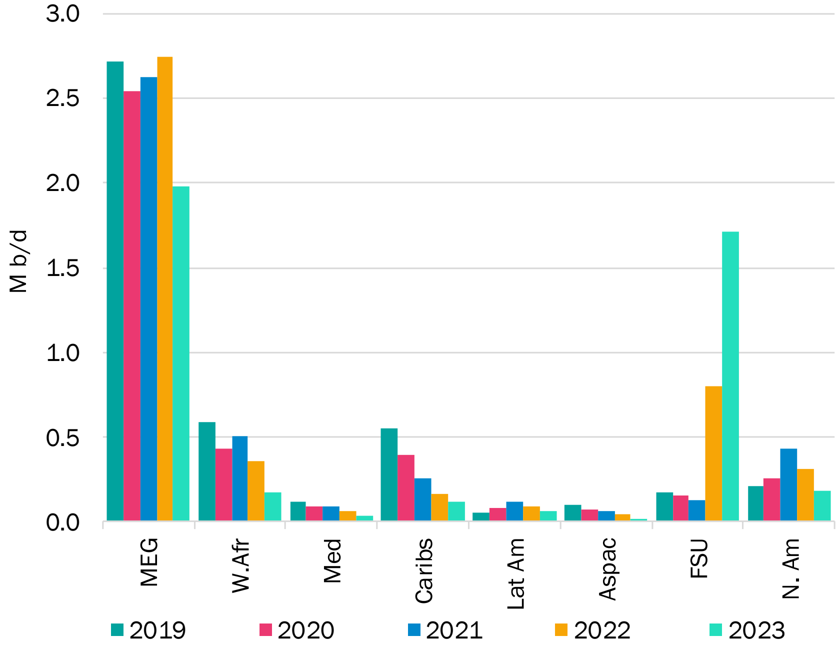
Asia Pacific & Middle East

- **India's crude oil imports from Russia** declined by 260K b/d m-o-m to 1.34M b/d in December, a four-month low, according to Reuters tanker arrivals data. Arrivals from WAFR increased by 90K b/d m-o-m to 250K b/d however, while shipments from the MEG also rose by 60K b/d m-o-m to 2.17M b/d. Overall imports eased by 10K b/d m-o-m to 4.48M b/d.
- **China's clean oil product exports** declined by 200K b/d m-o-m and 860K b/d y-o-y to 760K b/d in December, the lowest since June, according to China customs data. Gasoline exports decreased by 40K b/d m-o-m to 210K b/d, while shipments of jet fuel also fell by 30K b/d m-o-m to 380K b/d, a three-month low. **Refinery throughput** declined by 330K b/d m-o-m to 14.21M b/d, falling for the third consecutive month to a one-year low, according to data from the National Bureau of Statistics (NBS). Processing averaged 14.76M b/d in 2023, climbing by 1.18M b/d y-o-y to a record high.
- **China added roughly 1.39M b/d of crude to its inventories in December**, the highest monthly flows to storage since June 2022 and compared to roughly 20K b/d in November, according to Reuters.
- **South Korea's clean oil product imports** declined by 120K b/d m-o-m to 660K b/d in December, the lowest since August, according to preliminary data from the Ministry of Trade, Industry and Energy. Volumes from Europe decreased by 60K b/d m-o-m to 40K b/d, while shipments from the Middle East Gulf fell by 60K b/d m-o-m to 310K b/d, the lowest since July.

Implications

Indian crude imports from Russia eased from their recent highs amid payment and exchange issues, according to Reuters, and this trend may be exacerbated by the escalating situation in the Red Sea. Sovcomflot has reportedly been considering diverting its vessels away from Red Sea transits, according to newswires, and this could restrict Russian shipments from the Black Sea. This could provide support to the wider-trading fleet if Indian crude purchases from the MEG pick up, while higher volumes could also come from Atlantic basin exporters such as Venezuela or Brazil.

India's Crude Imports by Source



Source: PPAC, Refinitiv

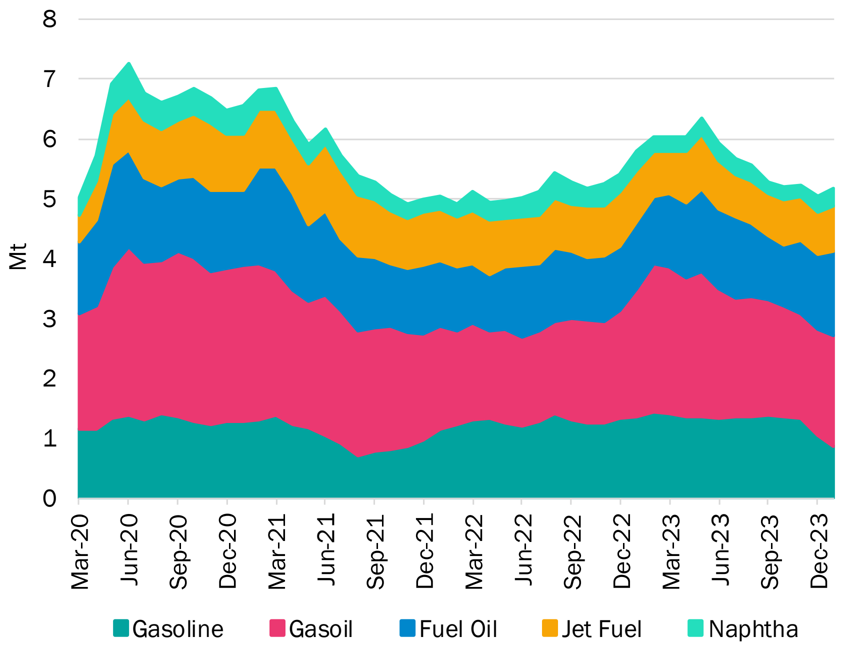
Europe, FSU & Africa

- **Oil product inventories at the Amsterdam-Rotterdam-Antwerp (ARA) storage hub** declined by 174KT w-o-w to 5.11MT during the week ending 18 January, according to Refinitiv. Gasoline stocks rose by 57KT w-o-w to 875KT, rebuilding after falling to the lowest level since October 2021 during the previous week. Diesel inventories fell by 119KT w-o-w to 1.84MT, while naphtha stocks also declined by 33KT w-o-w to 265KT.
- **Shell will undertake scheduled maintenance on multiple units at its 404K b/d Pernis refinery from end-January**, according to Reuters. This work is set to be completed by mid-April.
- **Production at Libya's 300K b/d El Sharara oilfield has now restarted** after being forced offline for almost three weeks following protests, according to Argus. Force majeure was also lifted on oil exports from the Zawia oil terminal. Libyan oil production previously increased to 1.18M b/d in December, the highest since at least October 2022, according to data from the International Energy Agency (IEA).
- **Nigeria's 650K b/d Dangote refinery has now started production**, initially operating at around half capacity according to Argus. Diesel and jet fuel supplies from the facility are anticipated to be made available in January. Once at full capacity the facility will produce roughly 215K b/d of diesel and 50K b/d of jet fuel, with 130K b/d and 35K b/d of these volumes being exported, respectively. Roughly 300K b/d of gasoline will also be produced, however these supplies are set to be sold domestically. **Nigerian oil production** increased by 100K b/d m-o-m to 1.35M b/d in December, according to the IEA.

Implications

European oil product inventories are likely to come further into focus looking ahead given the surging freight costs on long-haul shipments from the East of Suez and how this will impact the viability of these trade flows. In addition, many European refiners pushed back maintenance in recent years to capture elevated refining margins as EU/G7 nations halted Russian imports, and this resulted in a necessary heavy period of upcoming turnarounds for the region. This could prompt an increase in imports from other exporting regions such as the US, however with heavy maintenance also scheduled here and recent weather-related outages already pressuring throughput this could continue the draw on shipments from the East, supporting product tanker demand in the region.

ARA Oil Product Inventories



Source: Refinitiv

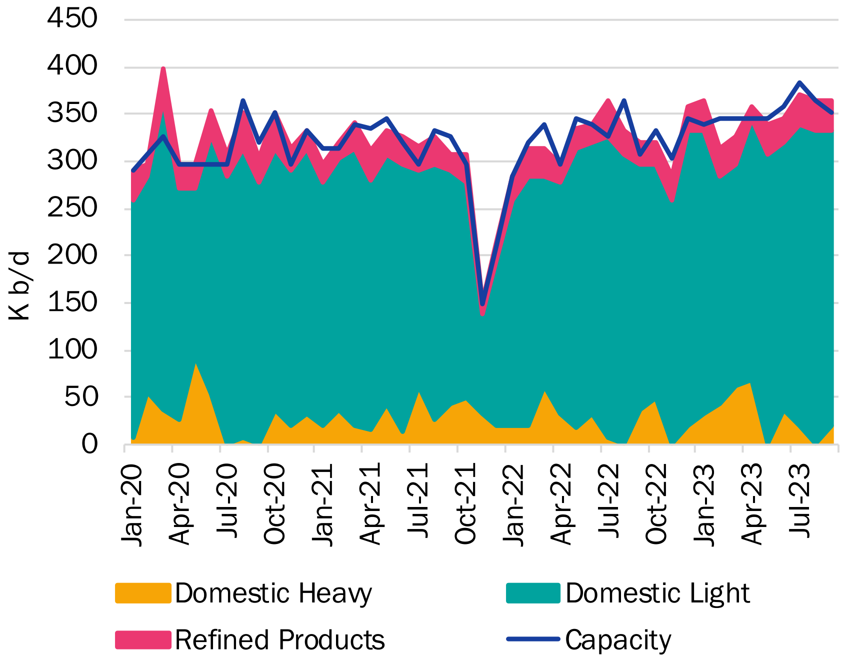
Americas

- Officials from the **Trans Mountain Expansion (TMX) pipeline project re-affirmed crude shipments are anticipated to start loading from Canada's Pacific coast in late March/early-April**, according to Argus. Line fill is anticipated to take two/three weeks and will begin once the final tunnelling stage is complete. The new pipeline addition (Line 2) is anticipated to operate at around 75% of its 540K b/d capacity within the first month of operation. **Canadian oil production** eased by 50K b/d m-o-m to 6.03M b/d in December, falling after previously reaching a record high in November, according to the IEA.
- Total **US motor gasoline inventories rose** by 4.9M bbls w-o-w to 253M bbls during the week ending 19 January, the highest level since February 2021, according to the US Energy Information Administration (EIA). **Refinery throughput** tumbled by 1.38M b/d w-o-w to 15.28M b/d, the lowest since early-November.
- **Enterprise Products Partners announced it expects to receive an export license for its Sea Port Oil Terminal (SPOT), Texas in 1Q24**, according to Reuters. The project incorporates a deepwater marine terminal near Texas which will link to onshore crude storage facilities and will be able accommodate VLCCs.
- The **US purchased an additional 3.2M bbls of crude for its Strategic Petroleum Reserve (SPR)** on 19 Jan for delivery in April, according to Reuters. The Biden Administration has now bought back roughly 17M bbls of domestically produced sour crude for the SPR, after a record 180M bbls release was implemented in 2022.
- **Brazilian crude oil exports** declined by 240K b/d m-o-m to 1.66 M b/d in December, a six-month low, according to preliminary data from Brazil's trade ministry. Loadings to NE Asia decreased by 170K b/d m-o-m to 740K b/d, while volumes to the Americas also fell by 80K b/d m-o-m to 290K b/d.

Implications

The start-up of crude shipments from Canada's west coast, amid the TMX expansion, will initially be restricted to Aframaxes due to draft restrictions at the Westridge Marine terminal, and while most cargoes are anticipated to head to refiners on the USWC there is also room for more heavy Canadian crude to move to Asia. This will lift Aframax demand within the WC Americas, but in turn is anticipated to weigh on shipments from existing suppliers, including the MEG and Latin America.

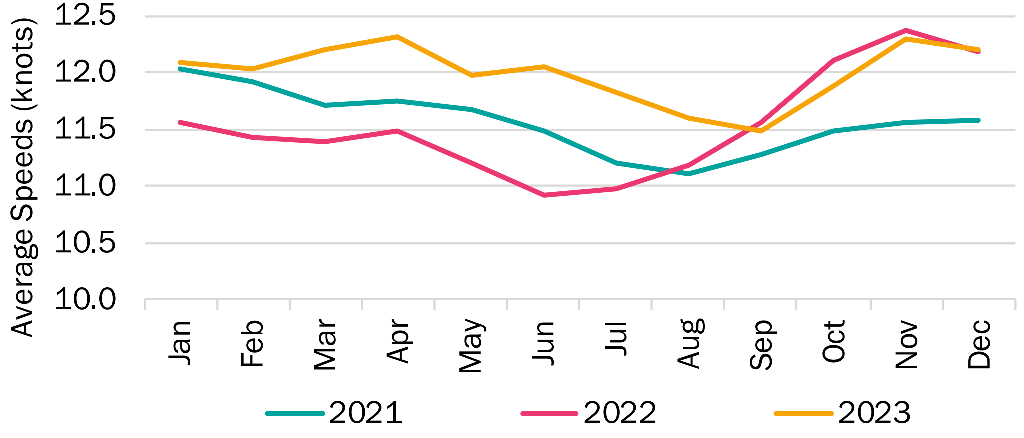
Trans Mountain Pipeline Throughput and Capacity



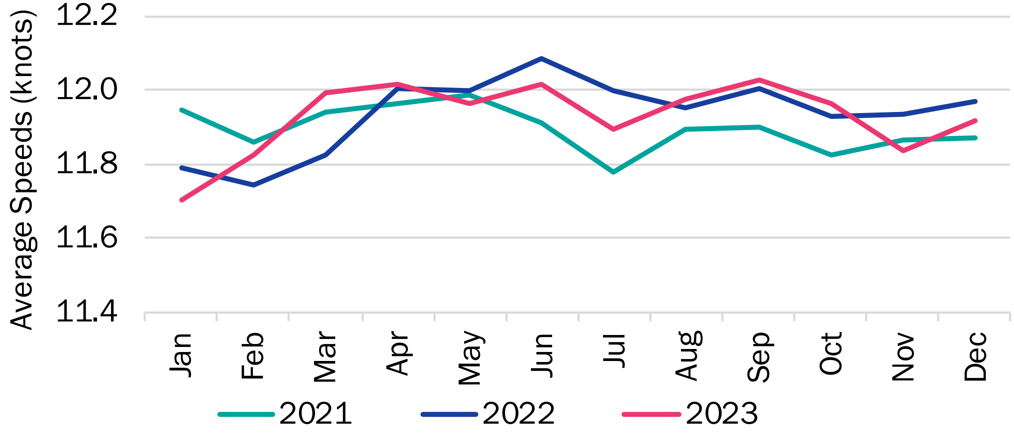
Source: Canada Energy Regulator

Fleet Dynamics

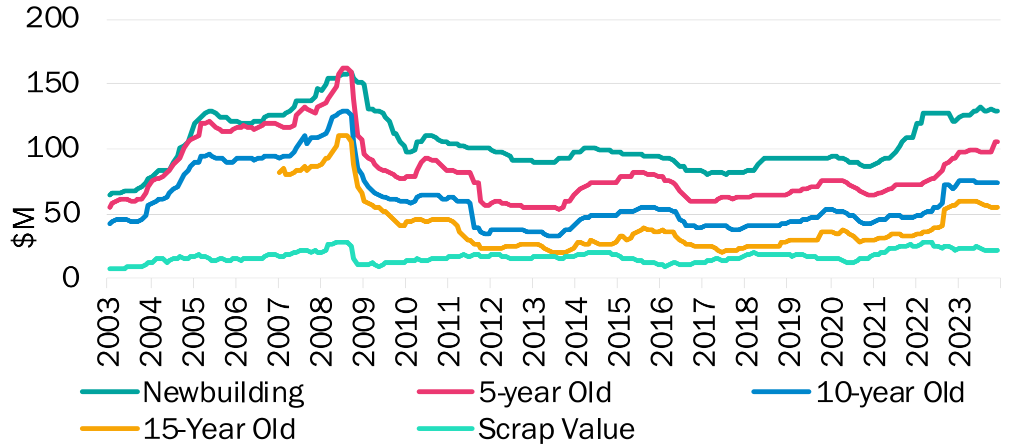
VLCC Ballast Speeds



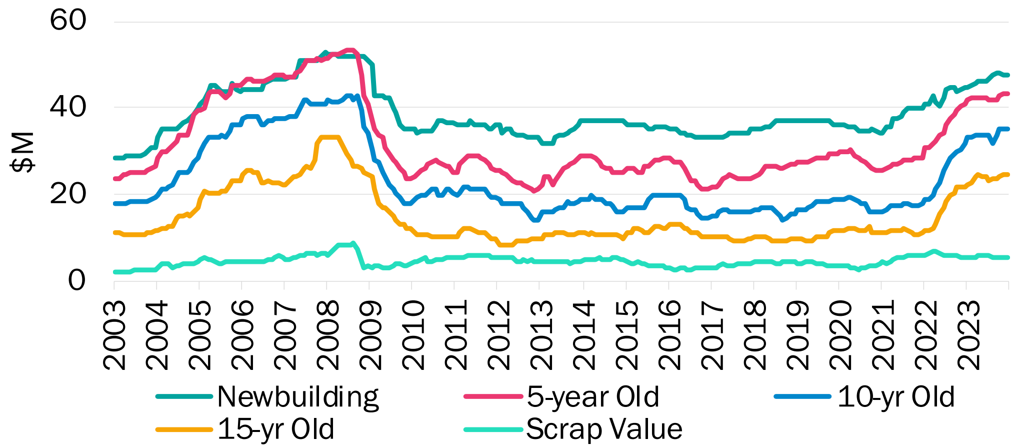
MR Ballast Speeds



VLCC Asset Prices



MR Asset Prices



Source: SSY, Signal Ocean

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