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No. 1 – 2019-2023 Tanker Market Outlook

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McQuilling Services is pleased to announce the release of the *2019-2023 Tanker Market Outlook*. This 200-page report provides a five-year spot and time charter equivalent (TCE) outlook for eight vessel classes across 24 benchmark tanker trades, plus four triangulated trades. Also included in the report is a robust five-year asset price outlook as well as a one and three-year time charter rate forecast through 2023. With 22 cycles of tanker rate forecasting expertise, McQuilling Services is a leader in the industry and continues to support a variety of stakeholders in the energy, maritime and financial services industries with its annual Tanker Market Outlook.

Methodology

The McQuilling Services rate forecast is based on the evaluation of historical and projected tonnage supply and demand fundamentals in the tanker market within the current and projected global economic environment, including oil supply and demand expectations. The forecasting process begins with the development of quantitative models, used to measure the correlation between historical freight rates and tanker supply and demand. This fundamental approach has proven to be reasonably predictive over the past 22 cycles. However, the forecasting process evolves past the modeling stage when the quantitative results are balanced with experiential knowledge and reasonable market assessments. Our January 2018 forecasts were within 10% of actual levels.

Key findings from 2018

In 2018, global ton-mile demand to transport crude and residual fuels increased by 1.9%, supported by a 1.4% increase in VLCCs (which accounted for 63% of the total demand for dirty tankers). Suezmax demand accounted for 25% of all DPP demand in 2018, 1% higher than 2017 due to higher crude exports from the Southern Europe and North Africa load region.

Transportation demand for refined products increased by 0.4% year-on-year in 2018 amid a 3.0% rise in LR2 demand, while the remaining vessel sectors experienced lower demand due to declining volumes transported in the LR1 sector and lower mileage traveled in the MR2 sector.

LR2 ton-mile demand increased by a solid 3.0% in 2018, broadly in-line with our January 2018 prediction of accelerating growth as the revival of the Middle East > Northern Europe gasoil and jet fuel trade supported demand. Our ton-mile demand estimates show growth of 25% year-on-year in 2018 for this trade, accounting for 13.4% market share.

Over the course of 2018, we counted 106 dirty tankers and 35 product + IMO III tankers delivered to the trading fleet. VLCC deliveries decreased relative to 2017 with 39 vessels observed in 2018 and a similar occurrence for the Suezmaxes at 32 additions. On the clean side, we recorded 16 LR2s, 12 LR1s and seven MR2s joining the fleet.

The number of vessels that exited the fleet in 2018 matched within 1% of our January 2018 projections, as 134 ships were sold for demolition or conversion, compared to our original January 2018 forecast of 133. VLCC removals totaled 35 tankers in 2018, while Suezmaxes and Aframaxes came to 22 and 37 vessels respectively. On the clean side, we observed a total 32 vessels exit the trading fleet in 2018.

Newbuilding ordering activity decreased 20.5% year-on-year in 2018 within the DPP sector amid tempered interest in the VLCC and Aframax segments, particularly in the second half of the year. In 2017, 62 VLCCs were placed on order, which fell to 43 in 2018. Suezmax orders remained flat at 25 vessels, while Aframax orders decreased to 32 vessels. Clean tanker ordering activity through 2018 represents a 14.3% increase in comparison to the previous year with 18 LR2s and 8 LR1s contracted. In the MR2 space, ordering gained 17% year-on-year with 76 vessels in 2018, while the MR1s observed less activity at 10 vessels.

Looking forward

Global economic growth decelerated in 2018 to 3.7% versus 3.8% in 2017. The International Monetary Fund (IMF) expects GDP growth to temper further to 3.5% in 2019, a downward revision due to trade tensions between key nations and European political uncertainty.

Global oil demand growth is likely to decelerate over the forecast period, down to +860,000 b/d in 2019 before falling further to just +394,000 b/d by 2023. Global crude supply growth is similarly projected to slow down, +830,000 b/d in 2019 amid downward pressure from

OPEC production cuts, offset by gains in North American and European output.

Crude and residual fuel ton-mile demand is projected to increase by about 0.9% on an annual basis throughout the forecast period with a decelerating trend observed in the outer years. We project 2019 demand growth of 1.0% as participants in the OPEC and non-OPEC production cut agreement limit crude output from the Middle East, somewhat counteracted by higher exports from the Atlantic Basin. We project annualized growth of 2.0% and 2.3% for the LR2 and LR1 sectors through 2023 and just below 1.6% for MR2 tanker

We anticipate total DPP 2019 deliveries of 134, before decelerating to 102 in 2020, which will begin to support a freight rate recovery to commence in the context of increasing deletions over the next two years. Our projections indicate that 58 product tankers will deliver to the trading fleet in 2019, partially offset by 39 deletions, while beyond this point we see greater contraction in the fleet. On the chemical side, the delivery schedule for IMO I + II tankers picks up to 74 vessels in 2019 before dropping to 58 vessels the following year.

On the basis of supply side pressure as well as demand indicators pointing to decelerating growth, freight rates in 2019 are likely to appreciate marginally; however, support for TCEs will stem from lower bunker prices with VLCCs averaging US $26,800/day and Suezmaxes averaging US $18,800/day. However, we see a much tighter balance for VLCCs in 2022 with earnings climbing to US $33,700/day. For an ECO-type VLCC, we project earnings of US $33,300/day in 2019 and US $42,800/day in 2022.

The story is quite different on the clean side of the market as supply fundamentals improve with growing demand earlier in the cycle. Spot market earnings in the LR2 and LR1 sectors are projected to average US $17,100/day and US $16,700 in 2019, respectively. MR2 earnings on a round-trip basis are, in general, expected to rise in 2019 with TC2 TCEs averaging US $6,600/day; however, higher earnings of US $14,500/day can be attained on the basis of the Atlantic Basin triangulation. Potential for supply side pressure on clean freight rates becomes evident in the back-end of our forecast period based on analysis of our new long-term delivery forecast methodology.

Our 2019 price forecast for the 5-year old crude tanker sectors sees VLCC values averaging US $66.1 million, a 5.4% increase from the 2018 average price of US $62.7 million. Modern Suezmax tankers are projected to cost US $45.0 million in 2019 with further appreciation to US $56.1 million in 2023.

Five-year old clean tankers are expected to see higher prices relative to their 2018 averages. For the LR2 space, we forecast a 2019 average price of US $37.8 million, a 5.2% increase from the average price recorded in 2018, while the LR1 sector is expected to see larger gains of 14% year-on-year to average US $32.7 million. The MR2 tanker is likely to appreciate 15% to US 30.7 million in 2019.

Our scrubber economics model shows that over the 2020-2025 period, VLCC (ECO) tankers with a scrubber will yield US $6,100/day more than for VLCC ECO ships without a scrubber. This average will fall to US $3,100/day over the following five-years, demonstrating the negative impact of converging fuel oil price differentials over the forecast period.

What's New in 2019?

In the 2019-2023 Tanker Market Outlook we have incorporated a variety of new features to provide our clients with a more robust view of global trade flows and major tanker trades:

- Enhanced utilization of remotely-sensed vessel position data to capture fleet growth in terms of newbuilding deliveries and vessel deletions

- Refined methodology in forecasting global bunker prices utilizing forward product cracks relative to a projected Dated Brent crude outlook

- An "Efficient Frontier" analysis, displaying various hypothetical portfolio constructs a fleet owner can employ when managing their assets

- Addition of the Aframax 70,000 mt USG > UKC trade to our freight rate forecast table expanding our coverage to 14 dirty and 10 clean tanker trades