

Oil contango holds little short-term promise for rates

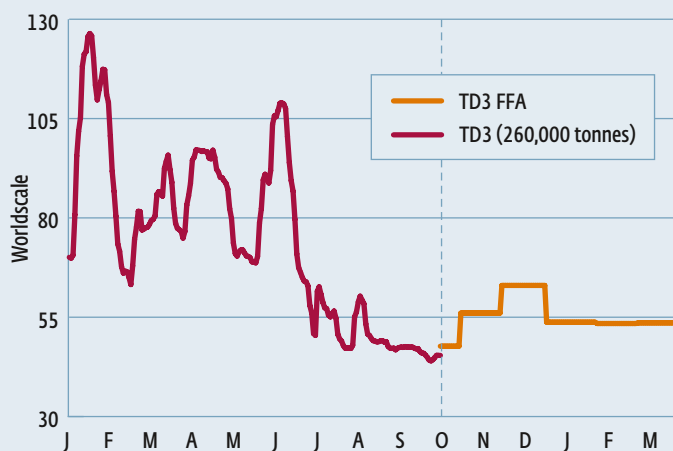
Off-shore crude storage prospects for VLCCs are evaporating

The failure of tanker rates to follow the historical pattern of an uptick in the 4Q10 has caused a somber re-assessment of market prospects, for the current quarter, and farther out into the future. In a new report, *The Tanker Abyss*, Morgan Stanley researchers Ole Slorer and Fotis Giannakoulis have now turned very cautious. In the process, they have downgraded two bellwether shipping stocks – Overseas Shipholding Group (OSG) and General Maritime Corporation (GMR).

The main bogey, in their view, is increased supply of tonnage, at a time that economic demand is lacklustre at best. One undercurrent is that “previously delayed vessel deliveries” will start to hit the water. In the economic models at MS (and elsewhere) rates are determined at the intersection of supply and demand; MS cautions that ‘utilisation’ (the measurement of tightness and surplus) will undergo a steep decline. Their numbers show overall vessel supply (including a wide swath of sizes) growing at close to 13% annually, over the next two years with 44M dwt being delivered (compared with 35M dwt during 2009-2010), while demand grows by 5% annually during the period.

In their view, the market is weighed down heavily by the failure of US economic growth to make real headway – which has kept crude and product inventories high. The MS team acknowledged China to be a source of continuing demand gains, but

Gulf to Japan VLCC rates, 2010-1Q11



An oil market contango of \$1.70/barrel would be required to make floating storage viable for oil traders

13%/year

Morgan Stanley estimate of annual crude oil tanker fleet growth (including a number of ship sizes) – with 44M dwt delivered – over the next two years

expect that US oil imports, an important demand driver when the imports are longhaul moves (for example from the Gulf to the Gulf of Mexico), will actually decline by 1.4% in 2011, due to a combination of increased production and the supply overhang.

Simon Chattrabuthi, head of tanker research at ICAP Shipping, emphasised the uncertainties emanating from the underlying commodity markets, in particular the development of the contango price structure in both crude oil and products prices. He also

expressed concern about the orderbook in the larger tanker sizes, saying that more than 40 VLCCs and 50 Suezmaxes had been ordered in 2010 for delivery mainly in 2012 and 2013. He predicted growth of the VLCC fleet for 2011 and 2012 at 8.7% and 8.5%, while Suezmaxes were estimated to grow at 9.2% and 8.2%. While Chattrabuthi said: “we are pretty bullish on demand growth in terms of tonne miles,” he acknowledged, “the gains in demand would probably be outpaced by growth in the fleet.”

When asked about what might swing his views about the market, the ICAP researcher pointed to floating storage, based on a view of possible excesses in the overall supply of oil. Chattrabuthi told *Fairplay*, “we are looking at the oil supply and demand balances as forecast by a number of agencies. It’s quite difficult to call, but it does look like, in this quarter and the next two quarters, there is a possibility of excess oil supply and this could cause a wider contango to develop.” He pointed to US Department of Energy data from the Energy Information Administration (EIA), that shows a surplus for 2Q11, saying, “in 2Q10, just past, we were seeing a surplus – this helped prop up the rates.”

While Chattrabuthi did not reveal his exact forecast of tanker rates; he told *Fairplay*: “in our view, storage is a key swing factor. If floating oil storage increases from current levels, and were to average similar levels to those seen this year, our models show that earnings should indeed be higher in 2011 than in 2010. On the other hand, if storage remains at current levels, or falls even lower, then the average supply/demand balance would be negatively affected, and 2011 average earnings should slip to levels below those for 2010 – where the market was quite strong in the first part of the year.”

The Morgan Stanley numbers put a further perspective on this question. Slorer and Giannakoulis tell their clients, “a flattening contango has reduced demand for floating storage from 43M barrels in early May to just 15M barrels; increasing tonnage availability by 28 VLCCs, an additional 5% of the global VLCC fleet.” They say that an oil market contango of \$1.70/barrel or more would be required to make floating storage viable for oil traders. But presently, with a flat oil price curve, they don’t see this differential. ■