Tanker rates soften; upturn not expected until 4Q10

Weakness will give way to better rates as weather delays kick in

By mid-August, the tanker market despair (along with talk of VLCC tonnage being held back by Frontline) turned to talk of the timing of the next uptrend.

Simon Chattrabhuti, head of tanker research at Icap Shipping, offered the following on market dynamics: "We are in a bit of a lull; at Icap, we expected the VLCCs to soften in August, and that's in fact what's happened." He added: "Despite more fixing earlier in July, which we had also expected, the market softened, a bit earlier than we thought it would."

Chattrabhuti attributed the decline to a build-up of tonnage in the Gulf, plus new deliveries of vessels that have outstripped removals of single-hull ships, at a time when vessels have been redelivering out of storage contracts. His statistics indicated year-to-date deliveries of VLCCs at 35 compared with 19 removals, and the current number of trading fleet VLCCs employed in storage at 20, down from a peak of 44.

Although rates on the barometer trades have turned upward, the battering suffered in early August has still left spot rates below the assessments on FFA trades. In the VLCCs, the spot levels on the TD3 run (Gulf/Japan) – around W56 (calculated by Imarex to equate to about $17,000/day TCE) – are significantly below the year to date $43,000/day TCE.

Traders appear to be optimistic: the December 2010 FFA has been rated by Imarex at $42,000/day. When applying the appropriate adjustments for expected future fuel prices, Imarex rates the levels for Calendar 2011 and 2012 at a healthy $37,000 and $39,000/day. Fearnleys in Oslo estimates a one-year period timecharter to be worth $41,000/day on a modern VLCC.

Suezmaxes, as shown by West Africa/US Atlantic (the TD5 route), exhibit a similar pricing structure. With a spot TCE above the VLCC rate, at $20,000/day TCE, FFA traders are valuing the December 2010 position at just above $30,000/day. Further out, Calendar 2011 on TD5 has been assessed at just under $27,000/day TCE (adjusted for likely fuel pricing), while the calendar 2012 position valued above $30,000/day. There are reasons for the positive outlook on the market.

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>
> **$17,000**
> **VLCC spot rates on Gulf/Japan**
>
> **$42,000**
> **Imarex expectation for December 2010 for the same route**

Icap's Chattrabhuti is anticipating a rebound moving into 4Q10. He pointed to an expected rise in demand as more single-hull vessels are removed from trading. Further tightening might come about, according to the Icap researcher, because of weather-related delays. Fourth quarter delays at the Bosporus bring upward pressure onto Aframaxes and Suezmaxes, while bad weather in the North Atlantic leads to longer voyage times across a broad spectrum of sizes.

Sentiment firms

China, with its increased liftings of inbound crude oil, had seen both weather delays and congestion during the past winter. "The practice of withholding vessels could also help a bit but, in any case, the sentiment has turned slightly firmer," commented Chattrabhuti.

The view from the trading desk matches the bigger picture economic prognosis. A new report from McQuilling Services, predicting a 2.2% pick-up in tonne-miles for 2010 compared with 2009, observed: "In the earlier part of this quarter, we saw some tanker demand destruction caused by a sudden drop in long-haul west-to-east fuel oil shipments."

However, Fearnleys provides a different take on the situation, suggesting to its clients that the VLCC market might have bottomed out as charterers are willing to pay up for Gulf/East voyages while enquiry to western destinations remains largely conspicuous by its absence." F

Insight: Yen strength weighs on owners

by our Japan correspondent

The general feeling in Japan is that the strength of the yen is feeding through to reduce demand for Japanese exports and affecting industrial output and growth. Obviously, this may represent a setback on the return to profit of the major shipping operators, whose car carrier and container divisions are affected by changes in Japanese industrial production.

On a more general level, however, Japan's shipbuilding and shipping sectors are dependent more on the health of the world economy than Japan's export trade, and the yen's continued climb against the dollar is the major burden. It puts a massive strain on competitiveness and reduces ship owners' earnings derived from dollar hire, while Japanese shipyards are uncompetitive in dollar terms for new business, especially as the Korean won is relatively weak.

Many Japanese owners are in a position where they would be able to sell tonnage if yen-denominated book values were lower, or if the dollar were stronger. However, financiers will not permit them to sell at a loss unless they can cover the shortfall, which in many cases is impossible. Consequently, they are stuck.

While owners in the dry sector are in a relatively stronger position, tanker owners, who also have a burden of high operating costs, are facing a market where returns are much lower, chartering out would in most cases be loss-making and asset values have crashed. Only the weakening of the yen back to cent parity with the dollar would alleviate their situation.