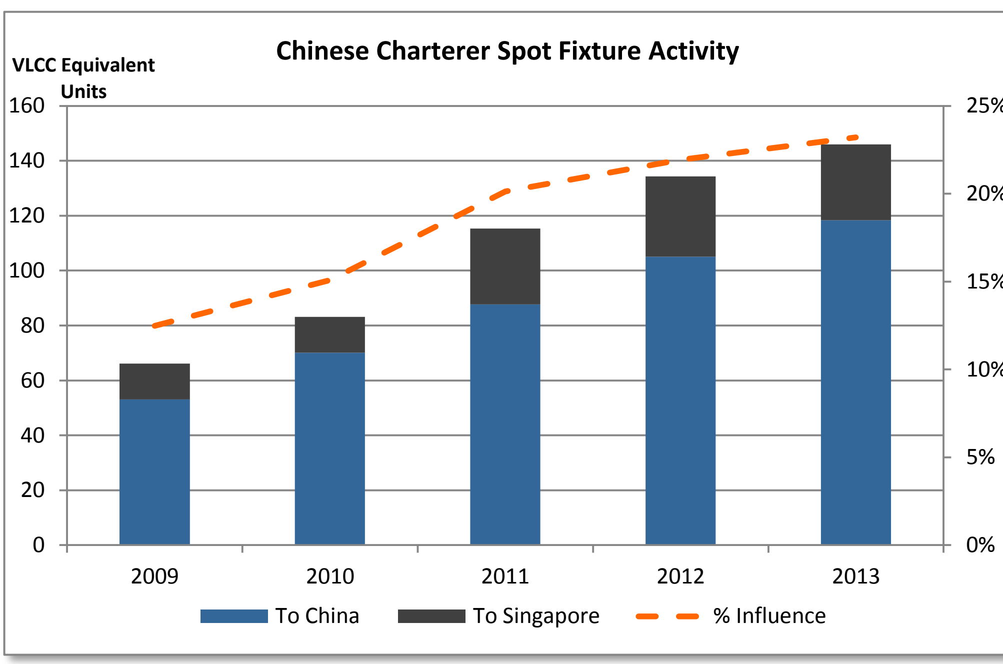
Is the Dragon Draggin'?

For most of the past decade, China has been the saving grace for the tanker, and other, shipping markets. While economic malaise pervaded in the West, China's economic dragon appeared difficult to tame. Recently released data suggest that China's incremental demand growth for transportation fuels may not be as robust as some originally anticipated. It is important to understand that this does not suggest a contraction in Chinese demand, but rather a moderation in its consumption growth rate. In general, the outlook at this point still appears rosy, but the recent moderation should be heeded as a warning sign for shipowners, especially those going all-in on the China bet.

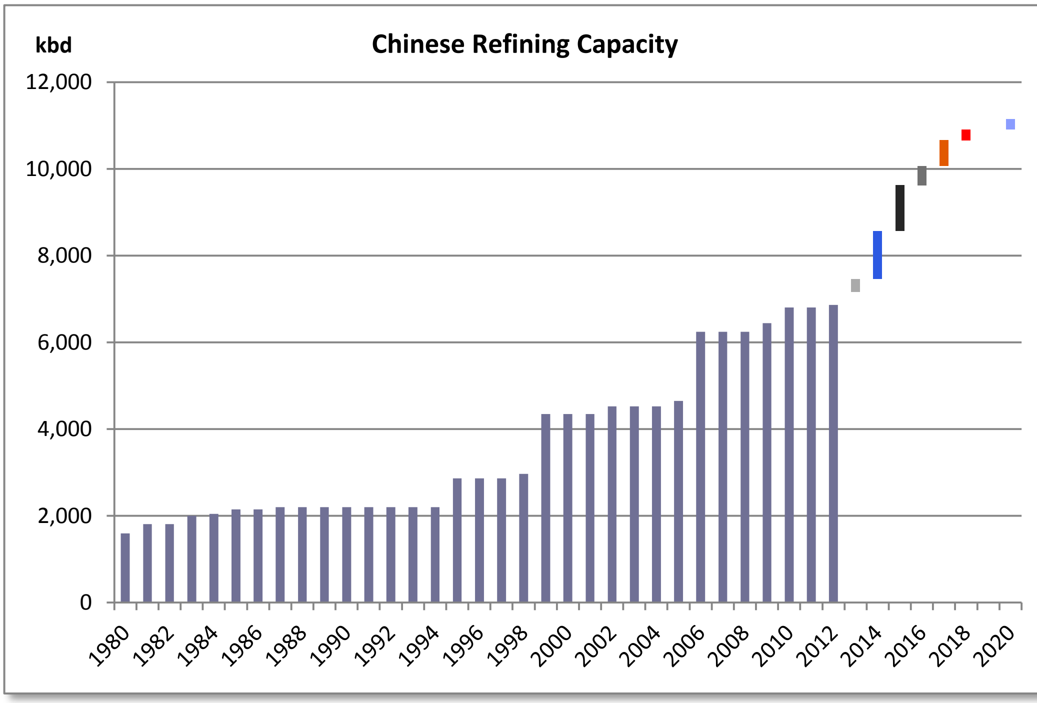
The chart below shows the effect Chinese charterers have had on the VLCC spot market. The reported spot fixture volumes have been converted into VLCC equivalent units in order to show how much demand per year is generated by this subset of companies. In 2009, Chinese spot fixture activity to both China and Southeast Asia (Singapore) created enough demand to fully utilize 66 VLCCs per year. In 2013, Chinese demand for vessels in the spot market has more than doubled to nearly 150 VLCCs, or 23% of the total VLCC fleet.



Source: Poten & Partners

The catalyst that sparked the past decade's significant uptick in VLCC demand was the expansion of Chinese refining capacity in the early 2000's. Demand for approximately 80 VLCCs was created when crude oil inputs increased from around 4.5 million barrels per day to current levels of around 7 million barrels per day. This analysis assumes a crude oil sourcing mix of 75% Arabian Gulf crude oil and 25% West African, for arguments sake. By comparison, the VLCC fleet size increased by only 49 vessels between 2003 and 2006.

The chart below shows the current outlook for Chinese refinery expansions, according to the EIA. The project slate is suggested to add 4.6 million barrels per day more of capacity through 2020. History has demonstrated, however, that not all refinery dreams come true. If Chinese refined product demand slows, there may be less incentive to see these projects to fruition.



Source: Poten & Partners

Reuters recently reported that "implied oil demand" rose by 1.6 percent in 2013 which is below the 3.8 percent rate expected by the International Energy Agency (IEA), yet in line with forecasts made by China National Petroleum Corporation (CNPC). Regardless of who's estimates are considered, the outlook for refining capacity expansions far outpaces that of expected increases in transportation fuel demand, calling into question the urgency of such projects.

While China's continued growth is still a sure thing by any measure, the outlook for refining capacity expansions should be viewed by shipowners with cautious optimism. The Chinese Government and its representative oil companies have proven they too can be austere when the market warrants.