



NO. 15— MID-YEAR TANKER UPDATE

AUGUST 7, 2013

In August, McQuilling Services publishes a review of our Tanker Market Outlook. At the start of 2013, we anticipated that on the back of a lower delivery profile, an elevated tanker exit program in 2012 and a slightly improving global economy, that dirty tanker rates would find support. Our expectation was the opposite for the transportation of clean petroleum products. Fueled by a seemingly insatiable appetite for new tonnage and a backlog of deliveries, our analysis was contrarian to the market by expecting spot rates in clean trades to weaken over the course of the year.

Now that the first half of 2013 is behind us and we have had the chance to look at preliminary trade data, it appears that our forecasts were too pronounced in 2013. Crude and residual trade requirements fell at the start of the year as ton-mile demand was pressured by elevated refinery maintenance across the globe that reduced feedstock demand. This, combined with tanker exits slowing to a crawl since the start of the year, magnified the excess availability of tonnage, holding rates down. Clean product trades were supported at the start of the year by these market imbalances, resulting in higher ton-mile demand.

As a result of these activities, ton-mile demand for dirty tankers contracted by 4% in 1H 2013 compared to 1H 2012 (Figure 1). Ton-mile demand in the VLCC sector

narrowed by 7%. This was further exacerbated by growth in non-OPEC production, in particular in the US, as imports fell to the lowest levels since 1996 in the first half of the year. In the other sectors, Suezmax ton-mile demand fell by 2%, Aframax by 2% and Panamax demand was flat.

However, these product imbalances supported CPP ton-mile demand, which was up by 4% during the first six months of 2013. The strongest increases were in the larger tankers, as LR2 and LR1 demand increased by about 10%, while MR2 demand grew by 2% and MR1 activity remained level. In the MR sector, ships on the Continent/USAC route traded at an average high of WS 171 in February. Since the start of summer driving season, however, rates fell off and in June traded at an average of WS 118, down 53 WS points from their peak.

The economic environment is showing some signs of rebalancing with China, which has been the engine of the global economy in recent years, starting to face the reality that its model must evolve. The United States will be at the center of global economic focus as market participants will monitor the actions of the Federal Reserve (Fed) and react to its decisions. The Fed recently announced that they would not change their current course monetary policy, if market conditions are not conducive.

Since the start of 2013, the story that has dominated the oil market is North American crude oil production. The

Figure 1: DPP Ton-Mile Demand

Total DPP Tankers - Billion Ton-Miles		-300	-200	-100	0	100	200	300	2013	2012	Δ Ton Miles	% Change	2013 Share
Middle East / Far East									990	1,169	-180	-15%	19%
Northern Europe / Northern Europe									716	737	-21	-3%	13%
Middle East / Indian Sub Continent									404	338	66	20%	8%
S. Europe/N Africa / S. Europe/N Africa									397	396	1	0%	7%
Middle East / N. America East Coast									331	388	-57	-15%	6%
Carib/EC Mexico/Ve./Co. / N. America East Coast									286	341	-55	-16%	5%
S. Europe/N Africa / Northern Europe									185	157	28	18%	3%
Middle East / S. Europe/N Africa									169	224	-56	-25%	3%
West Africa / Northern Europe									153	150	3	2%	3%
Carib/EC Mexico/Ve./Co. / Indian Sub Continent									114	45	69	151%	2%
West Africa / N. America East Coast									101	139	-38	-28%	2%
Northern Europe / N. America East Coast									92	89	4	4%	2%
South East Asia / Far East									91	94	-3	-3%	2%
Far East / Far East									90	70	21	30%	2%
West Africa / EC South America									71	51	20	40%	1%
Other									1,140	1,179	-38	-3%	21%
Source: McQuilling Services									5,330	5,564	-235	-4.2%	100%



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sustained high price of crude oil prices provided support to the upstream investment climate resulting in US crude oil production rebounding sharply from the low in 2008 of 5 million b/d to just over 7.5 million b/d in May of this year, according to data from the US Energy Information Administration. This production growth has been driven by the unlocking of shale oil deposits in the Bakken field play in North Dakota and the Eagle Ford play in Texas. Total year-to-date production in these states is up by 55,000 b/d to roughly 790,000 b/d and by 135,000 b/d to almost 2.5 million b/d respectively.

Regarding oil consumption, the International Energy Agency expects that global demand will rise by 930,000 b/d to 90.7 million b/d in 2013. This is an upward revision from previous estimates due to increased heating demand in OECD nations during Q2. The IEA expects 2014 oil demand growth to be 1.2 million b/d. Non-OECD nations will continue providing the most contribution to consumption increases, but an improving outlook for the US economy will also provide support.

Asset values remain low on the back of the weak spot market and restricted availability of financing. Newbuilding prices for all sectors had been on a steady decline since the start of 2011, but started to move sideways in 2012 and, in some cases, through 2013. Despite the weak spot market and owners' anorexic appetite for new vessel orders, the floor was laid on the back of shipyard overheads and demand for other vessel types.

Orders for clean tankers have yet to show a meaningful slowdown and rates have posted a clear downward trend. The exception to this trend is MR2 ordering activity, which is being fueled by optimism that the location of new downstream infrastructure projects will support ton-mile demand.

As a result of these activities, we have decided to slightly reduce our 2013 outlook for crude and residual product tankers due to a delayed recovery and give a small boost to Atlantic Basin spot rates for clean petroleum tankers. We maintain our opinion that the clean petroleum products (CPP) segment is likely to face an over-abundance of supply in the medium term, while upward potential exists in dirty petroleum products (DPP) trades.

Throughout the forecast period, we project TD3 will average US \$20,900/day as fundamentals gradually improve. In the clean trades, TC2 should average just shy of US \$10,000/day, sloping gently downwards as deliveries pressure fundamentals, in particular after 2015.



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