A Tale of Two Markets

2024 the Year Ahead

December 2023

It was the best of times, it was the worst of times.

It is hard to believe that it has been more than three years since the onset of the COVID-19 Pandemic and the uncertainty it cast on the global economy and shipping markets. In the early days of the Pandemic, traders stepped in to backfill critical roles in the market connecting supply with demand. Eventually, the producers found their footing and with that, we saw huge growth in demand as buyers transitioned from a “just in time” supply model to a “just in case” approach. With this improved demand we could see higher pricing conditions and better financial results.

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This improved demand also had positive implications for shipping markets across the board. The past decade has seen significant expansion in refining and petrochemical capacity east of Suez, much of which has been concentrated in China. This long-term effort on the part of the Chinese to become self-sufficient and reduce the need for imports has marked their drive towards a circular economy and become one of the linchpins in their “Belt and Road” initiative. China’s self-sufficiency is displacing significant amounts of volume which traditionally has been sourced from the Middle East, forcing these producers to find new outlets and develop new markets. Much of this has come at the expense of aging production, particularly in Europe, which is being reduced or shuttered altogether in favor of cheaper and more readily available imports. The extended lockdowns in China created significant length in production and nowhere was this more evident than with commodity chemicals. With the arbitrages into Europe and other developed markets wide open, there was a significant amount of pressure placed on existing fleet assets. This fundamental shift in sourcing translated into longer ton/mile and higher fleet utilization and for the first time in more than a decade, tanker owners/ operators were able to return to profitability.

Russia's unprovoked invasion of Ukraine in early 2022 resulted in additional tightening as Europe worked quickly to pivot away from Russian energy sources. With rising energy costs and a structural shortage of natural gas, much of Europe's manufacturing base was economically unviable placing additional demand on foreign-sourced material, and with energy security driving prices upward the fuel markets surged pulling "swing-tonnage" out of the chemical space allowing freight markets to begin a steady march up to historic highs.

The path to these historically high market levels did not happen overnight. It was the confluence of several factors since the commodity boom of the mid-2000s shipping has contended with a litany of challenges following the economic collapse of 2008. An oversupply of ships contracted before the crisis at high prices created an extended supply overhang. It also meant that shipping interests were highly leveraged with debt necessitating significant restructuring and subsequently an extensive amount of consolidation across the fleets. Despite the extended down market, ships were still ordered primarily on a speculative basis which only served to prolong the long-anticipated recovery. It was not really until the invasion of Ukraine that for the first time in more than a decade a sustained demand finally outstripped the supply of ships.

The events of the past three years have once again resulted in record-high new building costs and while the high freight markets certainly can justify further investment in ships, the lack of a clear path to being carbon neutral by 2050 is serving to limit investment in new capacity. With the fleet now below replacement levels the fundamentals are in place for a prolonged high freight market, however, this comes at a time when the markets are seeing a notable erosion in demand. We are learning firsthand that much of this improved product demand of the

past three years was being supported by low capital costs driven by a seemingly endless economic stimulus on the part of central governments around the globe. The result of this has been record-high inflation, forcing governments to intervene with more stringent fiscal policies resulting in a sharp rise in interest rates. This has restricted access to credit and limited the buying power of end users resulting in a slower global economy, tighter product margins, and general destocking across value chains.

Low water levels in the Panama Canal are limiting the number of transits forcing vessel operators to either pay hefty auction fees or consider alternate routings via the Cape of Good Hope or Suez. This is simple enough to quantify, however, according to many shippers the added costs are currently undermining the viability of certain product flows. With the recent attacks by Houthi Rebels on merchant vessels transiting the Red Sea there are additional challenges as operators look to ensure the safety of their vessels and crews while shippers look to shore up critical supply lines at a time when margins are already very tight. Even with the announcement that a coalition of naval forces will patrol the region, many operators are electing to route via the Cape substantially increasing the voyage lengths.

As 2023 comes to a close and we look ahead to 2024, it is difficult to imagine how the shipping landscape could get much more challenging. The implementation of the ETS in Europe was supposed to be the single biggest development of the year, however, most shippers have come to terms with these costs. The more pressing matter remains supply chain security and how to remain competitive when there is seemingly little light at the end of the tunnel. This will require transparency on the part of both owners and charterers to maintain positive earnings and preserve market share.

Here at Quincannon Associates we continue to grow our team and expand our services to help our clients navigate the ever-changing market landscape. For those whom we are working with today, we thank you for your trust and support, and for those looking for expertise in the marine space I encourage you to reach out to any of our many specialists in New York, Dubai, Singapore, and Shanghai.

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