Maritime Forum 3

Dry Bulk Market Outlook: Sustaining Cautious Optimism for Calmer Waters

Moderator: Peter Sand - Chief Shipping Analyst, BIMCO

Panel Speakers:

Burak Cetinok - Head of Research, Arrow Shipbroking Group
Nils Kristian Kovdal - Executive Director, Shipping Finance & Regional Head of Greater China and North Asia, Standard Chartered Bank (Hong Kong) Limited
Angad Banga - Chief Operating Officer, Caravel Group

Peter Sand, Head of Research, Arrow Shipbroking Group, introduced the session by pointing out that last year the dry bulk market was at rock bottom with the Baltic Dry Index (BDI) at 291 and the market's direction was extremely unclear. Aside from a false dawn in 2014, 2017 was the first improvement in the market in some time. However, the recovery is fragile, needs nurturing, and there is no guarantee Chinese growth will accelerate through to 2020. Next year is a window of opportunity to ensure oversupply of capacity doesn't halt the recovery.

Burak Cetinok, Head of Research, Arrow Shipbroking Group, asking if the recovery is sustainable, focused on three questions: What are the drivers behind the recovery? Will steel production restrictions in China have an impact on demand? What is the outlook for 2018 and 2019?

The recovery started in 2016 with the announcement of Chinese government infrastructure projects, including 40,000 km of new highways and a 30,000-km extension of the high-speed rail system, all commodity-intense projects. The main trigger for the surge came with a boost from the Chinese property sector. After a crash in 2014-2015, prices rose and construction picked up, driving up demand for raw materials.

Construction and infrastructure account for 60 per cent of iron ore demand in China and China accounts for about 80 per cent of the seaborne iron ore trade. Any increase or decrease in these two sectors alone has a direct impact on ship demand. According to various indicators, China is experiencing double-digit growth on a base of fast growth in 2016, which is very encouraging.

There may be some minor softening in steel production in China, but although seven major steel-producing areas are capping production in the face of increased environmental and safety inspections, producers in other areas will be incentivised to increase production as steel is highly profitable and consumption is strong.

Cetinok expects that since the fleet is growing at a slower rate as trade picks up, freight rates will continue to rise in 2018 and 2019.

Falling property prices in China as the government tackles overheating may lead to less construction, but the growth of other infrastructure projects will offset this. Demand for Chinese exports seems to be recovering too.

There's broad-based and synchronised growth in demand for commodities, which is quite positive.

Supply growth also seems to be slowing down. Dry bulk fleets grew by 2.8 per cent this year and there was sharp drop in demolitions. In 2018 deliveries are expected to drop by 50 per cent over 2017 and in 2019 they are expected to drop by another 30 per cent. Shipyard capacity means this cannot be changed.

Nils Kristian Kovdal**,** Executive Director, Shipping Finance & Regional Head of Greater China and North Asia, Standard Chartered Bank (Hong Kong) Limited pointed out that he was presenting the shipping department's view and not Standard Chartered's official view. Standard Chartered has a portfolio of $6 billion, across both debt and leasing in shipping.

Turning to current market conditions, Kovdal said that although the market has been in a downturn since 2008, 2016 was particularly painful, with the BDI at 291 points. Overordering in 2013/14 was to blame, and that was driven by what Kovdal calls an eco-ship bandwagon. Banks were also willing to lend as they called a recovery a little too early. However, there was a slowdown in 2015/16, resulting in challenges for operators.

Towards the end of 2017, the outlook was much brighter. BDI is back to a 1,500 level and earnings have almost quadrupled since 2016. Explaining the improvements, Kovdal looked at both demand and supply in the dry bulk market.

Demand growth in 2017 is at 4.2 per cent, or 2.5 times higher than the forecast. In terms of supply this has been reduced, as 2015/16 saw plenty of older ships scrapped, representing 4 per cent of the current fleet. Growth is expected to be manageable, at 2.6 per cent from 2015-2017, rather than the average of around 6 per cent seen in the last 20 years.

While demand is expected to decline although the minor bulk side seems to be holding up, on the supply side 2018 will see the lowest dwt added to the fleet in 10 years. Even investors who want to build more won't be able to as there are no free shipyard slots available until the second half of 2019. Environmental regulations, including Ballast Water Treatment Systems, are expected to lead to more demolitions. Supply growth then is expected to be at 3.4 per cent in 2018 and 1.2 per cent in 2019.

Rates are expected to grow by 20-25 per cent over the next four years and Kovdal doesn't expect to see any major downturns in the market in the future. However, the market has changed a little with shorter cycles and less volatility. In the discussion section, Angad Banga, Chief Operating Officer of the Caravel Group, emphasised that the China-driven boom of the 2000s was a one-off event and that operators now have to be flexible, which includes employing staff who understand the industry and can adapt and evolve.