

Economic Views on World Shipping Market – from 2010 to 2013

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Introduction

Key players in the maritime world are rewarded by allocating their scarce economic resources to be used in the unforeseeable future, and some do a better job than others by spotting a direction that is consistent with future market trends. Dr. Martin Stopford groups these key players in four categories of decision-makers, namely, ship owners, bankers, shipbuilders, and governments.

The goal of this paper is to pattern the various forces from a historical economic perspective, and the authors wish to provide positive suggestions that may help the four groups of shipping industry decision-makers in the year of 2013. This paper will first look at the changes of supply side market fundamentals after the 2008 Financial Crisis. Then the authors will consider the insights we learned from the 1980s world shipping downturn, and discuss the options available for dealing with supply side surplus in today's situation. Finally, this paper concludes that the short-term prospect is bright until the first quarter of 2013.

Supply side market fundamentals

To estimate the fundamentals of the shipping market, this paper starts with a supply side analysis – how many new ships (in terms of vessel types) have come recently onto the market. For estimating the supply-side dynamics of the world shipping situation, most researchers would pick year 2010 as a starting point. Reason: The time lag between ordering a vessel and having it delivered is about 2 to 3 years. Two significant events happened in 2008: (a) The 2008 Financial Crisis, and (b) the peak in the vessel order book. Therefore, it would be natural to use 2010 as the starting point to estimate the impacts of these vessel deliveries. The year 2010 saw record deliveries of new tonnage, 28% higher than in 2009, resulting in an 8.6% growth in the world fleet. The total deliveries set a new historical record which amounted to 3,748 ships, and in terms of total gross tonnage which amounted to 96,433,000 GT and 152.72million DWT. All these new ships can be traced back to orders that were placed before the 2008 economic crisis. But for the decisions of owners and shipyards to defer some deliveries, the number could have been much higher. For example, “non-deliveries” were estimated to be about 39% of the order book in the container sector. Table 1 summarizes the trend of new ships in terms of vessel types that were delivered from 2010 to 2012.

Table 1: Deliveries of newbuildings, different vessel types (million dwt)

Year	2010	2011	2012
Tankers	45.89	41.91	24
Bulk carriers	81.82	99.52	74.38
Container ships / Passengers	22.08	19.96	14.08
Miscellaneous	0.53	0.4	0.26
Offshore	2.4	2.64	1.91
Total	152.72	164.43	114.63

Source: Clarkson's Shipping Intelligence Network

As indicated in Table 1, the data in 2012 shows that dry bulk carriers continued to dominate deliveries. Some observers opined that it was the result of low demolition activities which occurred in this sector. For instance, during the first quarter of 2011, the dry bulk fleet grew by 2.7%, resulting from the delivery of 222 new vessels and the demolition of only 67 vessels.

Lessons from our 1980s experience

The 1980s experience in dealing with the large surplus of ships provides a valuable lesson. Before the 1980s, ship owners were encouraged by builders (shipbuilding countries put more concern on maintaining employment in their shipbuilding industry, and decide to expand capacity to build ships beyond the market's requirements) to make significant counter cyclical investment. This coupled with the trade collapse which was partially caused by governments' failure to handle the second oil crisis properly. Result: A large surplus of ships which, for the subsequently four years, produced earnings which were barely sufficient to cover operating expenses. This affected the banks which were holding the investment portfolio of ships. Acting together, all these decisions prolonged the recession.

By 1986, most bankers of maritime assets decided that it would be too risky to stick with the wait-and-see strategy and they more or less acted at the same time, with the strategy of foreclosure. The collective effect just made matters worse. Reason: They released too many ships to the market, and they soon found that the ships could not even be sold at distress prices which further undermined the value of the collateral supporting the bank portfolios.

Applying the 1980s Lessons

Given the lessons from our 1980 experiences, if we look at Table 1, it seems that bankers should hold more oil tankers rather than any ships in the dry bulk and container sectors. Some industrial observers have opined that the market may see a shortage of oil tankers in 2013. It seems such observation makes sense in light of the facts that demolitions of tankers more than doubled, which accounted for 41.5% of the gross tonnage demolished in 2010. On the demand side, global crude oil production is estimated to have risen by 2.2% in 2010 to reach 82.1 mbpd. Production in countries of the Organization of the Petroleum Exporting Countries (OPEC) increased by 2.5%, while non-OPEC production grew by 1.9 per cent, driven by growth in Brazil, China and transition economies of Asia. The importance of OPEC

producers is expected to grow with their share of global production, projected to rise from 40% in 2010 to 46% in 2030, a level not reached since 1977.

On the other hand, owners in both dry and tanker sectors should resist the temptations of the current low interest rate environment and place further new orders for at least two reasons: (a) The weak world economy would pose a challenge to owners on finding sufficient cargo to fill their ships; (b) When we compare cargo-carrying capacity in terms of the number of deadweight tons delivered and demolished, there were 15 times more deliveries of dry bulk tonnage than demolitions.

Making a significant counter cyclical investment may lead to negative stock performance in the short-term. For instance, OOCL ordered six 13,000 TEU container ships in March 2011 from Samsung Heavy Industries for approximately \$125 million. These are very large container ships that would be almost 50% bigger than any ship in its fleet. However, these ships can only be deployed on Asia-Europe services due to the fact that ports in the United States have restrictions on the size of vessels that can use the terminals. At the same time, while container volumes on intra-Asian trade routes are growing, operationally 8,000-13,000 TEU is too large for the trade. Thus, OOCL suffered from diseconomies of scale.

Another excellent example is the Danish shipping line Maersk who announced at the beginning of 2011 that it had ordered twenty 18,000 TEU ships, which is a new record for containership size. In term of financing, it is a risky move because the cost per ship is reported to be \$190 million. In terms of operation, the size has been announced as being 400m long and 59m wide, with a draught of 14.5m and tonnage of 165,000 dwt, and the delivery of the first vessels is scheduled to take place in 2013, to find sufficient cargo to fill a 18,000 TEU ship in a sluggish world economy may pose a serious challenge just to cover the operating expenses.

Slow Steaming – a sensible strategy to reduce supply side surplus tonnage

The combined idle tonnage of large tankers, dry bulk carriers and conventional general cargo ships at the end of 2010 is equivalent to 1.4% of the world merchant fleet of these vessel types. The idle tonnage in the container market had been significantly reduced by early 2011. The container sector mainly adopts the following two strategies to deal with the surplus tonnage: (1) slow steaming, and (2) delays in new deliveries.

Container lines in 2010 and 2011 adopted the operating strategy of “slow steaming” - to deploy ships at reduced operating speeds, with the aim of reducing fuel expenditure and vessel overcapacity. In container shipping, the normal speeds are of 21 to 25 knots for those engage in the Asia–Europe services, and under the slow steaming operations, the speeds run at only 17 to 19 knots (equivalent to 31.5–35 kilometres per hour). Depending on fuel prices, this may save the shipping line up to \$100 per each delivered TEU on major East–West routes. The question becomes : Which is a better way for the container lines to deal with the surplus tonnage: (a) charge a higher freight for a faster service, or (b) to charge a lower freight under slow steaming? The authors of this paper opined that even container lines have the market power to charge higher freights for faster services, judging from an economic view, the released containership capacity will add weight to the surplus tonnage, and in the long run, it

would put downward pressure on overall freight levels. Alternatively, some liner shipping companies like OOCL have further delayed delivery of two 8,600 TEU vessels to the fourth quarter of 2014 so as to save the operating cost and investment risk.

Conclusion

This paper submits a positive and bright outlook for the first quarter of 2013. After the 2009 slump of world merchandise trade, (which recorded a -12.9% and -12.0% in global merchandise trade imports and exports activities), a recovery has taken place, and the World Trade Organization announced an imports growth rate of 4.9% and exports growth rate of 5.0% in 2011. The following table summarizes the UNCTAD observations:

Table 2: Growth in volume of merchandise 2008 to 2011

	2008	2009	2010	2011
World Exports	2.6%	-12.0%	13.8%	5.0%
World Imports	2.9%	-12.9%	13.7%	4.9%

Data source: World Trade Organization, 2012

The Hongkong and Shanghai Banking Corporation conducted a global survey across 21 countries, which involved 6,390 small and medium-sized shippers and the results revealed that traders globally remain positive. Nine out of ten of the surveyed firms expected trade volumes would increase or hold at current levels in the next six months.

The World Trade Organization also observed that there was a surge in the volume of world exports and it concluded that it was the largest annual growth recorded in a data series dating back to 1950. The recovery was so strong that from mid-2009 to mid-2010 trade volumes expanded at an annualized rate of nearly 20%.

Finally, this paper also submits that in the long term there is a likelihood the momentum of growth may be hampered by protectionist measures. One factor that contributes to the risk of greater protectionism is coming from the uneven economic and trade recovery after the 2008 Financial Crisis. Although G-20 countries made renewed pledges in 2010 that they would refrain from increasing or imposing new barriers to investment or trade, they also pointed out that the refraining period works until the end of 2013. Even after the G-20 renewed pledges, non-tariff measures are being introduced under the headings of health and environment protections. The authors' conclusion is consistent with the observations reported by Economist Intelligence Unit that, between November 2009 and May 2010, potentially restrictive measures surpassed those facilitating trade by a ratio of 3 to 2.