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Outlook of global economy and trading and its impact on shipping

C. C. Tung

It is a pleasure to join you here today. My fellow speakers at this Forum are highly distinguished and I am honoured to be among them at this impressive gathering.

I would like to thank the sponsors and organizers for making it possible for us all to be here. It is especially appropriate that such a vibrant and dynamic forum is being held in Shanghai. With Expo fast approaching, the buzz and optimism in the air is palpable.

I am conscious that on day two of the Forum you will already have heard a lot of information. Rather than repeating what has already been said, I would like to pose a few ideas for further thought.

Let's consider the outlook for the global economy and trade, and try to examine where the future is heading in terms of the impact on the shipping industry. How can we all play a part in ensuring the long term sustainability of the industry?

During the past four or five decades, I have witnessed tremendous economic growth and much greater openness in the way nations do business with each other.

Merchandise exports grew on average six percent annually over the past 50 years, and total trade in 2000 was 22 times the level of 1950.

This growth accelerated following China's accession to WTO. In our industry, we saw an average demand growth of 12% per year from 2001 to 2007.

According to the OECD, a 10% increase in trade is associated with a 4% rise in per capita income. Let me state the obvious. Trade drives up standards of living, technological advances, fosters job growth and efficiency gains.

Trade actually helps to keep prices down, because it encourages competition between countries. Buyers can source high quality goods and services from the rest of the world at competitive prices.

However – in 2009 – the financial crisis spilled into the real economy. The growth of real world GDP was negative, estimated at minus 2.2 per cent.

World trade has also been negatively affected, with a freefall decline of around 12 per cent in 2009, mainly in consumer goods. This has been the sharpest decline since the end of the Second World War, and was caused by plummeting demand across all major world economies. The drying up of trade finance exacerbated the situation.

The International Labour Organization estimates the number of jobless people worldwide at over 200 million – the highest level ever.

The global economy, trade and shipping industry are inextricably linked. Three-quarters of world trade is in merchandise or goods primarily industrial equipment, consumer goods, oil and agricultural products. The vast majority – 90 percent – moves by sea.

It is undeniable that the container shipping industry, perhaps more than any other, is chronically vulnerable to economic shocks.

I've been in the industry for some 40 years now and have seen many ups and downs. But I can honestly say that this has been one of the most challenging and destructive times we have ever encountered.

With the downturn in the global economy, more than 70,000 factories in the Pearl River delta closed due to the lack of demand. Chinese exports suffered a sharp decline – up to 25% in early 2009, their biggest drop in a decade. Of course, as trade and shipping are so interlinked, this hit the shipping industry hard and many industry players became desperate to fill their ships at any cost.

Taking the optimistic view, I believe the worst part of the crisis is over and we are starting to see the first tender shoots of economic recovery.

In January and February 2010, Chinese export growth was more than 40%. However, this is still only just returning to the 2008 level.

The unexpected high demand before Chinese New Year caught some by surprise. But this could very well be a short-term boom due to inventory re-stocking.

Year-to-date inbound volume to the top five West Coast ports grew almost 14%, while US consumer spending only grew at 0.5% in January.

The IMF has revised up the global GDP growth forecast to nearly 4% for 2010 and 4.3% for 2011. There is reason to be cautiously optimistic.

However, many uncertainties remain. Stimulus packages in economies around the world have been instrumental in preventing further declines, while setting the path for growth.

Let us hope that private sector consumption and investment demand will respond to the pickup in activity prompted by fiscal stimulus and the inventory cycle.

In the meantime, there is an uneasy feeling in some parts of the world that some of these stimulus measures favour domestic goods and services at the expense of imports. Protectionism in difficult times can be a natural choice of governments looking to stimulate jobs and boost their domestic economies. Unfortunately this is a short-term solution to a long-term problem.

The economy needs other sources of growth, and this is where trade matters.

However – while trade is still slowly getting back on its feet after an almighty shock, for the container shipping industry, we must be aware that like a fragile seedling, these early shoots of recovery can be easily damaged and crushed.

The industry must nurture these early phases of recovery to ensure the shoots blossom into a full rice bowl, leading to a sturdy phase of growth and maturity.

As carriers begin to announce their losses – already more than US$11 billion for the industry in the first nine months of 2009 – one might wonder how long the bleeding will continue. Prospects for 2010 are better than last year, but certainly as an industry we are still in pain. Unfortunately, as happened during past downturns, we don't learn from past mistakes. In 2009 some carriers attempted to fight for market share and volume, trying to generate much-needed cash flow at the cost of lower freight rates. This only prolongs the suffering – particularly when the rates were insufficient to cover variable costs.

In a downturn, this strategy simply does not work in our industry, as we now know. We saw rates plummeting precipitously in the first half of 2009.

To an extent, we began to see the unusual phenomena of "the more we carry, the more we lose". This is not sustainable.

At OOCL, our capital costs of ships and equipment represent 16% of total costs. Recognising the lack of demand, our determination was to remove 10% of our surplus capacity, while offering superior services to our customers. As a result, we were able to retain much of the volume, thereby saving fuel, achieving higher utilization, and improving cost efficiency, far more than just offsetting the capital cost of the laid-up tonnage.

The freight market finally stabilized by the fourth quarter of last year, but at the current level, most carriers would still struggle to make a profit.

The industry is looking at a tremendous capacity overhang with an increase in the global fleet of 35% from the shipyard in the next four years, and another 9.3% of the global fleet is currently laid up.

At the same time, trade and therefore demand growth are looking at a possible protracted period of moderate growth of 6%. If this is indeed the situation, we are looking at *at least* three to four years of supply in excess of demand. Therefore, even if there is a rebound or upturn in the global economy, the container industry will not recover for some years.

How can we work towards improving the situation? I do have a wish list, which requires understanding and efforts from both the industry and our regulators.

We need to have a deep understanding of our costs before fighting for market share. We must find a way to educate our customers about these increasing costs which are often beyond our control.

We are threatened by sudden escalating fuel prices impacting other costs such as terminals and inland transportation costs. Financial products allow speculation which further threatens stability.

Our pricing structure needs to allow for shocks and uncertainties, in order to make us less vulnerable to fluctuations in the market and the economy.

Both carriers and shippers should work together to address the extreme volatility in pricing that, as we have so clearly seen, benefits neither group.

Climate change issues are being discussed at the IMO this month as we speak, at the Marine Environment Protection Committee meeting, (MEPC 60).

Clean fuel demands will escalate. Shippers are already asking for ways to lower their carbon footprints and are choosing 'green' carriers.

It is the industry's responsibility to tackle emissions and as responsible corporate citizens we are both willing and eager to do so. But how do we implement new green technologies, clean fuel standards and emissions reduction initiatives if we are not making a profit?

Slow steaming is a strategy which I believe is here to stay for the long term. Slow steaming saves fuel, helps lower emissions and can perhaps absorb excess global capacity. FMC now allows discussion of slow steaming for cost savings and the environment. The industry needs to brainstorm more of these issues and share information on how to proceed.

Now that we know what we are afraid of, how can we avoid the worst case scenarios? Are we destined for more boom and bust cycles? How can we ensure a sustainable future for the industry?

First and foremost, the key to a positive future and outlook is to ensure stability for the market. To achieve this we must understand the shipping industry's strategic importance in global trade and economics.

We must present our case to the people and organizations setting the rules for economy and trade. They are, of course, the governments of the major trading nations.

Unfortunately, some governments – including the EU – have dealt our industry a double whammy by banning all forms of communication and information exchange even if the information exchanged is crucial to ensuring market stability. They did not provide alternatives and failed to recognize that carriers need to discuss other important issues for the industry's survival in these unusual times.

Governments should avoid trying to place a "one size fits all" regulatory regime on industries with unique situations and problems. But at the same time, a number of governments are heavily distorting competition by providing financial subsidies in an effort to bail out their national carriers.

I believe governments should consider a short-term reprieve from antitrust regulations, particularly on capacity management, but without giving up their oversight responsibilities and rights of approval.

This would allow us to develop solutions to the problem. We in the industry know what needs to be done. Let us work together to achieve it.

We live in a global world. It is time to take a global approach, versus a national approach. And it is time for the shipping industry to take an industry approach to solving our problems.

If we look at history and past recessions, while the EU no longer provides individual exemptions to antitrust regimes, they have exempted capacity reduction agreements in the past.

In 1982, several European synthetic fibre manufacturers were facing increased competition from abroad and faced an imbalance of supply and demand.

At that time, the European Commission called upon member states to stop granting any form of state aid to the sector, in an attempt to avoid further deterioration of the capacity problem.

While there was no significant upturn in demand, an additional agreement became necessary. The EC rightly took the position that in a free market economy, when overcapacity becomes economically unsustainable, necessary steps must be taken to correct it. Structural adjustment was agreed temporarily and collectively, and technical and economic progress resulted.

What logic has changed since then in the EU? Economics is economics. In the current environment, the EU is a successful and dynamic body who can achieve results very quickly when it wants to. Could we look to the EU to take similar appropriate action for the container shipping industry, on which global trade is so dependant?

What we have to do as an industry is look for new ways to be competitive, new ways beyond “normal”.

As we have seen, a healthy shipping industry is the lifeline of trade worldwide. The expansion of our industry over the past decade has been fuelled primarily by the expansion of the Chinese export market.

China is well placed to take the lead as the world’s third largest trading economy. China's economic development, continued growth in the demand of bulk commodities, and promotion of domestic spending will lead to higher imports of consumer goods. China can help to drive the economy of the OECD countries to achieve recovery.

It’s an exciting time to be doing business in this region. Globalization will continue. We are watching something truly magnificent happening in China and we can see its growing strategic importance as a major player in the global trade arena.

We could look to the Chinese authorities to take the lead as part of trade facilitation and capacity building, to discuss and bring understanding to other governments on the need of a solution for our industry including for additional agreement as an interim measure or a possible exemption from antitrust for the container shipping industry.

Indeed, China's leadership in the implementation of freight filing for international container liner services, through the Shanghai Shipping Exchange, offers a good example to other countries. This is a fair and transparent means of avoiding the kind of destructive competition I talked about earlier.

In my company, OOCL, we are fortunate to have strong ties with China. We have looked at our business model and made some tough changes where needed. Our logo is the plum blossom, which is well known in China as being tough and resilient in the face of harsh winter conditions. While we continue to face challenges, we will focus on serving our customers and emphasize our people, IT systems, and our global network.

Individually, we will be fine. But there is only so much we can achieve as an industry without cooperation with our regulators, our peers, with banks and lawyers, and with our customers. The first step to success is in knowing what one wants to achieve.
Now that we have a wish list in hand, we must work towards the goal of a bright, sustainable future for the global economy, world trade, and our industry.

Thank you.

(Mr. CC Tung, Chairman & CEO, OOIL group)