DRY BULK BLUES

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The much heralded fourth quarter 2014 recovery in dry shipping has yet to arrive. Whereas the vast majority of analysts had expected a robust pickup in demand, the latest IMF, BIMCO and Clarkson's estimates point to an estimated slowdown in global economic growth this year to 3.3% and 3.8% in 2015.

What changes have taken place and why has the dry bulk market failed to perform as expected?

The main culprit this time has been a slowdown in the rate of growth of demand rather than a spike in new tonnage entering the market. The market has been in a chronic oversupply in the last 5 years made larger by the 2010-2012 newbuilding boom. With net annual capacity increase (after scrapping) of approx. 3.6% p.a. (Clarkson's) it had been widely expected that this year demand growth would outpace supply growth, thus resulting in a shrinking oversupply market. However, it did not happen.

The world economy has been labouring under a lot of constraints. Not only has China slowed down, but a large number of anti-trade developments have taken place. Starting with China, officially the annual growth estimate for 2014 remains at a healthy 7.4% p.a. However, commodity related demand growth has slowed down as a greater emphasis has been placed on internal consumption. Whereas a few years ago Chinese imports grew by 10-20% p.a., 2014 growth is expected at only 5% p.a. In addition, in US Dollars denominated terms, exports are currently growing at only 8% p.a., as opposed to 15% plus, in previous years. Clearly, therefore, the world's growth locomotive is slowing down, as has happened with previous 'champion' growth economies in the past, such as Japan.

Further evidence of the slowdown lies with the latest Chinese industrial production growth of 6.9% y to y and a forecasted economic growth in 2015 down from 7.1% in 2015 to 6.8% .

However, it is not only China that has affected the global economic growth figures. There exist a large number of negatives, such as import/export restrictions, taxes and tariffs involving China, India, Philippines and others. In addition, sanctions, e.g. Russia, Iran, and conflicts, e.g. Ukraine, Syria, have taken their toll and so has the unwillingness by many banks to finance international trade due to their own capital adequacy issues, as well as unattractiveness of returns in financing international trade.

To conclude, therefore, the negatives currently outweigh the positives.

According to ABN Amro, global trade only grew by 3% in 2014, although it is expected to rise to 6% in 2015-2016. However, given the still large orderbook, consistent annual growth rates of 6-7% are required to reduce the current oversupply.

Looking to the prospects of dry bulk shipping, despite BIMCO's prediction of lower demand in the coming years, I remain more confident of a gradual recovery. New dry bulk orders have slowed substantially over the last year and as vessels yield a very poor cashflow, delivery related delays and / or some cancellations, are expected. Moreover, the cost of maintaining overage tonnage is rising and the costs of passing a 4th or 5th special survey are now daunting. Moreover with increasing new regulations coming into effect in 2015-2016, scrap rates at $500 per ton may appear attractive. Consequently, we estimate a recovery of scrapping in 2015.

The taxes, tariffs, restrictions and sanctions issue remains a strong disincentive to international trade and still remains a factor which is difficult to forecast.

Overall, any recovery hopes lie in 2015 and more probably in 2016. This is a long time for a sector that has been involved in a relatively poor market now for 6 years. Banks which have restructured client loans may be running out of time and will soon be pressed by their central banks to sell off non-core assets (bad loans) and take provisions. This will have a huge effect on vessel values as a large number of vessels, especially in the 10-20 years old brackets, shall hit the market.

Added to this, there has been a rising number of sale candidates by Japanese owners who have been glad to see Yen related prices hold as a result of a weakening Yen. Lastly, it would be interesting to see the attitude of private equity to further disappointing dry bulk performance and whether they will stay the course or cut and run. I support the former, as there is little benefit in selling in a weak and falling market. Still, the love affair between shipping and private funds may well be seriously tested. However, private funds which have, so far, not gone into the shipping market, may find the risk/reward opportunities over the next 6 months or so quite interesting.

To conclude, therefore, dry bulk shipping may well wallow in the doldrums with periodic short term spikes over the next year or so. However, improving fundamentals may set off a slow recovery in 2015 with a pickup of the recovery in 2016. As always, opportunities for asset players will abound.