

The World Economy and the Shipping Cycle

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Macro Factors Affecting Dry Demand

- Macro and micro factors have caused a dramatic shift in demand from 2.4% above trend in Oct 2013 to 7% below trend in Jun 2015, a swing of nearly 10%. Prior to these shocks the underlying trend of demand from 2H12 was 6%.
- In 1Q15, the demand for dry fell -2.5% (q-o-q), an unprecedented plunge since the Asian-Russian crisis, and rose an estimated 0.2% in 2Q15. In 1H15 (from Dec to Jun) demand fell -2.3% and is likely to stage a 2.3% (q-o-q) rebound in 2H15.
- At the macro level there is a slowdown in world trade. A recovery is expected in 2016 on the back of worldwide easing of monetary policy and delay in Fed tightening.
 - World trade fell -1.9% in 1H15 (from Dec to June). The average annual growth rate in 1H15 declined to 1.7% (y-o-y).
 - The decline in world trade is due to renewed divergence between advanced (AE) and emerging economies (EE). This is the last phase of divergence as it is the result of previous opposing trends in monetary policy – easy in AE and tight in EE.
 - Tight monetary policy in EE was triggered by a reversal of capital flows from EE and commodity countries back to the US, as the slowdown of China imploded the commodities bubble and the US recovery became sustainable.
- Although the macro environment is likely to improve, uncertainty looms high regarding the micro factors in 2016.
- For the whole of 2015 (from Dec to Dec) demand will likely grow 2.5%. But as a yearly average, which is distorted by large swings within the year, demand is likely to increase at the paltry pace of 1% in 2015 from 5% in 2014.

Micro Factors Affecting Dry Demand

- At the micro level China has intensified the intervention in the coal market and extended it to the iron ore market this year.
 - Coal imports fell to 292 MT AR in 2014 from 327 in 2013 or -11%. In 1H15, they fell to 200 MT AR or -32%.
 - Anti-pollution policies and fettering with market forces (intervention) has each contributed 50% to the -32% plunge of coal imports in 1H15.
 - The aim of intervention is to eliminate the existing oversupply in the coal market and therefore reverse the downtrend in coal price. This is necessary to achieve the anti-pollution objective, as it is clear that a falling coal price acts as a hindrance to power stations switching to non-fossil fuels.
 - The coal price fell -16% last year and may fall an equal amount this year. The coal market may reach equilibrium in 2017. Hence, the price of coal may drop another -8% in 2016, requiring more intervention next year.
 - The impact of lower China's coal imports will be ameliorated from next year as India overtakes China.
 - China's iron ore imports fell to 900 MT AR in Jun 2015 from 1042 MT AR last Dec or -14%. Had there been no anti-pollution regulation and no intervention in the iron ore market, iron ore imports should have increased 10%, due to the overwhelming impact of the falling price and slight increase in steel production. Therefore, the combined effect of anti-pollution regulation and intervention resulted in -24% lower iron ore imports than otherwise in 1H15.
- The prospects of demand are highly uncertain because of possible intervention next year.

Supply Outlook and the Demand-Supply Balance

- The orderbook for dry bulks slid -30% (y-o-y) in July compared with 11.5% in Dec and 34% last May. The orderbook fell to 18.2% of the dry fleet in July from 23.4% in Dec. For the year as a whole the orderbook to fleet ratio is expected to decline to an average value of 19.1% from 24.6% in 2014.
- Although the net fleet expanded only 7 M DWT in 1H15, the increase in 2H15 may be much bigger giving 23 M DWT for the whole of the year, as the outlook improves.
- The demand-supply balance in the dry market, measured by fleet capacity utilisation (CU), may have bottomed at less than 84.5% in 2Q15. This is the lowest since records began, reminiscent of the first half of the 1980s. This year it will likely average 85.3%, which implies 86.2% in 2H15 from 84.4% in 1H15. There is 35% risk that after the summer surge demand and CU return to the depressed levels in 1H15.
- In conclusion, any increase in demand is likely to be partly offset by supply leaving little room for improvement in the demand-supply balance.

Table 1: The Dry Market at a Glance, Yearly Averages

	Demand for Dry MDWT	Demand for Dry %	Supply of Dry MDWT	Supply of Dry %	Fleet Capacity Utilisation %	BDI	Low end of range 95% (1)	High end of range 68% (2)	NB Prices \$/DWT	5Y SH Prices \$/DWT	10Y SH Prices \$M
2008	396	4.4%	407	6.5%	95.2%	6,070	822	9,678	885	1,135	52
2009	413	4.3%	438	7.3%	92.4%	2,641	1,427	3,521	614	513	22
2010	470	13.7%	503	13.8%	91.6%	2,675	1,938	3,276	577	589	28
2011	523	11.3%	582	14.6%	88.4%	1,532	999	1,804	545	500	23
2012	574	9.8%	662	12.9%	86.2%	885	672	1,042	478	382	16
2013	619	7.8%	710	6.9%	87.2%	1,256	710	1,757	473	381	16
2014	649	4.8%	746	4.9%	87.0%	1,065	786	1,275	520	433	19
2015	655	0.8%	768	3.0%	85.3%	853	575	1,096	471	308	13

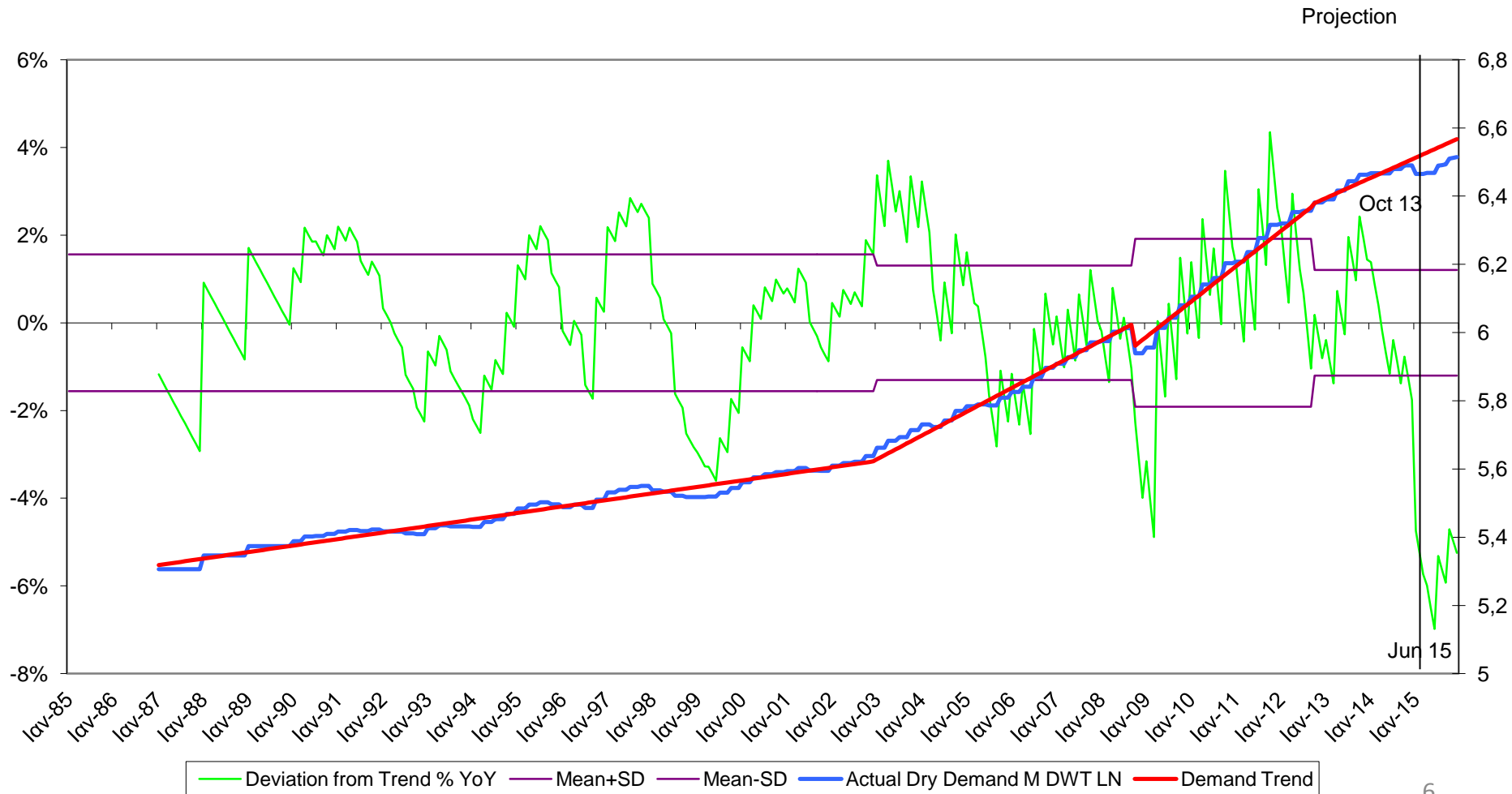
Notes:

(1) This is based on the volatility of months with negative returns (i.e. a fall in BDI relative to the previous month), measured by one conditional SD. The low end is obtained by subtracting 2 SD from the BDI-average.

(2) This is based on the monthly volatility within a year. It is measured by one conditional standard deviation, which when added to BDI-average gives the upper range of monthly averages in a year with 68% probability.

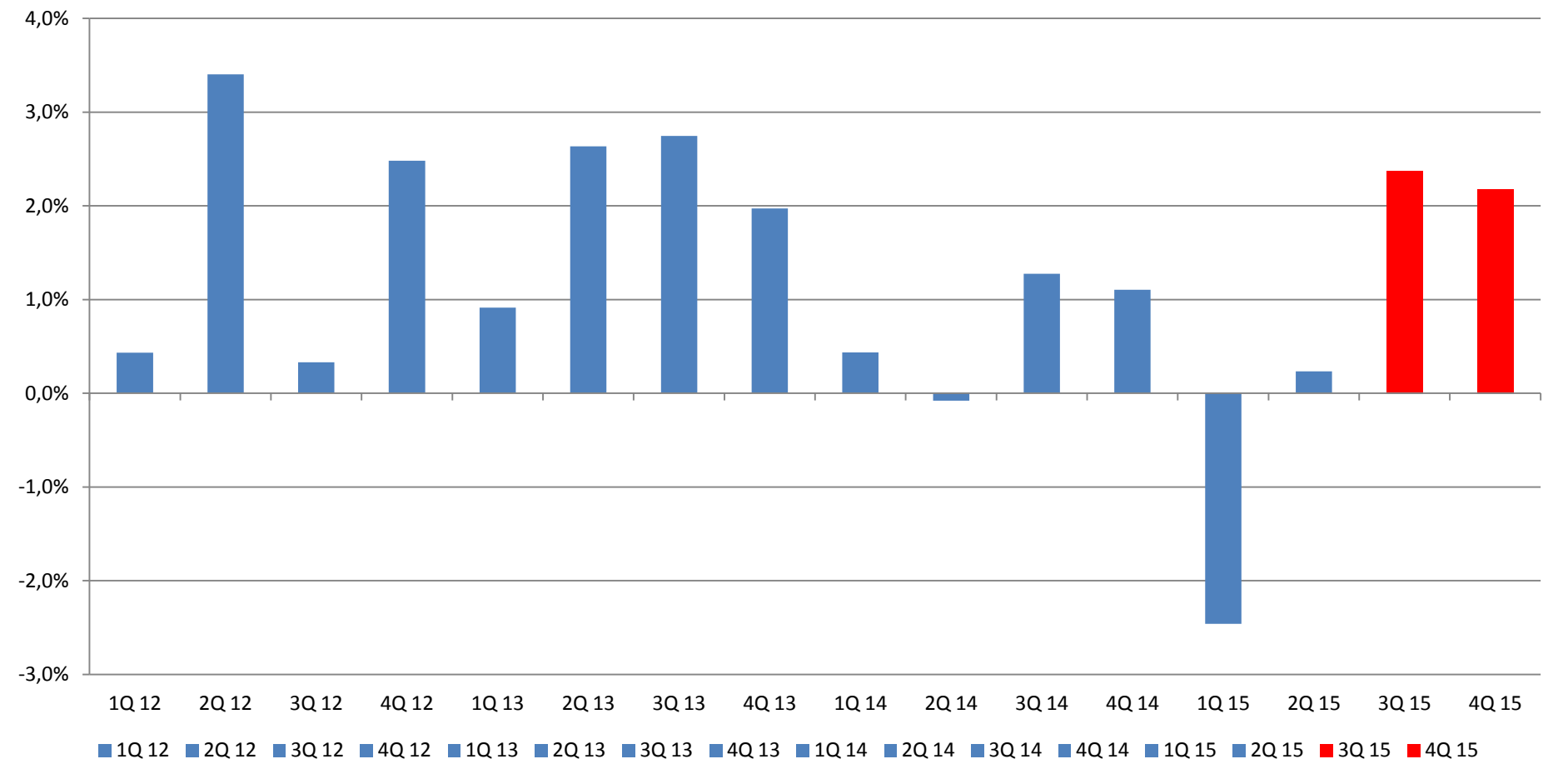
Macro and micro factors have caused a dramatic shift in demand from 2.4% above trend in Oct 2013 to 7% below trend in Jun 2015, a swing of nearly 10% (see green line). Prior to these shocks demand was growing on a 6% trend.

Figure 1: Decomposition of Demand into Trends and Cycles 2%, 7%, 10% and 6%



In 1Q15, the demand for dry fell -2.5% (q-o-q), an unprecedented plunge since the Asian-Russian crisis, and rose an estimated 0.2% in 2Q15. In 1H15 (from Dec to Jun) demand fell -2.3% and is likely to stage a 2.3% (q-o-q) rebound in 2H15. For the whole of 2H15 (Jul to Dec) demand will likely grow 4.8%, giving 2.5% for the year (from Dec to Dec).

Figure 2: DEMAND FOR DRY % QOQ



Macro Factors Affecting Demand: World Trade

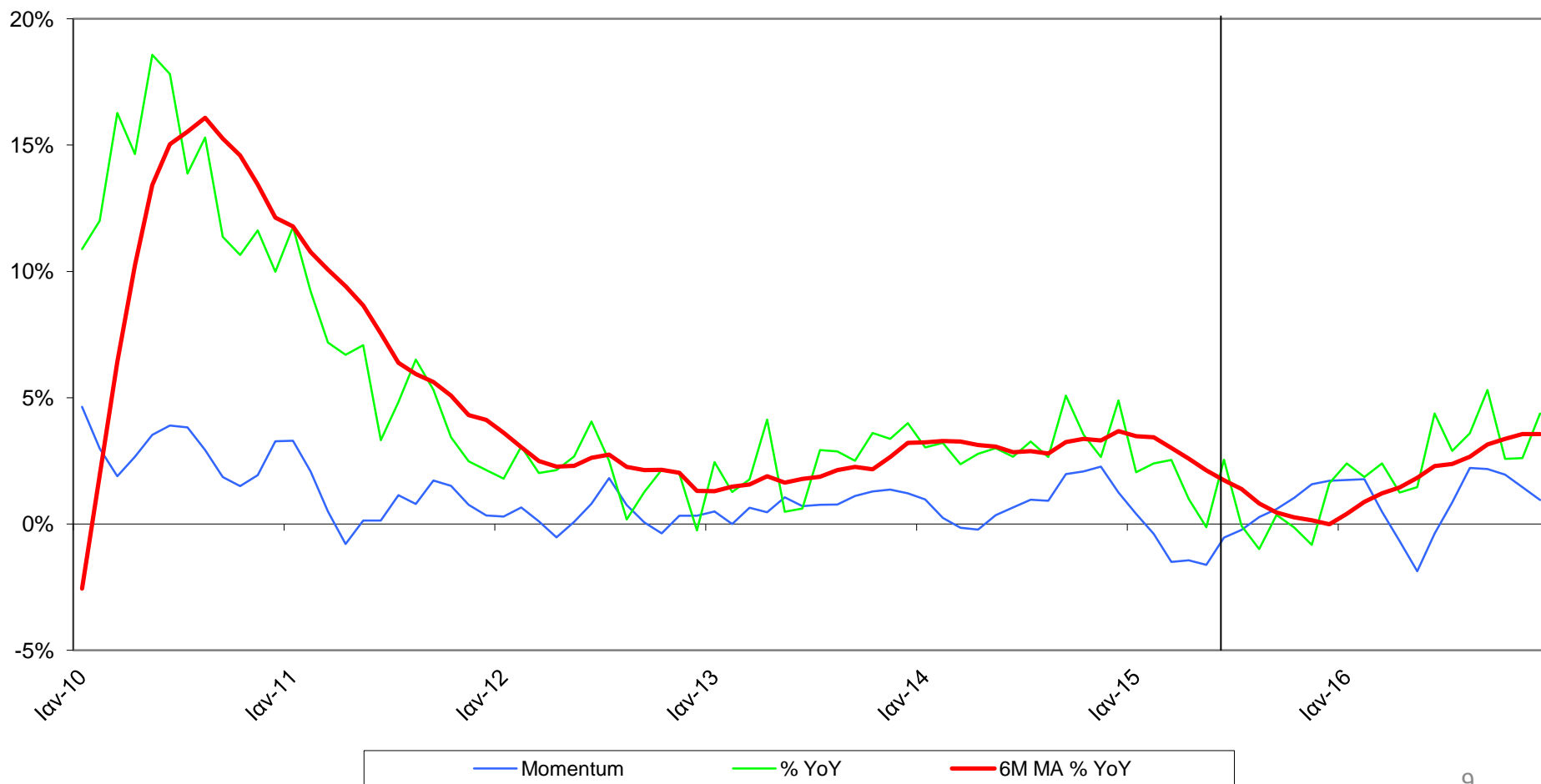
Table 2: World Trade Volume by Region and Country

	World Trade (WT)	Advanced Economies	US	Europe	Japan	Emerging Economies	Asia	Latin America	E&C Europe	Middle East & Africa
Share of WT in 2005, %		62%	16%	29%	5%	38%	20%	4%	6%	7%
Share of WT in 2014, %		50%	13%	23%	4%	50%	27%	5%	8%	10%
2008	2.2%	-1.8%	-3.7%	-1.4%	0.9%	7.8%	5.1%	5.1%	8.4%	16.6%
2009	-12.4%	-14.3%	-16.2%	-13.5%	-13.9%	-10.1%	-6.1%	-18.1%	-19.8%	-7.0%
2010	14.5%	10.8%	14.9%	9.1%	10.4%	17.3%	20.5%	24.9%	16.5%	5.9%
2011	5.9%	3.4%	4.0%	2.7%	4.9%	9.1%	7.4%	10.6%	14.3%	8.8%
2012	2.0%	-0.3%	2.8%	-3.5%	3.5%	4.4%	3.5%	2.2%	3.8%	8.9%
2013	2.5%	-0.4%	0.8%	-0.6%	1.6%	5.2%	5.4%	5.4%	4.8%	4.8%
2014	3.3%	3.0%	4.7%	2.4%	2.3%	3.5%	4.0%	2.7%	1.3%	4.5%
2015	0.9%	2.8%	5.5%	2.1%	-0.4%	-3.2%	-3.3%	1.8%	-4.3%	-4.7%

World trade fell -1.9% in 1H15 (from Dec to June). The average annual growth rate declined to 1.7% (y-o-y) in 1H15. A recovery is expected in 2016 on the back of worldwide easing of monetary policy.

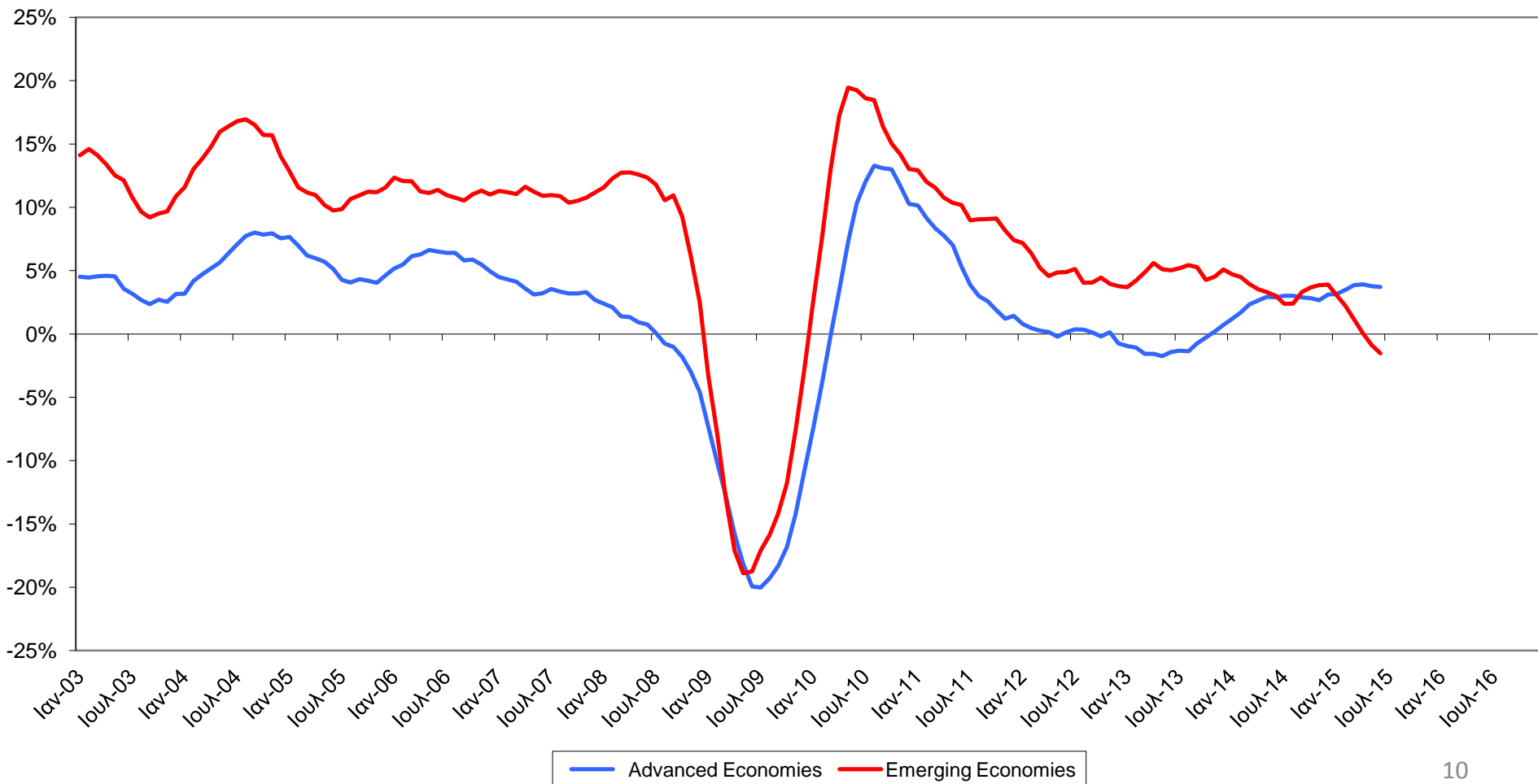
Figure 1: World Trade Volume

Projection



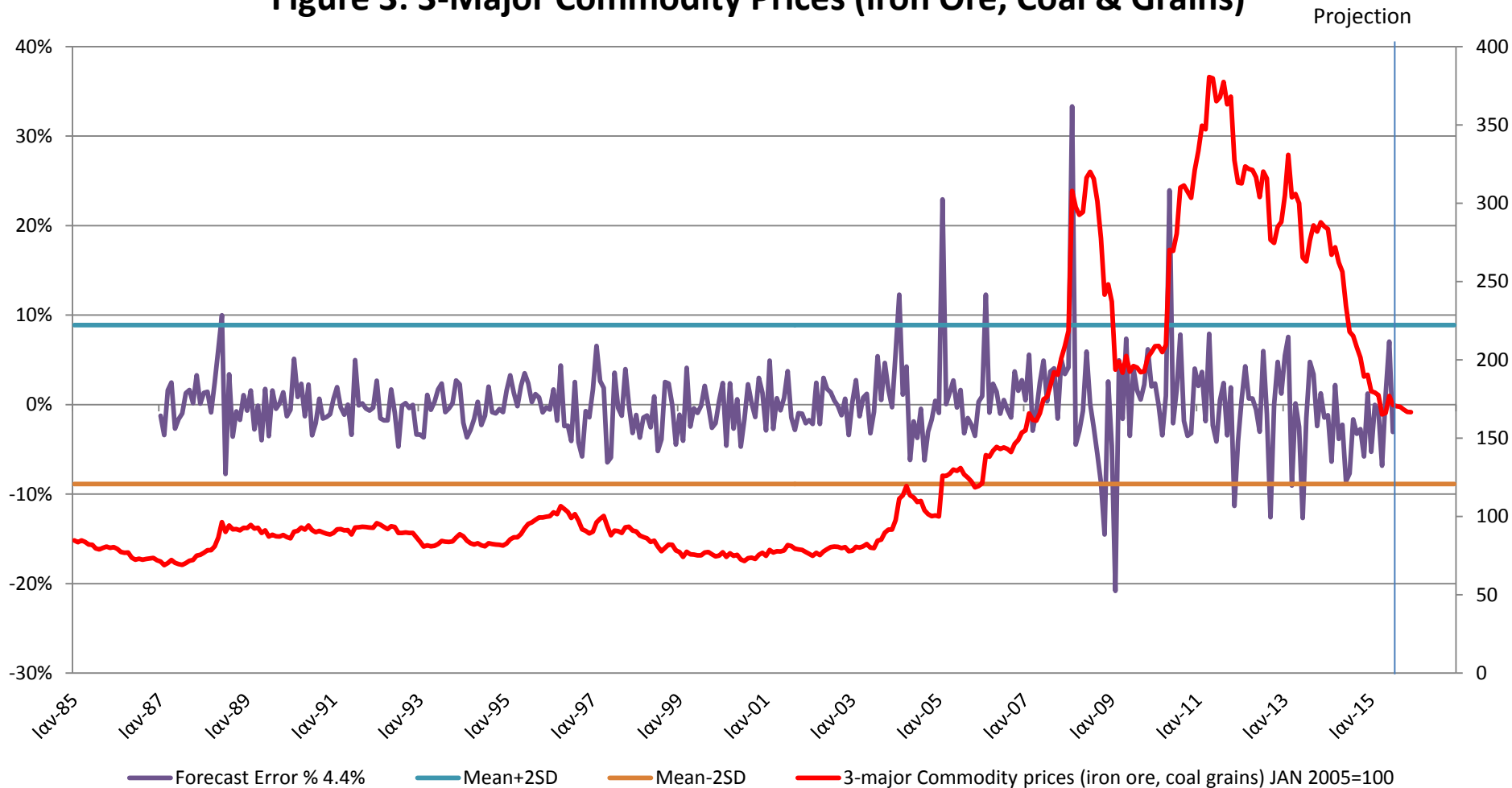
The decline in world trade is due to renewed divergence between advanced (AE) and emerging economies (EE). This is the last phase of divergence as it is the result of previous opposing trends in monetary policy – easy in AE and tight in EE.

Figure 2: WORLD TRADE TRENDS BY REGION, % (Y-o-Y) 6M MA



Tight monetary policy in Emerging Economies (EE) was triggered by a reversal of capital flows from EE and commodity countries back to the US, as the slowdown of China imploded the commodities bubble and the US recovery became sustainable.

Figure 3: 3-Major Commodity Prices (iron Ore, Coal & Grains)



Anti-pollution policies and fettering with market forces (intervention) has each contributed 50% to the -32% plunge of China's coal imports in 1H15.

Table 3: Impact of Anti-pollution and Intervention in China's Coal Imports			
	Coal Imports MT AR		
	Actual	Anti-pollution	Intervention
2014	292	292	292
1H15	200	246	-46
%	-32%	-16%	-16%
Share	100%	50%	50%

Table 4: China Coal Imports

	Coal Imports Upper Limit Scenario (1)		Coal Imports Anti-pollution Scenario (2)		Electricity Production		Coal Price (AUS)		Thermal Power Production		Hydro Power		Share of Thermal Power	Share of Hydro Power	Share of Other Source s
	MT AR	%	MT AR	%	KWH trillion	%	USD	%	KWH trillion	%	KWH trillion	%	%	%	%
2008	41		41		3.4		130		2.8		0.5		82%	15%	3%
2009	127	210%	127	210%	3.6	7%	72	-45%	3.0	8%	0.6	6%	83%	15%	2%
2010	166	31%	166	31%	4.1	14%	97	36%	3.3	10%	0.7	19%	80%	16%	4%
2011	183	10%	183	10%	4.6	11%	122	25%	3.8	14%	0.6	-8%	83%	13%	4%
2012	289	58%	289	58%	4.8	4%	97	-20%	3.7	-1%	0.7	23%	79%	16%	6%
2013	327	13%	327	13%	5.2	8%	86	-12%	4.2	11%	0.8	1%	81%	15%	5%
2014	292	-11%	292	-11%	5.4	5%	72	-16%	4.2	0%	0.9	24%	77%	17%	6%
2015	297	2%	246	-16%	5.6	2%	60	-17%	4.0	-4%	1.0	5%	73%	18%	9%

Notes: (1) No pollution regulations and no intervention in coal market. Electricity demand is met with thermal power.

(2) Anti-pollution regulations apply; but coal market unfettered. Policy of reducing the share of thermal power wholly successful.

China's iron ore imports fell to 900 MT AR in Jun 2015 from 1042 MT AR last Dec or -14%. Had there been no anti-pollution regulation and no intervention in the iron ore market, iron ore imports should have increased 10.5%, due to the overwhelming impact of the falling price and slight increase in steel production. Therefore, the combined effect of anti-pollution regulation and intervention resulted in -24% lower than otherwise iron ore imports in 1H15.

Table 3: Impact of Anti-pollution and Intervention in China's Iron ore Imports

	Actual Iron ore Imports	Crude steel production	Iron ore price	Intervention & Anti-pollution
Dec-14	1042	817	73	
Jun-15	900	827	61	
%	-13.7%	1.3%	-16.8%	
Multiplier		2.0	-0.5	
Contribution	-13.7%	2.5%	8.0%	-24.1%

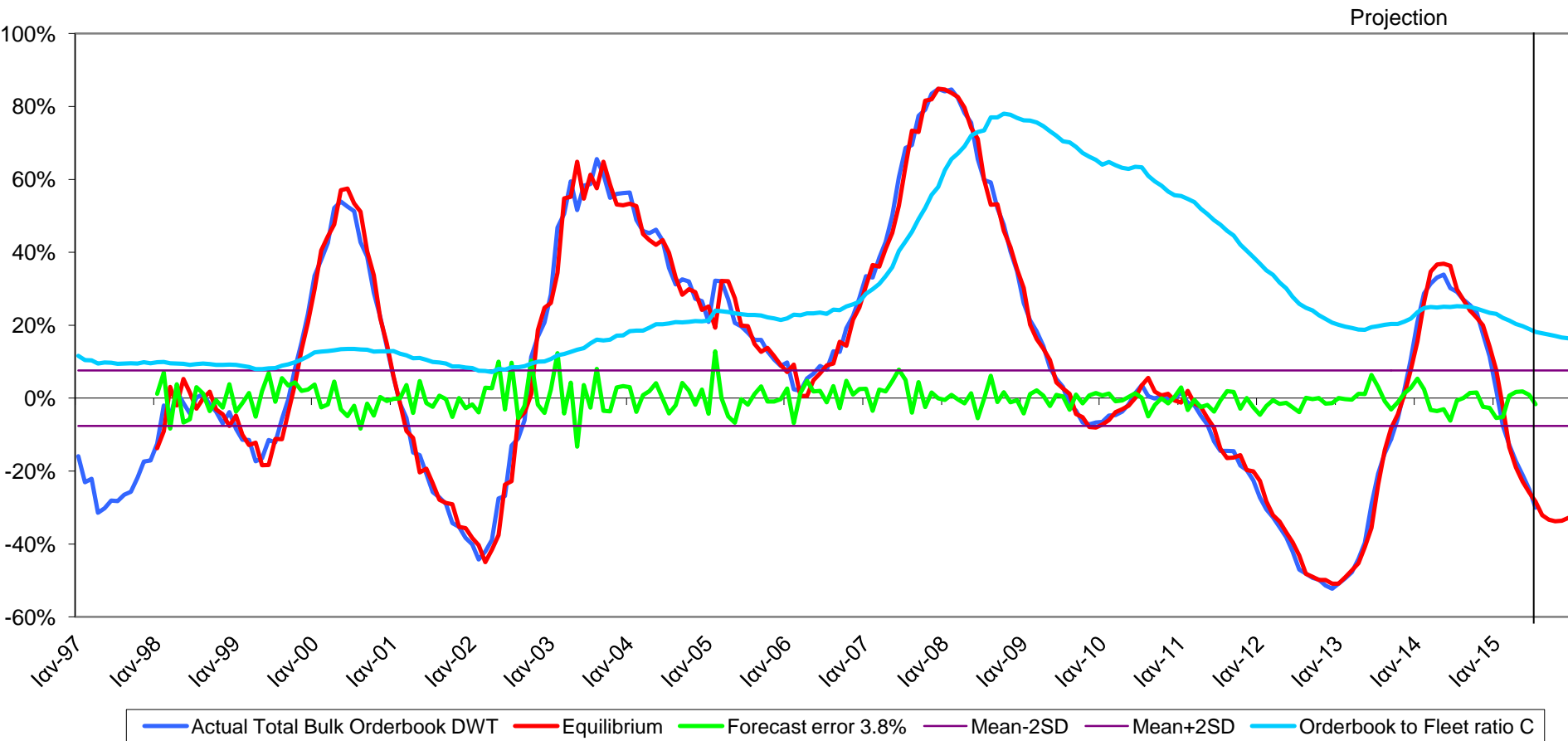
With unfettered market and no pollution restrictions, China's iron ore imports should increase 4.4% this year. The -38% plunge in the ore price should boost imports 18%. This should be ameliorated by the -1.1% likely fall in steel production.

Table 2: China Iron Ore Imports						
	Iron ore Imports		Crude Steel Production		Price of Chinese Iron Ore Imports, 62% FE	
	MT AR	%	MT AR	%	USD	%
2008	444		498		103	
2009	628	41.5%	566	13.8%	79	-23.3%
2010	619	-1.5%	626	10.6%	117	48.7%
2011	687	11.0%	684	9.2%	163	38.7%
2012	745	8.5%	709	3.6%	128	-21.2%
2013	820	10.0%	775	9.3%	133	4.0%
2014	933	13.7%	813	5.0%	101	-24.2%
2015	975	4.4%	804	-1.1%	62	-38.4%

Supply Outlook:

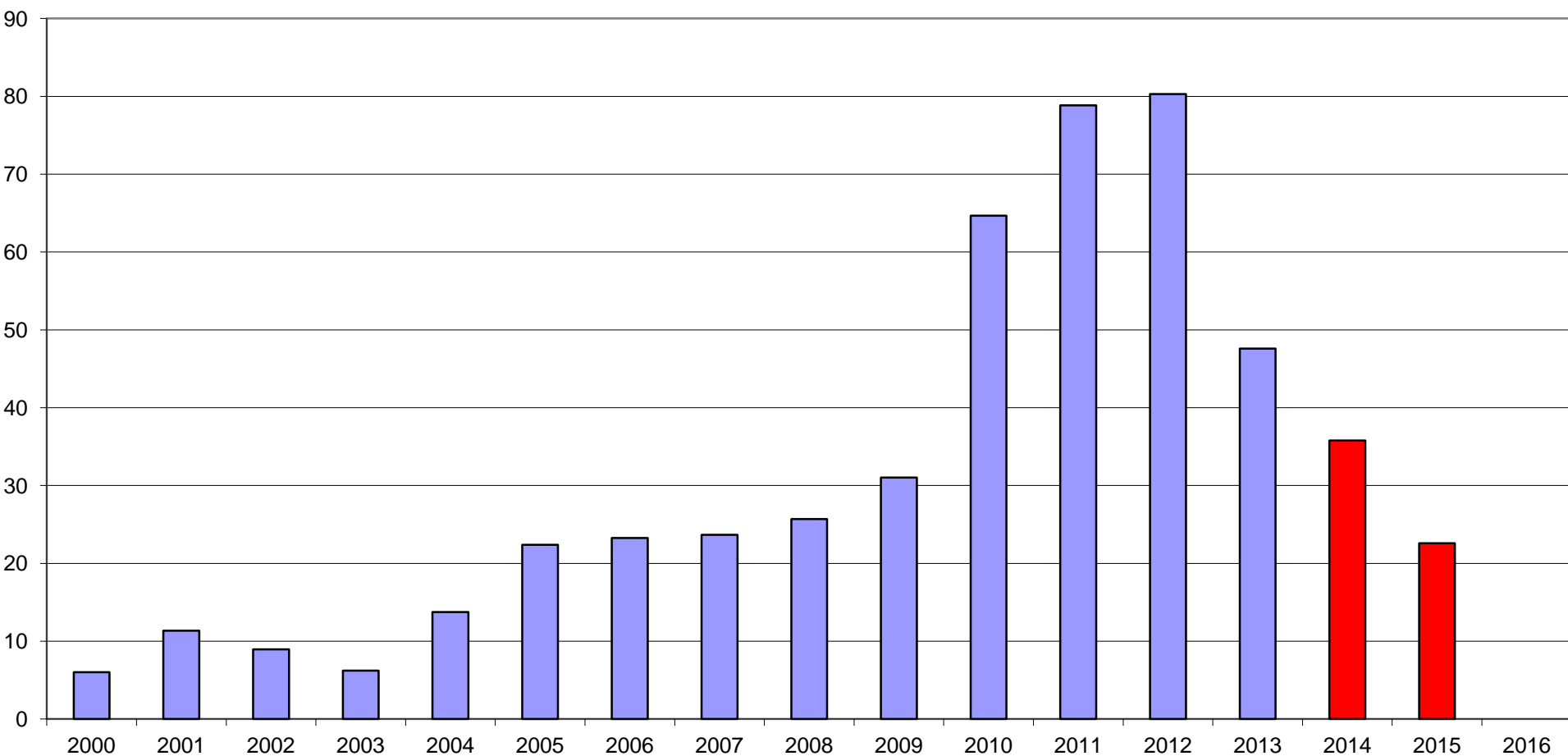
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FIGURE 4: TOTAL DRY ORDERBOOK



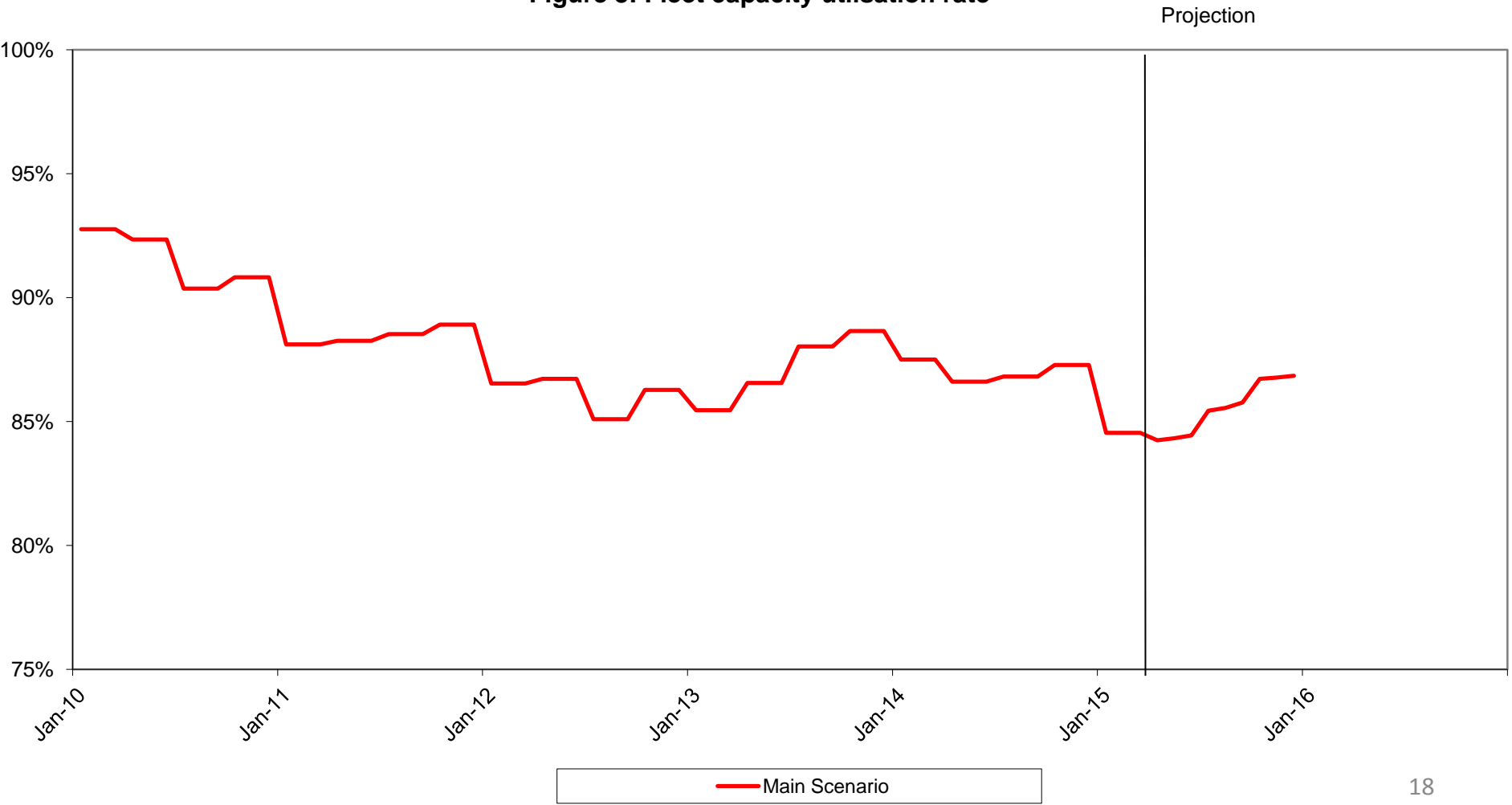
Although the net fleet expanded only 7 M DWT in 1H15, the increase in 2H15 may be much bigger giving 23 M DWT for the whole of the year, as the outlook improves.

Figure 5: Net total Bulker Fleet Expansion



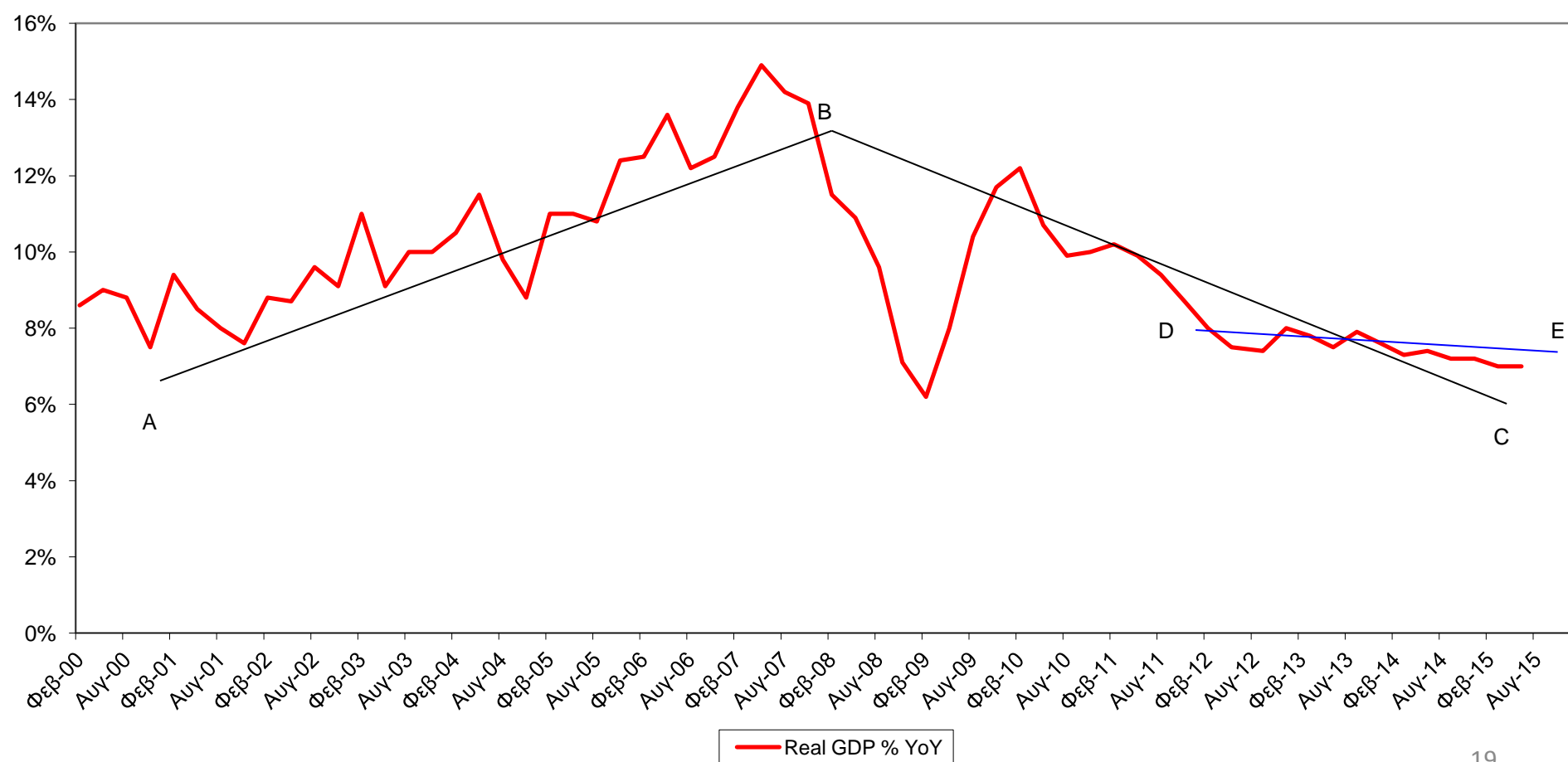
The demand-supply balance in the dry market, measured by fleet capacity utilisation (CU), may have bottomed at less than 84.5% in 2Q15. This is the lowest since records began, reminiscent of the first half of the 1980s. This year it will likely average 85.3%, which implies 86.2% in 2H15 from 84.4% in 1H15.

Figure 8: Fleet capacity utilisation rate



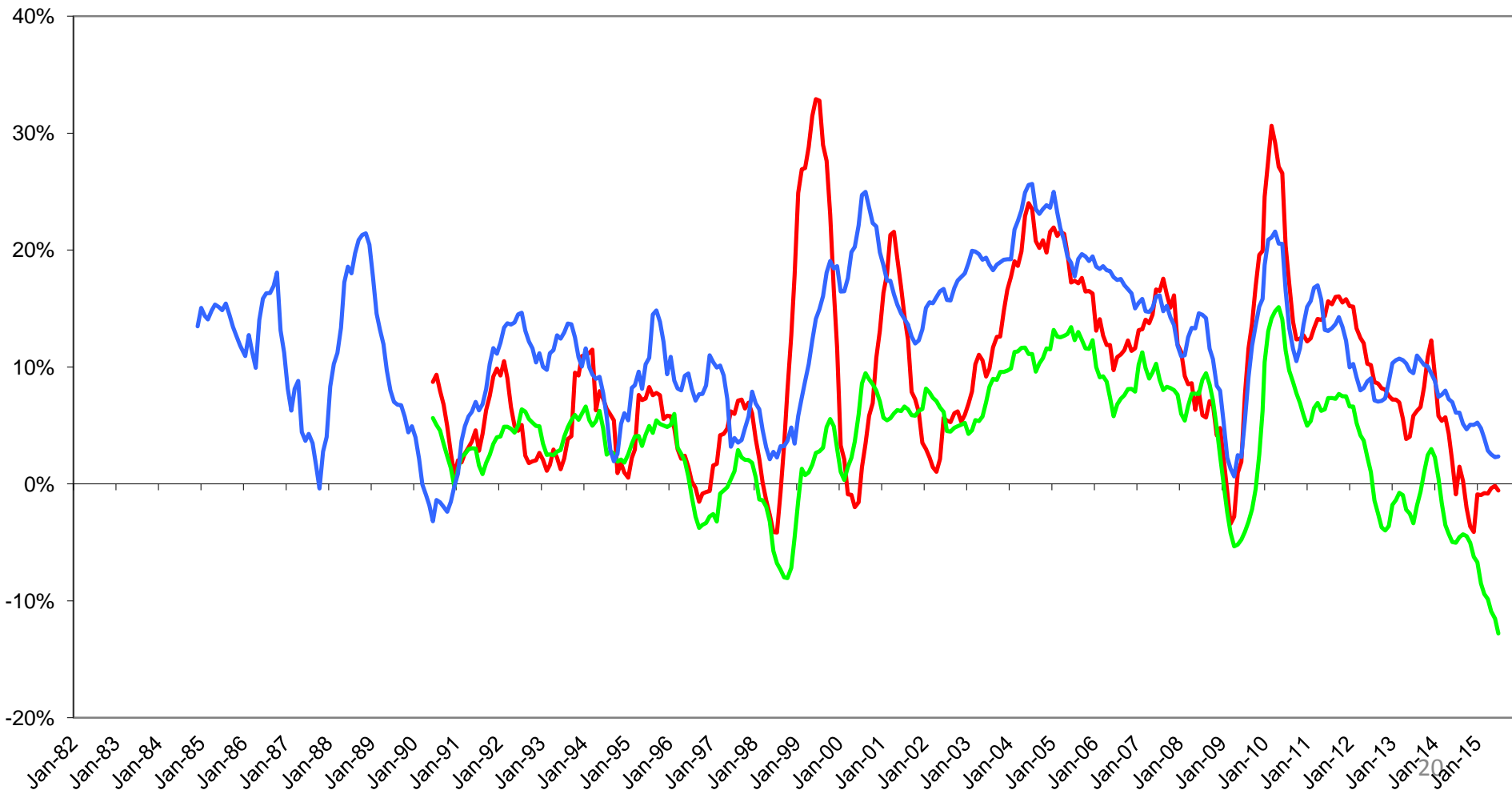
The misleading nature of China's GDP growth

Figure 3b: China Real GDP % YoY



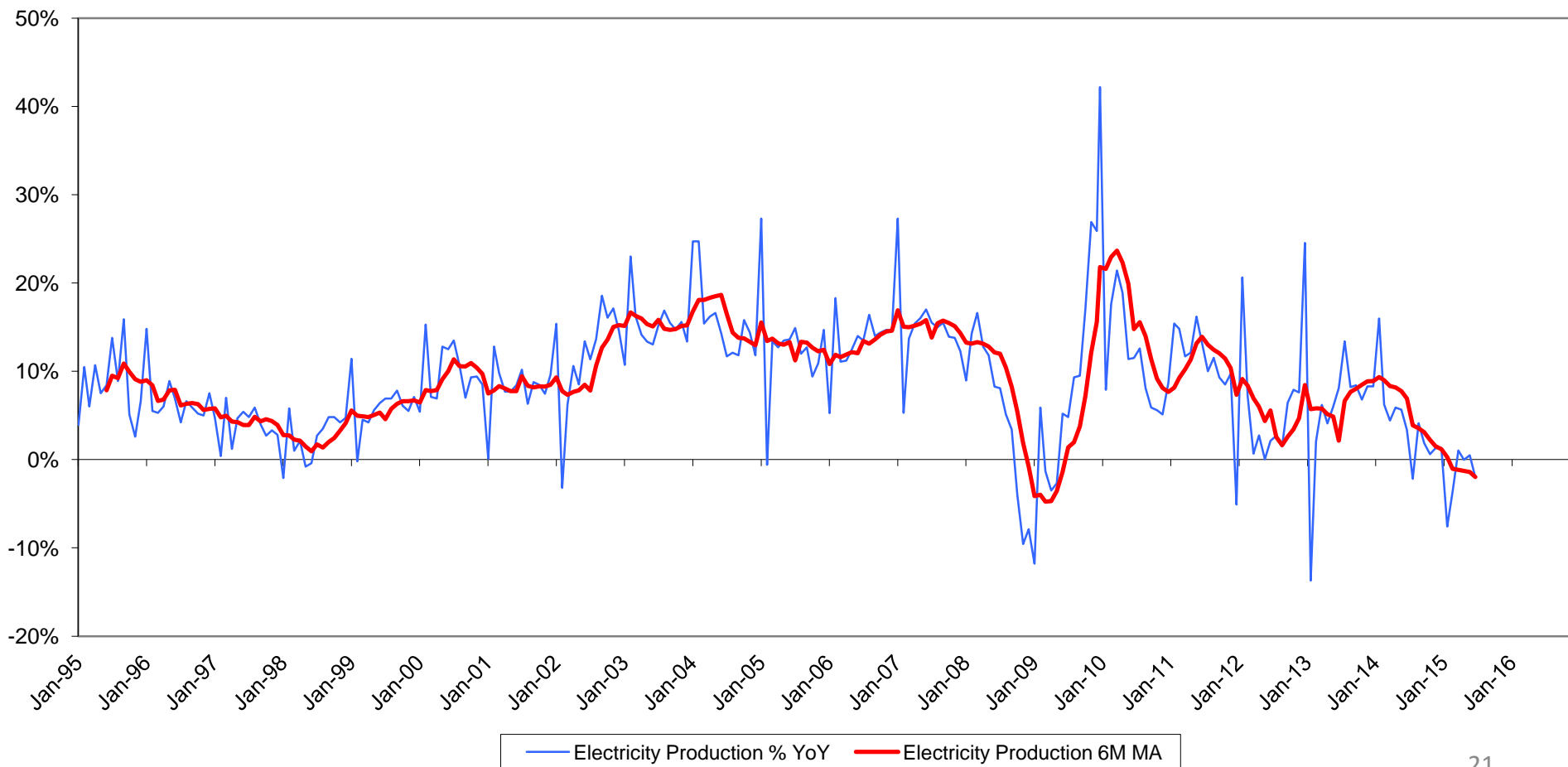
Transport growth is negative

Figure 10: Transport Volume Activity



Electricity production is falling

Figure 7: Electricity Production



Steel production is falling

Figure 7: China's Steel Production

