DRY BULK SHIPPING MARKET OVERVIEW AND OUTLOOK 2016

POOR FREIGHT RATES DESPITE STRONG DEMAND GROWTH FROM CHINA

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GLOBAL ECONOMICS

In the early aftermath of Brexit, the International Monetary Fund (IMF) published its new World Economic Outlook (WEO), where the organisation revised its previous growth forecast published in April. The global growth outlook for 2016 and 2017 has been reduced and according to the IMF, the deterioration reflects the uncertainty of Brexit's economic consequences.

In general, growth expectations for global GDP have come down by 0.1 percent for both 2016 and 2017. The drivers for this decline are the advanced economies, mainly the US and Japan. The advanced economies as a whole have been downgraded by 0.1 percent for 2016 and 0.2% for 2017 – and are now levelling at a 1.8% growth rate for both years. This might be the result of a normalised monetary policy in the US and an extraordinary monetary policy in Japan not being effective.

The IMF does not expect the combined growth for the emerging markets and developing economies to be affected. Their projection remains at the same levels as in the April WEO – a growth of 4.1% in 2016 and 4.6% in 2017. As the emerging markets rely on commodities as their main trade, this will not add to the headache for the currently depressed dry bulk shipping industry.

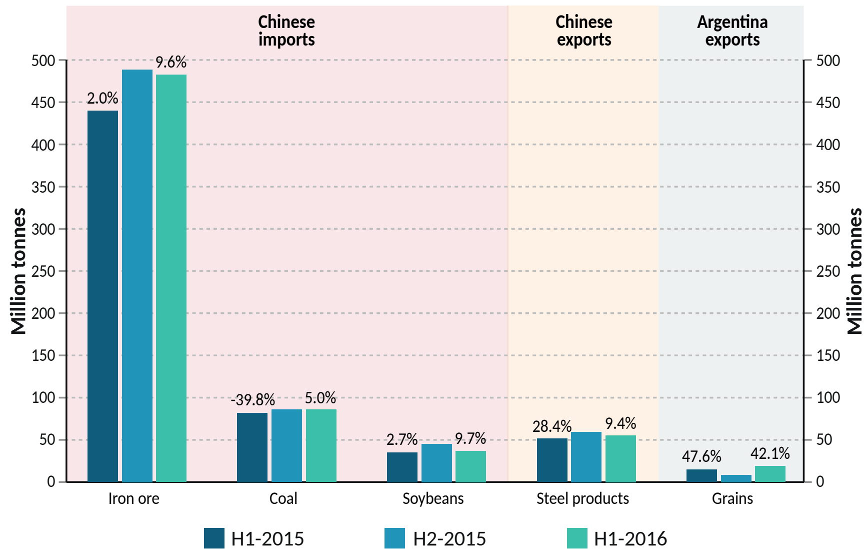
DEMAND

The dry bulk commodity imports into and exports out of China we have seen in H1, 2016 are very positive – and nothing short of extraordinary. But, putting it into perspective, compared to the devastating freight rate levels over the same period, it highlights that something is very wrong in the dry bulk market. The market is nowhere near balanced.

BIMCO's data on seaborne iron ore imports into China shows a growth of 9.6% for H1, 2016 as compared to H1, 2015. With seaborne coal volumes shipped into China during H1, 2016, which is on par with H2, 2015, this represents a 5% growth on H1, 2015. A continued surge

Seaborne trade in dry bulk commodities

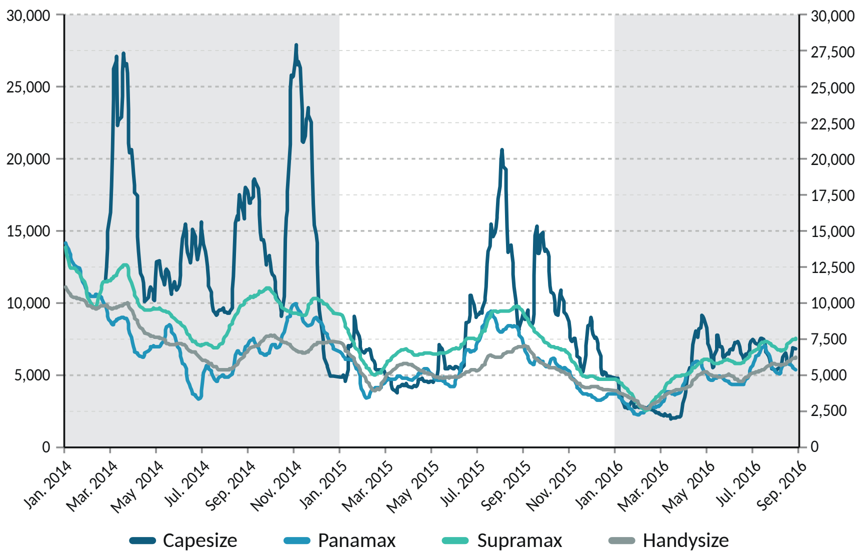
Volumes and year on year growth rates



Source: BIMCO, Clarksons, Chinese Customs

Baltic Exchange time charter averages

USD per day, 2014-2016



Source: BIMCO, Baltic Exchange, Clarksons

Change in valuation of dry bulk asset prices

from 1 August 2014 to 9 August 2016

DWT \ Year of build		2016	2015	2014	2013	2012	2011	2010
Capesize	180,000	-41%	-45%	-48%	-50%	-52%	-55%	-57%
Panamax	80,000	-27%	-34%	-39%	-42%	-45%	-48%	-51%
Supramax	60,000	-38%	-43%	-46%	-48%	-50%	-52%	-57%
Handysize	30,000	-52%	-54%	-55%	-56%	-56%	-57%	-58%

Source: BIMCO, VesselsValue.com

in thermal coal imports seems limited, as hydropower electricity generation due to heavy rainfall is likely to squeeze coal consumption (used for power generation) yet again.

Among the minor seaborne commodities, Chinese steel product exports continue to support its high steel production – and therefore also the elevated imports of iron ore. Exports are up by 9.4% in H1, 2016 compared to the same period in 2015. Trade barriers being set up against Chinese steel, primarily in the Western hemisphere, have little impact as most steel is exported to other Asian countries. Steel exports have been a steady and solid trade compared to Chinese coal imports, which were down in Jan/Feb but very strong in May/June.

Also, as expected, we saw a new record of grain exports out of Argentina during H1, 2016, up by 42.1% year-on-year.

At the same time, we witnessed appalling freight rates during the worst quarter ever (Q1, 2016) making it a terrible H1, 2016. Year-to-date, the Baltic Dry Index is down by 26% on last year's performance..

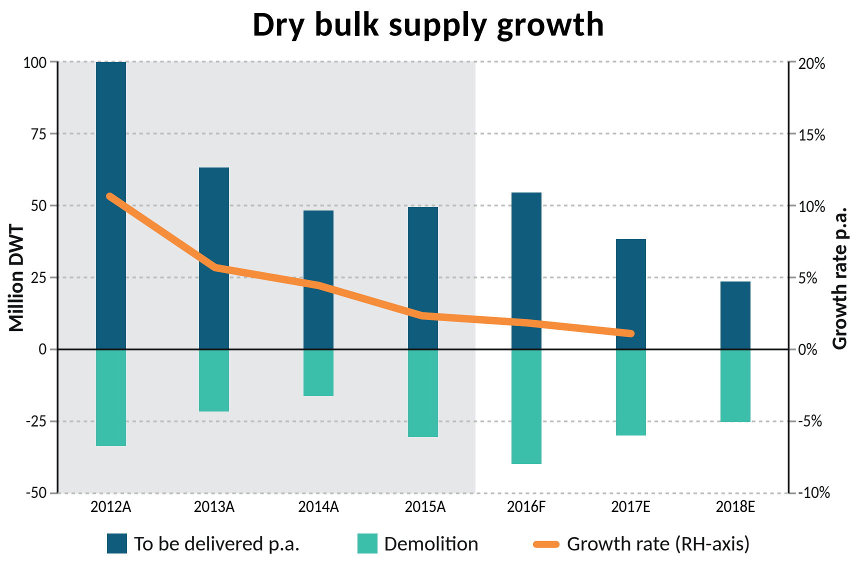
On August 10, 2016, freight rate levels are merely covering operational expenditures (OPEX), with no contribution to cover overhead and financing costs. BIMCO expects the industry to be lossmaking for the full year.

The devastating freight rates have left asset values for dry bulk ships battered. A 2010-built capesize ship was valued by VesselsValue.com on August 1, 2014 at US$49.75 million. Two years later, that same ship had lost 57.3% of its value and is now worth only $21.25 million. The pain is felt across the fleet; worse for older ships and slightly less severe a drop in value for newer ships.

SUPPLY

As 31 million DWT of new capacity has entered into the fleet since January 1, 2016, the order book is slowly emptying. Currently standing at 110 million DWT, the order book is now down at a level not seen since late 2006. Forget about the order book-to-fleet ratio being at a 13-year low as that ratio is irrelevant. What matters is that the fleet will not stop growing unless an equal amount of capacity is demolished at the same time.

So far in 2016, 23 million DWT has been taken out of the fleet and sold for scrap. This means the fleet, year to date, has grown by 1.1% by early August, 2016. This level of scrapping is as expected. Nevertheless, it is still worrying that the



Source: BIMCO estimates on Clarkson's raw data

A is actual. F is forecast. E is estimate which will change if new orders are placed. The supply growth for 2016-2018 contains existing orders only and is estimated under the assumptions that the scheduled deliveries fall short by 10% due to various reasons and 50% of the remaining vessels on order are delayed/postponed.

level of demolition is not higher. The dry bulk industry is faced with the lowest earnings ever, with overcapacity being the main problem and demolition the silver bullet. Difficult as it is to part with your ship, it's what the industry needs the most.

Over the course of the past two years, the dry bulk fleet (excluding handymax ships) has grown by just 2.3%. In contrast, the handymax fleet has grown by 12.9% - a net inflow of 308 new ships. None of the other dry bulk segments have grown substantially in numbers, but new ships have larger capacity than the scrapped ones, ensuring fleet capacity continues to grow.

This trend is set to continue for the rest of 2016, despite the fact that demolition of handymax and panamax ships has been the strongest in 2016 - relatively. As handysize demolition has cooled off, while capesize capacity is steadily leaving the fleet, compared to the full year in 2015.

The rate of slippage in deliveries remains very high, but is slightly reducing from the 50% seen during Q2, 2016. If this development continues, the fleet growth could reach 1.8% in 2016, which does not support an improvement in the market.

OUTLOOK

Positive demand growth rates across the board for dry bulk commodities are high, and there is one that is ruling them all - iron ore. In H1, 2016 we saw a volume growth of 42 million tonnes of iron ore going into China, compared to a combined volume growth of 12 million tonnes for coal, soybeans and steel products on other Chinese trades.

Increasing demand for iron ore is strong on the best trade lane of them all - Brazil to China. Shipments on that trade were up by 24% to reach 98 million tonnes in H1, 2016 compared to H1, 2015. Such a development used to mean much higher freight rates, but as 2015 passed, spot rates for capesize ships were only modestly buoyed by volume growth on this trade. BIMCO believes that a significant part of the iron ore has been transported on 'Vale's conveyor belt of Chinese-owned VLOCs'. If this continues to remove cargoes from the open market, volume growth on the Brazil to China iron ore trade - once the greatest driver of freight rates in the spot market - will no longer affect the spot market on this trade, nor the general freight market significantly.

Handymax ships, on the other hand, have seen a flurry of new ships delivered and have fared well due to the broad-based demand growth outside the iron ore market. They will continue to do so. The fast growing handymax fleet, however, will also put a lid on ship-owners and operators' chances of lifting freight rates into really profitable levels.

Growing iron ore imports have not meant higher steel production in China. We can conclude that some of the much needed substitution away from domestically mined, poor quality ore towards the import of higher iron content quality ores, and is happening at a fair pace.

This has stirred a surprising move by the Metallurgical Miners' Association of China (MMAC) who say the big three iron ore producers are 'using low-priced dumping to crowd out higher-cost producers [in China]'. They claim 329 mines were shut in 2015 and another 793 closed in the first five months of 2016. The MMAC crying foul is unprecedented. But for the dry bulk shipping industry, substituting the higher cost produced ore in China delivers much needed volume growth at sea.

For the coming months: September-November, BIMCO expects transported volumes to stay put - as the high volumes transported in recent months may have run ahead of underlying demand. Expect the freight rates to move up, down and sideways before moving up again in the fourth quarter of the year.

ABOUT THE AUTHOR

Peter Sand joined BIMCO in 2009 and holds the position of Chief Shipping Analyst. In this position he is responsible for analysing the commercial markets for dry bulkers, tankers and containerships. Taking the offset in global economics as the analytical starting point for all seaborne trade, he assists managements, members and clients with insight into many different aspects of the global shipping industry. He is also a Teacher of Maritime Economics at the Danish Shipping Academy, as well as guest lecturer at Copenhagen Business School - Blue MBA and Shipping bachelor.

ABOUT THE ORGANISATION

BIMCO is the world's largest international shipping association, with more than 2,200 members globally. It provides a wide range of services to its global membership – which includes ship-owners, operators, managers, brokers and agents. BIMCO's core objective is to facilitate the commercial operations of its members by developing standard contracts and clauses, while providing quality information, advice and education.

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