A NEW DAWN

FOR DRY BULK

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A gradually narrowing supply-demand gap augurs well for the dry bulk market. Good news at long last. Oversupply as a percentage of total demand is expected to come down from 28.5% in 2016 to 26.5% in 2017, which may well push the annual average 1-year time-charter rates for a typical 5-year old Capesize vessel to more than US$15,000 per day (pd) from a low of $8,100pd as recorded in 2016.

By 2021 oversupply might come down below 20% and then charter rates could move beyond $25,000pd. The basis of contracting oversupply originates from a robust demand growth from the developing world, as well as from a receding order-book to fleet ratio. A comprehensive and elaborate description is given in Drewry's Dry Bulk Forecaster.

ORDER-BOOK SHRINKAGE

For the first time since 2000 the order-book has shrunk below 8% of the total dry bulk fleet. A slim order-book will make room for slower growth in the dry bulk fleet over the next couple of years. Even if new orders increase, yards will take about two years to deliver the vessels. Thus, the supply of vessels will not be a cause for concern for dry bulk owners over the next two years. However, recovery in charter rates might entice owners to place new orders, further slowing down the recovery in charter rates.

INCREASED ORDERS IMPACT FLEET GROWTH

With a recovery in rates, ship-owners have started to place new orders. In Q1, 2017 more orders were in place than in the entire last year (ignore the 30 VLOCs ordered in the first quarter of 2016). If a similar trend continues for long, it will distort the supply-demand balance against any recovery. Deliveries are expected to slow down until 2019 and a growth of only 2% is expected till 2021. Any further increase in new orders in 2017 will strengthen deliveries from late 2018, increasing the pressure on the supply-demand balance from 2019, which will further delay the recovery in the dry bulk market.

Interest of ship-owners has started to reinvigorate in new-build tonnage because of two reasons - firstly, with the surge in second-hand activity, the price of second-hand tonnage is rising more rapidly than new-build tonnage, narrowing the gap between the two, making the latter a lucrative option. Secondly, only few young candidates remain in the second-hand market.

In order to acquire more fuel-efficient and modern tonnage, especially in the wake of upcoming environmental regulations, ship-owners seem to head towards new-build tonnage, mainly because of improving earnings expectations. Since the market is likely to do well in the coming quarters, financiers will be interested in providing finance.

In 2016, stringent finance policies were also responsible for the lull in new-building activity. Hence, with positive sentiments emerging in the market, new-building activity might pick up pace, but its revival may hurt the recovery process.

NEW-BUILD RESALE TO SLOW?

With financial positions continuing to tumble owing to the rock-bottom charter rates last year, some ship-owners are selling their young vessels to ease the liquidity crunch and repay their debts. About 10% of the vessels that changed hands in the second-hand market were either built in 2016 or are expected to be delivered in 2017 and beyond. This is significantly lower than last year: in Q1, 2016 about 35% of the vessels were built in 2015 and 2016. Earnings are expected to strengthen further, improving the financial position of ship-owners. Hence, new-build resale is likely to slow down from 2017.

EXCESS SUPPLY TO FALL

Drewry retains its view regarding moderate growth in the fleet supply during 2018 and 2019 because of the weak order-book. However, as charter rates improved in Q1, 2017, deliveries increased over the previous quarter. Moreover, a large chunk of the order-book is scheduled to get delivered in 2017, while the inactive fleet is expected to re-enter the waters. Hence, the fleet is likely to grow at slightly below 3% in 2017.

DEMOLITION TO GO SLOW

In second-half 2015 and first-half 2016, charter rates touched their nadir, making it difficult for ship-owners to cover even operating costs. Such desperate situations led a large number of vessels to the scrapyards. In fact, young vessels of 15 years fell prey to this awful situation. However, since the dry bulk market is recovering and charter rates are expected to improve from 2017, Drewry believes demolitions will decelerate in 2017-19, but will pick up pace thereafter once the IMO regulation on SOx comes into play.

When supply is expected to remain under check, the dry bulk market becomes more demand-dependent than ever before. A shift in trade lanes is expected to influence dry bulk market more than the increase in demand itself.

CHINA-BRAZIL IRON ORE TRADE

China's growing imports from Brazil will increase tonne miles by more than three times compared with its imports from Australia. There has been a shift in China's imports from Brazil in late 2016 and early 2017. With Brazil's S11D plan set to mine iron ore at a substantially low cost, there could be an increased shift towards sourcing iron ore from Tubarao. The shift in trade will bring more cheer to dry bulk owners.

Apart from iron ore, coal has played a key role in the resurgence of rates so far this year and is likely to play a major part in any further recovery. However, Chinese coal imports have remained volatile in the past and any definitive dependence on China might not help. A lot of hope hinges on Indian coal imports and a resurgence in the US coal story, which could support vessels trading in the Atlantic Basin.

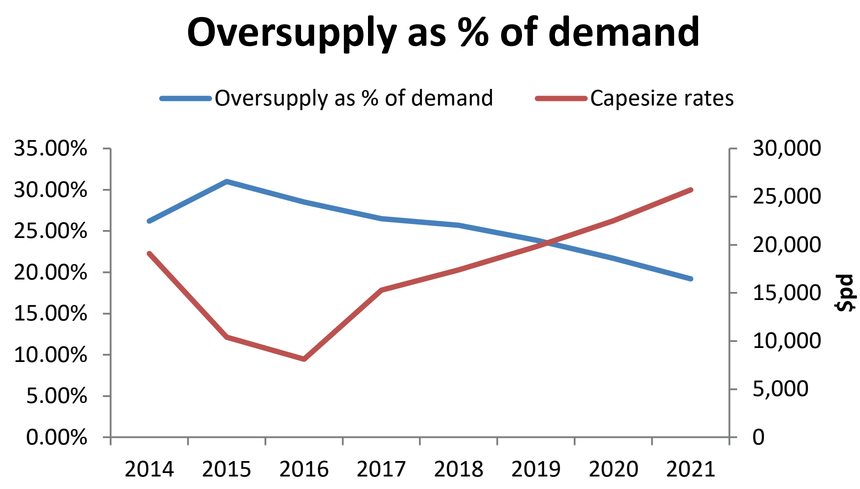

Figure 1: Source: Drewry's Dry Bulk Forecaster, 1Q17

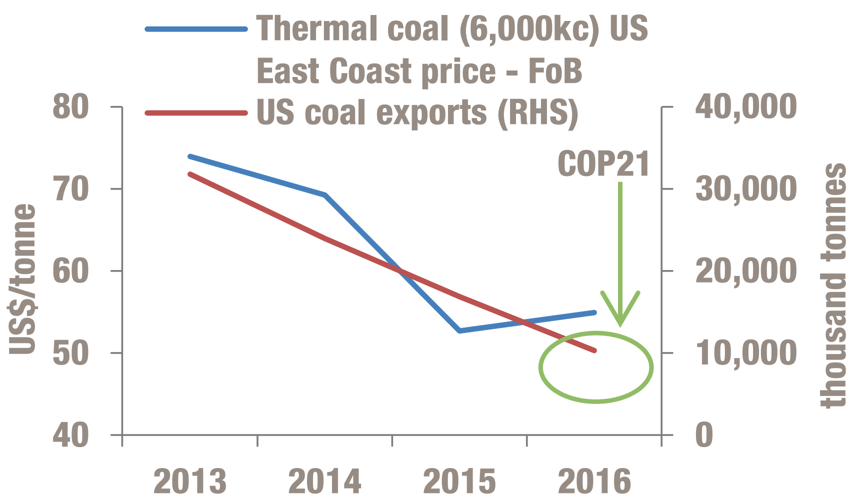

Figure 2: Source: Drewry's Dry Bulk Forecaster, 1Q17

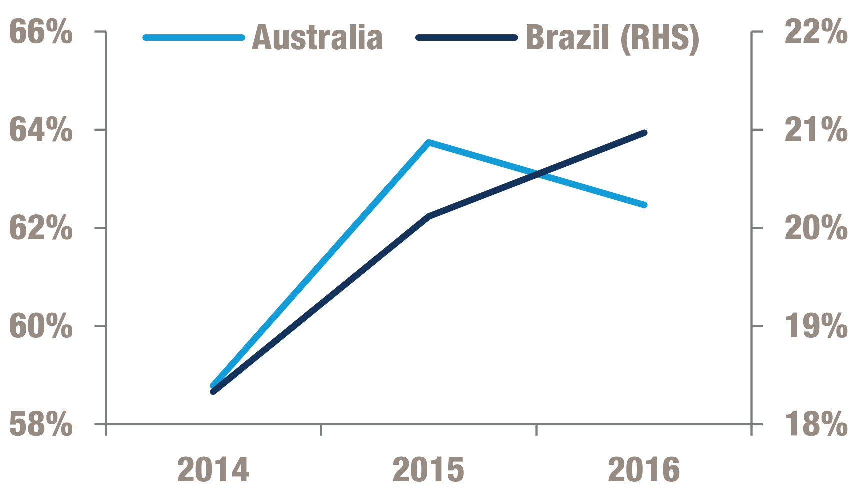

Figure 3: Source: Drewry's Dry Bulk Forecaster, 1Q17

TRUMP AND US COAL

The US exported more than 30 million tonnes of thermal coal in 2013, but as prices started falling, it became less profitable to produce coal in the country. Many coal miners started incurring losses, resulting in financial distress. The behemoth Peabody, had to file for chapter XI protection in April, 2016 as it could not compete with cheap gas in addition to a slowdown in China' s coal imports. Moreover, by end-2015 because of the Paris Climate Convention, there was a shift in US energy production, increasing the focus on renewables in 2016. Hence, despite improved coal prices in 2016, US exports kept declining. On the other hand, natural gas has replaced coal as the largest source for producing electricity in the US.

The Trump administration came into office on the promise of repealing Paris Climate Convention, and to reinforce coal production to bring back coal jobs. If this happens, an increase in the use of US coal could bring a further rally in its price and increase its production, which could boost coal exports from the US, supporting rates in the Atlantic Basin. However, the impact will only be seen once the global renewables sector shape up.

IMPACT OF RENEWABLES

The declining cost of producing energy from renewable sources and general acceptance of COP21 may impact the use of coal as a major source for producing energy. Although the share of renewables in energy production is quite low for most major economies, any shift away from coal could hamper the dry bulk trade over the medium term (1-3 years). The share of renewables in the energy production of China, India and the US remains between 15-20% as coal fulfils most of the energy requirement. Given the low base of renewables, Drewry expects the coal trade to remain dominant in the short term (over next one year).

In its 13th five-year plan on power, China aims to limit its coal-fired power generation capacity to 1,100 GW, which is 20% higher than the current 920 GW. Thus, despite its efforts on reducing CO2 emissions, China plans to use more coal, keeping dry bulk vessels employed in the Pacific. Drewry expects the country's thermal coal imports to increase by 4% annually over the next five years.

ABOUT THE AUTHOR

Rahul Sharan, Lead Research Analyst, Drewry, Rahul is the lead research analyst on dry bulk shipping at Drewry. Rahul has an advance master's degree in International Economics from University of Namur, Belgium. He has his post graduate degree in Economics from Jawaharlal Nehru University, New Delhi. He has been working on shipping and economic research for the past ten years. He has been the editor of Drewry's flagship monthly shipping insight. He has also been the editor of dry bulk publications –Dry bulk forecaster and dry bulk insight. He has been speaking on various facets of dry bulk market at various international conferences. In addition, he has also been working on consultancy assignments on ports and dry bulk freight market strategy. He is a regular contributor to various magazines and journals.

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