LINER SHIPPING IN 2019

WITH A VIEW TO 2020

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There are numerous indicators that can be used to gauge the health of the container shipping market, including port statistics, spot market freight rate benchmarks, the idle fleet ratio and carrier operating profits. Generally, these will all point broadly in the same direction, making it fairly easy to see if carriers have the wind behind them or pressing against them in front. Unfortunately, for independent observers such as Drewry, those metrics have been slightly less reliable in 2019 than in the past. The cause being two extraordinary and unrelated events that have skewed normal comparisons; namely the US-China trade war and the imminent IMO mandate on the use of cleaner marine fuel.

The trade war initially boosted port volumes through 2018 in the two affected countries as shippers front loaded cargoes to beat the ever-shifting tariff deadlines, causing something of a demand hangover in 2019. With last year's demand growth artificially super-charged, particularly in the second half, annual growth rates in 2H19 were destined to look weak in comparison. It was a similar story for Transpacific freight rates that enjoyed a tariff-induced spike before slumping when the demand lull arrived.

IMO 2020 is yet to come into effect, but its presence has long been felt on the supply side of the equation. Ordinarily, when the idle fleet ratio stands at 4.5%, as it did in early November, that would be a sure sign that the industry is in crisis and is shedding capacity quickly to better match demand levels. While it is true the container market is over-supplied, the reason for so many units being inactive is not because of cripplingly low utilisation, it is because more and more owners are sending their assets into dry-dock to have exhaust scrubbers retrofitted in order to be able to continue to use the cheaper high-sulphur fuel oil from 1 January, 2020. In turn, the sudden removal of ships from active service gave freight rates a fillip from mid-October even as demand growth remained fairly anaemic by all accounts. The phasing in of new bunker surcharges related to IMO 2020 by some carriers also drove the recent pricing increase.

All of which is to say that is very difficult to accurately call 2019 a good or bad year for carriers. The truth is somewhere in the middle. On the one hand, average all-in global freight rates are expected to end the year marginally higher than last year and carrier profits should stay in the black. On the other, demand is clearly slowing and were it not for the removal of large numbers of ships there would not have been much upside. The good news is that the disruptions caused by these events should lessen next year. Being more adjusted to their impact as well coming off a lower base, Drewry anticipates a slightly faster pace of demand growth in 2020.

THROUGHPUT PREDICTION

Drewry's recent Container Forecaster report (published at the start of October) pitched 2019 global port throughput growth at 2.6%, a downgrade on the earlier 3.0% forecast. This compares unfavourably with 2018's 5.5% rise, but the trade war front loading in effect stole some of the volumes from 2019.

For 2020, we now expect global port throughput to rise by 4.0%, down from a previous 4.5% projection. There is a danger that all of the negative economic and geopolitical news creates something of a self-fulfilling prophecy that might run contrary to the facts on the ground. Trade tends to find a way and our demand forecast is therefore cautiously pitched to acknowledge that the market is slowing (notwithstanding the skewed results of 2018 and 2019) while veering away from predicting an imminent apocalypse. Another potential boost to shipping volumes could come from greater production fragmentation. The trade war has forced some shippers to re-evaluate their supply chains and consider moving some production away from China to other Asian origins such as Vietnam and Indonesia.

China has developed its manufacturing capacity to such an extent that it barely needs intermediate inputs from the rest of the world to support its exports, which is partly why world trade has decelerated in the last decade. If and when final goods sourcing moves to countries currently without the same manufacturing eco-system as China they will require more intermediate inputs, meaning more production fragmentation and requirement for shipping. However, it is doubtful that all of these burgeoning new export hubs will soon be in a position to accommodate too much of China's export volumes given how far behind they lag in terms of infrastructure and connectivity.

There will be a small increase in freight rates 2020, but it won't be the result of improved supply-demand balance. Instead, it will be driven by higher bunker surcharges. We are forecasting that global all-in freight rates will rise by 6.5% in 2020. Excluding fuel costs the rise will be limited to just 3.6%.

IMO 2020

There is still no definitive guidance on just how much additional cost IMO 2020 (the switch to lower sulphur fuels) will land on the industry, although we have a slightly clearer idea following some actual bunkering transactions in Asian ports that indicate a LSFO premium of approximately 30%. However, because demand will intensify before the end of the year those early prices might not be a very reliable guide.

Our current estimate is that operators will be faced with an additional US$11 billion fuel bill. Therefore, to avoid heavy losses carriers simply must recover a higher percentage of the fuel cost than in the past. Our working assumptions is that they will claw back around 75% of the extra fuel cost, but if they don't they may be forced to take extreme action on the supply side.

Under this scenario it won't take long for carriers to dust off the decade-old playbook that was used to see them through the global financial crash. There will be much less focus on service quality and more on cost cutting. To protect cash flows carriers will consider a number of measures, including further slow-steaming, more blank sailings, off-hiring of chartered vessels and possible inclusion of feeder calls into mothership service itineraries to save money on feeder costs. Failure to recover more of the fuel cost is also likely to push more carriers/owners to either have more ships fitted with exhaust scrubbers to be able to continue running on the cheaper high-sulphur oil, and/or to ramp up demolitions.

CONCLUSION

If events follow this path the supply-demand balance will look very different from our current forecast. The worst case scenario, when most shipping lines lose stacks of money and some potentially face bankruptcy, would actually be a far quicker route to rebalancing the market than the current plodding track. Such a turn of events might ignite another round of M&A, although we do not expect to see that happen in our baseline model. Rather than chasing greater scale, we anticipate that the major lines such as Maersk and CMA CGM will continue to pour investment into their integrator strategies by acquiring more IT and logistics companies.

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ABOUT THE AUTHOR

After graduating in the mid-1990s Simon had a brief career in banking before joining liner shipping database ComPairData as a researcher. He then progressed to become a reporter and finally associate editor of sister-company American Shipper. He won The Seahorse Club Journalist of the Year in 2006. Simon joined Drewry in 2008 to work on a number of shipper-oriented reports. As well as lead analyst for Drewry's flagship Container Forecaster service and active contributor to consultancy projects in the sector, Simon is also editor of Drewry's long-standing Container Insight Weekly weekly publication commenting on box market supply and demand dynamics globally.

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Drewry is a leading independent provider of research and consulting services to the maritime and shipping industry, employing over 100 professionals across an international network of offices in London, Delhi, Singapore and Shanghai. provide our services through four business units: Maritime Research, Maritime Advisors, Supply Chain Advisors and Maritime Financial Research. These divisions, combined, support the operational and strategic needs of an elite and diverse client base of maritime and shipping industry stakeholders.

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