The state of the dry bulk market in Asia and the impact on P&I

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2015 saw increased pressure on the dry bulk market, with a drop of average bulk carrier earnings to $7,123/day, which was the lowest level since 1999. Many speculated that the markets could not get any worse from this position, but in 2016 there has been a further softening. In this article, we look at the ways in which owners have been responding to this unprecedented situation.

A downturn in Asia bulk imports has been a contributing factor
The two key players in Asian bulk imports, China and India, have both reduced their demand and this has had a detrimental impact on seaborne trade. India's impact is smaller, but nonetheless, the increase in domestic coal production contributed heavily to the first year-on-year reduction in bulk coal trade for over 30 years. China has had a more significant effect, and reductions in demand for coal, iron ore and steel reflect both a maturing of its economy as it moves away from reliance on heavy industry and then a partial collapse of the domestic Chinese construction market.

Key factors

The key issue for the dry bulk market is an imbalance of supply and demand. There has been a glut of new deliveries over the last seven years and, although ship demolition increased in 2015, the global dry bulk fleet still increased by 14% between 2012 and 2016. At the same time, there was a noticeable slowdown in global trade between 2010 and 2014, and the global bulk trade actually contracted in 2015 by 0.1%.

As a result, owners have been taking various measures to reduce the impact of this downturn by attempting to reduce the supply of ships.

Reduction in newbuilding orders

Newbuilding orders dropped by 30% in 2015 on a year-on-year basis and 2016 has followed suit with the lowest monthly order rates seen in over 30 years. Owners in China, South Korea, Singapore and Taiwan have all reduced orders compared to a 10-year average, although it should be noted that Japanese owners are an exception to the rule and have increased orders against the same parameter.

Lay-up

Another way owners have looked to control the supply is by idling or laying up ships. One only has to fly in or out of Singapore to see hundreds of ships lying idle in the outside port limits (OPL). Owners hoping for a short-term recovery have put them in hot lay-up, whereas those seeing no immediate turnaround in fortune have put ships into cold lay-up. The club can assist with advice for members on laying up ships and, where the right conditions are met, a return of premium can be made to the member given the reduced risk to insurers.

Scrapping

For some owners, the cost of putting ships into lay-up and then reactivating them is not offset by the value of avoiding losses, and demolition yards have been benefitting as a result. The demolition of bulk carriers increased by 87% in 2015 to 30.6m dwt and this is forecast to be surpassed in 2016 by some margin. Asian owners account for 35% of ships scrapped in 2016 so far. There are mixed feelings from a club perspective. The slowdown in fleet growth means that clubs will need to be more competitive for business when opportunities arise, but at the same time, the average age of the Asian fleet is set to reduce. In Asia, this will now be 17 years against a global fleet average age of 20 years.

Other impacts of the downturn

Financial difficulties

A different risk to owners and their clubs is that ship value reductions have led some creditors to reconsider their position in the Asian dry sector. This has affected owners in both north and south Asia, and the future remains unclear and unpleasant. For other owners and clubs there is an increase in counterparty risk, which in turn escalates trading difficulties and, for clubs specifically, may lead to an upsurge in FDD disputes.

Reduced maintenance standards
With bulk freight rates below or at the level of operating costs of vessels, even before financing is taken into account, some owners will be forced to reduce investment in their vessels. This has implications for ship maintenance and the standard of crewing. While the former may have a larger impact on H&M underwriters, P&I clubs remain vigilant for deteriorating technical standards and the clubs' loss prevention departments have a larger role to play than ever. Perhaps more significant for clubs and owners is the reduction in crewing standards and training. This has short-term ramifications as claims can increase, especially costly navigational claims, and then a longer-term impact for owners reliant on international crew.

Outlook

Unfortunately, the slump looks set to continue. The financial uncertainty in Europe and potential political change in the USA does not help matters, even in Asia. However, some owners do see some positives and are betting that the current efforts being made to trim the bulk carrier supply will help bring the Asian bulk market back into balance by the end of 2017. This is evident from the increase in second-hand acquisitions already in 2016.

One other positive is that there is a space for new companies that are able to take advantage of low ship values and relatively low overhead costs to find ways to make small profits.

Either way, we remain hopeful that the market will indeed recover and owners can put the last eight years behind them.

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