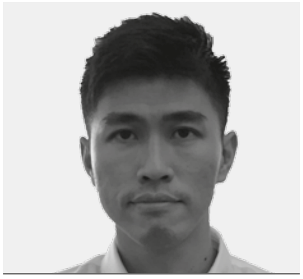
Market update: dry bulk rates

Will the Baltic Dry Index (BDI)[1] rebound or further decline? What issues do P&I clubs and their members need to consider in the event that the slowdown continues?

This article considers some of the issues.



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Tracking the BDI

After a depressed period of almost eight years, some predicted the dry bulk market to recover, or to at least improve, in 2017 from its record low of 291 points in February 2016.[2] The BDI began this year promisingly near the 1,000-point mark and rose to 1,300 points by April 2017.[3] However, there has since been a decline. At the end of July, it was hovering at around 960 points.

The long road to recovery

There are some signs of improvement. On the demand side, the dry bulk trade is predicted to grow about 2% this year. The key driver of this growth is the iron ore trade, which is estimated to grow by 4% in 2017.[4]

On the supply side, ship-scrapping activity has seen an overall increase in recent years. According to Clarksons, in the case of bulk carriers, around 28.8m deadweight tonnes were scrapped in 2016 alone.[5]

The average age of the bulkers scrapped has also decreased. The average age was 24 years in 2016, as compared to 26 in 2015, 30 in 2014 and 31 in 2013.[6]

With the increase in demand for bulkers following the stepping-up of the iron ore bulk trade and the reduction of the world's bulker fleet pursuant to the overall increase in demolition of bulkers of recent years, one might reasonably expect a positive realignment in dry bulk freight rates in the not too distant future, all things being equal.

Recent changes in the Indian and Chinese economies have particularly had an impact on freight rates.

Slowdown in China's economy

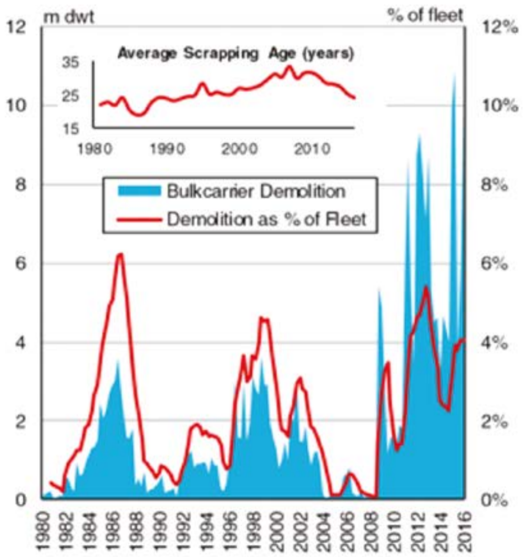
The demand for building materials in China has for some time significantly impacted freight rates in respect of capesizes, which trade in cargo related to steelmaking, such as iron ore and coking coal.

Traditionally, the BDI peaks during the spring and summer seasons when China's construction activities peak. Steelmakers import many steelmaking products during the period ahead of the anticipated increase in construction activities.

1 The BDI is compiled by the Baltic Exchange and tracks changes in the costs of transporting seaborne cargoes such as iron ore, coal and grains.
2 Bloomberg BDI graph: https://www.bloomberg.com/quote/BDIY:IND
3 Bloomberg: https://www.bloomberg.com/quote/BDIY:IND
4 Opensea.pro: https://opensea.pro/blog/dry-bulk-forecast-2017
5 Seeking Alpha: http://www.hellenicshippingnews.com/vessel-scrapping-in-2016-record-year-for-container-ships/
6 According to Lloyd's List Intelligence data. Ship&Bunker: https://shipandbunker.com/news/world/741276-2016-sees-record-year-for-container-ship-scrapping

Bulker Demolition - Owners Get Tougher On Old Ships

The graph shows quarterly bulkcarrier demolition in dwt (area, LHS) alongside bulkcarrier demolition over the most recent four quarters expressed as a percentage of the fleet at the start of that period (line, RHS). The inset graph shows the average age of bulkcarriers scrapped in each year.



Source: Clarksons Research, March 2016

In the first quarter of 2017, the BDI movements matched anticipated seasonal demand trends, with freight rates peaking in April 2017. However, economic indicators such as the IHS Markit Caixin's Purchasing Manager Index (PMI) fell to a seven-month low of 50.3 in April 2017.[7] This was below economists' estimates of 51,[8] and was thought to be due to a decreased appetite for these materials and a deceleration in China's economy.

China's economy has been sending mixed signals in the last few years. Recently, a clear pattern indicating a slowdown has emerged. In the second quarter of 2017, economic indicators such as the Caixin PMI suggest that China's private industrial sector is still growing, but at a slower pace and below economists' previous estimates.[9]

Likewise, China's growth in the service sector also decreased to 54.0 points in April 2017 as compared to 55.1 points in March 2017, based on the country's official services PMI. Consequently, China is likely to reduce its imports of raw materials. This is likely to lower freight rates, which in turn may negatively impact shipowners' profit margins.

India

While China's economy seems to have slowed down, India's appears to be gaining momentum, evidenced by the steady strong demand for high-quality coals. India has long been a coal-producing nation, but the country's local supply of coking coal – essential for steelmaking – is of lower quality than the premium-quality coals found in various locations outside India, hence the need to import.

Based on World Steel Association (WSA) figures,[10] India's steel production grew 9.3% between March 2016 and March 2017, which is in line with its aspiration to become the second-largest producer of steel by 2018, just behind China. India currently accounts for around 9% of the total steel global output. The Indian Steel Association has forecast the country's steel output to double by 2031 to 240m tonnes, up from its current 120m tonnes, due to the rapid growth in its economy and urbanisation.

India is therefore expected to import significant amounts of high-quality coking coal from Australia in the coming years to fuel its growing steel sectors. Currently, its imports of Australian coking coals are almost on par with the levels of demand from China and Japan, accounting for around 20% to 25% of Australian coking coal exports on a monthly basis.

Conclusion

Overall, despite challenging market conditions, the dry bulk market is in better shape than it was in 2016 and there is reason for optimism. In the first half of 2017, the prices of iron ore and coal stabilised, hinting that a stronger dry bulk market may be looming just ahead. Despite the slowdown in the Chinese economy seen earlier this year, the country's policymakers remain confident of economic growth of 6.5% in 2017 and have further approved an infrastructural stimulus plan in line with this goal.

Meanwhile, India's ramping-up of its steel production with the resultant increase in the import of steelmaking materials bodes well for the dry bulk market.

How the club can help

In a depressed market, a shipowner may be under significant financial pressure, yet, at the same time, shipowners remain obliged by law to maintain operational standards in the maintenance of ships, the training of crews, etc. The club continues to work together with the members to help them meet the challenges of operating in a tough market in order that they may continue to meet their obligations

To that end, the club's input and assistance include:

- day-to-day advice on operational and loss prevention issues
- initiatives to assist members to train and develop the knowledge of their crew
- ongoing reviews to monitor maintenance level and operational/ safety standards on entered ships.

The author acknowledges data from World Steel Association, Clarkson Research Services Limited, Lloyd's List, the Baltic Exchange and Credit Suisse in respect of the market figures referenced in this article. The comments expressed herein remain the personal views of the author.

7 The PMI is often used as a barometer in measuring expansion or contraction in manufacturing. Thus, a reading above 50 points indicates expansion in manufacturing activity, while a reading below 50 points indicates a contraction in the same.
8 CNBC: http://www.cnbc.com/2017/05/31/caixin-china-manufacturing-pmi-for-may-falls-to-11-month-low.html
9 CNBC: http://www.cnbc.com/2017/05/31/caixin-china-manufacturing-pmi-for-may-falls-to-11-month-low.html
10 Business Insider: http://www.businessinsider.com/cba-says-demand-for-australian-iron-ore-and-coking-coal-will-continue-to-increase-2017-5?IR=T&r=US&IR=T