THE FUTURE OF DRY BULK

BEYOND THE TRADE WAR

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The dry bulk market will continue to face risks in 2019 as tensions between China and the US further escalate following their highly publicised trade war of 2018, as high tariffs imposed by the US on imports from China will be detrimental for the Chinese exports sector in the long run. However, the Chinese government seems determined in warding off any influence of the trade war on its economic growth, yet to what extent and how long the government will succeed in keeping economic growth intact is difficult to quantify.

Despite all the fears and uncertainties we believe that charter rates will continue to increase due to a number of factors:

1. The economic and infrastructure development is driving up steel consumption in India. However, domestic iron ore is not able to match up with the growing steel production. Hence, import to India is rising swiftly.
2. The Indian government is looking forward to diversify supply sources for coking coal, which will result in increasing trade on long-haul routes (US-India and Canada-India).
3. Declining US soybean prices and increase in demand in Asian countries (except China) will support soybean trade in the next quarter.
4. Supply factors also seem conducive for the charter market. Impending IMO regulation will trigger a demolition of a large number of vessels, thereby restricting growth in fleet supply and a thin orderbook will also prevent any momentous increase in deliveries over next couple of years.
5. Rising interest of shipowners in retrofitting their young vessels with scrubbers will also reduce availability of vessels for some time period.

However, it is not all rosy for dry bulk owners. There remains some downside risk which could hinder the recovery process. First, iron ore inventories at Chinese ports are very high; more than 13% of the last year's imports, and rising risk in the Chinese market could compel steel mills to make greater use of accumulated inventories, which will be detrimental for iron ore imports. Secondly the Indian government has set the objective of lifting India's coal production beyond 1 billion tonnes by 2026. A steep increase in domestic coal supply will dent thermal coal imports. Thirdly, currency depreciation of emerging economies like India and worsening 'Balance of Payment' in some countries like Pakistan and Turkey could result into slowdown in commodity demand in the long- term. However, to what extent it will be worrisome for the dry bulk market is not clear yet because currency depreciation will also boost exports.

GLOBAL OUTLOOK

Overall, it will be a positive outlook for the dry bulk commodity trade. Global steel production has increased remarkably so far in 2018 and it is believed that the economic development in major steel producing countries will drive up crude steel production further. Firm steel production will also support iron ore and the coking coal trade, while rising trade on long-haul routes like US-India and Canada-India will provide additional tonne miles. Meanwhile, the grain trade will stay high amid strong consumption in Asian and African countries.

Elsewhere, steel production is likely to rise in the emerging economies of Asia, where India has already become the second largest steel producer, replacing Japan. Affordable

housing schemes and infrastructure development will also keep generating ample demand in the Indian economy. Tata Steel is aiming to increase production at its Odisha plant by 0.5 million tonnes in 2019. Meanwhile, Arcelor Mittal is expected to acquire bankrupt Essar Steel which will support Essar's production activity in 2019.

It is believed that the rising steel production will continue to drive up iron ore imports in Asia and the EU. Interestingly, increasing steel production is driving up iron ore imports in India which was one of the largest iron ore exporters before 2013. In the first three quarters, India imported 11 million tonnes of iron ore, representing an increase of more than six million tonne over imports in 2017 during the same period. With rise in steel production, consumption of coking coal is also rising in India. However, coking coal accounts for only a small share in India's total coal production. Hence, the country depends heavily on imports.

INDIA

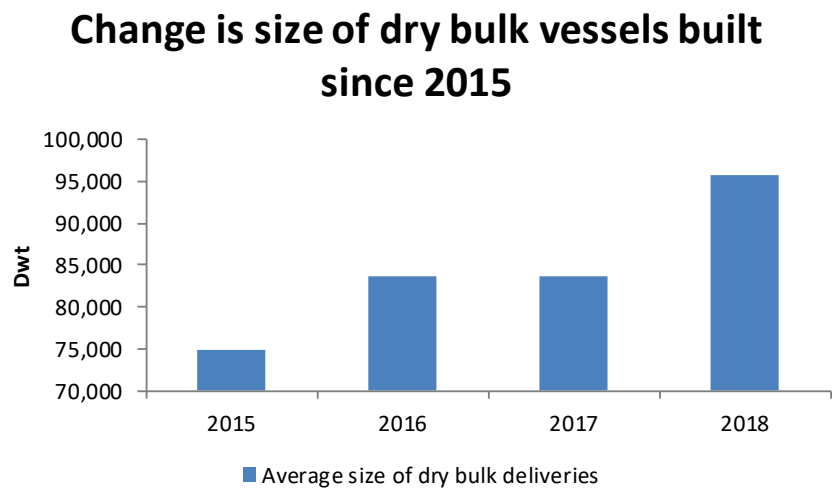
In the first three quarters, India imported around 41 million tonnes of coal, an increase of 12% over last year's coal imports during the same period. We believe robust steel production will continue to drive up demand for coking coal. Hence, imports will remain high in the next couple of years.

Rising imports will create more employment opportunities for dry bulk vessels, especially for Panamaxes. Additionally, there exists another opportunity in the backdrop: a rise in trade on long-haul routes.

At present, India's coking coal is primarily sourced from Australia, as reflected in the imports mix. In 2017, 82% of the coal was imported from Australia itself. Now the Indian government wants to diversify the supply source and is looking for opportunities in Canada and US. Until the third quarter this year, India imported more than four million tonnes of coal from US, which is 89% higher on yearly basis. Import from Canada has also increased by 27%. Hence, the share of Australia in India's coal imports registered a small dip while share of Canada and US has risen. The Indian government's objective of diversifying supply will further increase the presence of Canada and US in the Indian market, thereby benefitting Panamaxes.

RELIEF FOR SHIP OWNERS?

Amid a decline in deliveries, it is expected that the overall fleet will grow by 2.4% in 2018 against 3.7% in 2017. Over next couple of years, fleet growth will further decline because of the rise in demolition activity. Impending IMO regulations will result in scrapping of a significant number of vessels and restrict annual growth in fleet to below 2%. Fleet supply might further dampen by increasing preference of scrubbers among



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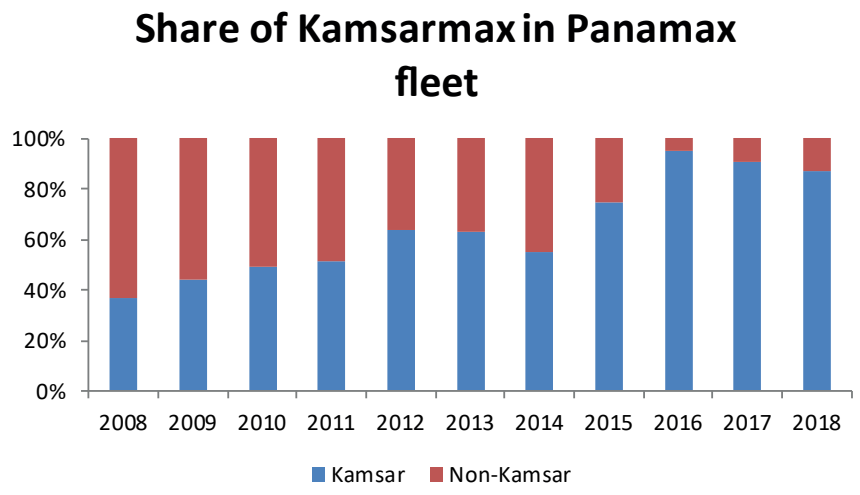

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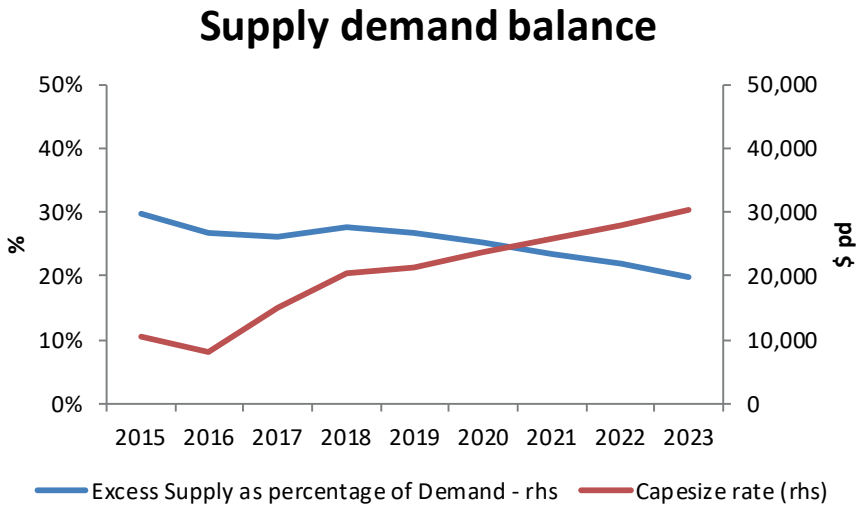

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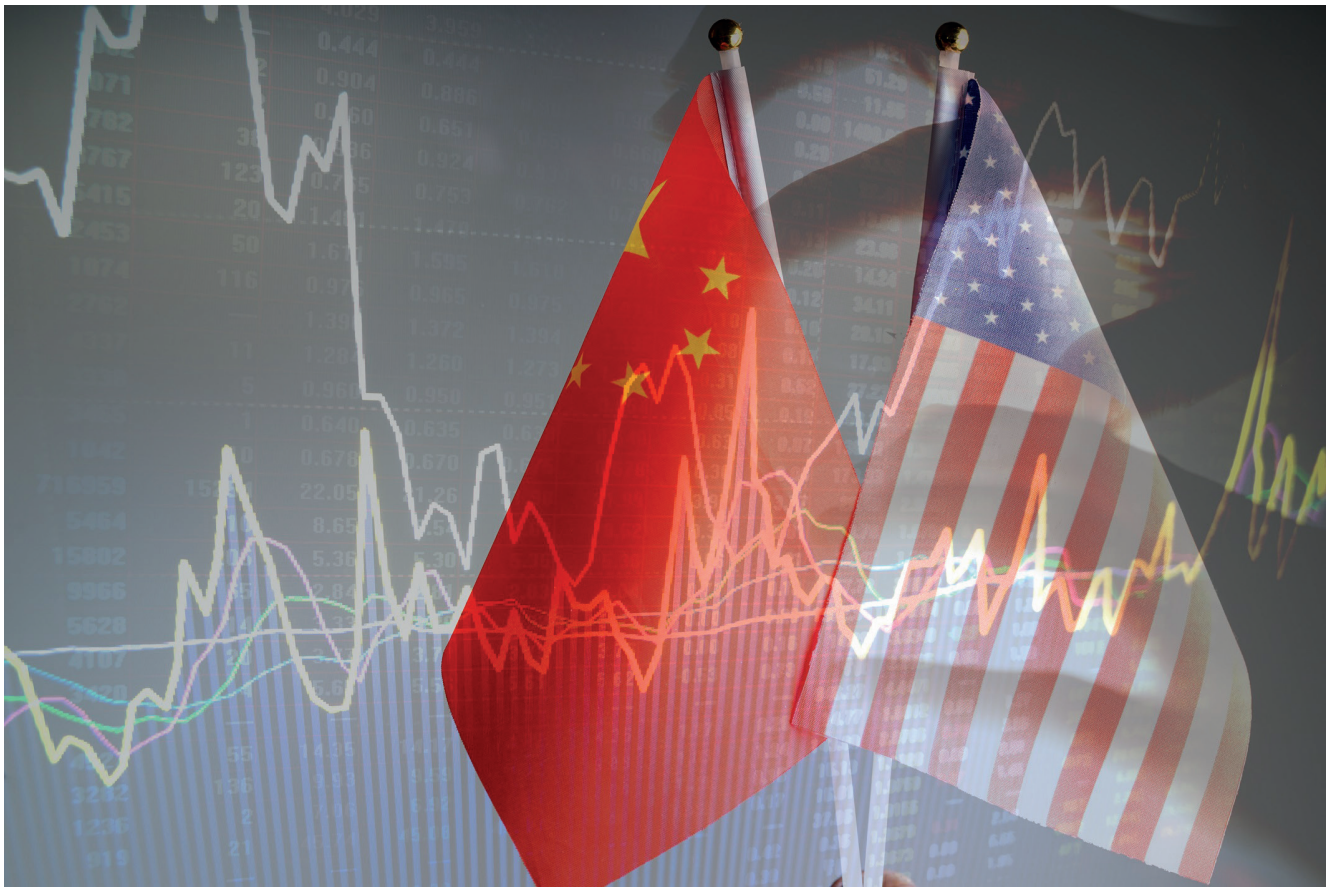

The US-China trade war has had global repercussions

shipowners. Many vessels are likely to sail to shipyards for scrubber retrofitting, thereby squeezing fleet availability for the period they are away at installation yards. In the long- term, a low number of new-build orders will keep a check on fleet expansion. In spite of the rise in charter rates, new build activity is lagging behind in 2018 compared with the orders in 2017.

Throughout 2018, shipowners remained wary of the demolition market. Only a handful of vessels were sold for scrapping. Such low demolition is unusual in the dry bulk market. In 2018, demolition as a percentage of fleet is just 0.5%. In 2007 and 2008 too, when charter rates were at their zenith, demolition as a percentage of fleet was 1.8% and 1.9% respectively.

Charter rates are likely to increase further in the fourth quarter. Hence, there might not be any momentous increase in demolition (annual demolition will reach to 80 vessels by the end of 2018). In 2007 and 2008, when charter rates were very high, more than 100 vessels were demolished.

However, we are still positive about demolition activity in 2019 and onwards. Enforcement of IMO regulation in the second-half of 2019 will eventually result in the demolition of aged vessels. Currently, 18% of the fleet in terms of number of vessels is more than 15 years old and will be the chief candidates for scrapping. By 2021, about 900 vessels are going to be demolished which will assist in restricting growth in fleet to below 2%.

INCREASING SIZE OF VESSELS

Over the years, the average size of dry bulk vessels has increased dramatically across all segments. Increasing parcel sizes and demand for more quantities have increased the requirement for larger ships.

The popularity of Kamsarmax could be taken as example of increasing average size of ships. As bauxite trade has grown in significance in recent years, the share of Kamsarmaxes in the total Panamax fleet has increased. A total 251 Panamax vessels have been delivered since the start of 2016. Of these ships only 20 vessels are smaller than 80,000 dwt and all the remaining ones are between 80,000-85,000 dwt. The new locks at the Panama Canal and increasing parcel sizes have made Kamsarmaxes more relevant, and we believe most new orders in the Panamax segment in future will be for Kamsarmaxes.

The increasing average size of ships will require bigger draughts, larger LOAs and Beams at ports to accommodate the increase in size of ships. Many ports in emerging economies, especially in Asia (except China) can only berth smaller vessels and need dredging to accommodate larger ships.

ABOUT THE AUTHOR

Rahul Sharan (Lead Research Analyst) - Rahul is the lead research analyst on dry bulk shipping at Drewry. He has an advance master's degree in International Economics from University of Namur, Belgium. He has been working on shipping and economic research for the past ten years. In addition, he has also been working on consultancy assignments on ports and dry bulk freight market strategy.

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