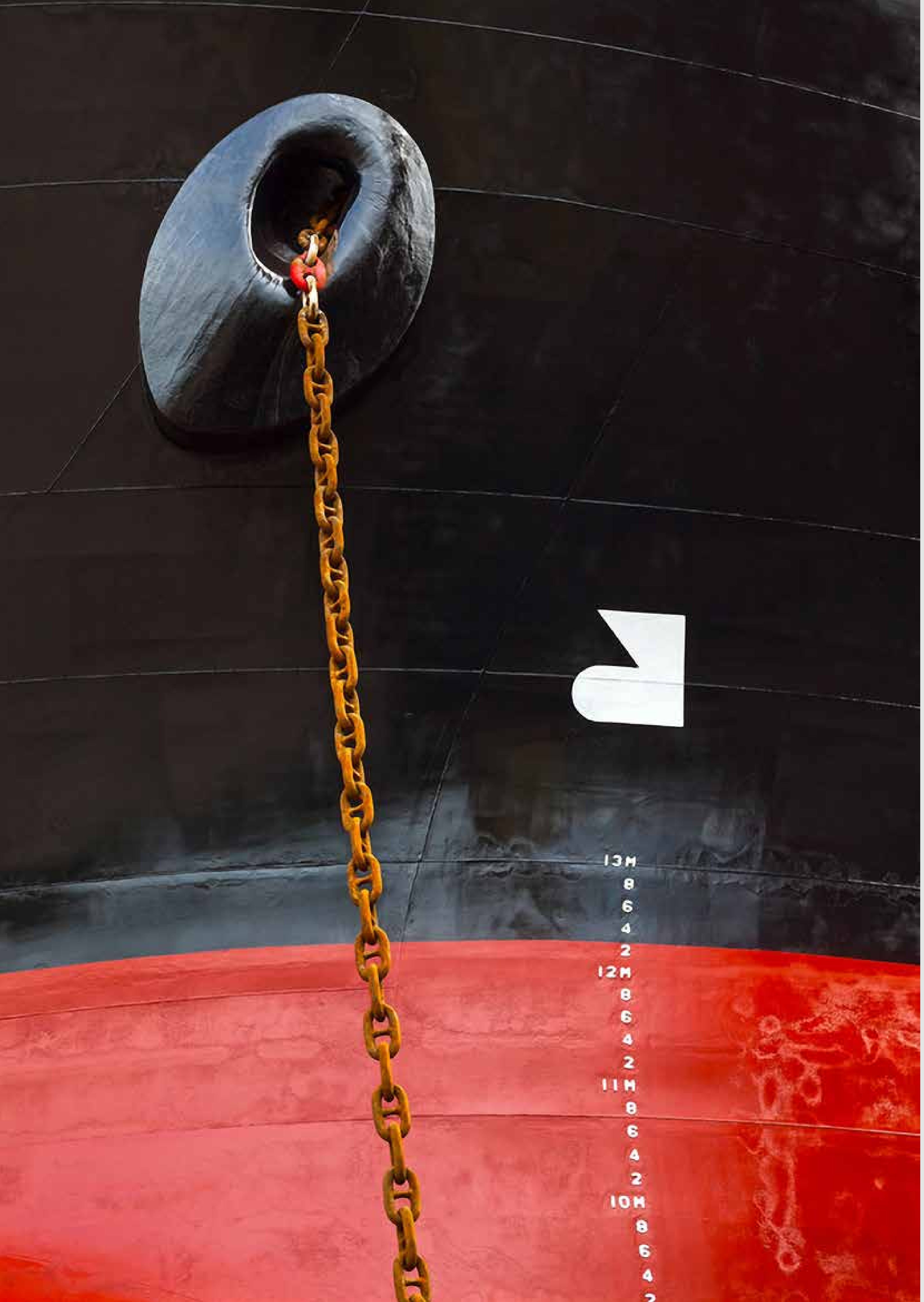
HARTLAND
SHIPPING SERVICES

Shipping Markets Outlook

2019 Edition



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Foreword

The theme of Shipping Markets Outlook 2018 was "Tacking into the Wind" as we anticipated that the market would continue to buffet us back and forth as we sailed into headwinds, making for slow forward progress. That turned out to be a fair assessment of 2018 as it was not an easy year in any of the three main sectors. However, as we move into the second quarter of 2019, we do perceive that supply and demand are becoming better balanced and this should lead to improved earnings and asset values. Frustratingly, it is all taking much longer than we had expected as the rate of progress slowed in 2018 after the quicker pace of 2017. Therefore, the theme for Shipping Markets Outlook 2019 is "The Long and Winding Road". We still have quite a lot of work ahead of us to get to that better place.

This has really been the story of shipping since 2009, a long and winding road to recovery after the excesses of 2004 to 2008, especially the tonnage supply growth caused by over-ordering in those years. As for the road ahead, we consider that we have good visibility in terms of the supply and demand data but, in reality, we are not entirely sure what lies around the next corner. Future demand is less clear as we face slower Eurozone growth, weaker Chinese growth, a global economic slowdown and unresolved trade wars. Future supply looks much better with low orders at the shipyards and the potential constraining effect of IMO 2020 and other regulations. The optimism that we felt at the end of last year was temporarily dented by volatile bulk carrier and tanker earnings and depressed container freight rates in the first quarter, but this will change.

May I take this opportunity to thank our customers around the world for their continued support and to our staff in London, Singapore and Shanghai for their hard work and best efforts. We still face challenging factors, many of which have little or nothing to do with shipping, but we continue to believe that our markets are on the road to recovery. To repeat what we said in last year's foreword: "The supply and demand fundamentals indicate that we have the most benign tonnage supply situation than in many a year, with historically low order book to fleet ratios." This remains the case, after markets stalled last year, setting things up for a better 2019. From the middle of this year we should begin to see the fundamentals asserting themselves and for that all-important ingredient of sentiment to lift, helping us to rediscover our sense of confidence and optimism.

Chris Ohlson
Managing Director
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Welcome to Hartland Shipping Services Shipping Markets Outlook 2019

Introduction to the Consultancy Division of Hartland Shipping Services

The Consultancy division of Hartland Shipping Services is a specialised shipping and shipbuilding industry team. It provides detailed sector research and consultancy to external clients in addition to consultancy services to the HSBC Group on a global basis. The Consultancy division has a track record of successfully completing shipping industry studies and consultations. These include providing commercial due diligence for investments in shipping and shipbuilding, conducting feasibility studies for new shipping operations, counselling banks on portfolio risk, engaging in commercial restructuring, and working on leading shipping mergers and acquisitions and equity capital markets projects.

Research publications include:

- Shipping Markets Outlook (annual publication)
- Weekly Commentary
- Market Monitor (weekly publication)
- On-demand bespoke shipping and shipbuilding
- Newbuilding market report

Consulting and advisory work scope includes:

- Commercial and strategic advice
- Feasibility study and business risk assessment
- Commercial due diligence for investments
- Vessel valuation and fleet analysis

The Consultancy division of Hartland Shipping Services aims to offer in-depth coverage of the interface between shipping markets and the global economy.

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Introduction

2018 built on the improvements witnessed in 2017 across the three main sectors of bulkers, tankers and containers although tankers and containers found it to be a more challenging year than bulk carriers.

The ClarkSea Index, a broad measure of overall performance across the shipping sectors, rose 13% in 2018 to $12,144 per day, having risen 14% in 2017. This takes the index to just above its average level of $11,751 per day since the global financial crisis in the 10-year period between 2009 and 2018. This makes 2017 and 2018 years of steady if unspectacular gains. Overall fleet growth was at 2.6% in 2018 after 3.4% in 2017 and trade growth was at 2.7% in 2018 after 4.2% in 2017. The 2.7% trade growth last year (3.1% in tonne-miles) took total seaborne volumes to 11.9 billion tonnes. In 2019 we will need to watch China's industrial production growth and progress in averting an escalation in US-China trade friction. Only 11% of the fleet is on order while demolition fell 12% year-on-year in 2018 to 31m-dwt, implying expectations of better earnings ahead.

We still have some excess tonnage supply to burn off after successive years in which supply growth has outgunned demand growth, but at least we are now seeing better supply-demand balance. With modest expectations of supply growth ahead we are hoping that continued positive demand growth will return us better earnings and higher asset values across all three main sectors. So, with supply under reasonable control, it is demand that will hold the key, and it is this area that is posing some risks as we move into 2019. Out in Asia, we are seeing signs of slower growth in China and Japan that does not bode well for the main drivers of consumption in the region. In Europe, we have the conundrum of the UK possibly leaving the EU and upsetting the economic order across Europe. Europe's economy is evidently ailing judging from Italy being in recession, drastically slowing German economic performance as its exports fall, and France in the grip of low level disruption from the populist gilets jaunes movement.

In the fourth quarter of 2018, the UK registered GDP growth of just 0.2%, after 0.6% in Q3. This took annual GDP growth down to 1.4% for 2018, the lowest since 2012, according to the Office for National Statistics.The European Union did no better last year, merely matching the UK rate of 1.4%. Since Q1, its growth rate fell from 0.5% in Q2, to 0.3% in Q3 and to 0.2% in Q4. The EU leader, export-dependent Germany, managed annual GDP growth of 1.5% in 2018 after 2.2% in 2017 and 2016. In Q3 it contracted by 0.2% and in Q4 it came back to zero growth. 2018 was Germany's worst performance since 2013. French GDP growth matched Germany's at 1.5% in 2018 following 2.3% in 2017. The trend is already clear as Europe is witnessing slower economic growth on fears of the consequences of Brexit locally and of US-initiated trade friction globally.

Across the Atlantic, US GDP growth came in at a stronger 2.9% for 2018, boosted by corporate tax cuts, after 2.2% in 2017. However, it posted three consecutive quarters of falling growth in going from 4.2% in Q2, to 3.4% in Q3 and to 2.6% in Q4. Signs of growth fatigue were evidenced by 12 consecutive months of falling pending existing home sales, a process that accelerated in Q4. A protectionist US, belatedly trying to get even and level the playing field with its overseas competitors - ranging from neighbours Canada and Mexico to more distant Europe, India and China - has set up a more hostile global trade environment. The Fed has gradually raised rates from 0.25% to the current 2.5% where it is now likely to pause as economic uncertainties demand. It is in the process of unwinding QE while the ECB is struggling to end its own stimulus programme. The Bank of Japan has not yet started any pause or reversal of its own QE programme as domestic and global growth slow. The Japanese economy expanded by an estimated 1.0% in 2018 following 1.7% in 2017.

Environmental issues, and most immediately IMO 2020, are amongst the greatest technical uncertainties facing shipping today, and they threaten to impose extra costs on all participants in the shipping industry. The switch from maximum 3.5% sulphur content fuel (effectively HFO) to 0.5% sulphur content fuel (close to MGO at 0.1%) is a big shift. IMO compliant low sulphur fuel oil (LSFO) should be available in sufficient quantities when the deadline of 1st January 2020 is reached. This will require an estimated switch of some 2.5m-bpd of HFO to LSFO or MGO. The world's refiners are not yet providing us with confirmation that they will have sufficient quantities of LSFO available in time, as to do so would only undermine future LSFO pricing. Nor are they guaranteeing sufficient quantities of HFO for the years following IMO 2020, as this would undermine the future price of HFO. Thus ships, power stations and other users of HFO that are investing in scrubbers are left without a clear picture of the future availability or pricing of high sulphur fuel.

All they can rely upon is the alleged high cost of refinery conversion from HFO to LSFO (typically over $1 billion) and the long lead time (typically over 5 years). The assumption is that there will be sufficient HFO available in worldwide bunkering ports for scrubber-fitted ships for years to come. It is an uncomfortable assumption for those who plan to invest in exhaust gas cleaning equipment to continue burning HFO that the IMO arguably should have decisively banned for the avoidance of ambiguity. 5-10% of the commercial fleet is expected to be fitted with scrubbers in time. The rest of the fleet will default to LSFO or MGO and expect to recover the extra costs from charterers, and ultimately from the end consumer. It is a polarising issue with one of the largest listed bulk carrier players, Star Bulk, going all-in for scrubbers and the largest listed tanker company, Euronav, staying all-out. The debate is emotional and often involves the highly selective use of research and data.

There are plenty of opinions about scrubbers but there is rather less hard evidence at this stage. Suffice to say that Euronav perceives there to be a public relations risk in being seen to convert airborne pollution into seaborne pollution. Star Bulk points out that the seawater washing of exhaust gas in an open loop scrubber simply adds sulphates to the ocean that already exist in large quantities, as well as helping to remove other impurities such as particulate matter. Furthermore, such scrubbers were actually approved by the IMO, which complicates matters. The Worldscale system needs to be reformed if tanker owners are to be compensated for their actual fuel costs and bunker adjustment factors need to be refined if the container lines are to recover their costs. Bulk carrier owners enjoy a better pass-through mechanism on voyage terms and can always opt for time charter out if charterers are unwilling to pay freight levels that cover the actual cost of bunkers.

DNV estimates that some 2,700 commercial ships of all types may be fitted with scrubbers by 2020, with over 80% being open loop. Scorpio Group, with fleets of both tankers and bulkers, has committed to installing open loop scrubbers on more than 100 ships. Taken together with the other major IMO initiative, the obligatory installation of ballast water treatment systems, it is facing a capital outlay of around $500 million for its fleet. It mentions that, as far as BWTS, about 30% of the 108 systems that it has purchased to date have been declared non-operational through a combination of defects. This has involved seven manufacturers and four different technologies over the past five years. It must fear similar risks for largely untested scrubbers. Star Bulk, is fitting its entire fully delivered fleet of 112 large bulk carriers, ranging from supramax to newcastlemax, with open loop scrubbers. The total capital cost is estimated at $185m with about 70% of this to be financed by loans. As with Scorpio, it is reliant upon IMO 2020 being enforced from 1st January 2020.

It is of concern to such companies that have committed to significant scrubber investments that the IMO has reopened discussions around scrubber technology so as to harmonise future rules relating to scrubber use. An IMO subcommittee entitled Pollution, Prevention and Response 6 (PPR 6) met between 18-22 February in London to consider latest submissions from IMO flag states and NGOs. Just ahead of the meeting, the European Commission reported on the subject and suggested that "the sooner uniform and unambiguous regulatory measures are developed and adopted, the better the potential pollution will be controlled and the less significant the economic impact will be both on industry and administrations." Its findings were based upon a German study that was presented to the IMO at the end of 2018. The EC's concerns have found support from the flag state of Panama which presented a report that it commissioned from the Massachusetts Institute of Technology (MIT). It suggests that damage can indeed be done to the marine environment by open loop scrubbers and it questions the assumption of equivalence between burning HFO with scrubbers and the burning of LSFO.

The German report asserted that "the operation by ships of exhaust gas cleaning systems is expected to lead to a degradation of the marine environment due to the toxicity of water discharges." It pointed out that the composition of exhaust gases made it inevitable that scrubber effluent wash water contains heavy metals, nitric acid, sulphuric acid, sulphates, nitrates and polycyclic aromatic hydrocarbons (PAH). This appears to be a condemnation of the practice of deploying scrubbers, especially open loop models, despite the fact that the IMO had approved their use in 2015. The report mentioned that about two-thirds of the nearly 1,500 scrubbers already installed or on order are of the open loop variety. Scrubber users have conducted their own scientific studies that refute claims that their use may harm the marine environment. In direct challenge to the EC report, a Japanese government study into open loop scrubbers was also presented to the PPR 6 meeting and it found that there are no unacceptable effects from their use on marine organisms or the quality of the sea.

The study established that the amount of heavy metals in the sea emanating from open loop scrubber use is about 100 times less than the limit of heavy metal concentration permitted from land discharges in Japan. Japan is the world's second largest shipowning and third largest shipbuilding nation, so its opinion may prove to be influential. Furthermore, Japan is backed up by the Clean Shipping Alliance 2020 which produced a long-term study of the ships in the fleet of one of its members, Carnival Corp. The findings were in line with those of the Japanese government with scrubber discharge water falling within safety standards. In the real world the likes of China, Singapore and Fujairah have already introduced limitations on the use of open loop scrubbers in their ports and territorial waters. Anyway, the debate about scrubbers will rage on and the uncertainties will continue as PPR 6 decided that there was insufficient lead time for the IMO to revise its 2015 scrubber guidelines when its Environmental Protection Committee convenes its 74th session in London in May. Any new guidelines will not be ready until PPR 7 in a year's time, after the new rules become effective.

Another topic arising from the IMO's PPR 6 meeting concerned the continued use of HFO in the event of concerns about the quality and safety of available compliant fuels. It might be interpreted as an all too familiar fudge and the perception of a potential weakening of enforcement procedures against the burning of HFO without scrubbers after the 1st January 2020 deadline. The IMO agreed that ships can continue to burn HFO beyond the deadline if the owners can prove that they have legitimate concerns about the quality and safety of available compliant fuels. This safety get-out clause will be added to the fuel oil availability report (FONAR) which can be presented via the flag state to Port State Control as proof that complaint fuel was not available without making an unreasonable deviation in the ship's trading route. The IMO has a tough task getting universal member agreement to policy and enforcement issues. In this instance, Port State Control will have to be the judge of what constitutes legitimate grounds for continued use of non-compliant fuels in 2020. The International Chamber of Shipping (ICS), in support of the IMO, has warned that FONARs cannot be used as a free pass to continue carrying non-compliant fuel. Measures will be put in place to avoid abuse.

There is no doubt that IMO 2020 and other environmental regulations, such as BWTS, are set to play a significant role in reshaping the size and operational characteristics of the global commercial fleet. The popular perception is that these regulations will impose extra burdens and costs upon the industry. The most likely upshot is that we will see an increase in scrapping and a decrease in vessel speeds, thus reducing effective shipping capacity at the margin. This is going to happen over the next few years when we expect quite limited fleet growth in each major sector thanks to poor earnings, lack of finance, high newbuilding prices and regulatory uncertainties. This positive supply-side development is accompanied by corresponding potentially negative demand-side developments. These include the US pulling out of the TPP and rejigging Nafta and embarking upon trade disputes with Canada, Mexico, Europe and Asia.

The biggest ongoing trade dispute is the one between the US and China, the two largest economies in the world. It is either causing or contributing to slower economic global growth. The sooner the two sides come to a short-term agreement on tariffs, and agree to engage in a longer term discussion about trading practices, the better for shipping.

The most recent news, in mid March, is that the US and China appear to be inching towards a deal that may be scoped out by end March and ratified by Presidents Trump and Xi by end April. The leaders of each country are keen to avoid being blamed for causing a damaging deceleration in economic growth. China is reportedly offering to boost its purchases of farm and energy products (such as soybeans and LNG) while making modest concessions on technology transfer, intellectual property, market access, industrial policy and subsidies. This covers a broad range of short-term and long-term issues. The first covers the tariffs and the US bilateral trade deficit (which was at $375bn in 2017 and rose to an all-time record of $419bn in 2018) and the second covers structural changes that will take much longer to thrash out. Separating the two might help reach a solution. China is agreeing to buy more US crude and LNG, which it was on target to do in any case, at the expense of other suppliers such as Canada, Russia, Australia and the Middle East. It should not have a problem with that.

China can resume buying most of US soybean exports, which is inevitable in any case, at the expense of rival exporters in Brazil, Argentina and Ukraine. Once again, it should have no problem with that. China has other tools at its disposal to compensate for any loss of traction with those nations that lose out in the short run. China can also increase its capital goods purchases, especially aircraft, which will please Boeing but maybe not Airbus, although this concept does face some problems after the grounding of the global fleet of Boeing 737 Max aircraft. President Trump's re-election prospects next year will certainly get a boost from easing the pain that is being felt in the farming and energy dependent states. President Xi will also get some relief from the price rises that have been caused by its tariffs on assorted US imports at a time when the economy is growing at its weakest rate in 30 years. The US and China have identified each other as leading technology competitors and strategic adversaries but, for now, both presidents stand to gain from a truce; so too will shipping and trade.

With modest expectations of supply growth ahead we are hoping that continued positive demand growth will return us better earnings and higher asset values across all three main sectors. So, with supply under reasonable control, it is demand that will hold the key, and it is this area that is posing some risks as we move into 2019.

The Economic Backdrop

Volatile stock markets

Stock markets had a roller coaster year in 2018, commencing strongly but ending the year lower than where they started after a poor last quarter. By the end of the year, the DJIA was down 5.6%, the S&P 500 was 6.2% lower and the Nasdaq was down 3.9%. Even steeper falls were suffered overseas with the FTSE All Share Index off 12.0%, the FTSE 100 down 12.5% and the European Stoxx 600 off by 13.2%. In Asia, the Nikkei 225 was 12.1% lower and the Hang Seng was down 13.6%. However, somewhat ominously, the steepest losses were booked in China with the Shenzhen Composite down 33.1% and the Shanghai Composite off 24.6%.

This all changed in 2019. As we approach the end of the first quarter, Chinese stock market indices have performed better than others. China is defying gloomy expectations as well as benefiting from a rebound in investment inflows ahead of changes to MSCI index weightings. In the year to Friday 15 March, the Shenzhen Composite was up 30.6% and the Shanghai Composite was up 22.6%, even after having suffered sharp 3-4% corrections at the end of the first week in March on a combination of market jitters and a bout of profit taking. Despite these early March corrections, the Chinese indices are still ahead of the rest.

By way of comparison, in the year to Friday 15 March market close, the DJIA was up 10.7%, the S&P 500 was 12.5% higher and the Nasdaq had rebounded 13.8%. The FTSE ASI rose 7.8% over this period while the more focused FTSE 100 was up 7.3%. The Euro Stoxx 600 managed to put on 13.0% while its two main German and French components were either side of this measure with the DAX up 10.4% and the CAC 40 up 15.3%. In Spain, the IBEX 35 was up 9.3%. Out in Asia, the Nikkei 225 was 9.7% stronger while the Hang Seng was up 15.4%. These stock market gains in 2019 to date are all the more remarkable given the manifest uncertainties.

Weaker Chinese growth

Official figures suggest that the Chinese economy grew at a rate of 6.6% in 2018 having slowed to 6.4% in the final quarter. This is the slowest rate of growth since 1990 when the Chinese economy was just getting into gear. This year Chinese GDP growth is set to slow to around 6.3% according to consensus. The Chinese GDP figures are nominal given the official practice of smoothing; actual growth in 2018 was probably closer to 5%. The latest government target for 2019 is in the 6.0-6.5% range, as set by the NPC in early March.

China is definitely suffering from a slowdown according to an assortment of metrics. Weaker domestic demand is illustrated by a 6% fall in domestic car sales in 2018 to 22.7 million units, according to the China Passenger Car Association. One leading Chinese automotive manufacturer, Geely, saw its sales drop by 44% year-on-year in December 2018 alone. This is the first time that sales of cars have fallen in China in at least 20 years. It coincided with the ending of government subsidies for vehicle purchases last year.

Chinese consumers appear to have been affected by the tit-for-tat import tariffs imposed on imported US goods. The prices that they have to pay have gone up and so their purchases have gone down. Many Chinese citizens would also have been influenced by the sharp drop in domestic stock market indices last year, leading to retail sales growth falling to a 15-year low in 2018. In early March, Beijing revealed that China's exports in February fell 20.7% year-on-year, the steepest drop since 2016, and its imports were 5.2% lower than in February 2018. These weak import-export figures may also reflect the distorting effects of the CNY holidays.

Stronger US growth

In contrast to China, the US economy grew by 2.9% in 2018, up from 2.2% in 2017, while inflation was subdued at around 2%. The US stock market boom was initially inflated by President Trump's tax cuts and then deflated by his pursuit of trade wars with both friend and foe. Other impeding factors were the effect of rising rates, the unwinding of QE and the 35-day partial government shutdown. S&P 500 companies saw their average earnings rise by about 20% in 2018 with around 8% of this apparently attributable to the tax cuts. In early January, Wall Street consensus was that they might expect to grow earnings by some 8% in 2019. This would give an average P/E ratio of just below 15, at about the mean for the past ten years, and a few points below the average for the past five years. By late January, the consensus forecast of earnings growth had slipped to 6.5% in 2019. This decline is all the more relevant in the context of the 10% forecast as recently as last October.

The US is still doing well when it comes to job creation. Non-farm payrolls rose by 222,000 last December and then by 304,000 in January. This was followed by a shocking drop to just 20,000 jobs growth in February, against a forecast of 180,000. It was the worst reading in 17 months but might easily be put down to the uncertainty caused by the government shutdown. It was inconsistent with the unemployment rate falling from

The result of China's state-driven economic and trade policy is global overcapacity in industries such as steel and cement which leads to excess production being dumped in overseas markets, including Europe. In this sense, one might see President Trump's 'America First' and 'Make America Great Again' campaigns as much needed antidotes to China's 'Made in China 2025' campaign.

4.0% to 3.8% in February and with the 3.4% year-on-year rise in hourly earnings, the best rate since 2009.

Back in January, Oxford Economics was expecting real US GDP growth to slow from around 3% year-on-year in 2018 to about 2% by the end of 2019 as policy-driven economic headwinds – trade policy, fading fiscal stimulus, and tighter monetary policy – would weigh on economic momentum. By early March, most forecasters were trimming their US growth forecasts for 2019: the OECD to 2.6%; the World Bank and IMF to 2.5%; the Economist to 2.3%; Goldman Sachs and Morgan Stanley to 2.0% or less. It appears that the US will fail to escape contamination from slowing global growth.

This means that President Trump is likely to fall well short of achieving his ambitious aim of 4% growth. No doubt he will blame the Federal Reserve, Europe and China for any failure to deliver on his 2016 campaign promises. His biggest campaign pledge was to build a wall on the southern border with Mexico and get the Mexicans to pay for it. In the end he decided that Congress should advance $5.7bn to pay for it in exchange for a budget deal to avoid a second shutdown.

On 15 February, after Congress refused to advance the money, Mr Trump approved the $333 billion federal government spending bill but, at the same time, he declared a state of national emergency. This enabled him to allocate about $8 billion in emergency funds that were set aside for the military and disaster relief. A coalition of 16 US states, led by California and all governed by Democrats with the exception of Maryland, is suing the Trump administration hoping to block such a perceived misuse of presidential power.

US-China trade friction

In early January, the Office of the US Trade Representative declared that three days of talks had discussed ways to achieve fairness, reciprocity and balance in trade relations between the US and China, and the need for effective enforcement of any deal. China pledged to buy a substantial amount of energy, manufactured foods and agricultural products from the US as a means towards narrowing the bilateral trade gap which reached $375 billion in China's favour in 2017. The US president is determined to see a narrowing in this trade gap but, unfortunately, most recent data shows that it actually widened in 2018.

The USTR expected to usher in structural changes to China's trade policies that would protect US intellectual property and curtail technology transfers to Chinese firms. President Trump might originally have been hoping to announce an end to the trade wars to coincide with the World Economic Forum in Davos at the end of January. However, Mike Pompeo's video-linked address to the WEF gave no hint of any breakthrough and the talks looked set to go all the way to the 1 March deadline. Shortly before the deadline was reached, the president decided to temporise any tariff increases to give the two sides a chance to reach agreement.

As part of the ongoing trade talks, China has pledged to buy an additional $1.2 trillion of US goods imports over six years. This would include more purchases of soybeans, corn, natural gas, crude oil and capital goods. Boeing aircraft are a key component of the latter category. The worldwide grounding of the Boeing 737 Max series after two recent crashes complicates the issue as China is thought to account for about 10% of the unfilled orders for this aircraft. Avolon and its subsidiaries are said to have over 100 orders, BOC Aviation has 90 on order and China Development Bank has 77. China is unlikely to confirm its purchases of the 737 Max until the safety issues are resolved and this could make it more difficult for China to reach the $1.2tn target.

UK is weakened by Brexit

The UK economy is struggling ahead of its planned departure from the European Union on 12 April. On 10 January, Jaguar Land Rover announced that it was cutting 4,500 jobs in Britain blaming a 12% fall in global sales in September and a 46% drop in sales in China, its biggest market. It also noted the accelerating move away from diesel engine cars in Europe. On the same day, Ford announced that it would cut thousands of jobs across Europe and the UK. Slowing sales and new environmental rules, both familiar subjects in shipping, demand radical restructuring. The ongoing political uncertainty in the UK caused by Brexit has made the UK auto industry an obvious target. In early February, Nissan announced that it will no longer be building its X-Trail SUV at its plant in Sunderland, shifting production to Japan instead. On 12 March, it announced it will cease UK production of its luxury Infiniti brand in Sunderland.

On 19 February, Honda announced the closure of its flagship British plant in Swindon in 2022, leading to at least 3,500 job losses, and possibly up to double that. This is Honda's only plant in Europe which last year made 160,000 Civics. 90% were exported to the EU and the US. It cited the small European market and the shift to electric cars. Swindon's capacity rose to 250,000 cars a year in 2001, but it only ever got to a peak output of 230,000 units before the 2008 downturn. After that output levels collapsed, leaving it 36% below capacity. By comparison, it makes around 2 million cars a year in both China and the US. The threat of US import tariffs of up to 25% set alarm bells ringing but it was the recent EU-Japan trade deal that probably sealed Swindon's fate. Under these terms, Japanese-built cars can be exported to the EU at zero tariff levels from 2027, avoiding the 10% common tariff that would be payable on cars imported from the UK once it has left the EU.

The UK's Office for National Statistics recorded a quarter-on-quarter growth rate of just 0.2% in Q4 of 2018 from 0.6% in Q3, 0.4% in Q2 and 0.1% in Q1. In mid March, the ONS reported that the unemployment rate had fallen to 3.9%, the lowest since 1975. Year-on-year growth in average weekly wages rose to 3.4% suggesting that the labour market is quite tight. Domestic investment in the UK economy declined quarter-on-quarter in each of the first three quarters of 2018 as businesses have no clarity of the terms of trade beyond the end of March. In Q3 last year, investment was 2.2% lower when compared with the last quarter of 2017. It is likely to have fallen again in Q4 when the ONS releases its latest data at the end of March. 70% of investment in transport equipment, machinery and IT, intangible assets, and buildings and infrastructure is by companies; the rest is by central and local government. Such investment levels now fall well below the UK's European peers in Italy, France and Germany. In mid March, the Office for Budget Responsibility reduced its forecast of UK growth to 1.2% for this year, the weakest since the financial crisis. The OBR also estimated that business investment will fall 1% this year, similar to last year's drop.

Germany joins the US in pushing back at China

In early March, the ECB reduced its forecast of Eurozone growth in 2019 to 1.1% from its previous 1.7%. It announced that it would keep interest rates on hold and be willing to deploy new stimulus if necessary, thus temporising the stimulus withdrawal process. Slowing growth in Europe, matching slowdowns elsewhere, is nowhere more marked than in Germany. Its growth rate fell to 1.5% in 2018, from 2.2% in 2017, and is expected to fall further to 0.7% this year, even behind the UK's 0.8%, according to the OECD. Germany's export-dependent economy is finding that demand for its goods in overseas markets is waning. In sympathy with this observation, Germany's industrial orders fell 2.6% year-on-year in February. A leading German industry body, the Federation of German Industries (BDI), possibly emboldened by President Trump's attacks on unfair Chinese competition, recently spoke out against unchecked competition from China's state-controlled economy.

The BDI complained that Beijing is not liberalising its economy, despite claims to the contrary, as its markets and prices are distorted by state aid. It is instead establishing its own political, economic and social model that enters into systemic competition with more liberal economies such as that of Germany. The result of China's state-driven economic and trade policy is global overcapacity in industries such as steel and cement which leads to excess production being dumped in overseas markets, including Europe. The BDI has warned that the same may happen in other areas, such as robotics and batteries. It urged Brussels to adapt its legal framework to confront dumping and subsidies as well as state-financed acquisitions of foreign technology companies. The BDI acknowledged that China remains the driving force of the global economy and is an important sales and procurement market for German industry, but it seeks better protection from non-EU non-market economies that seek to be active in Europe.

In this sense, one might see President Trump's 'America First' and 'Make America Great Again' campaigns as much needed antidotes to China's 'Made in China 2025' campaign. From the BDI's perspective, what is required is a sharpening of EU state aid legislation and anti-subsidy instruments as Germany wakes up to the fact that China is a competitor as well as a partner. In 2017, Sino-German trade reached €187 billion, being €86 billion in exports and €101 billion of imports. This was equivalent to 30% of total EU-China trade in 2017, making China Germany's most important trading partner outside of the EU. The problem with current US trade policy is that it is not aimed exclusively at China, it is also a threat to others including Germany.

The Trump administration is toying with the idea of imposing punitive tariffs of up to 25% on cars sourced from the European Union on national security grounds. This would only make Germany's current economic problems worse. VW, Daimler and BMW have large plants in the US that could end up being hit very hard. In 2018, the US bought the equivalent of $31 billion worth of German vehicles and components, making it the largest

This trade dispute is about much more than Chinese intellectual property theft or the widening US-China trade deficit. It is about who wins the technology race and is a tug of war for global domination.

export market for the German automotive industry. VDA, the German auto industry association, reports that German brands such as VW, Porsche, Mercedes, BMW and Audi sold 1.34 million cars in the US last year.

Reuters informs us that German companies built some 750,000 luxury cars at US plants in 2018, of which 44% were sold domestically and the rest were exported overseas, including almost 100,000 cars to China. Around 690,000 German vehicles were sold in the US in 2018 that were imported from factories within the European Union, of which 470,000 came from German plants, according to the VDA. Mercedes sold 316,000 cars in the US last year, 14% of its global sales, while BMW sold 355,000 cars and VW 638,300 cars in the US in 2018. Evercore analysts estimate that, in the event of 25% tariffs, VW Group would take a €2.5bn hit, Daimler €2.0bn and BMW €1.7bn. The stakes are high, and the unpredictable Mr Trump is on the other side of a deal.

IMF downgrades global growth

The IMF downgraded its forecasts of global growth in response to January data that the Chinese economy had grown at its slowest rate since 1990. It now predicts global growth of 3.5% in 2019, down from its October forecast of 3.7%. Growth for 2020 is put at 3.6%, 0.1% down on its previous estimate. Weakness in Europe and Japan caused it to reduce its growth forecast for advanced economies from 2.3% in 2018 to 2.0% in 2019 and to 1.7% in 2020. Global risks include Brexit and a greater than expected slowdown in China than previously envisaged. China seems to be suffering from the impact of its initial trade skirmishes with the US, exacerbated by the fact that these are happening at a time of a structural economic deceleration.

More government stimulus will follow in the form of infrastructure spending and looser bank lending rules, but this is only likely to increase the national debt burden. It is unlikely to help the raft of private companies that are failing as they cannot access traditional financing. Xi Jinping's policy is to support the unreformed state-owned sector and project its subsidised might strategically in international markets. It is confrontational and China's major western trading partners, including the US and Germany, are belatedly realising that China can be both friend and foe. The US use of trade confrontation may yet reap some short term rewards but it has backfired in other ways as the 2018 bilateral trade deficit with China rose to $419 billion in 2018 from $375 billion in 2017.

The rise in populism

The rise of populist authoritarian movements across the globe, allied to attacks on multilateral institutions – such as the IMF, World Bank, WTO and Nato – find their most obvious and recent manifestations in Brexit and Trump but, in reality, they can be traced back at least to the aftermath of the 2007-08 global financial crisis. The regulatory and policy response to the global financial crisis proved to be socially divisive and financially polarising as those that caused it seemed to get further ahead, while those that were victims of it appeared to get left further behind. This view is contested, as central bank policy responses – slashing interest rates and deploying quantitative easing – actually did work; and the benefits were more widely distributed than often claimed. The fact remains that, beyond the US, we have yet to normalise these policy responses, and now the US has stopped in its tracks as well.

The populism that has been incubating over the past ten years is part of a backlash against globalisation that has served shipping so well. As FT columnist Martin Wolf has observed, the essence of authoritarianism is the absence of democracy; this is when democracies morph into dictatorships. In the period from 2000 to 2010, examples of this transformation were Russia under Putin, Turkey under Erdogan and Venezuela under Chavez. More recently, the Philippines under Duterte, Hungary under Orban and Brazil under Bolsonaro appear to be well on the road from populism to dictatorship. The well supported US view is that Venezuela under Maduro is an illegitimate dictatorship after fraudulent re-election. Since mid February, Trump and Maduro have been on a collision course as the US has tightened sanctions. The Venezuelan president has refused to yield office to his political rival, Juan Guaido, who has widespread external recognition as the country's legitimate leader. The regime's blockage of US and foreign aid at the border is causing a national and regional catastrophe.

Many people see Mr Trump as a right wing populist with authoritarian traits. Such traits include having loyalists in positions of power (such as in the government and in the courts), the promotion of family members, asserting that the traditional elite is corrupt and incompetent, that experts and the media are not to be trusted, and the promotion of personal rule by intuition. In the case of Mr Trump, he is at least constrained by the very institutions that he despises, so the checks and balances exist even after the failure of partisan self-serving politicians. Populist and authoritarian rulers are greatly assisted by the decline of the old media and the multi-messaging capabilities of the new media. New media spreads doubt by destroying the authority of experts, elites and the traditional media through a casual attitude to the truth. However, autocracies usually fail. Mr Putin has presided over post Cold War Russian economic decline. In the new cold war, China has replaced Russia as the greatest threat to traditional western values.

Business confidence is lower

A business confidence survey conducted by PwC in January showed that almost a third of chief executives believe that the global outlook is darkening, compared with just 5% a year ago. Trade tensions and rising protectionism are to blame. One also needs to take into consideration that global trading activity accelerated in the final quarter of 2018 as imports were brought forward ahead of anticipated US tariff increases from 1 January and subsequent Chinese retaliation. UNCTAD reported a 19% fall in global foreign direct investment in 2018 as US companies repatriated vast overseas profits in response to lower corporate taxes. Latest data indicates that pending existing home sales in the US slumped 9.9% from a year earlier in December 2018, following a 7.9% decline in November and a 6.4% fall in October. In January, they were down another 2.3% marking the 13th consecutive month of declines in such sales.

The rate of decline in existing home sales intensified in Q4 from the earlier quarters in 2018 but moderated in January, giving us cause for hope. The decline still seems significant when taken together with other economic indicators. Any future escalation in the US-China trade dispute would be harmful. It is at least welcome that the threat to increase US tariffs on $200 billion of Chinese imports from 10% to 25% has been indefinitely postponed. Both sides have been given more time to strike a deal. Crunch talks are being held in late March but there is no clarity on the chances of success. This trade dispute is about much more than Chinese intellectual property theft or the widening US-China trade deficit. It is about who wins the technology race and is a tug of war for global domination. US victimisation of Chinese telecom powerhouse Huawei is emblematic of the struggle as it is reckoned to be at least a year ahead in its development of global 5G networks.

Complicated geopolitical risks

The geopolitical situation is unusually complicated. The US is proving itself to be an unreliable partner after Mr Trump's public attacks on Germany, the EU and Nato and on other countries, blocs and multilateral institutions. The US, quite understandably, wishes its European Nato allies to pay their fair share for having American forces and equipment deployed in Europe for their protection. Many European countries are behind on their defence budget obligations; the latest US demand is that they pay the full cost plus another 50% on account. As the US plays catch-up in the 5G networks of the future, it is demanding that its partners in the Five Eyes intelligence alliance (Australia, Canada, New Zealand, UK and US) drop Huawei from their 5G roll-out or find themselves excluded from intelligence sharing. Such is the extent

of US fear of Chinese espionage and its infiltration of western companies and government agencies via technological means. These US threats against its usual allies risk the break-up of the powerful alliances that have helped prevent wars between superpowers.

After the Obama administration failed to act on its red lines in Syria, relating to the use of chemical weapons, Russia seized the initiative. It worked with Assad, Iran and Hezbollah to weaken and push back the regime's multiple opponents, all conveniently labelled as terrorists. Islamic State is not yet defeated but, back in mid December, Mr Trump unilaterally announced his intention to pull US troops out of Syria. He was effectively willing to abandon his Kurdish allies to a possible Turkish attack and the region to even greater Iranian and Russian influence. Iran already has its Shia crescent stretching from Tehran to Beirut via Iraq and Syria, giving it an outlet on the Mediterranean Sea. Ever since Mr Trump's announcement, US administration officials have been trying to reassure its 'allies' in the Middle East that it has no intention of an immediate pull-out, but this has not stopped Israel and Iran directly engaging with one another in Syria. It is accepted that, if the US leaves too soon, then Syria will become an extended battlefield and IS will regroup amidst the chaos.

Iran is suffering from US sanctions against its oil industry, cutting off its access to finance, and weakening its ability to further extend its influence across the Middle East given the deprivations of its citizens at home. The media would have us believe that there is very little support among moderate Iranians for the regime's interventionist activities in Yemen, Syria, Iraq and Lebanon. However, Mr Trump's lack of respect for his general's does not bode well for regional peace. Saudi Arabia's war against Iran-backed Houthi rebels continues in Yemen while US-Saudi relations remain strained after the Khashoggi affair. Further east, there is an ever-present risk of military confrontation between the US and China as the latter extends its control over the South China Sea, with its nine dash line, and the former challenging it. No progress has been made with North Korea on denuclearisation after the Singapore summit in June last year and the Hanoi summit in February. The latter broke down after a lack of preparation and a misunderstanding of the scale of each other's ambitions. Latest news is that there is satellite evidence that North Korea is rebuilding previously dismantled parts of its missile infrastructure. Failure to make any progress in Hanoi on North Korea's nuclear threat may make the US administration keener to achieve some kind of deal on the US-China trade front.

State of the Union

In his 5 February State of the Union address to Congress, President Trump managed to send out the usual paradoxical messages. As with all political leaders, he took credit for everything good that has happened on his watch while blaming others for everything bad. He called for an end to partisan politics, which makes sense given that he has lost control of the House to the Democrats, but still he was unable to avoid attacking his political opponents. He has accentuated divisions between Republicans and Democrats and he has polarised opinions across America on lines of race, religion, gender and wealth. Internationally, he is in retreat from the multilateral institutions that have secured world peace in favour of bilateral deals in which America can bully its way to victory. Despite all this, Mr Trump is widely admired for his pugnacious attempts to level the playing field and fight back against unfair competition from America's foes and below-par contributions from its friends. His unconventional approach has not been tried before due to the constraints of diplomacy and politesse.

He has threatened military intervention in backyard Venezuela, while overlooking human rights abuses in other Latin American countries. He is seeking regime change in Caracas after alleged rigged elections and the installation of pro-US Juan Guaido. This move has allowed President Maduro to claim that the US is after its oil reserves, which are the largest in the world. This is fanciful given that US oil output is already the world's highest, averaging 11.0m-bpd in 2018, while Venezuela's has dwindled to below 1.5m-bpd. Other major producers such as Russia (11.2m-bpd) and Iran (3.8m-bpd for Jan-Sep 2018) are also under US sanctions while Saudi Arabia (10.3m-bpd) is kept close despite its well documented issues in Yemen and Turkey. Mr Trump has prioritised weapon sales over human rights in Saudi Arabia but this is no different to other suppliers, including the UK. It is no doubt true that the Russians and Chinese would be happy to step in and fill any void but the world would probably prefer a more diplomatic, nuanced and less public approach to such conflicts of interest.

Trump seeks re-election by being tough

This president tends to see everything through the lens of money and deal-making with moral principles not counting for much. He still has a loyal hard-core support base that identifies as much with his abrasive policies as with his well documented, and accepted, human failings. This base is predominantly white, male, middle income and Republican. A recent Politico/Morning Consult poll indicated that his approval rating has slipped from a peak of 56% two years ago to 41% today. He has lost ground in every single category of race, gender, income, party, education and age. His chances of a second term appear to be diminishing although the Democrat opposition has handed Mr Trump a gift in allowing him to campaign against their increasingly socialist leanings. He can now run on an anti-socialism ticket. The president has taken credit for strong economic growth and record low unemployment,

ignoring the fact that growth momentum picked up under President Obama. Meanwhile, the stimulating effects of Mr Trump's December 2017 $1.5 trillion tax cuts have already faded, leaving a legacy of trillion dollar annual deficits to be paid back by future generations.

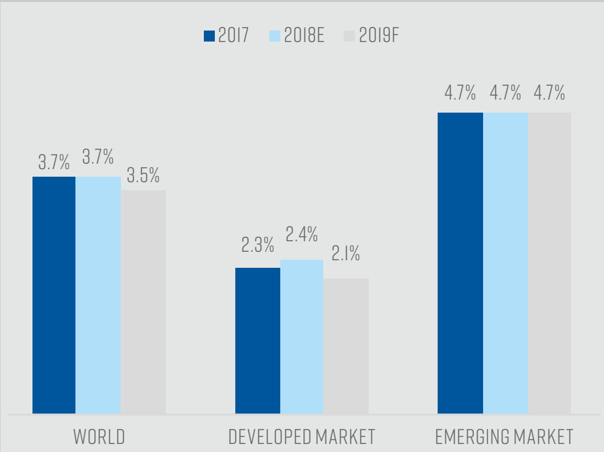
Mr Trump regularly calls for an end to the witch hunt into possible collusion between his campaign and Russia in the 2016 election. The initial results of the Mueller enquiry absolve the president of colluding with Russia, although allegations of obstruction of justice remain open. He has withdrawn the US from the Intermediate-Range Nuclear Forces Treaty, accusing Russia to be in violation, an assertion in which he is supported by Nato. The trade discussions with China continue as the two superpowers jockey for leadership in technical innovation and future world domination. Telling China that "it must include real, structural change to end unfair trade practices, reduce our chronic trade deficit, and protect American jobs" is quite a big ask. China's state-centric model is the basis for China's future domestic economic growth and overseas expansion and it is inseparable from China's one-party political system. Mr Trump has no shortage of international support for taking this strident approach with China. To his credit, he is quite willing to bypass the conventional diplomatic channels to put his opponents off balance and this often proves to be as much of a surprise to Washington as it is in Brussels, Moscow, New Delhi and Beijing. He is happy to take the lead out front in attempts to cut deals for America, leaving his underlings to work out the mechanics of execution.

So, whatever the polls say, it is up to the opposition Democrats to field a strong opponent and to assemble a powerful message. Invoking a socialist agenda will allow the Republicans to run a McCarthyist campaign that could gain real traction with voters. If the US economy continues to out-perform then Mr Trump will see his popularity rise. To this end, a conclusion of part one of the US-China trade dispute, the bit concerning mutual tariffs, will give an economic boost to both sides and to global trade, especially if each side can claim to win something. Part two, concerning open market capitalism versus state capitalism, will take very much longer to resolve. By linking the avoidance of tariff escalation, and the removal of the original tariffs, with demands that China rein in industrial subsidies, reduce forced technology transfer and crack down on intellectual property theft makes coming to an agreement that much more difficult. Hence, escalation may be more likely than resolution. A new cold war is taking shape with the US and its allies on one side and China and its allies on the other. Actual military confrontation may be avoidable but wars in cyberspace appear likely as each nation vies for technological supremacy, whether by fair means or foul.

Global Macro Environment

- We are facing a slowdown in China and Europe that the United States may not insulate itself from, while the US-China trade talks cast a shadow over markets.
- We also have record low unemployment, rising wages, low interest rates and benign inflation - these pro-growth conditions should be enjoyed while they last.
- The global economy is doing well in the context of geopolitical instability, rising nationalism and a race for technological supremacy between the two superpowers.

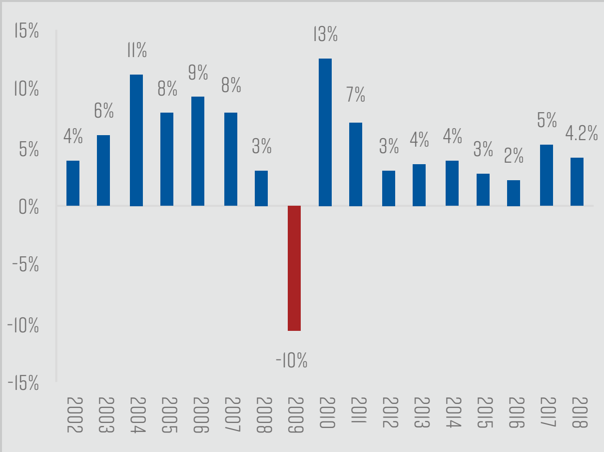
1. 2018 growth was solid but 2019 may prove to be softer.



Global GDP growth YoY % (Nominal)

SOURCE: IMF, HARTLAND SHIPPING

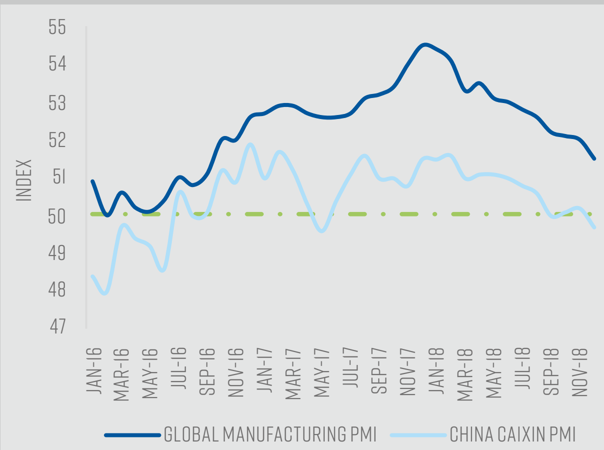
2. The global rebound in trade...



Global Trade growth YoY %

SOURCE: IMF, HARTLAND SHIPPING

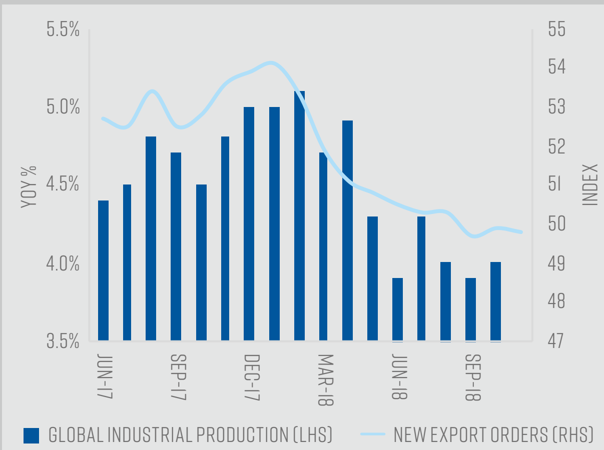
3. ...manufacturing activity...



Global and China Manufacturing PMI (Seasonally Adjusted)

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

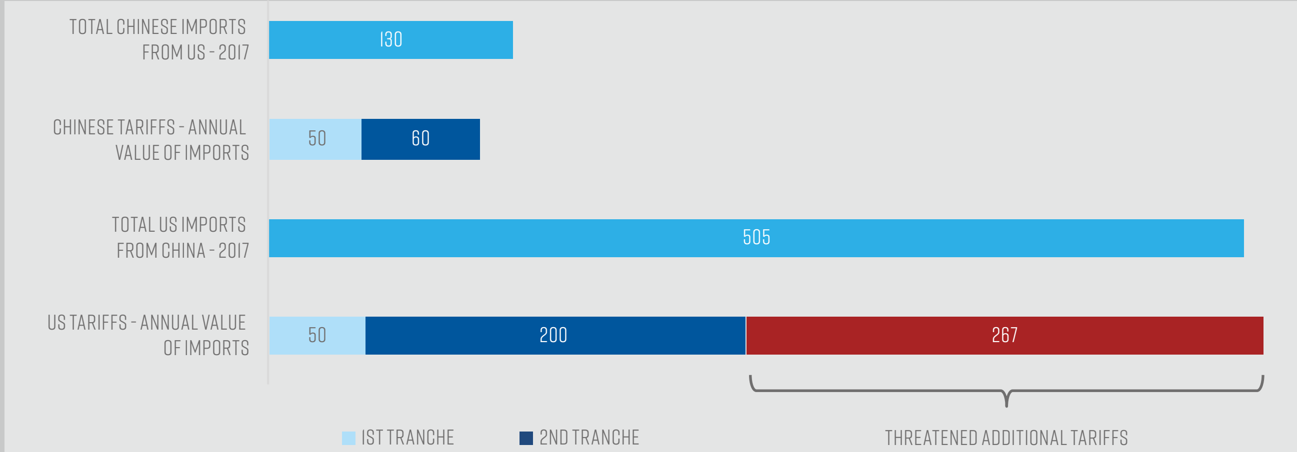
4. ...and industrial production is decelerating.



Global industrial production and new export orders

SOURCE: WORLD BANK, HARTLAND SHIPPING

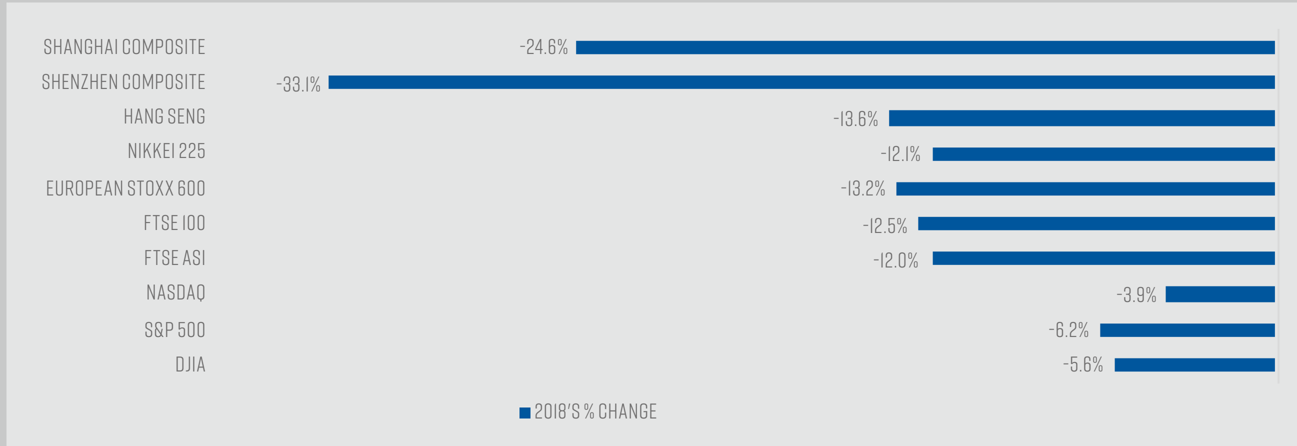
5. Trade war tensions remain unsolved and elevated...



Current and threatened tarriffs between China and the US ($ Billion)

SOURCE: UNITED STATE TRADE REPRESENTATIVE, HARTLAND SHIPPING

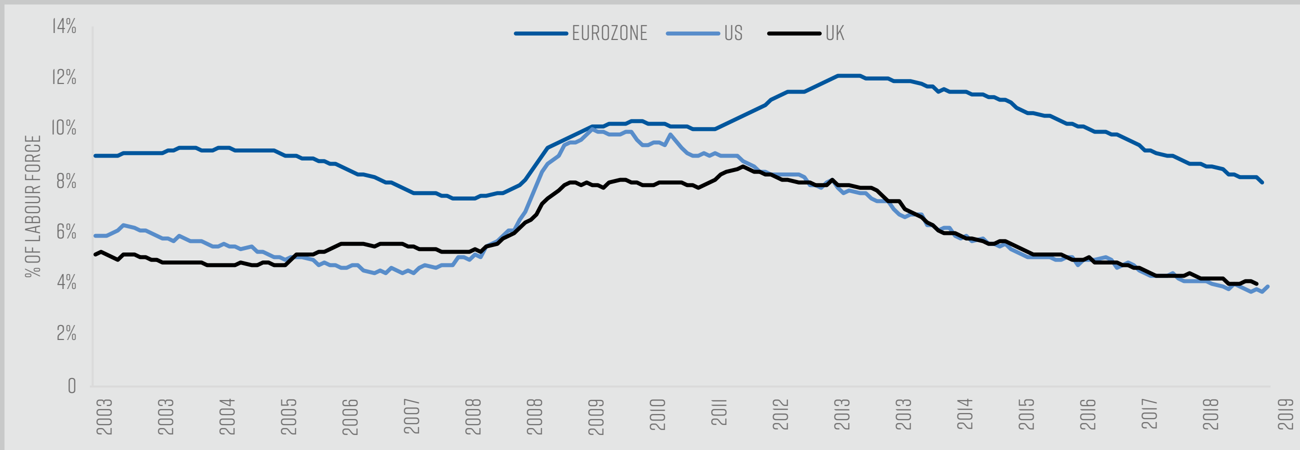
6. ...which affected stock market performance last year.



2018 Stock market indices performance YoY %

SOURCE: HARTLAND SHIPPING

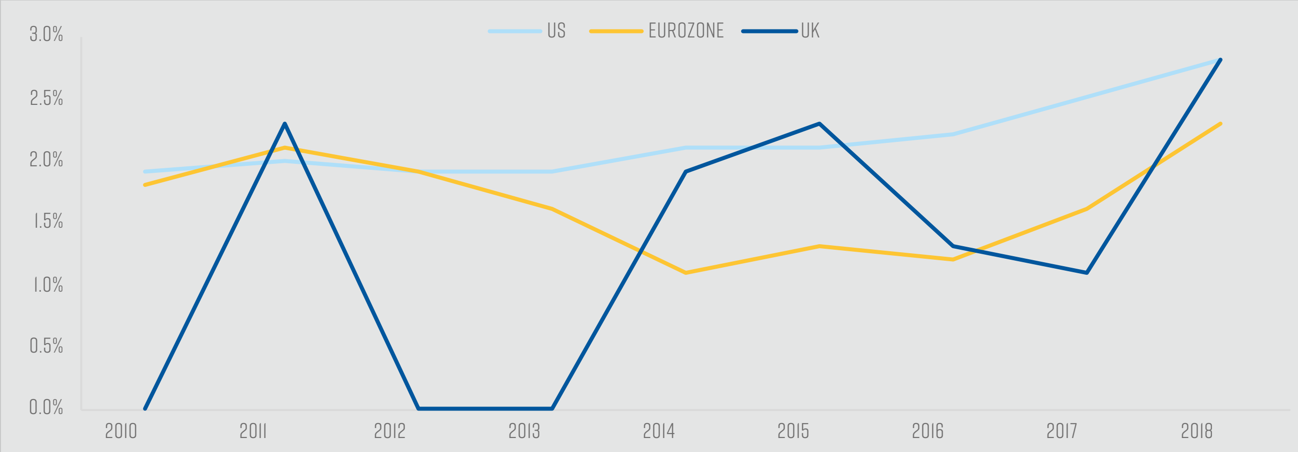
7. Although unemployment levels reached record lows....



Unemployment rate

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

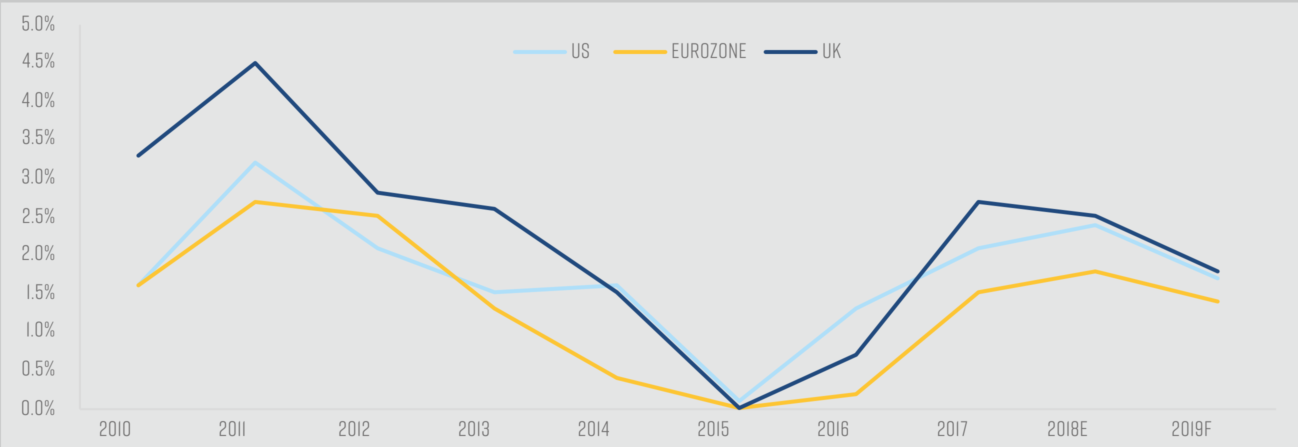
8. ...and wage growth is improving, albeit slowly...



Wages growth YoY %

SOURCE: HSBC GLOBAL RESEARCH, HARTLAND SHIPPING

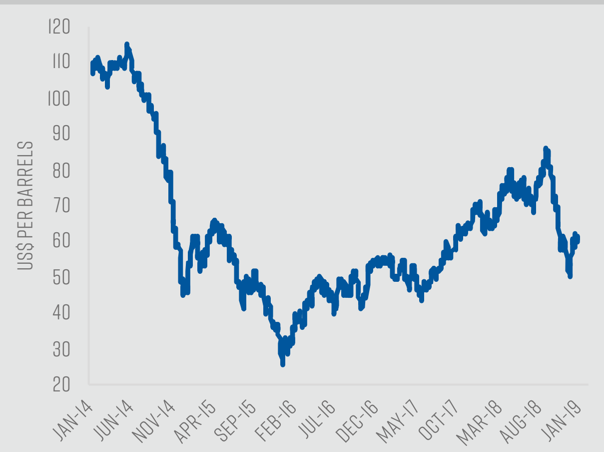
9. ...inflation expectations are revised down...



Consumer price index YoY %

SOURCE: HSBC GLOBAL RSEARCH, HARTLAND SHIPPING

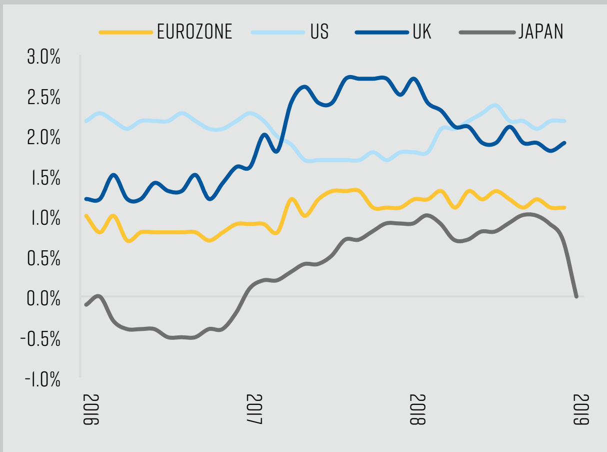
10. ...partly supported by a cheaper oil price environment...



Brent spot price

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

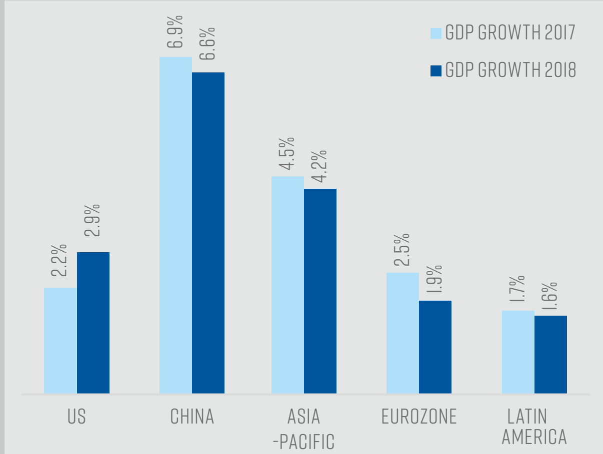
11. ...and core inflation is expected to remain below target.



Core Consumer Price Index YoY %

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

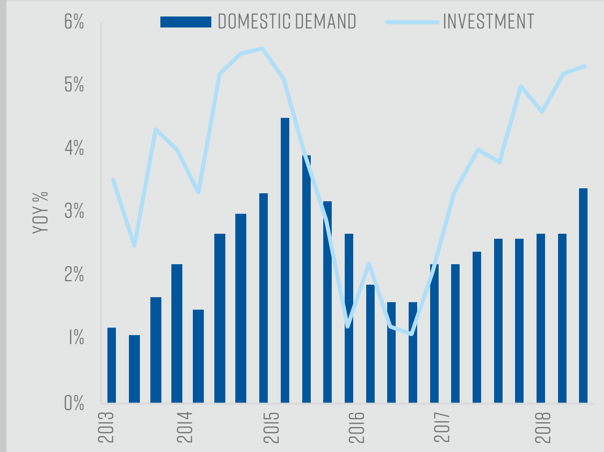
12. Policy divergence ended global synchronised growth.



GDP growth by regions

SOURCE: HSBC GLOBAL RESEARCH, HARTLAND SHIPPING

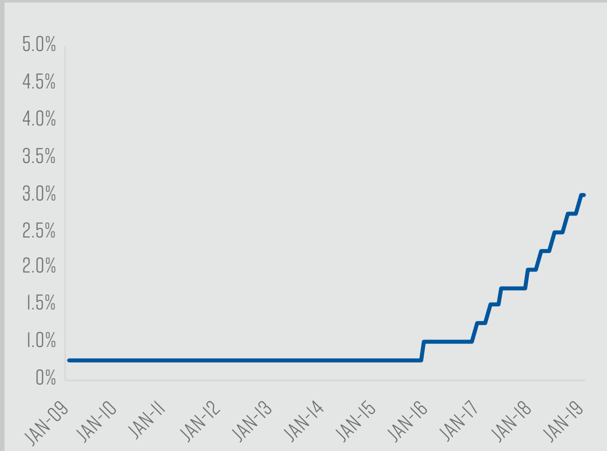
13. US: $1.5tn tax cuts stimulated investment and demand...



US Investment and domestic demand growth

SOURCE: WORLD BANK, HARTLAND SHIPPING

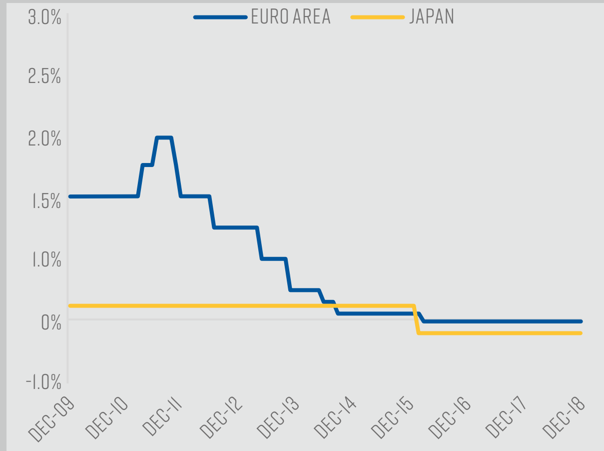
14. ...leading the Fed to hike interest rates 4 times last year...



US interest rates

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

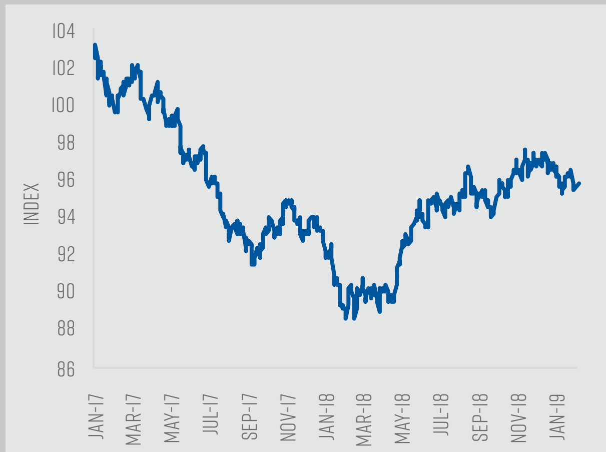
15. ...while the ECB and the BoJ are not yet ready to tighten.



Euro Area and Japan interest rates

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

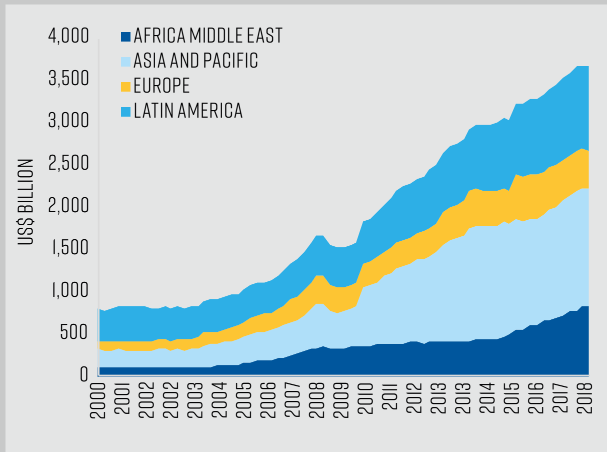
16. This de-synchronization led to US dollar appreciation...



US dollar Index

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

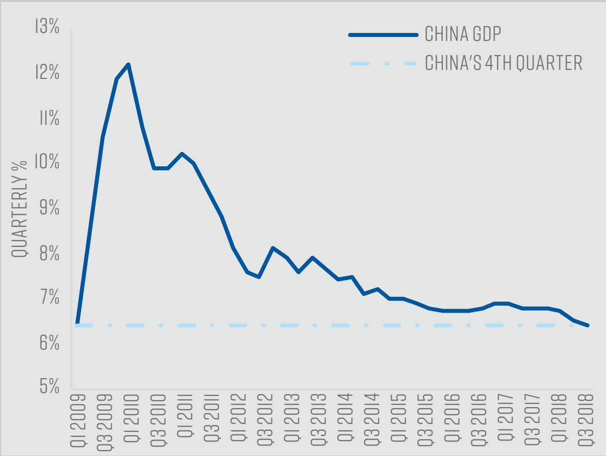
17. ...pressurising EM servicing of dollar-denominated debt.



US dollar-denominated credit to non-banks in EMEs, by region

SOURCE: BIS, HARTLAND SHIPPING

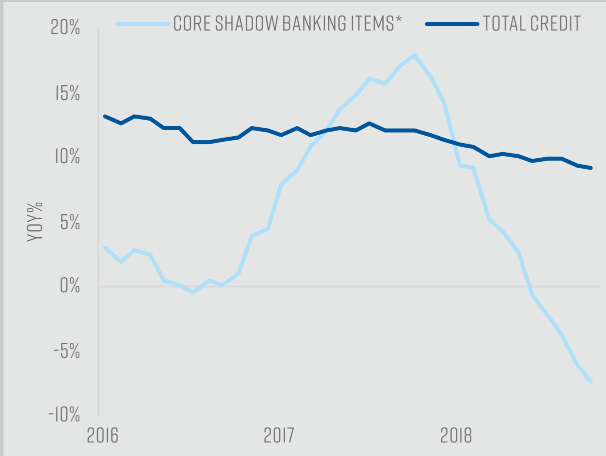
18. China slowdown is structural, 6–7% the new normal.



China quarterly official GDP

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

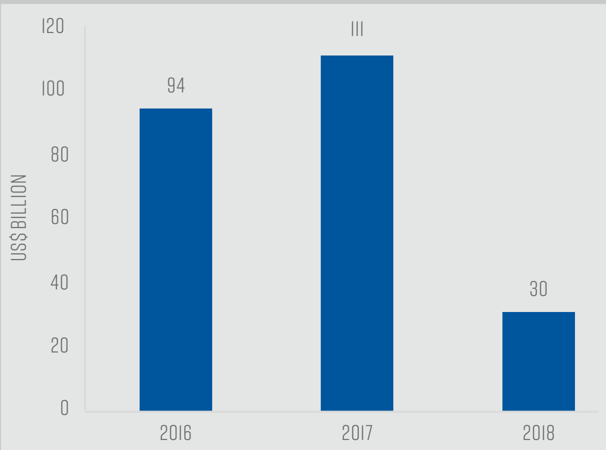
19. Shadow banking has been reined in...



*China total credit & Core shadow banking items**

SOURCE: WORLD BANK, HARTLAND SHIPPING

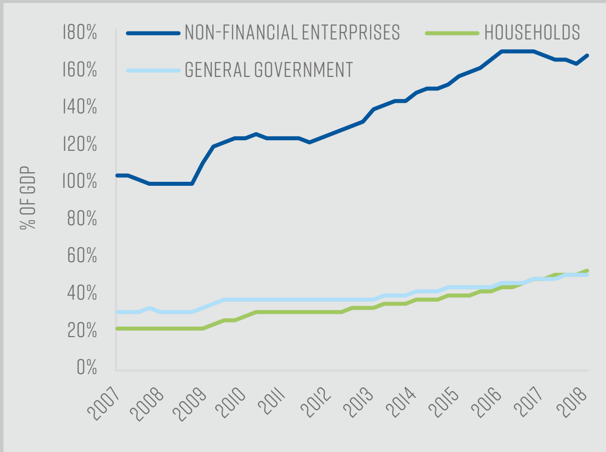
20. ...along with global offshore holdings...



Chinese Foreign Direct Investment into North America and Europe

SOURCE: BAKER & MCKENZIE, HARTLAND SHIPPING

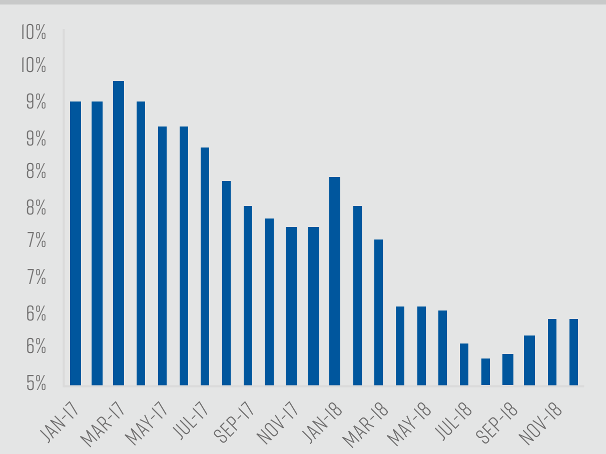
21. ...and corporate debt has stabilised, but at a high level.



Chinese debt as % of GDP

SOURCE: WORLD BANK, HARTLAND SHIPPING

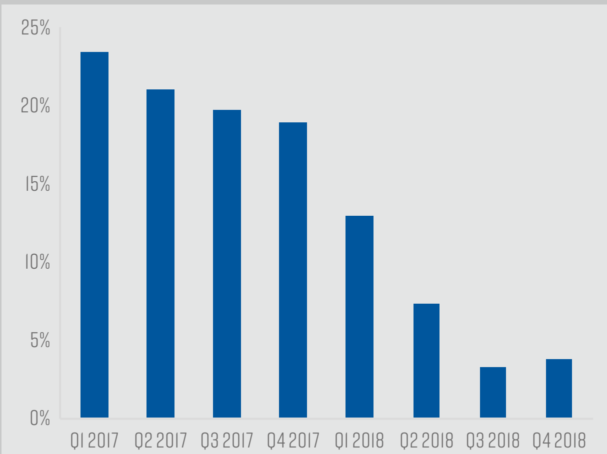
22. Deleveraging slowed fixed asset investment...



China fixed asset investment YoY %

SOURCE: NBS, HARTLAND SHIPPING

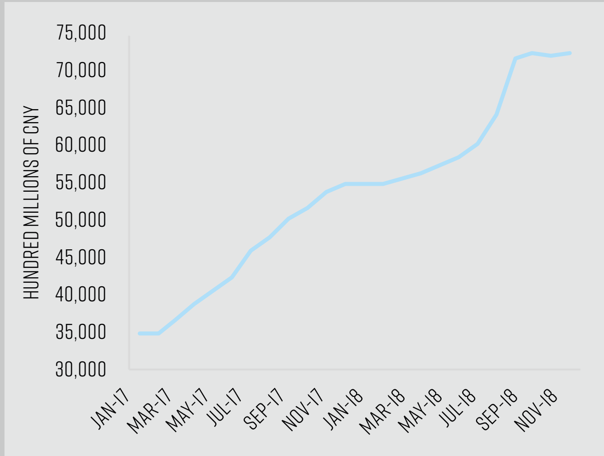
23. ...especially in infrastructure...



China FAI in infrastructure YoY %

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

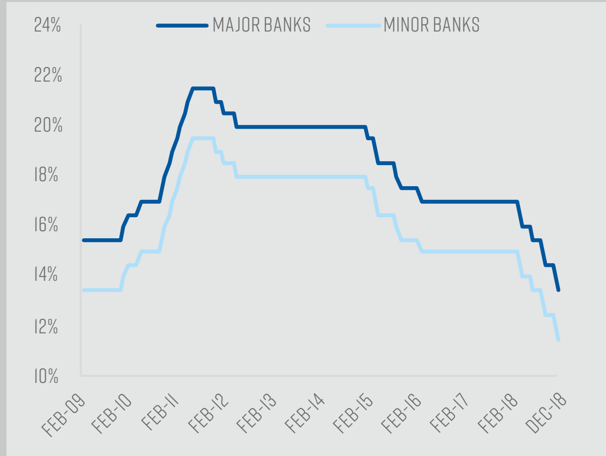
24. ...prompting policy makers to use other means of stimulus...



Chinese local government special bonds issuance

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

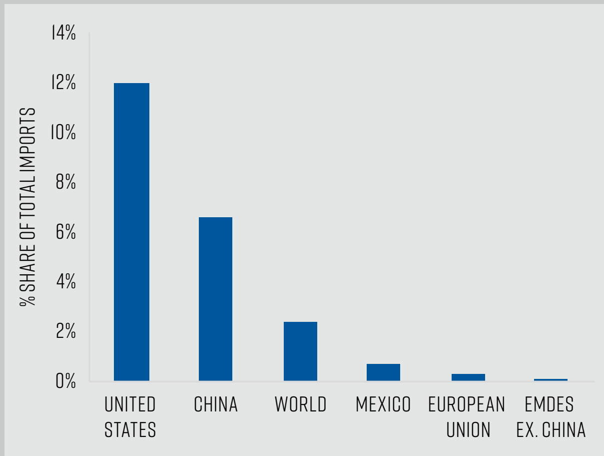
25. ...including local government bonds and lower RRRs.



China required deposit reserve ratio

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

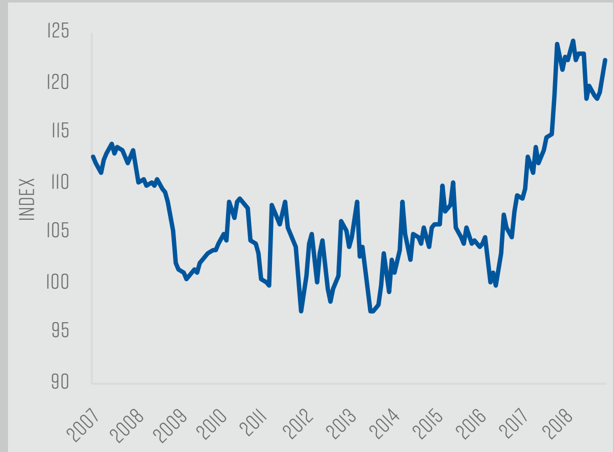
26. The US trade war is adding further stress to the economy...



Share of goods imports affected by new tariffs, 2018

SOURCE: WORLD BANK, HARTLAND SHIPPING

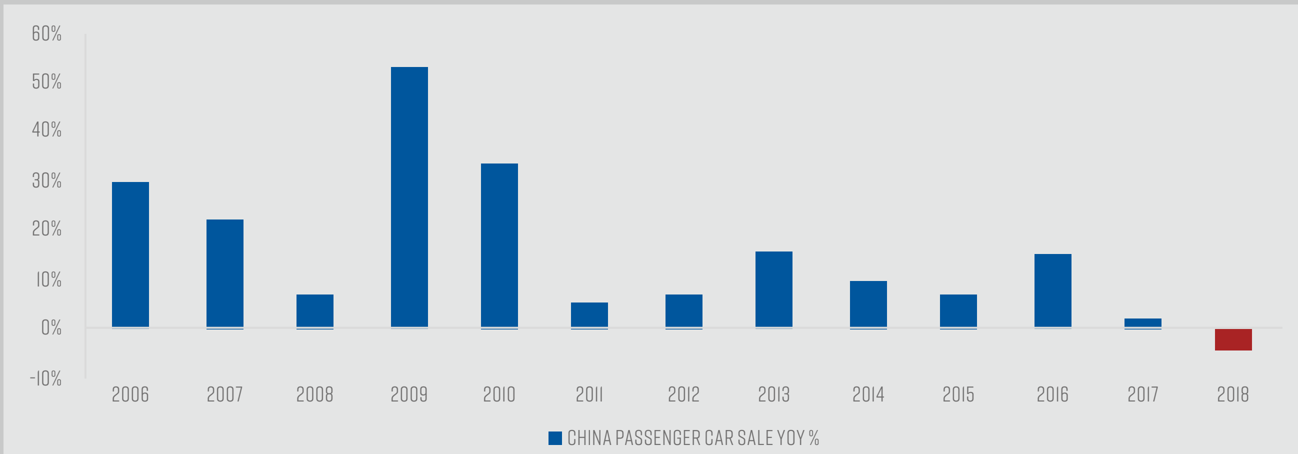
27. ...by undermining domestic sentiment.



China consumer confidence index

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

28. Car sales contracted for the first time in more than 20 years...

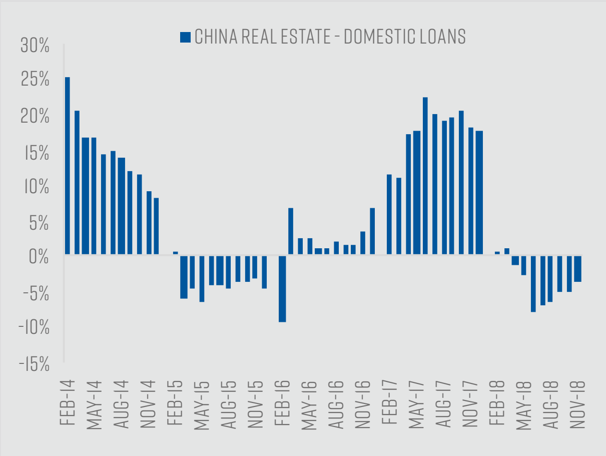


China passenger car sales YoY %

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

* *Core shadow banking items include entrusted loans, trusted loans and undiscounted bankers' acceptance.*

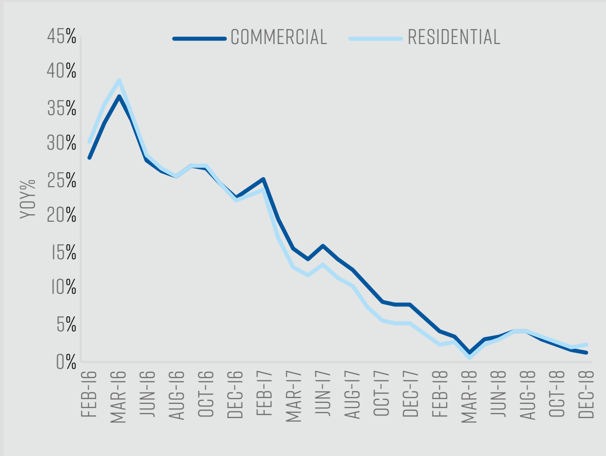
29. ...and the property market is cooling...



China real estate – domestic loans YoY %

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

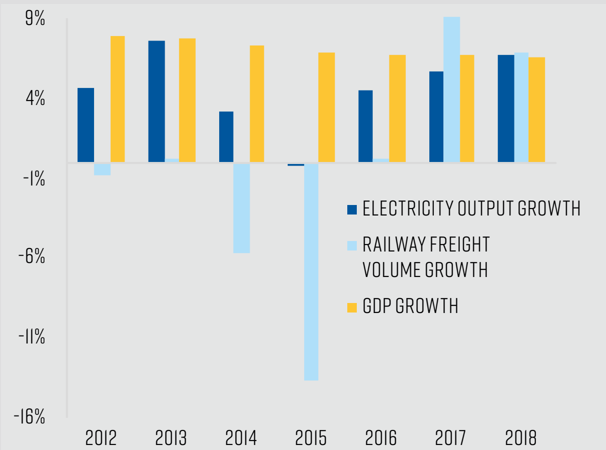
30. ...with falling house sales.



China residential and commercial house sale YoY %

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

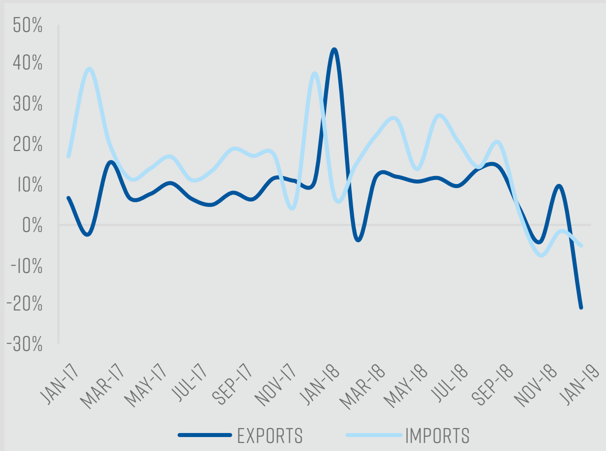
31. Old metrics are still positive but the economy is changing...



Li Keqiang index YoY %

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

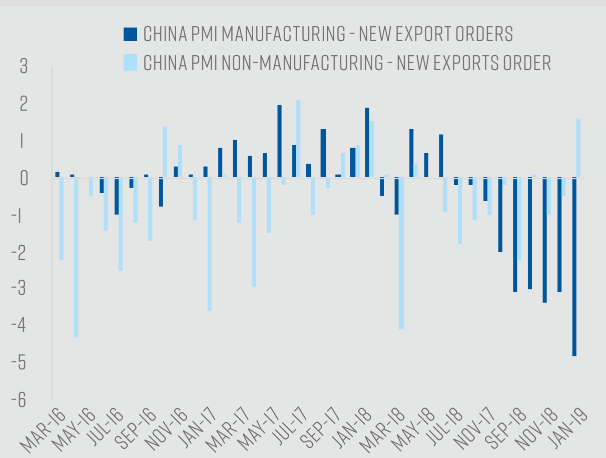
32. ...overall exports & imports dipped sharply in December...



China imports and exports YoY %

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

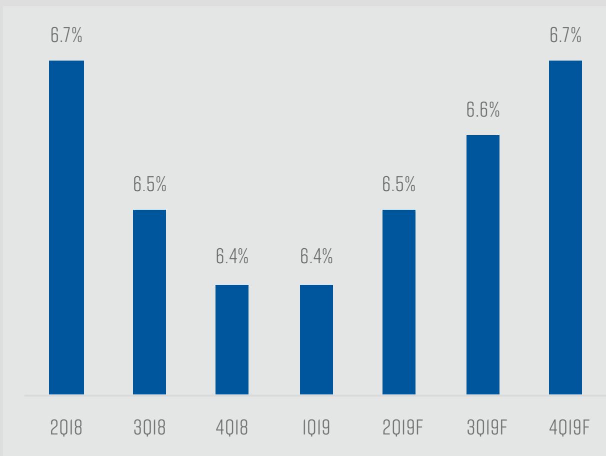
33. ...but supportive policies will be more evident as the year goes on...



China PMI – Contraction or expansion

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

34. ...China has embarked on a choppy start to 2019. Much will depend on the size and effect of further economic stimulus.



China's quarterly GDP growth

SOURCE: HSBC GLOBAL RESEARCH, HARTLAND SHIPPING

Chartbook

This is a brief commentary to the chartbook that gives us a rolling pictorial sequence of how various shipping relevant issues are evolving.

The IMF is forecasting world economic growth to slow from 3.7% in 2018 to 3.5% in 2019 with developed markets slowing from 2.4% to 2.1% and emerging markets holding steady at 4.7%. World trade volumes recovered to a firmer range of 4-5% year-on-year growth in 2017 and 2018 from a weaker range of 2-4% growth over the previous five years from 2012 to 2016. Global and Chinese purchasing managers' indices (PMI) have been in decline since the start of 2018 while global industrial production (IP) and new export orders have been decelerating over the same period. US-China trade wars remain unresolved, although we are hoping that the potentially debilitating effects of escalation should lead to an imminent compromise. In 2017, China imported some $130 billion of goods from the US while the US imported around $505bn of goods from China.

The US has already imposed import tariffs on $250bn of Chinese goods, in two tranches of $50bn and $200bn, leaving another $267bn at risk. Meanwhile, China has retaliated on $110bn of US imports, in two tranches of $50bn and $60bn. China's tariffs are designed to target key Republican and Trump support bases while the US is confident that it can outgun China by imposing duties on the totality of its imports in order to reduce the 2017 $375bn annual trade deficit. So far, this policy has not worked as the US trade deficit with China rose to $419bn in 2018. The fact of voluntarily imposing taxes of US domestic consumers is not a recipe for increasing sales and thus global stock markets sold off last year, with the Chinese indices hit by far the hardest. Given the huge deficit, the Chinese have less scope for retaliation but will rely upon the one-party state and a perceived greater capacity for suffering to square the odds with vulnerable American workers and voters.

Unemployment levels in the US, UK and Eurozone reached their lowest levels in 15 years in 2018 while wage growth has been steadily rising in the 1-3% per year range over the past five years. Inflation expectations across these regions are being revised down, helped by lower oil prices and the prospect of slower global economic growth. The suppression of interest rates through quantitative easing has made borrowing and debt servicing manageable while pushing financial assets higher. This necessary policy remedy has also hurt savers, pensioners and workers who have less bargaining power and lower incomes. Wages are rising but, if core inflation remains at or below central bank targets, then wage growth and returns on savings are likely to continue being constrained. The increasing adoption of robotics, artificial intelligence, part-time and casual working continues to put pressure on labour, making it more of a price-taker rather than a price-maker.

The globally synchronised growth of 2016-17 came to an end in 2018 and now we have more divergent growth paths. US GDP growth rose to 2.9% in 2018 from 2.2% in 2017 while Eurozone growth fell to 1.9% last year from 2.5% in 2017. Chinese growth fell to 6.6% in 2018 from 6.9% in the previous year while the Asia-Pacific weakened to 4.2% last year from 4.5% in 2017. US domestic demand and investment got a boost from $1.5 trillion in tax cuts and the repatriation of overseas corporate profits. This enabled the Federal Reserve to raise rates four times last year on its path to 'normalisation'. The fading effects of the tax cuts have led it to pause its rate rises for now. This is in response to slowing Chinese and global growth, the possibility of escalating US trade tensions with its partners, and rising geopolitical risks as multi-lateralism gives way to nationalism. The ECB and BoJ have either failed or been unable to raise rates and now have little room to cut in the event of a recession.

Resilient US economic performance has seen the dollar strengthen against a basket of currencies putting pressure on emerging markets from the Middle East and Africa to the Asia-Pacific and Latin America that have gorged on US$-denominated debt. Of particular concern is China's structural slowdown as it transitions from state to private, from manufacturing to services, and from heavy polluting industry to less environmentally damaging economic activity. China's GDP growth rate of 6.6% last year was its lowest since 1990 and is set to fall further. Chinese shadow banking has been reined in, total credit is trending down, overseas investment has been drastically reduced and corporate debt has stabilised, albeit at a high level of around 160% of GDP. This deleveraging process caused fixed asset investment to shrink in 2018 and for infrastructure spending to be curtailed.

These have been key growth drivers in previous slowdowns but nowadays such central government spending generates diminishing returns and increased wastage. In response, emphasis has transferred to the regions and local government special bond issuance has increased and the required reserve ratios (RRR) of both major and minor banks have been significantly reduced over the course of last year. Chinese premier Li Keqiang, in his opening address to the National People's Congress in Beijing on 5 March, announced some limited stimulus measures, including tax cuts and spending increases, in an attempt to keep the growth rate above the 6% mark. The threat of escalating US-China trade wars has caused Chinese consumer confidence to wobble as there are unlikely to be any winners if the world's two largest economies continue a policy of raising tit-for-tat tariffs.

Chinese manufacturing and non-manufacturing PMIs indicate year-on-year shrinkage in new export orders in nine months of 2018, possibly reinforcing the observation that stimulus measures are having less effect, and domestic car sales contracted for the first time in more than two decades last year. On top of all this, the normally robust domestic real estate market has witnessed meaningful loan shrinkage in almost every month of 2018 after strong loan growth in every month of 2017. Commercial real estate and residential house sales have been on a declining trend since 2016 and fell to below 5% year-on-year growth in 2018 compared with above 30% in the early months of 2016. Li Keqiang's favourite economic indicators of electricity consumption, rail freight volumes and loans saw the first two go up around 8% year-on-year while loan growth slowed to the tune of around 5% year-on-year in 2018.

The relevance of the Li Keqiang Index is less than before as the economy rotates away from manufacturing and heavy industry towards greater emphasis on consumption and services as rising prosperity changes spending patterns. Xi Jinping's commitment to the largely unreformed state-owned enterprises, at the expense of faster growing private enterprises, represents another possible threat to future growth. A state-controlled economy that directs state-owned capital towards SOEs both at home and abroad shows no vision of a transformed future. It also puts China on collision course with market-based economies in the US, Europe and other Asia. China experienced a sharp dip in exports and imports at the end of 2018 and this continued into Q1 2019. On the bright side, even a partial resolution of the US-China trade spat might reverse these declines and lead to a more imaginative and less confrontational trade policy.

As mentioned earlier, the US-China trade dispute is about much more than tariffs and the yawning US deficit with China. President Trump has made any settlement of the trade dispute conditional upon China ending alleged unfair trade practices, ceasing state subsidies and winding down support of the state-owned enterprises. It amounts to a demand that China changes its economic model, and this is simply not going to happen any time soon, if at all. The US long ago chose a democratic system and an open market economy. 70 years ago China chose a single party autocracy and a closed socialist market economy. The economic systems in each country are wedded to the political systems in each and have become inseparable. The US and China need to deal with tariffs and the trade deficit separately from the much longer term discussion of reforming China's statist economy and mercantilist trade policy.

Shipping and trade will be damaged in the short term if the US and China are unable to come up with a compromise on tariffs and trade. That could serve as a prelude to urging China to continue with past pledges to reform the SOEs and channel more support to China's fast growing but cash-starved private sector. But this does represent a dilemma for China's leadership, as encouraging private enterprise as an engine of future economic growth will inevitably undermine the central control of the Chinese Communist Party. That is why President Xi Jinping prefers the safer route of sticking with the unreformed and inefficient state-owned economy, as it shores up the party and his leadership and contains the ambitions and power of the people.

Finally, we might observe that the Chinese people are beginning to show signs of losing confidence in their political class, just as this is evident abroad in countries ranging from the UK to the US and from France to Germany, and many more besides as dissatisfied populism spreads. President Xi Jinping may have made a strategic mistake in rolling out his 'Made in China 2025' campaign as this was effectively akin to throwing down the gauntlet and challenging the US for world supremacy. This manifesto pledge makes clear that China wishes to close the gap with the US in future technology sectors ranging from aerospace and biotechnology to industrial robots and electric vehicles. In a world where much technology has both military and civilian applications, some in China see such an overt challenge to American supremacy as unnecessary provocation.

President Trump's 'America First' response, dating back about a year ago, was to initiate a US-China trade war as a means of containing China's aspirations, often now perceived as threats. This has put the world's two largest economies at loggerheads. The drift back to supporting state-owned enterprises at the expense of the fast-growth private sector appears to be a retrogressive step. It characterises Mr Xi as more Mao Zedong and less Deng Xiaoping, and as more of a reactionary than a reformer. The US can rightly claim that state subsidies and state-financed companies represent unfair competition in international markets and the US has good reason to hit back at China's aggressive industrial strategy. The US victimisation of Chinese telecoms company Huawei is a good example of how suspicions have risen. It begs the question of just how independent a successful private company can be as it has an overriding obligation to put the state first. It will be instructive to see how the cases of the US government versus Huawei, and vice-versa, are resolved.

Western suspicion of China's overseas expansion, as seen in its annexation of vast swathes of the South China Sea with its nine dash line and its Marco Polo inspired Belt and Road Initiative, will only grow. China's decades of insisting on intellectual property sharing, and an undefined measure of IP theft, have provided every good reason for the US and its allies to push back against the Chinese state on grounds of national security. For this development alone many people would applaud President Trump. The reforms that Mr Trump is insisting upon, such as ending state subsidies and protecting intellectual property rights, might also end up being in the best interests of the Chinese people. He may even transition from being short-term enemy to long-term friend. An economically reformed China, led by a fast-growing and entrepreneurial private sector, will actually be much more of a competitive threat to the US and its allies than an economically unreformed China led by a lumbering and inefficient state-owned sector.

Shipping Markets Outlook
2019 Edition

The Dry Bulk Market

"Rainbow Quest." Image courtesy of Marine Capital

The Dry Bulk Market

In the context of general uncertainty, shipping is involved in a dogged recovery as we move further into 2019, trusting that even tepid demand growth will reward a rare phase of supply discipline.

The broadest barometer of the dry bulk market, the BDI, rose from 1,230 points on 2 January 2018 to 1,271 points by 24 December 2018, representing a miniscule rise of just 41 points, or 3.3%. Naturally, there was plenty of volatility during the course of the year as the market reached a peak of 1,774 points on 24 July before trending back down to the end of the year. In time charter equivalent earnings (TCE), the Baltic's BCI-5TC had capesize average earnings starting the year on $15,125 daily and ending it on $14,797 per day, a 2.2% decline from start to finish. The annual peak was posted on 6 August when the reading was a more respectable $27,283 daily. The same figures for kamsarmax, as defined by the BPI82-TCA, were $11,720 at the start and $12,484 at the end of 2018 with a yearly peak of $16,110 per day on 16 October.

The BSI58-TCA, covering supramax average earnings, started the year on $10,312 per day and ended it 9.1% higher on $11,252 daily having hit its annual peak of $13,431 on 11 October. Finally, the BHSI-TCA, representing average handysize earnings, kicked off the year at $8,924 and ended it on $8,636 per day, some 3.2% lower, having hit a yearly peak of $9,772 daily on 25 October. All four indices suffered a weak finish to 2018 followed by a poor start to 2019. Thankfully, an abysmal January was at least followed by a bounce back in February for all segments, apart from capesize, but we are still well down on start year levels. Capesize started 2019 on $15,344 only to fall to an annual low of $4,236 per day on 8 March followed by a welcome turn back up to $6,387 by 15 March. Kamsarmax average earnings started the year on $12,243 before falling to a low of $5,898 on 5 February and then pulling back to $8,876 daily by 15 March. The supramax average started 2019 at $11,141 before dropping to a low of $4,837 on 6 February and then recovering back to $8,709 per day by 15 March. The same figures for the smaller handysize were $8,524 at the start to a low of $4,198 on 7 February and then back up to $6,437 per day by 15 March.

The best gain in earnings was back in 2017…

The above Baltic Exchange data illustrates start year, peak year and end year average earnings in 2018 in each main segment, followed by a dispiriting performance in Q1 2019, although these were all on the turn back up by mid March. Average annual earnings are a little more uplifting as they still manage to show a gently improving trend across the entire bulk carrier sector, but they also demonstrate that most of the big gains were booked the previous year in 2017. In 2017, average earnings for a modern capesize were up 123% year-on-year from $6,035 to $13,475 daily whereas, in 2018, they were up only 4% to $14,026 per day. Average earnings for a modern panamax rose almost 58% year-on-year in 2017 from $6,712 to $10,570 per day and, in 2018, they increased a further 22% to $12,866 daily. This trend was repeated further down the size scale with average earnings for a modern supramax rising 69 % year-on-year in 2017 from $6,264 to $10,590 per day but, in 2018, managing only an incremental 14% rise to $12,112 daily.

Baltic FFAs – a good buy?

The Baltic Exchange Forward Freight Assessments do little to create positive expectations. Based upon the 15 March readings for a modern 180,000-dwt capesize, the 5TC average was set at $8,688 in 2Q19, $12,633 in 3Q19 and $16,083 in 4Q19. Going forward to the annual FFAs, on 15 March the figures were $12,988 for Cal 20, $12,208 for Cal 21, $12,200 for Cal 22, $12,575 for Cal 23, $13,458 for Cal 24, $13,650 for Cal 25 and $13,767 for Cal 26. Given widespread expectations of better supply-demand balance and rate recovery ahead, one can imagine that these low numbers may send out a strong buy signal to those who trade paper, as forward cover looks cheap. At the other end of the size scale, the same might be said of the Baltic Forward Assessments for a 58,000-dwt supramax. On 15 March, the 10TCS-FFA stood at $9,825 for 2Q19, $10,629 for 3Q19 and $11,238 for 4Q19. Forward cover could be bought at $9,788 for Cal 20, $9,108 for Cal 21, $8,592 for Cal 22, $8,163 for Cal 23, and at $8,263 for Cal 24, Cal 25 and Cal 26. There is not much evidence of the anticipated recovery in these forward freight assessments.

Since the bottom of the bulk carrier slump in early 2016, newbuilding prices have risen in line with increased input costs. Along with regulatory confusion, this has fortunately acted as a deterrent to new vessel contracting and rendered the secondhand marketplace a better hunting ground.

Baltic SPAs – slower asset value appreciation in 2018

Baltic Exchange data for 5-year old bulk carriers shows minor gains in asset values in the 12-month period between 2 Jan 2018 and 2 Jan 2019. This is a reflection of the murky economic, trade and geopolitical backdrop and lower growth in spot market earnings in 2018. A 180,000-dwt capesize was up 8.2% from $32.8m to $35.5m in 2018. This was a relatively gentle gain compared to the 46.4% rise over the previous 12-month period from $22.4m in early January 2017. A 74,000-dwt panamax was up 5.3% from $20.5m to $21.6m. This compared with a 48.6% gain from $13.8m over the previous 12 months. Finally, a 58,000-dwt supramax was up 5.8% from $17.3m to $18.3m. Over the previous 12-month period, spanning 2017, the nominal value had risen 26.3% from $13.7m. Hence, the strong value gains of 2017 gave way to much slower asset value appreciation over 2018 reflecting the deceleration of gains in average earnings.

S&P activity snapshot in 2018

The index gain over the course of 2018 for a 5-year old capesize was modest at 8.2% and actual sales seemed to bear this out. In the case of elderly Japanese-built capes, in early January, the Kerkis 177,489 2006 was reported as sold for $22.5m and, by early August, a sister ship the Royal Chorale 177,544 Mitsui 2006 was reported at the same price. In late August, the NSS Grandeur 176,882 Mitsui 2006 was reported at a slightly lower $22.0m and, in mid September, the larger Cape Dover 185,805 Kawasaki 2006 was reported sold for a slightly higher $23.0m. There was not much movement in prices in the first nine months of the year and then, in late October, the one year younger Pacific Explorer 177,456 Mitsui 2007 was reported at a lower $21.0m. There have been no reported sales of capes of this popular vintage since then.

In early December last year, Unisea was reported as the purchaser of two modern Hyundai-built capes from PIL for $33.0m each. They were the Shagang Hongfa 179,461 HHI 2011 and the Shagang Hongchang 179,469 HHI 2011. Back in late May, the New Mighty 179,851 HHIC-Subic 2011 was reported at a much lower $27.5m, the difference accounted for by a weaker market and a Philippine discount for the Hanjin Subic facility. Star Bulk was on the acquisition trail in 2018 with purchases of the mini-capes, conventional capes and kamsarmax sizes from Augustea, Songa and E.R. Schiffahrt. The latter late August purchase involved six 179,000-dwt capesize units that delivered from Korean-controlled yards (HHI, Hyundai Samho and Daewoo Mangalia) in 2010, in a cash and shares deal.

The index rise for a 5-year old panamax rose only 5.4% during 2018 and sales basically reflected this rather flat change in values. In the kamsarmax segment, the difference

in perceived quality between Asian shipbuilding nations was illustrated in reported transactions. In late January, the Key Spring 80,596 Universal 2012 was mentioned as having been sold for $22.5m while two months later, in early March, the Sea Ace 81,755 Longxue 2012 was reported at a much lower price of $18.5m. That set an indicative $4m, or 22%, premium for Japanese over Chinese built. By end October, the Korean-built Prime Lily 81,507 SPP 2012 was reported at an inbetween price of $20.5m, inserting the Korean-built at the midway point between Japanese and Chinese.

Sales of 10 to 15-year old conventional panamax tonnage revealed inconsistent pricing. In early February, the Drake 76,781 Sasebo 2006 was reported sold for $13.6m and in, mid April, the one year older DR Bravo 76,806 Sasebo 2005 was reported at $12.6m. Towards the end of July, the two year younger Lady Maria Ocean 76,662 Imabari 2007 was mentioned as being sold for a disappointing $13.0m. By early October, the Double Prosperity 76,633 Imabari 2005 was reported at the low level of $10.6m. Star Bulk also picked up tonnage in this segment of the market alongside its capesize acquisitions. As part of the Augustea deal, it scooped up three 92,000-dwt post-panamax and five 82,000-dwt kamsarmax. They all delivered from top Japanese and Korean shipyards between 2010 and 2017. As part of the Songa deal, it took over control of ten 80,000 to 83,000-dwt kamsarmax. They all delivered from top Japanese and Korean yards between 2008 and 2014.

The 2018 Baltic index gain for a 5-year old supramax was only 5.8% and, once again, this was broadly backed up by actual sales in the marketplace during the year. There were plenty of sales of this class in 2018 and 10-year old 56,000-dwt units built at Japanese controlled yards proved popular. In mid January, the Poseidon SW 55,688 Oshima 2008 was reported sold for $12.5m whereas, by mid July, the Navios Armonia 55,522 Kawasaki 2008 was reported done at a stronger $14.2m. By Mid November, the market had eased off a bit and the Gemini Pioneer 55,624 Mitsui 2008 was reported sold for $13.6m. It was a similar pattern for satellite Japanese shipyards as, in early February, the Angel B 58,679 Tsuneishi Cebu 2008 was reported at $14.2m and then, by late July, the Tschaikowsky 58,790 Tsuneishi Cebu 2008 was reportedly done at $14.0m. By early October, the Medi Firenze 58,722 Tsuneishi Cebu 2008 was said to have gone for a lower price of $13.0m.

There are always good reasons for differences in selling prices ranging from condition and equipment to survey status and market timing. The supramax second-hand market lost momentum in the second half of 2018 and actually declined in Q1 2019. The ships are of course one year older after we have moved into the new year of 2019 but, when combined with a falling market, the change in values can be quite severe. In mid February, the Alster Bay 55,430 Kawasaki 2008 was reported sold for $12.0m which is $1.6m lower than the report of the Gemini Pioneer above. Scroll forward to mid March and the Nord Express 58,785 Tsuneishi Cebu 2007 was reported sold for $11.0m, quite a low price but maybe reflective of being one year older than the above reports and sold into a weakening market with poor sentiment.

Dry bulk supply-demand balance

According to SIN macro data, in 2018, the bulk carrier fleet expanded by just 2.9% from 817.4m-dwt to 841.2m-dwt while total dry bulk trade rose by 2.3% in absolute terms and by 2.7% in tonne mile terms. In other words, supply growth was just ahead of demand growth in 2018. This year, a delivery schedule of 42.4m-dwt indicates maximum fleet growth of 5.0%, but this will dwindle with demolition and slippage. Dry bulk trade is forecast to expand by 2.3% in absolute terms and by 3.1% in tonne mile terms in 2019. If these numbers prove to be correct then we should see another year of earnings growth and asset value gains, with much of this postponed until the second half of the year. The total bulk carrier order book is 88.5m-dwt, or 10.5% of the fleet, its lowest ratio since 2002. The largest bulk carriers are set to see the greatest fleet growth while medium and smaller sizes will see more modest expansion. A return to better supply and demand balance is essential, but we should not forget that supply growth exceeded demand growth for many years in the last decade, meaning that we have embedded oversupply.

Interesting changes are evident in the demand side as we face declining growth in major bulks and rising growth in minor bulks. The former might be correlated with old school industrial production, as they are dominated by iron ore and coal, while the latter are usually considered to be better correlated with overall GDP growth.

Brazil and China hold key to demand

On the demand side, the greatest threats to growth are US-China trade relations and the slowing global economy. The iron ore trade is critical to the bulk carrier sector as it sets the tone from the top down. Monthly imports in the final quarter of 2018 were subdued, with 86.7mt in December after 86.3mt in November and 88.4mt in October. The 2018 Chinese iron ore import tally was 1,064 billion tonnes, down just over 1% from the 2017 annual record of 1,075bt, the first annual decline since 2010, according to the General Administration of Customs. Chinese steel exports continue to fall as US import tariffs bite and competition from India, Russia and Turkey takes its toll. Steel mills will resort to stock drawdown and to taking lower grades of iron ore to rescue profit margins, which fell 70% in 4Q18. In 2019, Chinese steel output is set to decline on waning domestic and international demand. The tragic dam rupture on 25 January at Vale's Corrego de Feijao iron ore mine, above Brumadinho in Minas Gerais, has cost over 300 lives making it the worst environmental accident in Brazil's history. This event reinforced negative sentiment in the dry bulk sector in the first quarter.

Vale's problems

Vale announced its intention to decommission ten similar dams over a 3-year period at an estimated cost of $1.3bn. Nine other such upstream dams had already been completely decommissioned since the Samarco Mariana dam accident in November 2015. On a phased basis, the latest announcement will involve taking off line some 40mt, or about 10%, of Vale's current annual production. The loss to the seaborne iron ore spot market would be significant, as 40mt represents two-thirds of the 60mt per year that is exported from Brazil on a spot, uncontracted basis. This is estimated to equate to around 65 standard 180,000-dwt capesize Brazil-Far East round voyages. However, one must account for phasing and also for new and restarted output from other domestic mines. Vale modestly estimates that its S11D mine will raise output by 15mt this year while another 10mt of iron ore that was to be feedstock for 11mt of pellets will now be exported as fines. This still leaves it 15mt down, but this amount can be covered in the export market by last December's restart of Anglo American's Minas Rio mine. It closed early last year to fix two pipeline leaks and managed only 3.4mt of exports in 2018 after 17mt in 2017. In 2019, it should recover to 19mt, leading to a 15.6mt gain over 2018.

The dire predictions of cargo being lost to the largest bulk carrier segments seemed to be a bit overdone and knee-jerk at the time. But the news did hit sentiment hard when combined with various other factors. In early February, the situation grew even murkier as a Brazilian court ordered that use of the Laranjeiras dam at Vale's Brucutu mine in Minas Gerais be halted, potentially affecting 30mt of annual production. Within days the mine's operating licence was revoked. This was indeed a more serious situation than originally envisaged. It sent the share prices of competing miners such as BHP and Rio soaring, and iron ore prices were firming up even as steel prices remained flat. Part of the reason for such a poor start to the 2019 capesize market has been the tendency for Chinese steel mills to draw down cheaper and lower quality port inventories that have been very large. They hit a 2018 peak of 162mt in early June 2018, before falling back to an annual low of 137mt at end 2018, and then recovered to 145mt by end February 2019. This process has been reinforced by the rising price of iron ore, flat steel prices and an uncertain demand outlook. The substitution of high Fe iron from Brazil with lower Fe iron from Australia translates into a loss of tonne miles. The potential drop off in seaborne iron ore trade was making a bad situation even worse for capes. Then, on 19 March, Vale announced that the Brucutu suspension was soon to end, ushering in a possible reprieve for capesize.

Global seaborne iron ore trade

It is worth taking a look at the global prospects for the seaborne iron ore trade. The most recent February 2019 Dry Bulk Trade Outlook contains updated estimates for total seaborne iron ore trade and this latest version involves quite considerable downgrades from January. It stood at 1,473mt in 2017 (up 3.9% year-on-year); 1,473mt in 2018 (no change); 1,480mt in 2019 (up 0.5%) and at 1,501mt in 2020 (up 1.4%). This represents three consecutive years of flat growth from 2017. Brazil's seaborne iron ore exports have been revised down to take into account Vale's production problems, mitigated slightly by new projects that it has coming on stream. In rounded numbers, its exports stood at 380mt in 2017 (+2.7%) and are estimated to have risen to 388mt in 2018 (+2.0%). They are forecast to fall to 370mt in 2019 (-4.6%), down from 406mt in January, and recover to 397mt in 2020 (+7.4%), down from 416mt in January. Finally, China's seaborne iron ore imports are showing signs of slowing down according to latest estimates: 1,058mt in 2017 (+5.0%); 1,047mt in 2018 (-1.1%); 1,048mt in 2019 (+0.1%) and 1,059mt in 2020 (+1.0%). The 1.1% decline in 2018 can be attributed to heavy port inventory drawdown, increased use of steel scrap and a general economic growth slowdown. Going forward, the risk is that demand for iron ore and steel will plateau as growth slows in a transitioning economy.

Other major dry bulk trades

The grains and oilseeds trades have been affected by the ongoing and unresolved US-China trade dispute. In retaliation, China imposed 25% import duties on US soybeans and looked to buy replacement supplies from Brazil and other beans, processed soy oil and soybean meal from Argentina. The ravages of African swine fever across China's provinces have resulted in a massive pig cull which also dented import demand for soybeans and soybean meal. In rounded numbers, Chinese soybean imports fell over 7% year-on-year from 95mt in 2017 to 88mt in 2018 and, in the month of January of this year, such trade fell by 13% year-on-year to around 7.5mt. In full year 2019, China's soybean imports are forecast to rebound by over 5% to 93mt, which will be slightly down on 2017 levels. Recently announced Chinese purchases of soybeans, of up to 10mt or so, are probably purchases by state buyers for inventory building, and thus excluded from the 25% import tariff. Overall global seaborne trade in soybeans is expected to recover about 6% to 158mt in 2019 after around only 2% growth in 2018. Total world seaborne trade in grains (soybeans, wheat, corn, barley, sorghum, oats and rye) was flat at 477mt year-on-year in 2018 and is forecast to rise 4% to 496mt in 2019 and by 3% to 511mt in 2020.

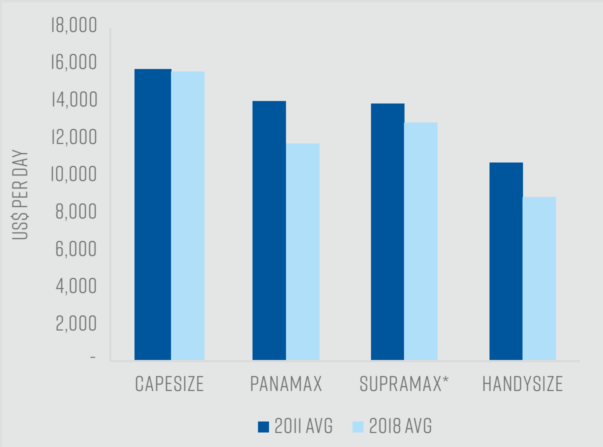
The global oilseed trade is proving to be surprisingly fungible with China able to buy non-US origin soybeans from Brazil and Argentina and other places such as Canada and the Ukraine. Canada processes and consumes its own crop but this year it has taken advantage of higher prices in China to export some of its beans to China while importing cheaper US beans for its crushers in an opportunistic price arbitrage. The global seaborne grains trade, at around 500mt a year, is not as significant as iron ore or coal. The global seaborne trade in coal rose over 3% year-on-year in 2018 to 1,240mt and is forecast to expand by almost 2% in 2019 to 1,264mt and by another 1.5% in 2020 to 1,283mt. Estimates and forecasts of China's seaborne coking coal imports are flat at around 36mt in 2018 (down 16% on 2017's 43mt) rising only marginally to 36.5mt in 2019 and 2020. The same numbers for seaborne thermal coal are 191mt in 2018 (which was up 10% year-on-year) falling to 184mt in 2019 (-4%) and 176mt in 2020 (-4%). Falling Chinese coal imports would seem to be consistent with declining industrial output, as the government tackles overcapacity and pollution, and a slowing economy.

In contrast, India's seaborne thermal coal imports are rising with an estimate of 161mt in 2018 (up 7% year-on-year) rising to 170mt in 2019 (+5%) and to 175mt in 2020 (+3%). Japanese and South Korean seaborne thermal coal imports are quite flat over the 2018 to 2020 period averaging about 131mt and 117mt a year respectively, thus they are unable to compensate for China's retreat. During this 3-year period, Japan's seaborne coking coal imports are expected to be flat at about 55mt a year while South Korea's are estimated to be constant at around 25mt a year. Indian coking coal imports by sea, in contrast, are estimated at 60mt in 2018 (+14% year-on-year), rising to 63mt in 2019 (+6%) and to 66mt in 2020 (+5%). At a time of slowing demand in China, it is encouraging to see that India is generating extra demand that partially compensates for China's loss.

Dry Bulk Market

- The capesize segment has delinked from the others as Vale's production problems, and other supply interruptions, have temporarily cut seaborne iron ore supplies.
- Sentiment was poorly affected in the first quarter of this year but, by the second half of 2019, better supply and demand fundamentals should assert themselves.
- We continue to believe that IMO 2020 and other regulations will further cut effective tonnage supply through a combination of rising scrapping and slower steaming.

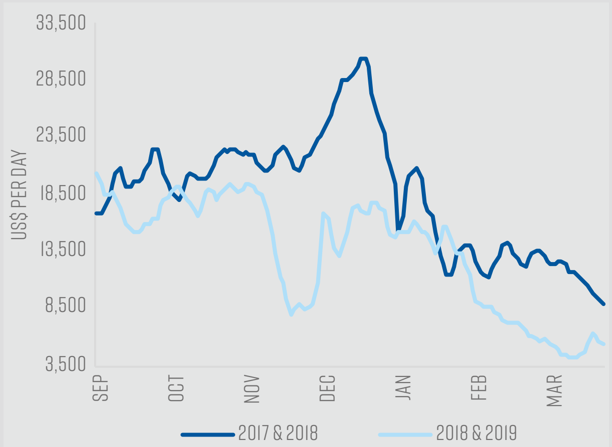
1. Average earnings enjoyed their best year since 2011...



Average earnings comparison by segment type

SOURCE: BALTIC EXCHANGE, HARTLAND SHIPPING

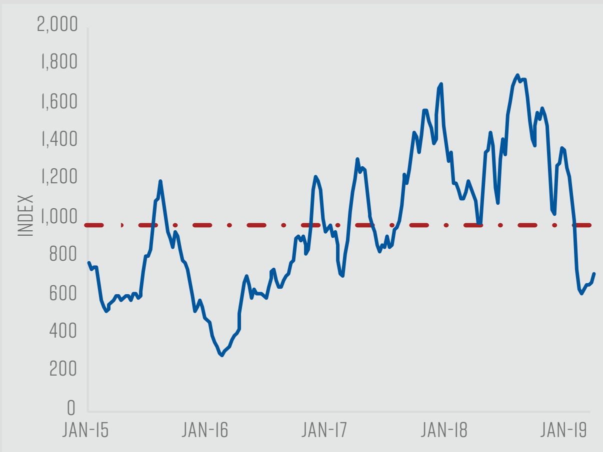
2. ...but capes did badly in Q4 2018, and even worse in Q1 2019



Capesize earnings in the Sep–Mar period by comparison

SOURCE: BALTIC EXCHANGE, HARTLAND SHIPPING

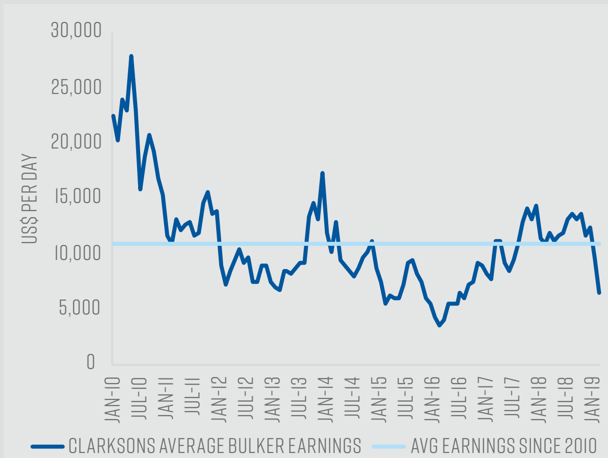
3. The BDI stayed above 1,000 points for most of last year...



Baltic Dry Index

SOURCE: BALTIC EXCHANGE, HARTLAND SHIPPING

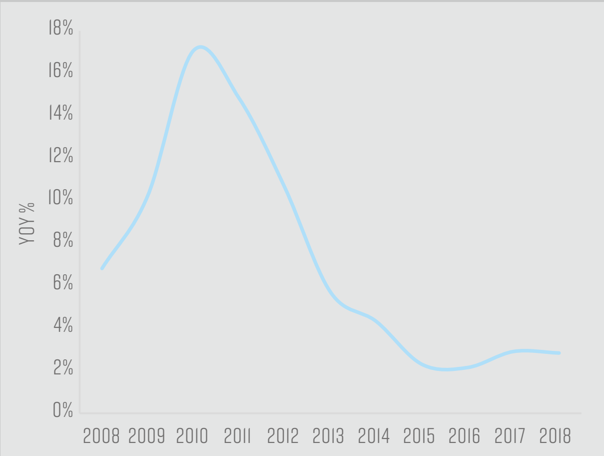
4. ...but upside earning potential became restrained by...



Average monthly bulker earnings

SOURCE: CRS, HARTLAND SHIPPING

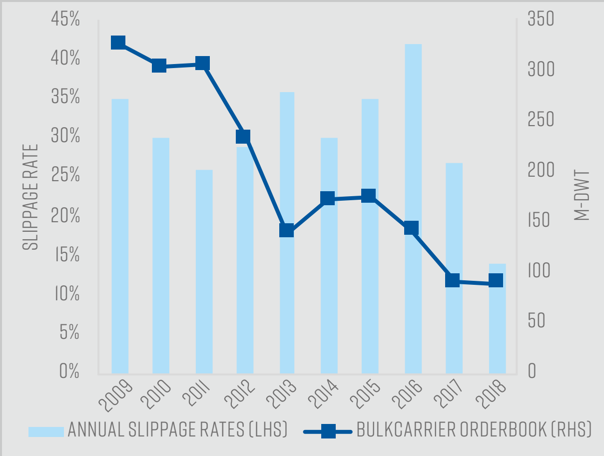
5. ...faster than expected fleet growth...



Bulkcarrier annual fleet development

SOURCE: CRS, HARTLAND SHIPPING

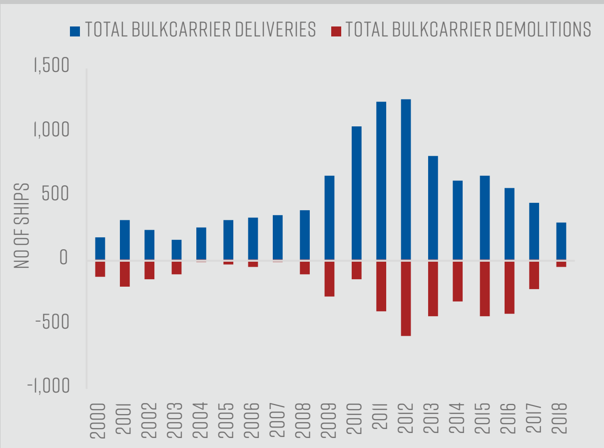
6. ...on the back of falling slippage rates.



Bulkcarrier annual slippage and orderbook

SOURCE: CRS, HARTLAND SHIPPING

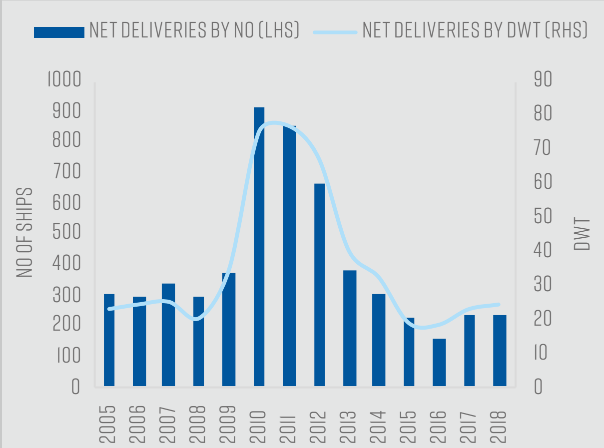
7. We had fewer deliveries, but also much less demolition.



Bulkcarrier deliveries and demolitions

SOURCE: CRS, HARTLAND SHIPPING

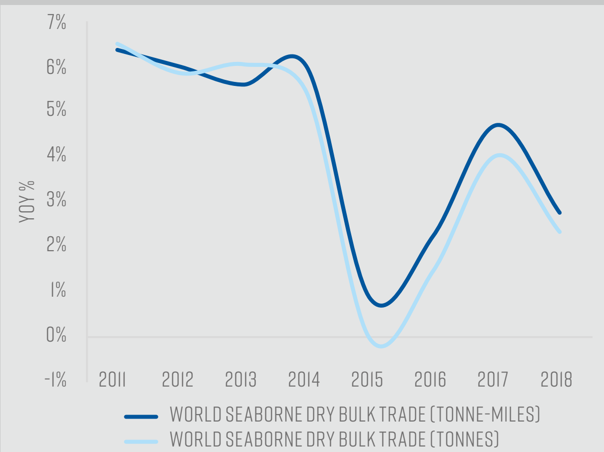
8. Therefore net deliveries were on par with 2017...



Bulkcarrier net deliveries

SOURCE: CRS, HARTLAND SHIPPING

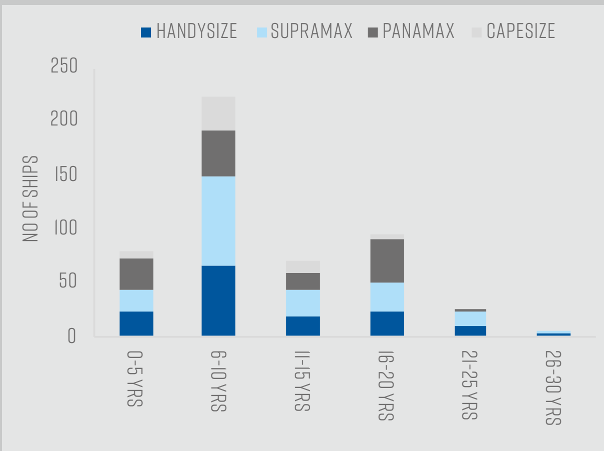
9. ...while seaborne trade growth expanded at a slower pace.



Drybulk seaborne trade growth

SOURCE: CRS, HARTLAND SHIPPING

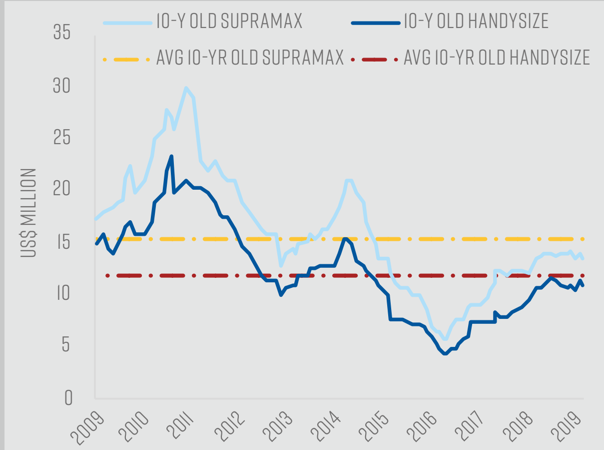
10. Middle-aged Handysize and Supramax were popular...



Bulkcarrier second-hand sales by segment and age range

SOURCE: CRS, HARTLAND SHIPPING

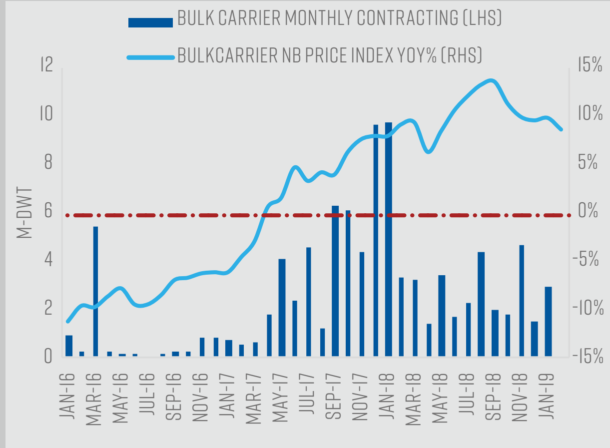
11. ...helping to push values close to their post GFC average.



Supramax and Handysize 10-year old values

SOURCE: HARTLAND SHIPPING

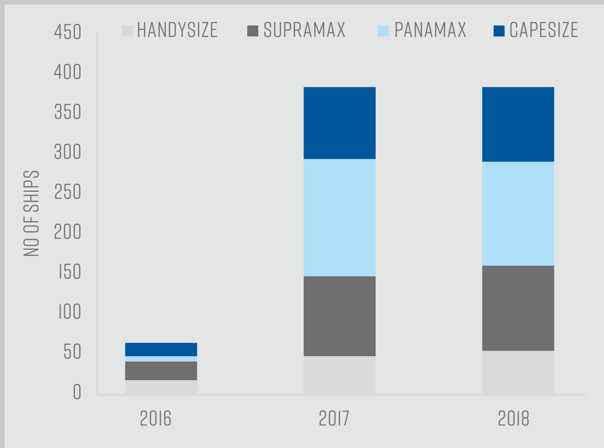
12. Higher NB prices terminated strong ordering of Q1 2018.



Bulkcarrier monthly contracting and newbuilding price index

SOURCE: CRS, HARTLAND SHIPPING

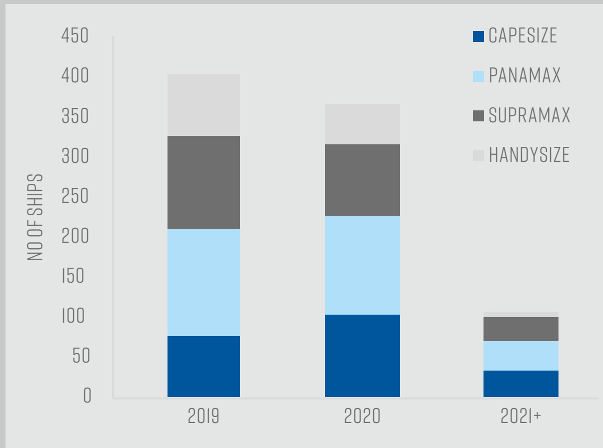
13. This resulted in slightly fewer orders when compared to 2017...



Bulkcarrier contracting

SOURCE: CRS, HARTLAND SHIPPING

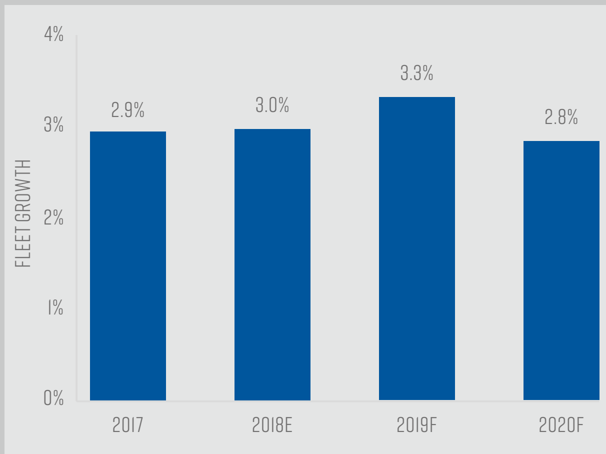
14. ...and the delivery schedule over the next two years...



Drybulk orderbook delivery schedule

SOURCE: CRS, HARTLAND SHIPPING

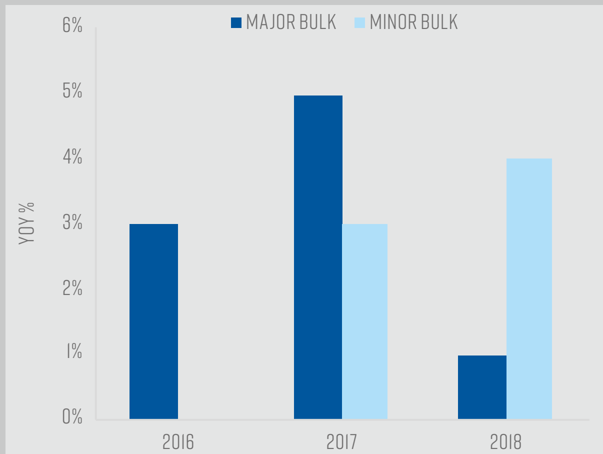
15. ...suggests that fleet growth will be above 3% this year.



Drybulk fleet growth

SOURCE: CRS, HARTLAND SHIPPING

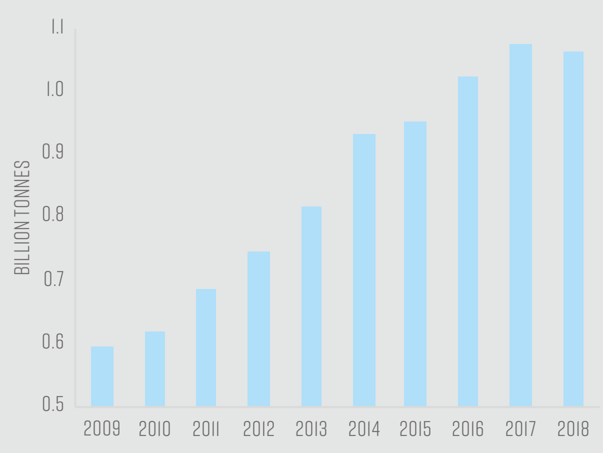
16. 2018's demand growth was dominated by minor bulks.



Drybulk seaborne trade growth

SOURCE: CRS, HARTLAND SHIPPING

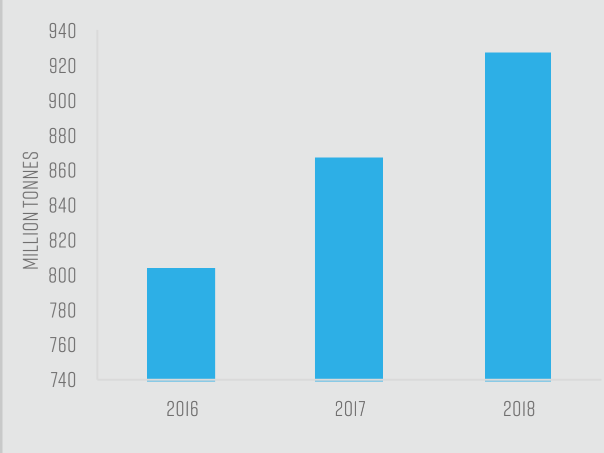
17. Iron ore imports peaked in 2017 but 2018 still over 1bt.



China annual iron ore imports

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

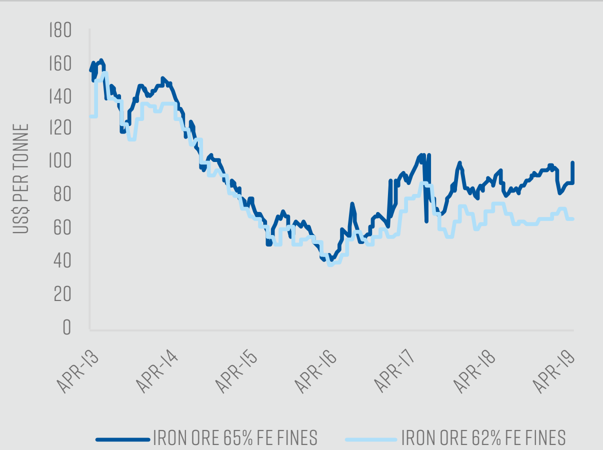
18. Despite this, steel production reached another record...



China annual crude steel production

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

19. ...as China raised use of higher grades and steel scrap...



Iron ore prices

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

20. ...as well as drawing down its iron ore port stocks.

China iron ore inventories

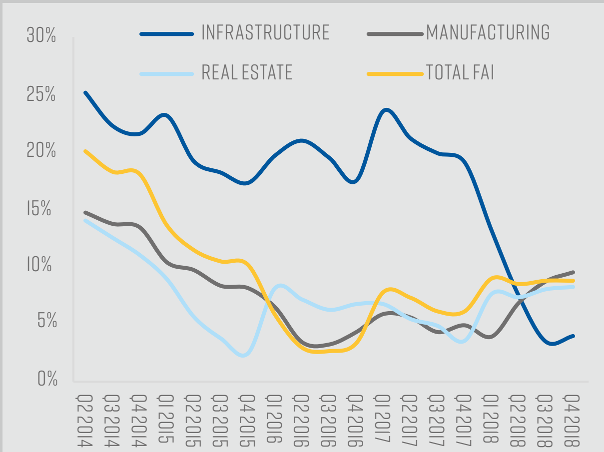
SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

21. Steel mill margins being squeezed by higher ore prices...

Iron ore prices

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

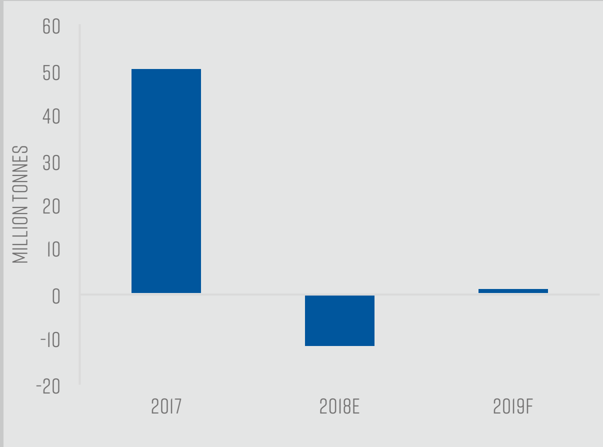
22. ...and uncertainty about the size of future stimulus...



China fixed asset investment YoY % growth

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

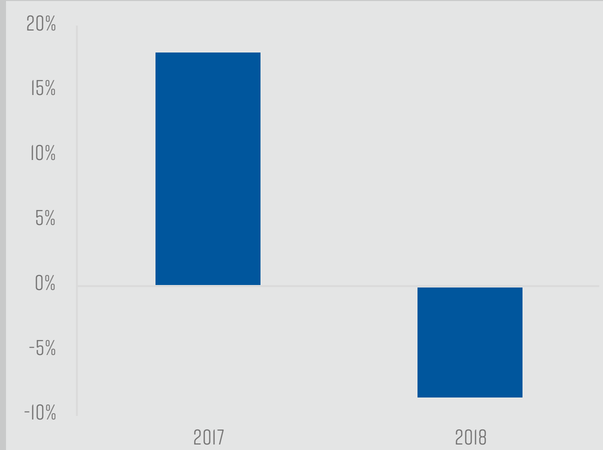
23. ...leaves little room for more import demand this year.



China iron ore incremental imports

SOURCE: CRS, HARTLAND SHIPPING

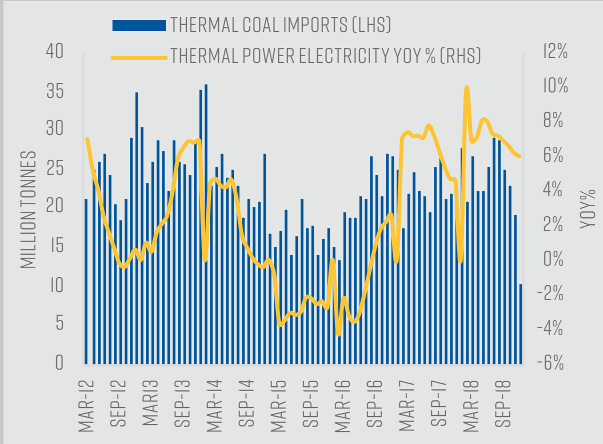
24. Low steel prices and winter cuts reduced coking coal imports...



China coking coal imports YoY%

SOURCE: CRS, HARTLAND SHIPPING

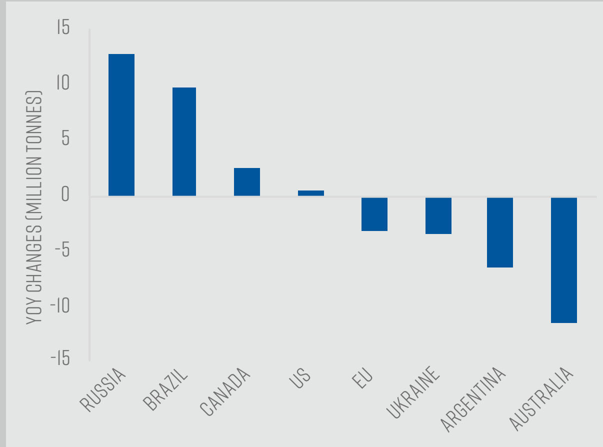
25. ...while thermal coal imports rose on higher electricity use.



China thermal coal imports and electricity consumption

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

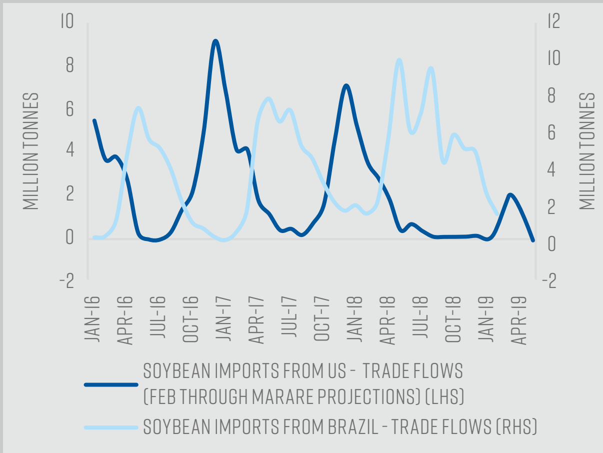
26. Grain exports stayed flat last year on a net basis...



2018 Grain exports, main changes by country

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

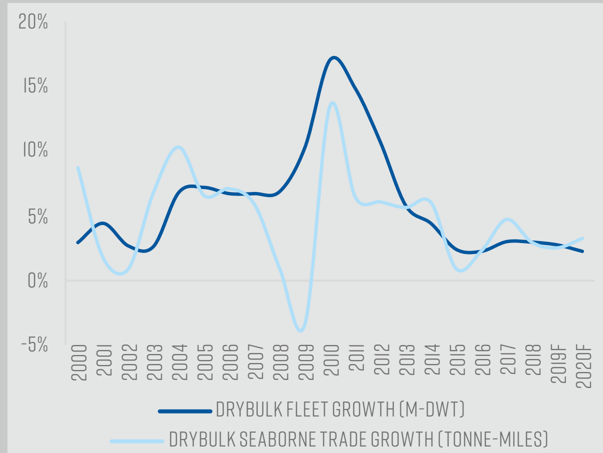
27. ...while trade wars upset seasonal export flows.



China soybean imports from US and Brazil

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

28. Nonetheless, supply and demand are coming into better balance!



Drybulk supply & demand balance

SOURCE: CRS, HARTLAND SHIPPING

Chartbook

In our chartbook we can see in graphic terms how the dry bulk sector has performed in recent years, thus providing some context for this year and last.

Bulk carrier earnings have been slow to pick up but they are improving nonetheless. In fact, average earnings across the bulk carrier sector in 2018 were the best since 2011, albeit still below 2011 levels in each segment. Capesize averaged $15,465 daily in 2018, just behind the $15,639 per day that they earned in 2011. Panamax were at $11,654 daily in 2018 compared with $14,000 per day in 2011; supramax were at $12,783 versus $13,814 and handysize were at $8,700 compared with $10,552 per day. We still have a way to go to get back even to 2011 average earnings. However, capesize were not so far behind 2011 and would have exceeded those levels but for a disappointing performance over the past six months. On 8 March, the BCI-5TC sunk to a 2019 annual low of $4,236 per day but has since begun a tentative recovery.

A more generic measurement is the Baltic Dry Index. The BDI averaged 1,353 points in 2018, 18% up on the 1,145 point reading of 2017, and its best year since 2011 when it averaged 1,549 points. This year we have unexpectedly hit the doldrums with the BDI plunging to a 2019 low of 595 points on 11 February. Everyone had expected a bounce following Chinese New Year but it has not been forthcoming. Mining problems in Brazil and the shadow cast by the unresolved US-China trade wars are damaging to both trade volumes and sentiment. Looking further back, we have witnessed steady improvements since the beginning of 2016 when the BDI sank to an all-time low of 290 points on 10 February. Average bulk carrier earnings recovered from a low of $3,636 daily in February 2016 to an interim high of $14,297 per day in December 2017. In February 2019, we found ourselves back down to $6,637 daily and wondering when the improving supply-demand dynamics would kick in, overwhelm any negative sentiment, and finally take rates higher.

Fleet development in the bulk carrier sector has slowed in recent years but has yet to recover from the excesses of the 2004 to 2008 period. The over-ordering of those years was drip-fed into the market over the following five years or more, even after cancellations and conversions, and this still proved to be too much for demand growth to contend with. From 2004 to 2008, year-on-year fleet growth was running at between 6% and 7% a year, after which it accelerated. In 2009, it rose by over 10%, in 2010 by 17%, in 2011 by close to 11%, and in 2012 by over 10%. By the end of 2012 the fleet was close to 688mt-dwt. Since 2012, we have seen a slower rate of year-on-year fleet growth as market forces have reduced new supply and helped to compensate for chronic embedded oversupply. Besides, owners had little money to spend and banks little appetite to lend. The growth rate subsequently slipped to below 6% in 2013, to just over 4% in 2014 and then to between 2% and 3% in the following years to end 2018. The end 2018 fleet stood at just under 841mt-dwt.

The bulk carrier orderbook has progressively fallen since the 2008 market crash, although delivery slippage rates have remained high and volatile until quite recently. Slippage includes ghost orders, miscounted options, cancellations, default, negotiated delays and non-negotiated delays. This process creates a lot of uncertainty over future supply growth but, as time passes and more ships deliver, the actual situation becomes clearer. The bulk carrier orderbook has fallen from 326mt-dwt at the start of 2009 to 91mt-dwt at the beginning of 2019 while bulk carrier annual slippage rates, expressed as a percentage of the overall orderbook, averaged around 30% in the years between 2009 and 2015. The very poor market of 2016 saw the slippage rate spike up to 42%, as owners succeeded in stalling deliveries from the shipyards, before falling back to 27% in 2017 and 14% in 2018.

Since 2008, bulk carrier deliveries hit a peak in 2012 of 1,253 units totalling 100.7mt-dwt. 2012 was also the peak demolition year with 590 units of 33.4mt-dwt leaving the fleet. Market conditions dictated that as more new ships delivered more old ships had to make way. By 2018, deliveries had sunk to a 10-year low of 293 units of 28.2mt-dwt while gradually improving earnings and values sent demolition to an 11-year low of 57 units of 4.5mt-dwt. The simultaneous reduction in the rate of deliveries and scrapping saw net fleet growth in the sector of 235 units of 23.8mt-dwt in 2018 following 232 units of 22.5mt-dwt in 2017. Both these years compare favourably with the peak post-2008 year of 2010 which saw net fleet growth of 906 units of 74.9mt-dwt. We are slowly returning to early boom growth levels as seen in 2005 when net fleet growth stood at 300 units of 22.6mt-dwt and 2004 with 249 units of 19.2mt-dwt. Before 2004, fleet growth ran at lower levels.

Turning to the demand side, we appear to be coming to the end of a 15-year period of Chinese-driven turbocharged demand growth. This started in 2003 following China's entry into the WTO at the end of 2001 and may have come to an end in 2017. World seaborne trade, in tonne-mile terms, was expanding at just 2% year-on-year in 2001 and 1% in 2002 before jumping to 7% in 2003 and to 10% in 2004. Importantly, this unexpected boost in demand caught supply on the hop and it took some years before we got the time-delayed supply-side response that culminated in egregious over-ordering. Tonne-mile trade growth maintained 6-7% annual expansion between 2005 and 2007 before collapsing to just 1% in 2008 and then contracting by 3% in 2009. By then, the sector was committed to fantasy levels of supply just as demand was beginning to cool. 2010 enjoyed a 13% year-on-year demand snapback, set against the base effects of 2009's contraction, and demand then grew at an annual rate of 6% each year between 2011 and 2014. We have since slowed to 3% in 2018 with a similar subdued level predicted for 2019 and 2020.

Under such circumstances of structurally slower demand growth it is even more important than ever that supply be kept under control. On 5 March, 2019, opening the National People's Congress in Beijing, Chinese premier Li Keqiang informed the world that Chinese GDP growth will continue to slow after posting its slowest rate since 1990 at 6.6% last year. This year, the target growth rate has been lowered to between 6.0% and 6.5%. There is some degree of messaging going on here as China is keen to head off any escalation in its trade dispute and tariff war with the US. Falling Chinese demand is a product of China's shift towards a more consumer-driven and service-based economy. As the world's second largest economy after the US, a 6% growth rate is still respectable in the context of US growth of around 3% in 2018. Both countries are enduring an economic slowdown as US growth, at an annualised rate, slowed from 4.2% in 2Q18, to 3.4% in 3Q18, to 2.6% in 4Q18, and it is set to slow further in 2019. If the US and China can see a way to unwinding existing tariffs and avoiding new ones, then their economies and the global economy will be in a better place. Premier Li alluded to tough times ahead and announced a limited series of stimulus measures ranging from lower VAT rates to Rmb800bn ($120bn) in local government bond issuance to fund infrastructure spending.

According to reported sales in the bulk carrier space in 2018, the most interest was generated by the handysize and supramax segments. The most popular age group was from 6 to 10 years of age. In this age group, 65 handysize totalling 1.9mt-dwt and 82 supramax totalling 4.6mt-dwt were reported sold last year. This was also the most popular age profile for larger panamax and capesize segments with 31 capesize of 5.1mt-dwt and 43 panamax of 3.6mt-dwt reported sold. The keen interest in handysize and supramax bulk carriers helped to restore 10-year old values to around the post-GFC average of $12.0m for handysize and $15.5m for supramax. Since the bottom of the bulk carrier slump in early 2016, newbuilding prices have risen in line with increased input costs. Along with regulatory confusion, this has fortunately acted as a deterrent to new vessel contracting and rendered the secondhand marketplace a better hunting ground. For example, newbuilding prices fell each month on a year-on-year basis from the beginning of 2016 to the end of 1Q17. From that point, the monthly change in the Newbuilding Price Index went from a 1% year-on-year gain in April 2017 to an 8% gain in December 2017.

The rising price trend led to a strong month of contracting in December 2017 of 70 units of 9.3mt-dwt, followed by 50 units of 7.9mt-dwt in January 2018. Maybe it was a case of FOMO, fear of missing out. Orders started tailing off by mid-2018 as prices showed in excess of 10% gains each month on the prices in the same month of the previous year. It illustrates how everyone wants a bargain but it takes a while to identify the trend, and it also helps to have the company of others when making such large investments. A combination of an improving earnings market and rising prices definitely affected contracting behaviour as bulk carrier orders by number went from 64 in 2016, up to 379 in 2017, and back to 307 in 2018.

The delivery schedule for the current bulk carrier orderbook is naturally concentrated on 2019 and 2020 with a much thinner delivery schedule for 2021, so far at least. 40.5mt-dwt is scheduled to deliver in 2019, 41.3mt-dwt in 2020, 12.1mt-dwt in 2021, and 0.9m-dwt in 2022 and beyond. The 94.8mt-dwt bulk carrier delivery schedule is broken down as 50.9mt-dwt of capesize, 23.9mt-dwt of panamax, 15.1mt-dwt of supramax and 4.9mt-dwt of handysize. The average unit size on order in each segment is 236,318-dwt in capesize, 82,833-dwt in panamax, 61,840-dwt in supramax and 33,618-dwt in handysize. Overall, recent and future growth in the dry bulk fleet is put at 2.9% in 2017 and estimated at 3.0% in 2018 and then forecast at 3.3% in 2019 and 2.8% in 2020. What really matters is the estimated forecasts for 2019 and 2020 as these should be more or less set in stone by now. The capesize segment is forecast to grow by 3.6% in 2019 and 4.3% in 2020, panamax by 4.0% in 2019 and 3.3% in 2020, supramax at 3.0% in 2019 followed by 1.0% in 2020, and handysize by 1.4% in 2019 followed by 0.2% in 2020. Hence, the handysize segment faces the most benign supply growth.

Interesting changes are evident in the demand side as we face declining growth in major bulks and rising growth in minor bulks. The former might be correlated with old school industrial production, as they are dominated by iron ore and coal, while the latter are usually considered to be better correlated with overall GDP growth. Major bulks, carried mostly by larger bulk carriers, rose 3% in 2016, 5% in 2017 and just 1% in 2018 while minor bulks, carried mostly by smaller bulk carriers, saw flat growth in 2016, followed by 3% in 2017 and 4% in 2018. Significantly, we may be seeing an inflection point in China's iron ore imports which have been rising steadily since the 2008 shock of the GFC. In 2009, China's iron ore imports stood at 614.6mt rising steadily to a peak of 1,058mt in 2017. Then, last year in 2018, they fell back 1% year-on-year to 1,047mt. We will need to monitor the import data for 2019 to assess whether or not China is approaching 'peak steel'. The answer is probably not, as China is raising the quality of the iron ore it imports, thus increasing efficiency and needing less product. It is also using more steel scrap for processing in electric arc furnaces. China's crude steel production has been steadily rising from 804.8mt in 2016, to 867.5mt in 2017 and to 927.5mt in 2018.

Since the beginning of 2016, China has been ramping up its purchase of higher grades of iron ore, thus supporting a widening price differential between 65% and 62% Fe iron ore fines CFR Tianjin. The switch to higher grades increases efficiency and also lowers pollution, and one cannot under-estimate the urgency of the drive to reduce pollution in China's main cities. However, one must also respect China's ability to pragmatically change course when the facts change. The Feijao mine disaster in January, and a court ruling in February, could have shut in as much as 70mt of Vale production. This is the equivalent of 18% of Brazil's exports and 5% of global seaborne supply. The resulting firming in global iron ore prices prompted many Chinese steel mills to switch back to lower grades, or even seek alternative feedstock. The final net effect will depend upon the actual ramp up of Vale's S11D mine, the return to form of Anglo's Minas Rio mine, and any other Brazilian contributions that might close the actual supply gap. The negative impact for the biggest ships in the capesize segment, and above, is already reflected in the awful Q1 average earnings. It has negatively affected sentiment with time charter equivalent rates falling to below $5,000 daily in first half March from over $16,000 in early January.

Another factor for Chinese steel mills is their existing inventories of iron ore as well as their port stocks. These rose quite considerably in 2018 from 151mt in early 2018 to a peak of 162mt in early June before falling back to an annual low of 137mt at the end of the year. It is never quite clear what proportion of these inventories is beyond use from a quality perspective or beyond sale from a price perspective. Anyway, since the end of last year inventories have been building again and were back up to 145mt by the end of February. The reasons for this restocking may have been influenced by the timing of the Chinese New Year holidays; but also, purchases may have increased to protect against the possibility of supply disruption from Brazil. There is something of an economic clash between the recent trend of rising iron ore prices and falling Chinese domestic steel prices with the Shanghai Steel Price Index down over 15% from 140 at the end of December 2018 to 118 at the end of February. Fortunately, Chinese iron ore imports are likely to be supported by the enforced reduction of Chinese low grade and illegal mining in the interests of higher quality and lower pollution. Chinese domestic iron ore output has fallen from a monthly average of about 130mt in 2014 to less than 70mt a month in 2018.

We can only speculate as to the prospects for Chinese iron ore imports over the balance of 2019 given the current disconnect between iron ore input prices and steel output prices. The situation should normalise soon enough once we get a better idea of iron ore supply and steel demand. As things stand, China's iron ore imports fell to a 10-month low of 83.1mt in February, after 91.3mt in January, and were about 1.5% below the 84.3mt of February 2018. The Jan-Feb 2019 total came in at 174.4mt, being 5.5% below the Jan-Feb 2018 tally of 184.6mt. There is also the question of the amount of new capital that will be invested in Chinese infrastructure as stimulus is generating less bang per buck invested and Chinese banks are becoming dangerously over-extended. Premier Li Keqiang's recent announcement at the NPC did not hint at a stimulus programme large enough to really move the needle. China is also a major importer of coal but these imports have been under downward pressure from slower growth, lower steel prices, domestic environmental issues and tactical trade disputes with Australia. China's grains imports in 2018 saw a rise in Russian and Brazilian imports thanks to bumper crops and a decline in Australian and Argentinian imports due to drought.

Shipping Markets Outlook

2019 Edition

The Tanker Market

The Tanker Market

Tankers had a dreadful year for most of 2018 before a rousing final quarter illustrated just how quickly fortunes can change.

Tankers had a dreadful year for most of 2018 before a rousing final quarter illustrated just how quickly fortunes can change. According to SIN data, the larger crude oil tanker segments performed broadly in line with one another in 2018. Average earnings for a modern VLCC came in at $15,561 daily for the year, while a modern suezmax was at $16,466 and a modern aframax was at $16,175 per day. These annual averages would have been much lower but for being redeemed by a strong fourth quarter when spot earnings spiked up to and beyond $50,000 per day in each of the large crude oil tanker segments.

Up to mid March 2019, we have seen a V-shaped performance in spot market VLCC earnings so that, in the year to 15 March, a modern VLCC has averaged $26,924 per day. In contrast, a modern suezmax has endured sliding earnings since the beginning of the year but has still managed to average $23,784 daily, not so far behind the VLCC. A modern aframax has followed a similar path to the suezmax, with earnings having come off sharply since the start of the year, giving a year-to-date average of $24,169 per day. Just as in 2018 they broadly tracked one another, and so too in 2019 so far, but at an average of 55% above full year 2018 earnings.

Baltic Exchange data indicates that the VLCC-TCE peaked at $35,772 on 3 December before sinking 91% to a trough of $3,110 on 8 February, back to a peak of $22,793 on 1 March, and then back down to $15,021 on 15 March. Such volatility is not for the faint-hearted. The Suezmax-TCE fell 81% from its peak of $50,633 on 24 December and then fell throughout Q1 to a trough of $7,054 on 15 March, with no signs of a turnaround. Meanwhile, the Aframax-TCE has fallen 70% in value from its Q4 peak of $44,167 on 19 December to $14,949 on 15 March. It has at least recovered from its Q1 trough of $10,843 per day as recorded on 12 February.

Finally, on the clean side, MR earnings averaged $8,750 per day in 2018 and were 52% higher at $13,286 daily in the year to 15 March. Earnings have been in steady decline in Q1 2019 but are still benefitting from the gradual stepping down from the much stronger levels recorded in Q4 last year. Baltic Exchange data shows that the MR Atlantic Basket peaked at $33,118 on 12 December and has since fallen 58% to a reading of $13,791 on 15 March. The prospects for the balance of 2019 should be brighter once the better supply and demand fundamentals assert themselves, and as we get closer to the regulatory challenges of 2020.

2018 still saw tanker asset values rise

Tanker asset values made a hesitant recovery over the course of last year according to Baltic Exchange data that tracks 5-year old tanker values. In the 12 months between early January 2018 and early January 2019, a 305,000-dwt VLCC was up 4.6% from $61.4m to $64.2m; a 105,000-dwt aframax was up 5.2% from $29.5m to $31.0m and a 51,000-dwt MR was up 11.5% from $23.7m to $26.3m. It was a King Canute like achievement for asset values to rise against the incoming tide of disappointing earnings.

In the early months of 2019 we are still witnessing improvements in nominal prices despite the generally weaker earnings environment. The Baltic's measurement of 5-year old values sees the VLCC up 4.5% from $64.2m in early January to $67.1m on 18 March. Similarly, the Baltic's 5-year old aframax is up 6.8% from $31.0m in early January to $33.1m on 18 March and its 5-year MR is up 5.3% from $26.3m to $27.7m over the same time frame. Buying interest is strong based upon belief in an earnings recovery over the course of 2019.

In 2019, after a reasonable first quarter performance, we are expecting further improvements in average earnings that will take asset values higher. The Tanker Secondhand Price Index has shown similar volatility to spot earnings. It went from 110 points in December 2018 to 117 in January, to 117.5 in February and then down to 114.5 by mid March. The strong upwards adjustment in January was based upon the market rally in Q4 which has gradually dissipated as we approach the end of Q1.

We have a constrained supply side and the prospect of IMO 2020 disruption to effective tonnage supply growth. We are less clear on trade flows as the US ramps up its crude oil exports while Opec and Russia cut their output by 1.2m-bpd or more to protect oil prices.

Tanker Asset Sales

VLCCs

In February 2018, Ocean Yield purchased four 319,000-dwt HHI-built VLCC resales from Kyklades Maritime for a reported $335m en bloc, giving a unit price of $83.75m with delivery in Q2 and Q3 2019. It was a complex investment deal involving a 15-year bareboat charter back to clients of the sellers and a 5-year sub-timecharter to an industrial end user, believed to be Koch Industries. The sellers have options to buy the vessels back at pre-agreed strike prices after seven years into the charter. These were the only resales recorded last year. In mid June, Euronav sold six 300,000-dwt SWS-built VLCCs to International Seaways for a reported en bloc price of $434m as a side deal to its purchase of the Gener8 fleet. Five of these had delivered from the Chinese yard in 2016 and the other one in 2015.

Some older VLCCs were also sold starting with the Sea Latitude 309,285-dwt HHI 2001 reported in August at $22.5m from Agritrade to Ocean Tankers. In September, the Seaways Sakura 298,530 Hitachi 2001 was reported sold by International Seaways to Hellenic Tankers for $18.5m and some ten days later the sister Front Ariake 298,530-dwt Hitachi 2001 was reported sold for a higher $20.7m by Ship Finance to undisclosed interests. It was rumoured that the ship had gone to buyers who will convert it to an FPSO, and the purchase process usually attracts a premium price. In November, the Alter Ego I 309,371 Samsung 2001 was reported sold by NGM Energy to Kunlun Shipping for $21.5m.

Higher prices have been achieved this year for similar vintage VLCCs including, in January, the Pacific Glory 299,999 Imabari 2001 reported sold for $23.5m from Sinokor Merchant Marine to Kunlun Shipping and, in February, the VL Sakura 298,530 Hitachi 2001 which was reported sold for $24.0m from Hellenic Tankers to FPSO operators Nathalin Group. This latest sale would suggest that Hellenic Tankers pocketed a $5.5m or 30% profit in less than six months in reselling this tanker to the Thai offshore company. It confirms the firming trend in asset values since the beginning of 2018.

Suezmax

There were few notable deals in the suezmax space in 2018 but, in September, Central Shipping of Monaco was reported to have sold two resale 157,000-dwt tankers to Polembros for $65.0m each which will deliver from Hyundai Samho in 2020. In November, Icon was reported as the seller of the Shamrock 156,516-dwt Rongsheng 2011 to Navigare for $30.0m. In the same month, Cepsa was reported to have sold its Toldeo Spirit 149,990 Daewoo 2005 to Eurotankers for a little over $19.0m. In January this year, Eurotankers was reported as the seller of their vintage Eurohope 159,539-dwt Daewoo 1999 to Middle East buyers for $12.9m.

Aframax

There was more activity in the aframax crude tanker segment. In February, Hansa Shipping was reported to have sold its HS Carmen 113,033-dwt Hyundai Samho 2003 for $11.0m to Coral Shipping. In the same month, Maersk Tankers was linked with the sale of its Maersk Privilege 105,483-dwt Sumitomo 2003 for $12.5m to Winson Oil. By June, Enesel was reported to have sold a pair of sistership aframax tankers to Thenamaris, being the Pantelis and the Sparto, both 114,500-dwt Samsung 2004, for $11.5m each. Come July, K-Line was the reported seller of the River Eternity 105,445-dwt Sumitomo 2006 to Greek buyers for $13.25m.

In November, DHT was reported to have sold its DHT Sophie 112,045-dwt Hyundai Samho 2003 for $11.9m and

The newer refineries east of Suez are best placed to produce LSFO and can do so with sweet or sour crudes with the choice driven mainly by the relative cost of each. long-haul movement of crude from west to east and of product from east to west is a pattern that has existed for many years already, with IMO 2020 set to give it a significant boost.

its DHT Cathy 111,928-dwt Hyundai Samho 2004 for $12.4m, both to Horizon Tankers. Also at that time, Hansa was linked to the sale of its HS Tosca 115,635-dwt HHI 2004 for $13.0m to Union Maritime. More modern ships included the report of the Glory Crescent 105,405-dwt HHI 2013 from Mitsubishi to AG Shipping for $24.5m. Finally, in January, Viken Shipping was reported to have sold a trio of 115,341-dwt Samsung-built ships to Middle East buyers: the Troviken (2006), Tofteviken and Telleviken (both 2005) for $48.5m in total.

MR

There was plenty of activity in the MR second-hand segment in 2018, although values were fairly flat during the year, as illustrated by the March reported sale of the Pacific Rainbow 45,986-dwt Shin Kurushima 2008 for $16.0m from Taiheyo to Maritec and the December reported sale of the Ayesha 47,134-dwt HMD 2008 for $16.0m from Product Shipping to Norden. In January, the Marine Express 45,902-dwt Shin Kurushima 2009 was reported sold by Mitsui Warehouse to undisclosed interests for $16.0m and, in February, the Queen Express 45,902-dwt Shin Kurushima 2009 was reported sold by Fuyo Kaiun to Transocean Maritime, also for $16.0m. Later in the same month, the same buyers were linked to the purchase of the High Strength 46,646-dwt Naikai 2009 for $16.4m from D'Amico. Buying and selling interest has been keen in this segment.

In September 2017, Scorpio Tankers sold five 50,000-dwt HMD 2012-built MR product tankers to BoCom Leasing. The reported unit price was $27.5m each with a 7 years bareboat charter back at $9,025 daily per vessel, with three 1-year extension options and purchase options from end year two. Assuming these details to be correct, then this is a classic example of one-way optionality, in this instance all against the lessor. The product tanker highlights of 2018 were five follow-on deals announced between May and July. They involved 23 MRs and 5 LR2s from the Scorpio stable. The buyers were Avic Leasing, Huarong Leasing, CMB Leasing, ICBC Leasing and one other undisclosed financial institution. The typical model was 7-8 years bareboat charter back, purchase options from end year three, and purchase obligations at charter expiry. In this way Scorpio was able to destress its balance sheet while still keeping operational control of the assets.

Tanker supply and demand balance

The total tanker fleet (crude and product) rose only marginally in 2018, by just 1.1%, going from 581.9m-dwt to 588.1m-dwt. The combined delivery schedule for 2019 is 41.3m-dwt, or just 7.0% of the start year fleet. This will reduce during the course of the year with scrapping and slippage. The total order book is set at 11.3% of the fleet, which is historically low. In simple rounded numbers, in 2018 total tanker supply rose 1% against total tanker demand of 2%. In 2019, supply and demand are expected to rise by 3% each. Drilling down, crude tanker fleet growth was only 0.2% in 2018 and forecast to expand by 3.6% in 2019 while crude tanker demand was at 2.2% in 2018 and forecast to grow by 3.6% in 2019. Supply and demand is coming into balance but we still have a tonnage overhang from prior years of oversupplying actual demand growth.

The product tanker fleet grew by 1.6% in 2018 and is forecast to expand by another 2.6% in 2019. This compares with product tanker demand rising 2.3% in 2018 and forecast demand growth of 3.2% in 2019. This supply-demand combination suggests that good times lie ahead for clean tankers. We have a constrained supply side and the prospect of IMO 2020 disruption to effective tonnage supply growth. We are less clear on trade flows as the US ramps up its crude oil exports while Opec and Russia cut their output by 1.2m-bpd or more to protect oil prices. Both Venezuela and Iran are suffering from dwindling output and exports as the US subjects both countries to sanctions. In Venezuela, the US does not recognise the re-election of President Maduro and in Iran the US wants to choke off oil income which it suspects is financing Iran's nuclear weapon ambitions.

Rising US crude output

The US government is tightening its sanctions on the oil industries of Iran and Venezuela and this is giving the oil bears pause for thought. US production and export of light sweet grades continues to rise as the EIA put average production at 11.0m-bpd in 2018 and is forecasting US output growth of 1.4m-bpd in 2019 to 12.4m-bpd and then another 0.8m-bpd in 2020 to 13.2m-bpd. This will take US output well clear of Russia and Saudi Arabia that are part of an Opec-plus group that has pledged to reduce production to counter balance the relentless rise in US output. As it stands, the US is expected to eclipse the Opec-plus reduction all on its own this year. With reduced output from sanctions and unreliable output from various African producers the market may be tipped into shortage in 2019, thus pushing up oil prices. By mid March, Brent was up to $67 a barrel from a 52-week low of $50 a barrel on Christmas Eve.

Oil trading patterns

The seaborne trading of crude oil and oil products faces a shake-up as refiners jockey for the sweet or sour crude feedstock that are optimal for their refining systems. However, in many ways not much has changed. IMO 2020 will see around 2.5m-bpd of heavy fuel oil (HFO) replaced by IMO compliant low sulphur fuel oil (LSFO) or MGO. The newer refineries east of Suez are best placed to produce LSFO and can do so with sweet or sour crudes with the choice driven mainly by the relative cost of each. This should reinforce Asian demand for imported crude oil, thus supporting long-haul crude shipments from the Atlantic to the Indian Ocean and the Far East, while also underpinning long-haul oil product shipments from east of Suez into consumer markets in the Atlantic. The long-haul movement of crude from west to east and of product from east to west is a pattern that has existed for many years already, with IMO 2020 set to give it a significant boost.

China crude imports

In the largest crude oil tanker segment, it is worrying that 65 VLCCs are set to deliver over 2019, with 11 having already delivered in January, 3 in February and another 51 scheduled to deliver over the balance of the year. VLCCs in particular are facing the disruption of lower exports from Saudi Arabia, Iran, Russia and Venezuela as a combination of sanctions and output cuts take effect. At least China is still raising its oil imports. In 2018, China's total crude oil imports averaged 9.2m-bpd, up 10% year-on-year, according to Chinese customs data. It set monthly record highs in 4Q18 (i.e. higher than any month preceding 4Q18) at 9.6m-bpd in October, 10.4m-bpd in November (its highest ever, and up 8.5% year-on-year) and 10.3m-bpd in December. This was largely inspired by the teapot refineries rushing to take up their annual import allocations, possibly anticipating imminent price increases should the Chinese central government impose tariffs on imported US crude oil. In January 2019, China's crude oil imports were up 5.1% year-on-year to 10.1m-bpd, followed by 10.2m-bpd in February, up almost 22% on the 8.4m-bpd of a year ago. This is a promising start to the year. Incremental demand is being helped by the gradual ramping up of throughput at two new Chinese refinery start-ups: Hengli Petrochemical and Zhejiang Petrochemical.

US-China trade tensions

Earlier this year, Reuters reported that oil traders had viewed the 1 March deadline for the resolution of US-China trade friction as the most significant date in the calendar. On 25 February, the US president blinked first and announced that good progress in the bilateral talks would warrant an indefinite delay to the tariff escalation deadline so that the US and China could cut a deal. It has become evident that the trade war between these two superpowers is already affecting global growth even at the lower tariff levels, ample justification for trying to avoid an increase. This may only be a truce in a much longer war. There is the short-term discussion around tariffs and the bilateral trade balance and the long-term political issue of reform of the Chinese economic model. The US is taking exception to China's form of state capitalism that is grounded in the one party state. It involves central and local government support of state-owned enterprises and is lubricated by policy bank loans and subsidies.

This creates a clash with the western concept of open market economies and a level playing field that officially, at least, outlaws state aid. It should be possible for China to give adequate pledges to increase the purchase of US agricultural and capital goods, open up its domestic market and crack down on intellectual copyright breaches. The economic reform agenda is one for the backburner as it will run and run and it can only get in the way of achieving deliverable goals on the more immediate trade issues. This simmering dispute between the world's two largest economies is transmitting negative demand impulses around the world, eating into the global consumption of middle distillates used in transport, manufacturing, mining and farming. Distillate consumption has been closely correlated with the US and global business cycle over the past 50 years. We can imagine that even a partial resolution of the US-China trade issues will give a boost to the tanker trades as it will clear the way for new investment and stronger economic growth.

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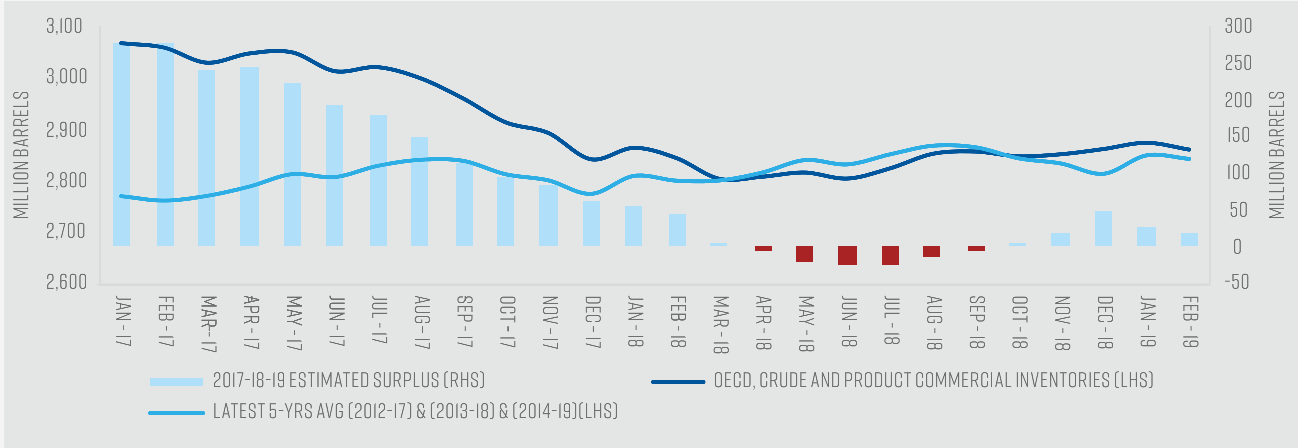
The Tanker Market

- Global oil demand is still rising despite slower global economic growth. The IEA forecasts global oil demand growth of 1.4% in 2019. Seaborne oil demand is forecast at over 3%.
- Lower crude output from Opec, Russia, Iran and Venezuela favour more long-haul west to east exports from non-Opec Atlantic producers. The converse should apply to products.
- This year we foresee both crude and product seaborne demand exceeding crude and product tanker supply in what promises to be a harbinger of better rates and values.

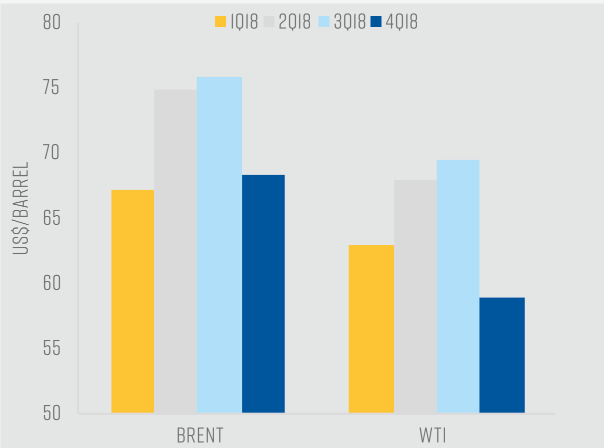
5. It was also a reflection of the status of OECD commercial inventories.



OECD, crude and product commercial inventories

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

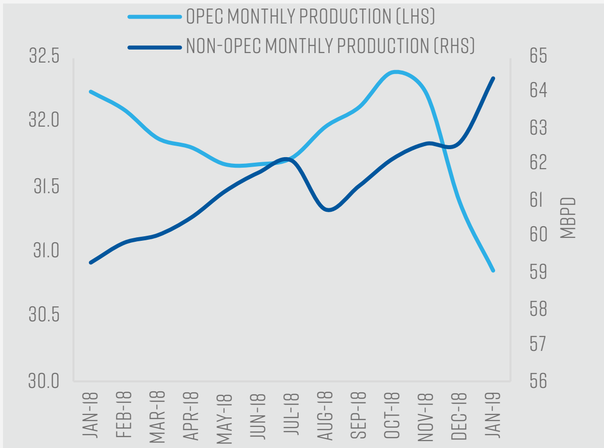
1. The rise and fall of oil prices in 2018....



Brent and WTI quarterly average price

SOURCE: HSBC GLOBAL RESEARCH, HARTLAND SHIPPING

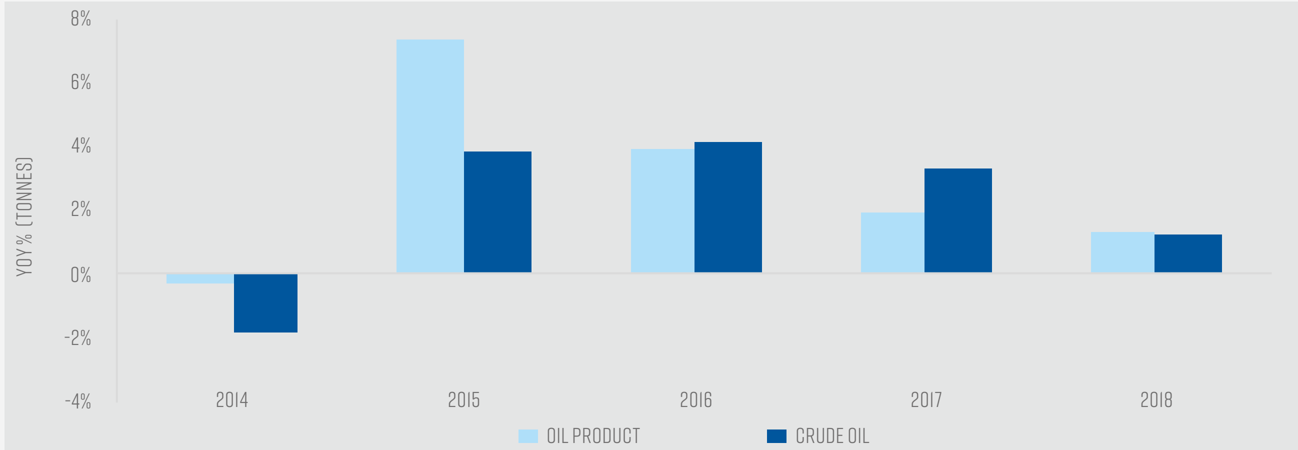
2. ...helped by higher OPEC production in Aug-Nov 2018...



Opec and non-Opec monthly production

SOURCE: EIA, HARTLAND SHIPPING

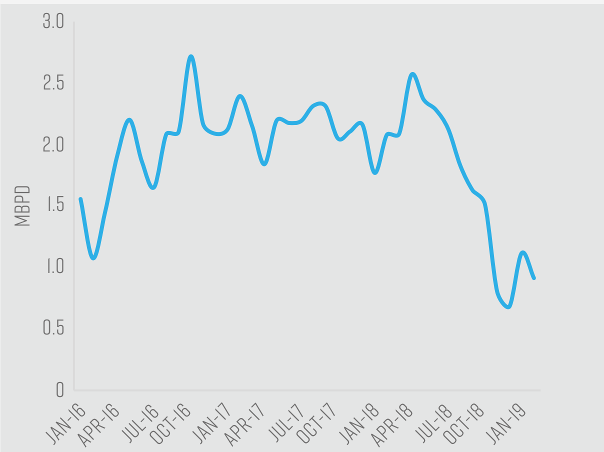
6. Absolute growth in the global seaborne trade of crude oil and oil products weakened last year...



Crude and product seaborne trade

SOURCE: CRS, HARTLAND SHIPPING

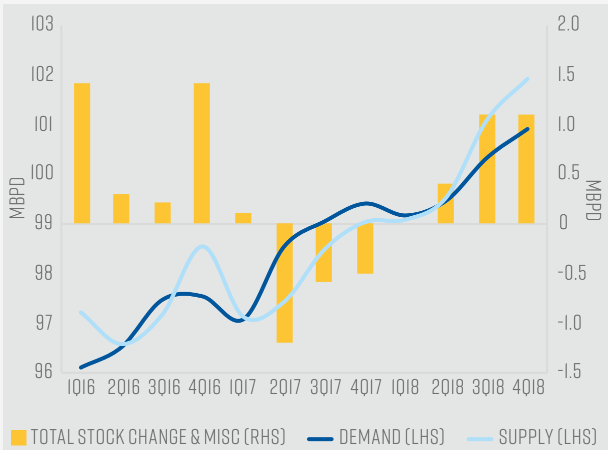
3. ...offsetting lower Iranian exports as sanctions bit...



Iran crude oil exports

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

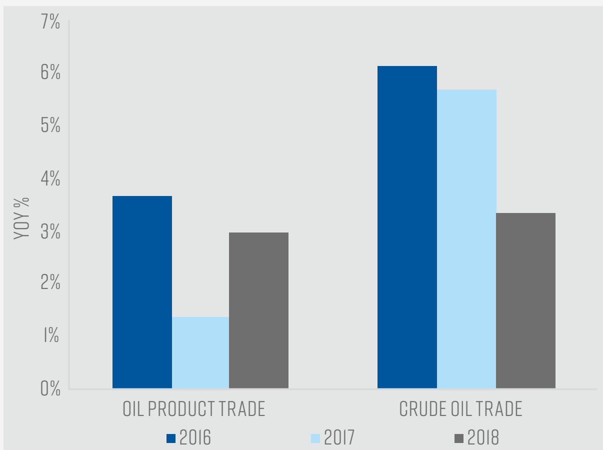
4. ...led to a surplus in the second half of 2018.



World oil supply and demand balance

SOURCE: IEA, HARTLAND SHIPPING

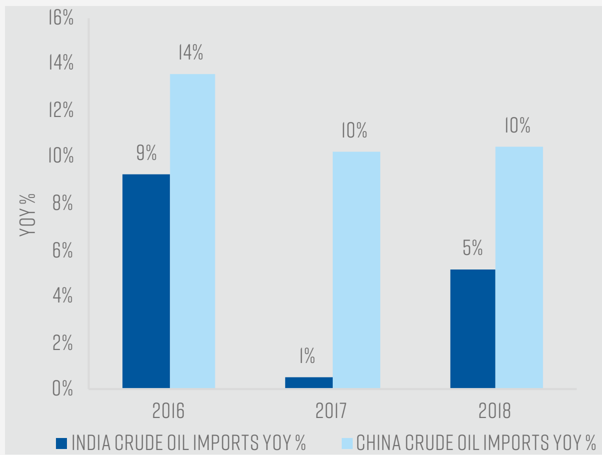
7. ...despite stronger gains in oil product tonne-mile trade.



Crude and product seaborne trade (tonne-miles YoY%)

SOURCE: CRS, HARTLAND SHIPPING

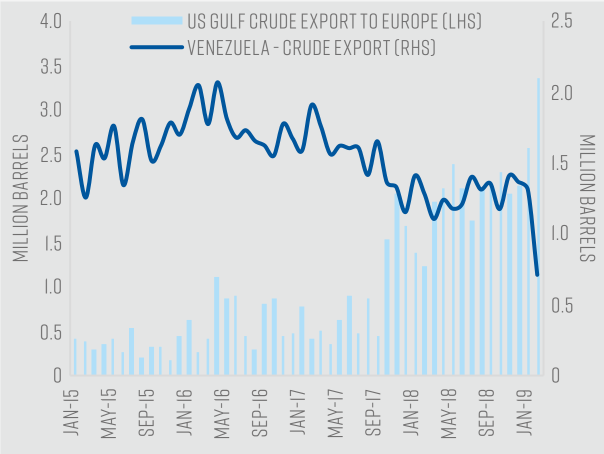
8. Strong Chinese and Indian crude import growth helped...



China and India crude oil imports

SOURCE: EIA, HARTLAND SHIPPING

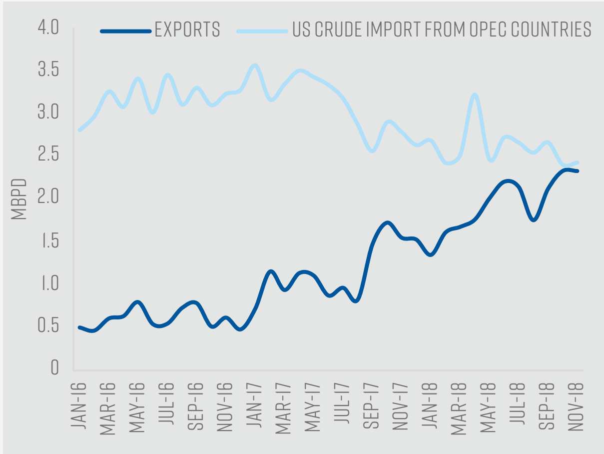
9. ...while US sales to Europe offset falling Venezuela exports.



US Gulf crude exports to Europe and Venezuela crude exports

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

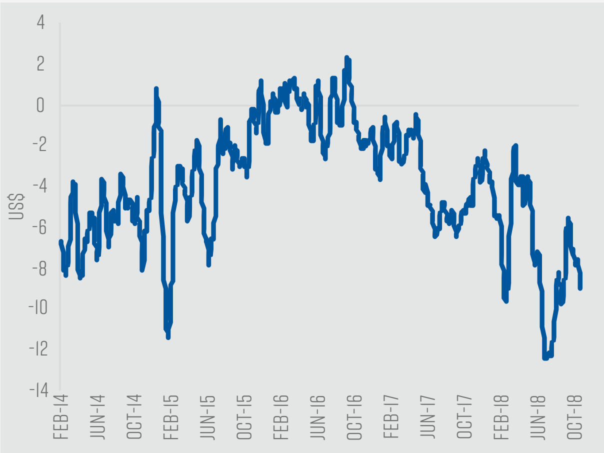
10. Overall, US crude oil export growth played a big part...



US crude exports and US crude imports from OPEC countries

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

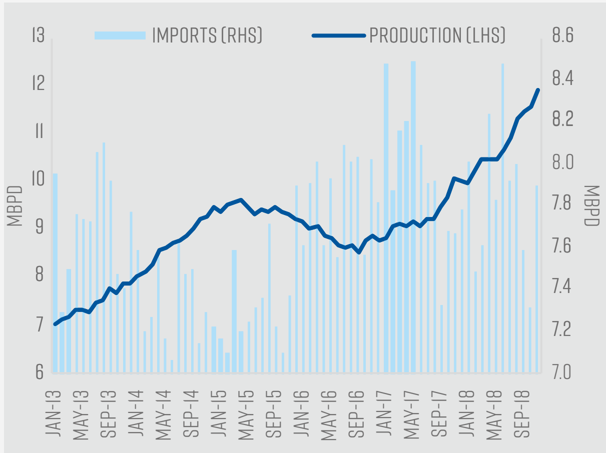
11. ...supported by a deepening WTI discount...



WTI discount versus Brent

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

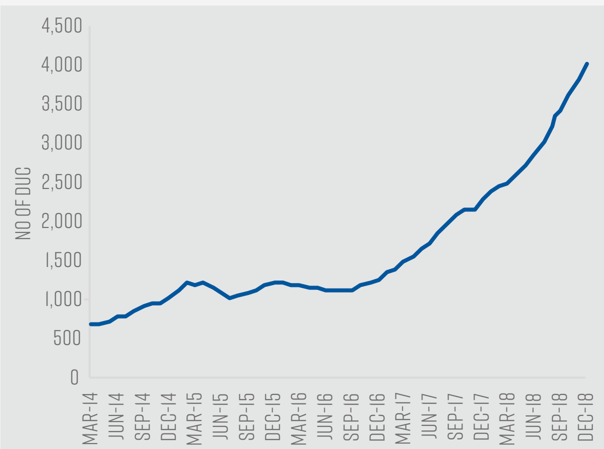
12. ...while production is reaching new highs...



US total crude imports and US crude production

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

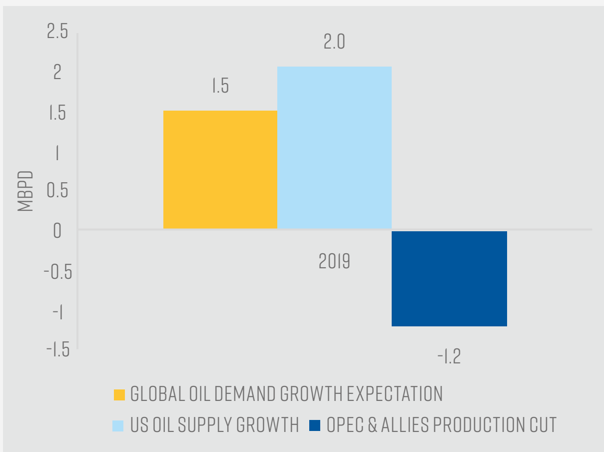
13. ...with plenty of potential for additional new supply.



Drilled but uncompleted rig count – Permian Basin

SOURCE: BAKER HUGHES, HARTLAND SHIPPING

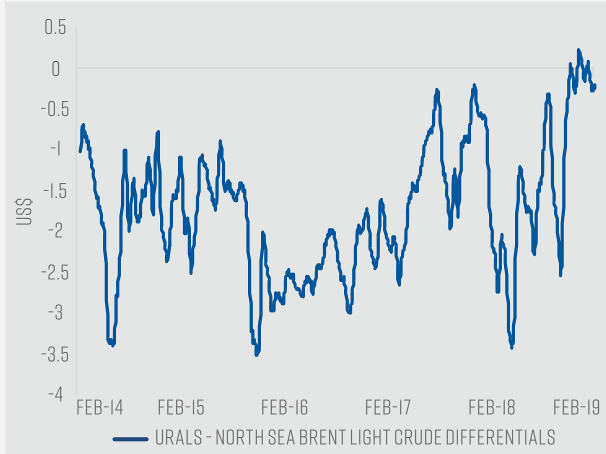
14. This left Opec and its allies with no choice but to curtail output yet again this year, with an intended 1.2m-bpd cut in 2019.



Oil demand growth, US oil supply growth and OPEC and allies production cuts

SOURCE: EIA, HARTLAND SHIPPING

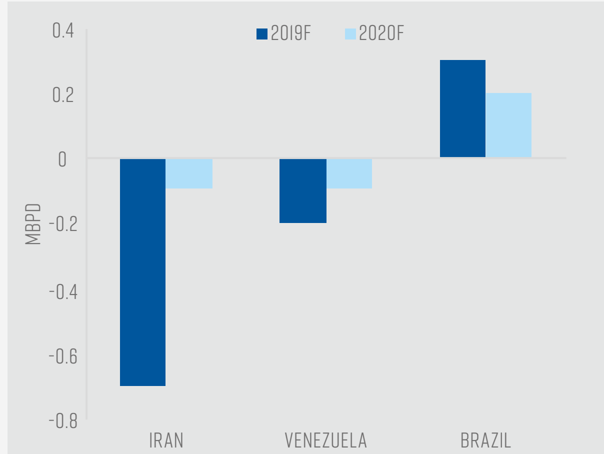
15. Sanctions on Iran and Venezuela, with the OPEC cuts, is reducing the supply of medium and sour crude grades...



Crude differential – Heavy vs light grade

SOURCE: THOMSON REUTERS, HARTLAND SHIPPING

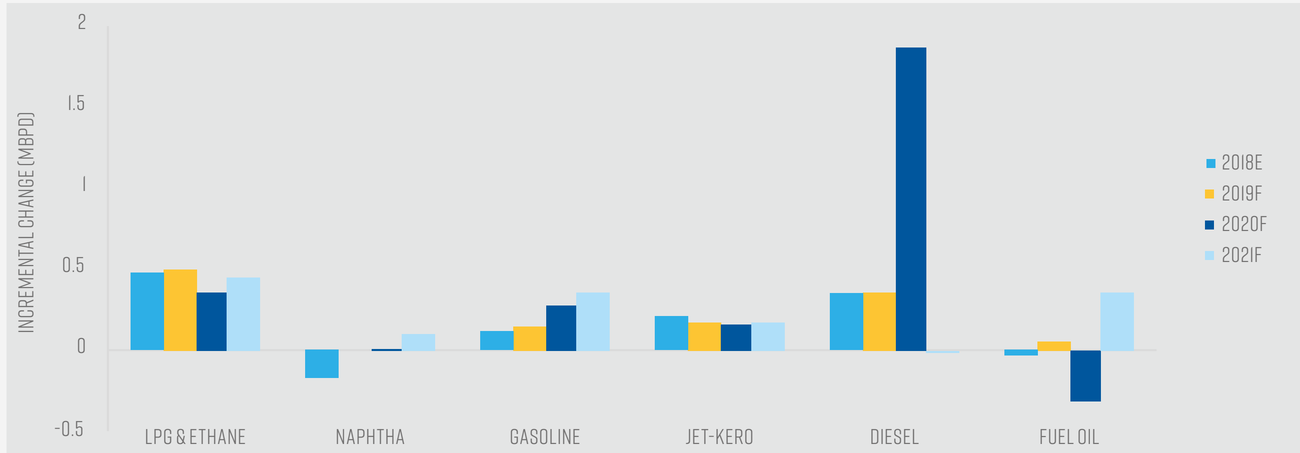
16. ...but a rebound in Brazilian oil output is expected to partially offset the loss...



2019 Incremental oil supply forecast

SOURCE: CLARKSONS, HARTLAND SHIPPING

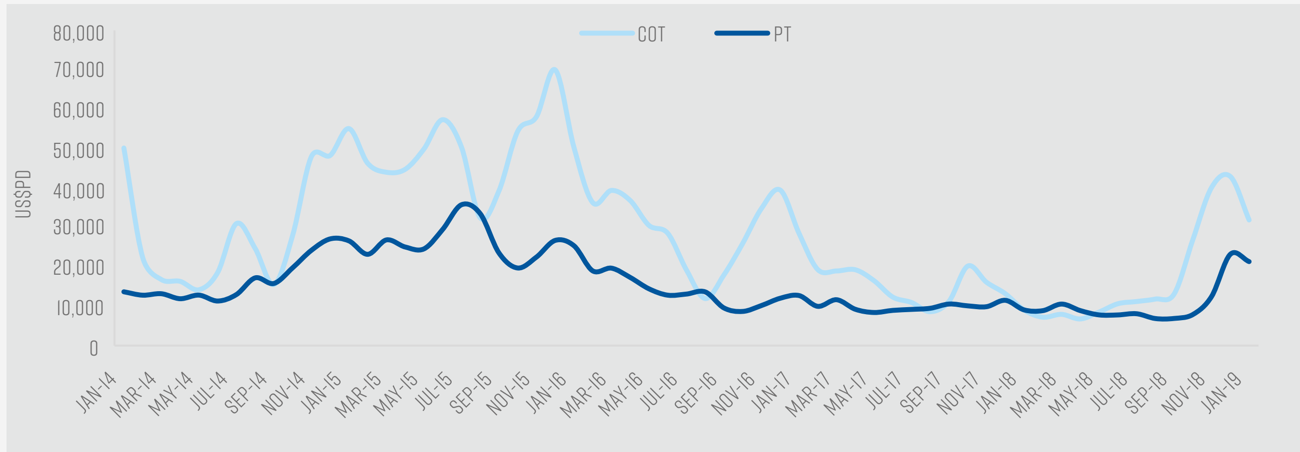
17. ...and IMO 2020 is expected to lift demand for light sweet grades.



Oil product demand forecasts

SOURCE: ARGUS, HARTLAND SHIPPING

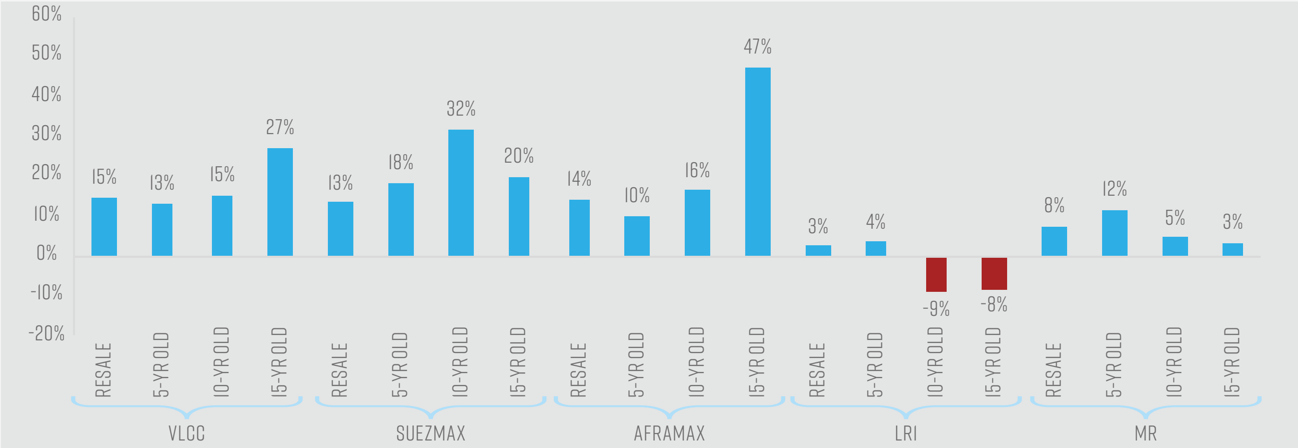
18. Tankers endured another difficult year but the last quarter proved how quickly earnings can recover...



Average crude oil and product tankers earnings

SOURCE: CRS, HARTLAND SHIPPING

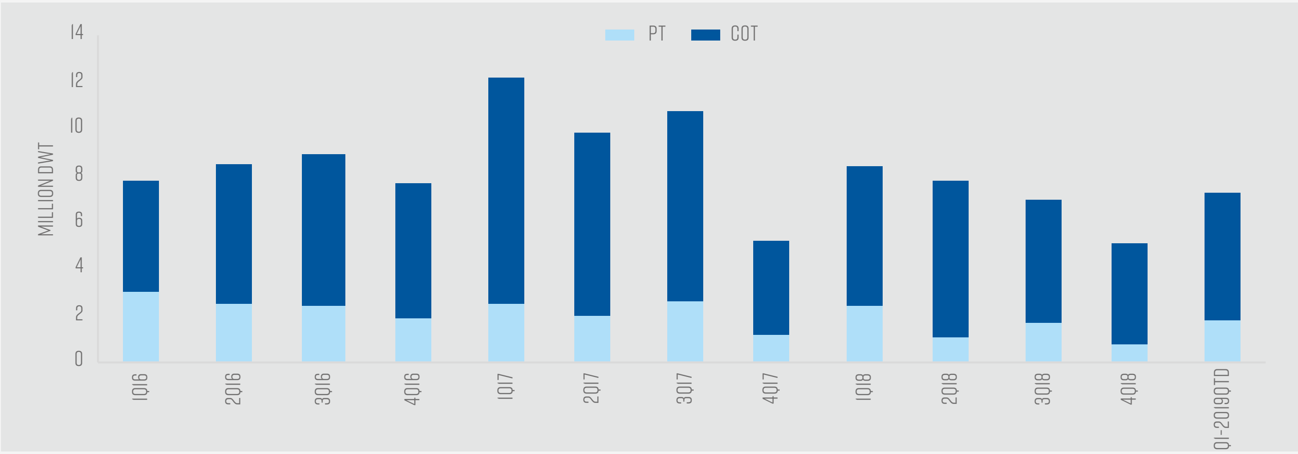
19. Attractive second-hand values rose on strong buying interest.



Change in asset values by segment and age group (Jan-18 to Jan-19)

SOURCE: HARTLAND SHIPPING

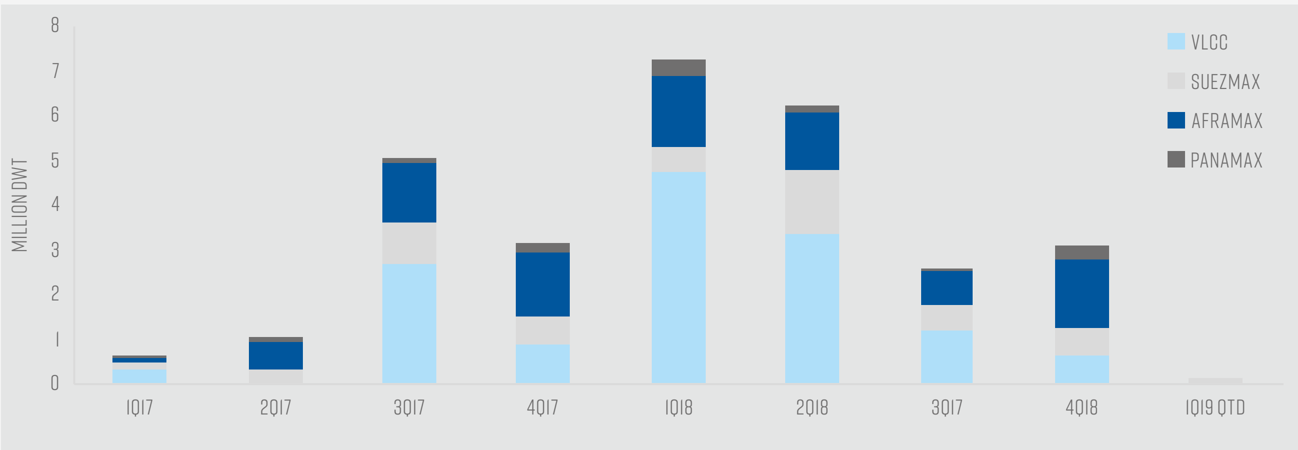
20. The pace of deliveries slowed, but still remained elevated.



Quarterly vessels deliveries

SOURCE: CRS, HARTLAND SHIPPING

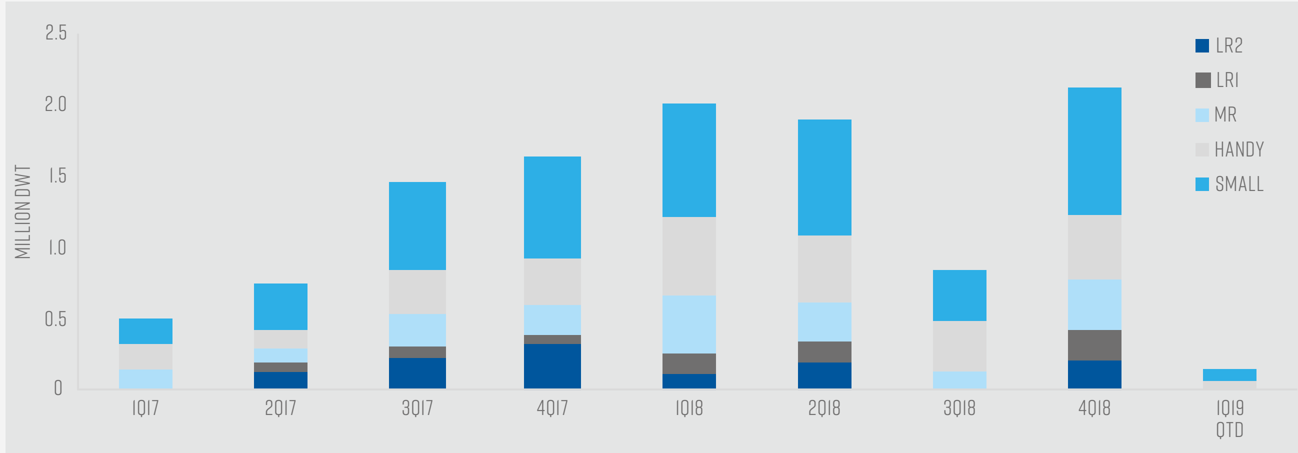
21. Active crude tanker scrapping, particularly in the medium to large size segments...



Crude oil tanker quarterly demolitions

SOURCE: CRS, HARTLAND SHIPPING

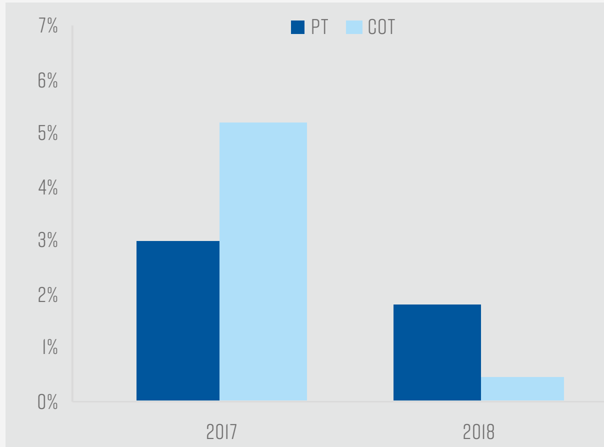
22. ...and in the small to medium size product tankers...



Oil product tanker quarterly demolitions

SOURCE: CRS, HARTLAND SHIPPING

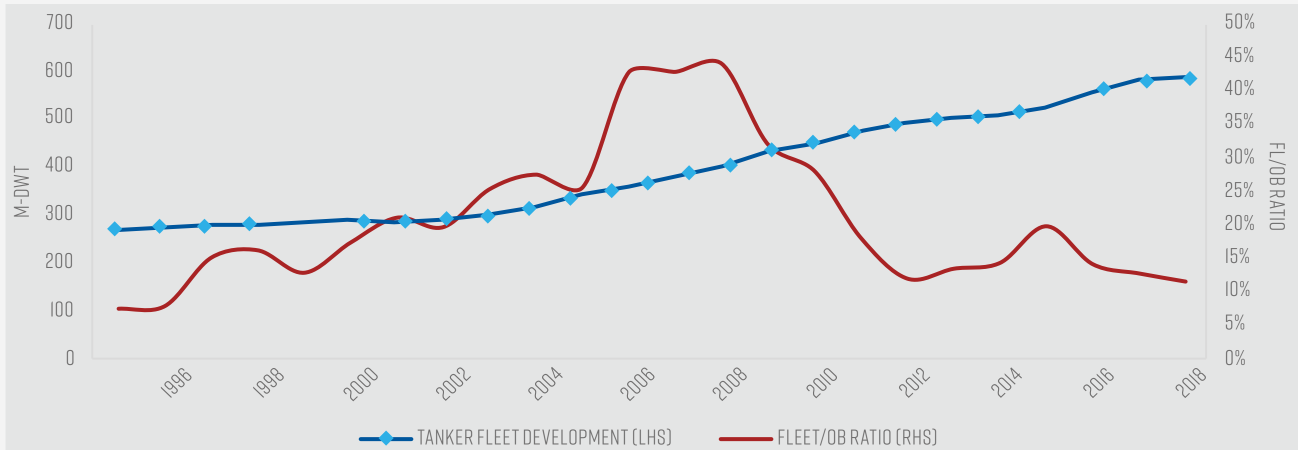
23. ...helped to minimise fleet growth in 2018.



Crude oil and product tanker fleet growth

SOURCE: CRS, HARTLAND SHIPPING

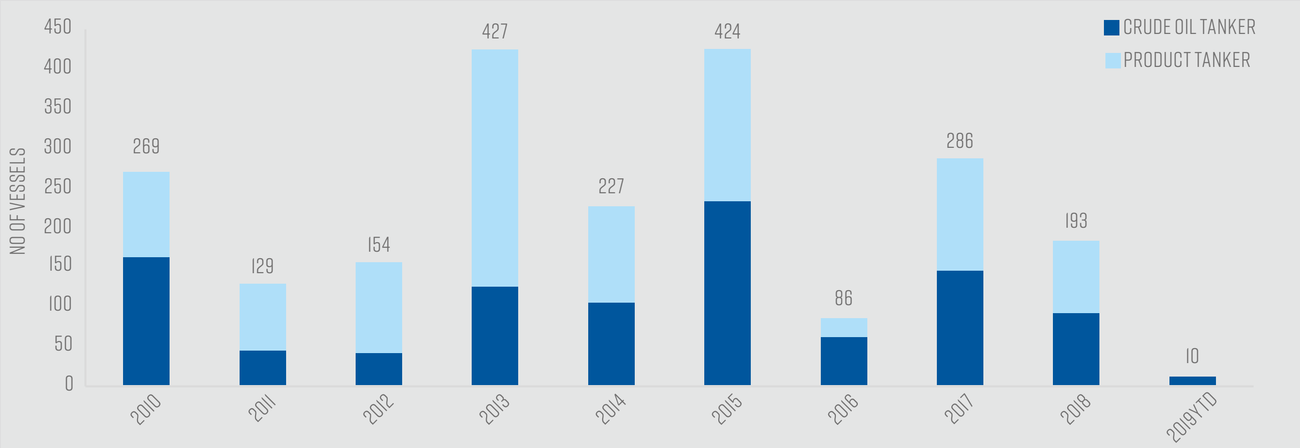
24. The OB/FL ratio stayed at its lowest level on record...



Tanker orderbook as a percentage of the fleet

SOURCE: CRS, HARTLAND SHIPPING

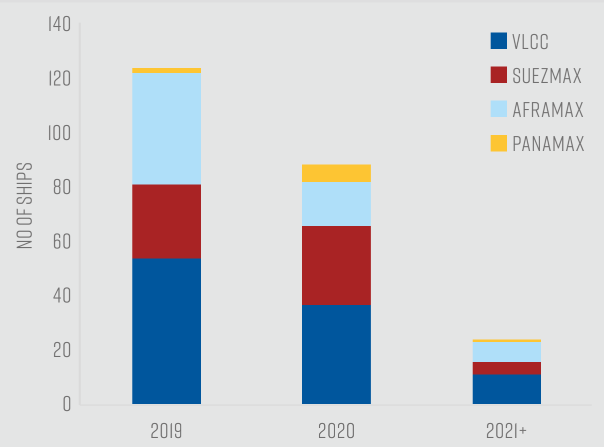
25. ...thanks to relatively low ordering.



Crude oil and product tanker contracting

SOURCE: CRS, HARTLAND SHIPPING

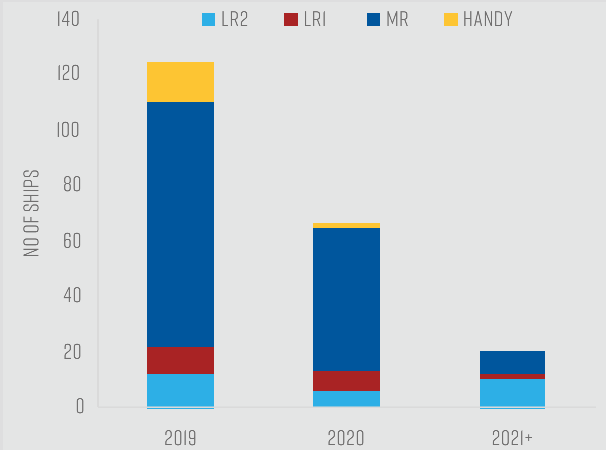
26. The COT delivery schedule is slowing, except VLCC/Aframax...



Crude oil tanker delivery schedule

SOURCE: CRS, HARTLAND SHIPPING

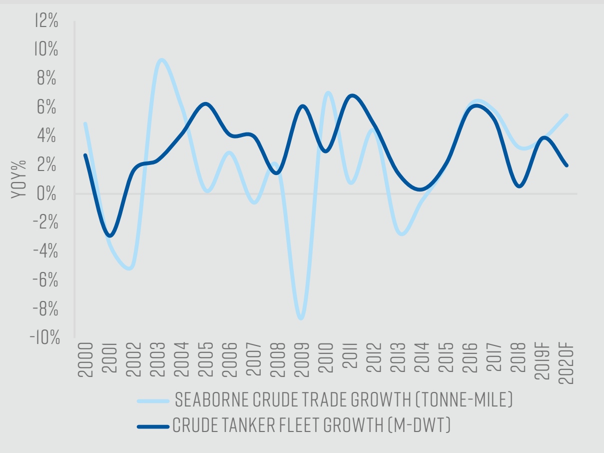
27. ...while 70% of the product tankers on order are MRs.



Oil product tanker delivery schedule

SOURCE: CRS, HARTLAND SHIPPING

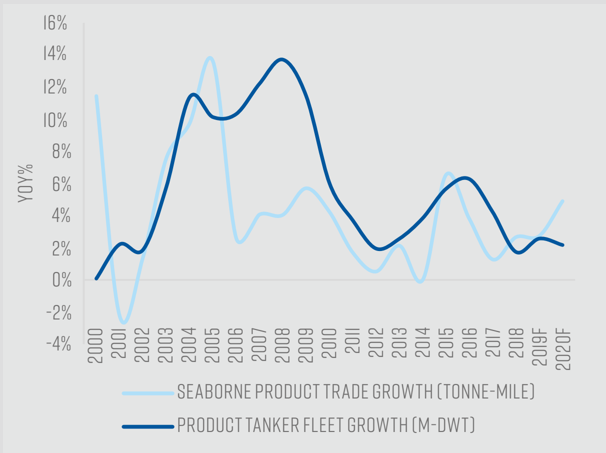
28. Overall we are at an inflection point in the crude sector...



Crude tanker supply and demand balance

SOURCE: CRS, HARTLAND SHIPPING

29. ...and so too in the product sector. Better times lie ahead!



Product tanker supply and demand balance

SOURCE: CRS, HARTLAND SHIPPING

Chartbook

Turning to the chartbook, we can see a pictorial time-line of what happened in the oil and tanker world in 2018, starting with crude oil price fluctuations.

Last year, Brent prices ended 30% higher year-on-year while WTI was up 27%. The two grades tracked each other and enjoyed their strongest quarters in Q2 and Q3 before plunging in Q4 on fears of US-led oversupply at a time of slowing global economic growth. In its best quarter Brent averaged $75.80 in Q3 and in its worst $67.30 in Q1. For WTI, its best quarter was $69.50 in Q3 and its worst was $59.00 in Q4. WTI was at a significant discount to Brent all year, a function of it being oversupplied in the US where there is insufficient refining demand for such lighter grades. Shale oil production is rising faster than pipeline and port infrastructure can get it to market. This causes supplies to build up at Cushing and prices to fall. Fortunately, there is export demand for WTI in Europe and Asia but Chinese buyers have been holding back from buying US crude while the two countries are at loggerheads over trade issues.

The cooperation agreement between Opec and the non-Opec 11, led by Russia, to cut output in the face of rising non-Opec supply, held up well in 2018. Non-Opec production rose all year going from 59.3m-bpd at the start to 62.6m-bpd at the end of 2018 while Opec output fell from 32.0m-bpd to 31.4-bpd over the course of the year. By end January 2019, non-Opec output had risen sharply to 64.4m-bpd while Opec output had fallen further to 30.9m-bpd. Renewal of the Opec-Russia agreement will see them target combined cuts of 1.2m-bpd during 2019 despite the impact of US-led sanctions on Iran and Venezuela that are reducing their output and exports. In 2018, Iranian crude oil exports fell from a yearly peak of 2.6m-bpd at the end of May to an annual low of 0.7m-bpd by end December, while Venezuelan crude oil exports oscillated in the range of 1.1 to 1.4m-bpd in 2018, well short of the 1.9m-bpd that it exported in early 2017. Venezuelan output and exports will continue to reduce under US sanctions. Conversely, total US oil production rose to an average of 11.0m-bpd in 2018, according to the EIA, and is forecast to rise to 12.4m-bpd in 2019 and to 13.2m-bpd in 2020.

[By 4Q18, global oil demand had hit a peak of 100.9m-bpd while global oil supply was one million barrels higher at 101.9m-bpd, according to the IEA. By 4Q19, world oil demand is forecast to rise to 102.2m-bpd while world oil supply is estimated to hit 102.4m-bpd. Thus, a 1.3m-bpd increase in demand will be met by a much smaller 0.5m-bpd increase in supply, with a narrowing overhang suggesting that oil prices may find support. OECD commercial inventories had declined over the course of 2017, from just over 3.0 billion barrels to just above 2.8 billion barrels, taking them back to 5-year average levels. This helped oil prices recover in Q2 and Q3 before returning to a small surplus in Q4 and consequentially lower prices. US strategic oil reserves fell from 696 million barrels in early 2017 to 691 million barrels in early 2019, while US commercial oil inventories fell from 483 million barrels in early 2017 to 440 million barrels at the start of 2019.]

In its 15 March Oil Market Report, the IEA noted that global oil demand growth slowed to 0.95m-bpd in Q4 2018, a 0.3m-bpd reduction compared with 4Q 2017. This was put down to slower OECD demand, with large falls in Europe and Asia and slower demand in the Americas. Despite this, it is staying with its previous estimates and forecasts of global oil demand growth of 1.3m-bpd in 2018 and 1.4m-bpd in 2019. This is largely premised on stronger demand growth in non-OECD countries, especially parts of the Middle East and Asia. Global oil output was at 99.7m-bpd in February, up 1.5m-bpd on a year ago, led by the US and other non-Opec producers. It reckons that non-Opec production growth will slow from a record 2.8m-bpd in 2018 to 1.8m-bpd in 2019.

The IEA claims that Venezuelan output stabilised at around 1.2m-bpd in recent months before dropping off in recent weeks. After the Opec-plus 1.2m-bpd cuts, it puts Opec's effective spare capacity at 2.8m-bpd. Iran and Venezuela are excluded from the calculation. Much of this spare capacity is crude oil of similar quality to Venezuela's exports, thus major supply disruption can be avoided even if Venezuela's production falls further. At present, supply and demand are seen to be in balance. The big game changer for the IEA is its estimate that the US will become a net oil exporter on an annual average basis by 2021. As Canadian oil production is also rising, with most of it going to US refiners, US crude will be freed up for export. This year US seaborne oil trade will move into surplus and net exports will rise to nearly 4m-bpd by 2024.

The rising profile of the US in global oil markets provides greater choice to consumers and gives America security of supply at a time of tense geopolitics. Being able to generate extra tax revenues from exporting oil is good for the US at a time of expanding annual budget deficits.

Growth in the seaborne trade of crude oil and oil products slowed down in 2018, partially explaining the dismal earnings environment in all but the last quarter. After negative year-on-year growth in 2014 there was a bounce back in 2015 when crude oil trade rose 3.8% and product trade rose 7.3%. Thereafter growth slowed, to 4.1% for crude trade and 3.9% for product trade in 2016 and to 3.3% for crude and 1.9% for product in 2017. Last year, in 2018, both crude and product trade grew by just 1.3% each to 2,039 million tonnes for crude and to 1,080mt for product. Global crude trade is forecast to rise in absolute terms by 1.7% in 2019 and 3.0% in 2020 while global product trade is estimated to rise 3.0% in 2019 followed by 4.0% in 2020. These would be positive developments after such lacklustre demand growth in 2018, all the more so as fleet supply growth should be constrained in both 2019 and 2020. Put another and better way, in tonne mile terms, the demand outlook is even better. Crude trade grew by 6% in 2016, 6% in 2017 and 3% in 2018 while product trade rose by 4% in 2016, 1% in 2017 and 3% in 2018. In tonne mile terms, crude trade is forecast to rise by 4% in 2019 and 5% in 2020 and product trade is forecast to increase by 3% in 2019 and 5% in 2020.

Underpinning the global growth in crude oil trading on the buy side were China and India. China's crude oil imports rose 14% year-on-year in 2016, followed by 10% in 2017 and 10% in 2018 while India's crude oil imports increased 9% in 2016, followed by 1% in 2017 and 5% in 2018. China's crude oil imports amounted to 464 million tonnes in 2018, up from 420mt in 2017, while India's crude oil imports came to 227mt in 2018, up from 216mt in 2017. For two fast growth countries each with populations of close to 1.4 billion people, China's crude oil imports were running at double that of India's last year. Underpinning global growth in crude oil trading on the sell side was the US with its enormous gains in output. Since the lifting of the ban on crude exports, on 18 December 2015, the US has found overseas export markets for its mostly light sweet grades of crude. Before that date, it could only export condensate and that was in very small volumes.

In Europe, it had a willing buyer for these lighter grades and so, from virtually zero exports to Europe in 2014, it went to 4.12 million barrels (11,288-bpd) in 2015, to 7.47mb (20,466-bpd) in 2016, to 10.61mb (29,068-bpd) in 2017 and to 23.68mb (64,877-bpd) in 2018. We have seen spectacular year-on-year growth in US crude oil exports to Europe but the total 2018 figure is still insignificant when compared with China. According to Chinese customs data, China imported an average of 245,616-bpd of crude oil and oil products in 2018, 25% up on 2017. It imported minimal volumes since July and nothing in December. The EIA puts the 2018 average of crude oil imports at 219,340-bpd, the difference being the product imports. The 2018 total would have been higher but for zero Chinese imports of US crude oil in August, September and October and only 8,000-bpd in November and 97,000-bpd in December. Chinese buyers held back, probably in solidarity with national interest, despite US crude not being on the tariff list. This year, we understand from Reuters that no US crude was imported by China in January. None is scheduled to arrive in either February or March, although a 2-million barrel VLCC shipment of US crude is set to arrive in China in mid April.

US sanctions on Venezuela are opening up more export opportunities for US crude as Venezuela's production and exports decline. Its crude oil exports fell from an average of 1.55m-bpd in 2017 to 1.29m-bpd in 2018 and latest figures show that its exports tumbled to just 0.71m-bpd in February 2019. Total US crude oil production has risen from 9.2m-bpd in January 2016 to an all-time record of 12.0m-bpd in January 2019, a 30% gain in three years, after averaging 11.0m-bpd in 2018. This has led to an increase in US exports and a downward trend in US imports, particularly of Opec crude. This is geopolitically helpful as it reduces American dependence upon Opec. Instead, the US finds itself competing with Opec for crude oil sales in global markets. US crude oil exports have risen around five-fold from January 2016 when it exported only 0.49m-bpd. In Q4 2018, it exported 2.33m-bpd in October, 2.61m-bpd in November and 2.51m-bpd in December. Since January 2016, US crude oil imports are still holding at around 8.0m-bpd as it needs to import heavier grades of crude oil than it produces domestically for its refining complex in the Gulf of Mexico. However, US imports of Opec crude have fallen from an average of 3.18m-bpd in 2016, to 3.12m-bpd in 2017 and to 2.62m-bpd in 2018.

US crude exports have been helped by overseas demand for light sweet crude and by the fact that transport and pipeline bottlenecks in the US have led to a glut of WTI around Cushing, Oklahoma, the WTI storage and pricing point. This has meant that WTI has been trading at a wide discount to Brent which has made it an attractive buy in the Far East, even after adding in the costs of pipeline and seaborne transportation. In 4Q16, Brent traded at about a $2 a barrel premium to WTI but since then it has been at a discount as US crude oil production has steadily ramped up. In 4Q18, this discount went out as far as $12 a barrel. The drilled but uncompleted rig count in the Permian Basin stands at over 4,000 units up from around 1,200 only three years ago. This creates the potential to easily increase production should prices justify it.

Oil market supply and demand is precariously balanced, which might explain why hedge funds are flipping between being long and short. Rising production of lighter sweet grades, especially from the US but also Brazil, is in conflict with falling production of heavier sour grades, from the likes of Iran and Venezuela. This situation is being exacerbated by the voluntary Russian and Opec output cuts of similar heavier grades from Middle Eastern producers such as Saudi Arabia, Kuwait and the UAE. Urals, a high sulphur Russian crude, would normally trade at a discount to low sulphur Brent from the North Sea. Typically, over recent years, this discount has been up to $3.5 a barrel compared with Brent but, in early 2019, it is trading on a parity basis. Changes to output and pricing suggest that there is currently a surplus of the lighter crude oil grades that easily convert to middle distillates such as gasoline, diesel and jet. At the same time, there is a relative shortage of the medium to heavier grades that are in demand from complex refineries, and of the residual fuels that are used as HFO in ship engines for propulsion and by utilities for power generation.

IMO 2020

From a shipping perspective, the implication is that there is plenty of feedstock for 0.5% sulphur LSFO but less feedstock for up to 3.5% sulphur HFO. This suggests that the price spread between the two may narrow if the current market dynamics persist, which seems likely at present. The shipping industry was expecting a price delta of $250-300 a tonne between HFO and LSFO by 2020; this has been regarded as an attractive margin and might easily justify fitting scrubbers to certain larger ships. However, at the end of February, the futures market was showing a lower discount of $175-185 a tonne for calendar 2020. As more refineries upgrade their HFO output to more refined grades, and as more ships fit scrubbers, the availability of HFO will fall and its price will rise. Conversely, the abundance of light sweet crude in the market makes its cheaper to produce middle distillates, demand for which may be under pressure as the global economy slows. Hence, we have a pincer movement that will most likely compress the HFO-LSFO spread.

At this point we return to tanker earnings taking a longer 5-year perspective from the beginning of 2014. Average crude tanker earnings have outperformed average product tanker earnings over this period. The large crude tanker annual average earnings are derived from the combination of the VLCC, suezmax and aframax segments. In 2014, they managed £27,393 daily; in 2015, $49,663 per day; in 2016, $30,503 daily; in 2017, $15,880 per day; and in 2018, $15,969 daily. The average earnings for these large crude tankers have settled at around $15,900 per day in the last two years of 2018 and 2017, about half the level of 2016 and 68% below the level of 2015. Still positive demand growth and restrained supply growth indicate that we should be in for a cyclical recovery in earnings in 2019. The large product tanker annual average earnings are derived from the combination of the LR2, LR1 and MR segments. In 2014, they achieved $16,016 daily; in 2015, $26,537 per day; in 2016, $14,584 daily; in 2017, $10,023 per day; and in 2018, $9,751 daily. The $9,900 per day average of the last two years was 32% lower than 2016 and 63% lower than the best year of 2015. Like crude tankers, the supply and demand data suggests that we are due for a cyclical recovery in earnings in 2019.

Despite the weak earnings of 2018, investors have been anticipating better times ahead and last year they were prepared to pay up to secure second-hand tankers at historically depressed valuations. The best year-on-year asset value gains in each segment in 2018 were: 27% for a 15-year old VLCC; 32% for a 10-year old suezmax; 47% for a 15-year old aframax; 4% for a 5-year old LR1; and 12% for a 5-year old MR. Total tanker deliveries remained quite elevated in 2018 at 281 units of 28.3m-dwt after 2017's 336 units of 38.0m-dwt. Half way through the first quarter of 2019 we had already taken delivery of another 57 units of 7.3m-dwt. In deadweight terms, crude tankers easily outdid product tankers, as to be expected. One good thing about the poor earnings of last year is that they encouraged a higher rate of scrapping. In the crude sector, 19.1m-dwt of crude oil tankers were dispatched to the breakers in 2018 after 9.8m-dwt in 2017. In early 2019, little has been scrapped. In the product sector, 6.9m-dwt was sent for demolition in 2018 after 4.3m-dwt in 2017. The scrapping was marginal relative to deliveries but it all helps towards achieving better supply-demand balance.

Future fleet growth

Future tanker fleet growth, crude plus products, will be slower for the next few years as fewer ships have been ordered. At the beginning of 2017, 78.4m-dwt was on order against a fleet of 555.2m-dwt, giving an OB/FL ratio of 14.1%. At the start of 2018, 74.2m-dwt was on order against a fleet of 581.8m-dwt, giving an OB/FL ratio of 12.7%. At the outset of 2019, 67.8m-dwt was on order against a fleet of 587.7m-dwt, giving an OB/FL ratio of 11.5%. This is the lowest OB/FL ratio since 1997 when it was at 7.9%. With the lowest fleet growth in over 20 years this year we expect that demand can hold up sufficiently to deliver stronger earnings, leading to higher asset values. 2018 was a more restrained year of tanker ordering compared with 2017 and that should feed through. By segment, VLCC saw 42 orders in 2018 after 56 in 2017; suezmax 23 after 27; aframax 28 after 64; LR2 6 following 32 and MR 71 following 95. The crude tanker delivery schedule stands at 123 units of 25.7m-dwt in 2019; 88 of 17.7m-dwt in 2020; and 26 of 5.1m-dwt in 2021 and beyond. VLCC and aframax crude tankers dominate deliveries over this year and next. The product tanker schedule is at 124 units of 7.0m-dwt in 2019; 66 of 3.8m-dwt in 2020; and 20 of 1.7m-dwt in 2021 and beyond. It is dominated by MRs. The crude tanker OB/FL ratio is at 12% while the product OB/FL ratio is at 8%.

Shipping Markets Outlook
2019 Edition

The Containership Market

The Containership Market

The container market continues to suffer from top-down oversupply as all carriers take delivery of large ships to achieve economies of scale.

Fleet growth

The rate of overall cellular fleet capacity growth is thankfully slowing. After growth of 5.6% in full year 2018 the fleet is forecast to expand by only 2.9% in 2019 and 3.2% in 2020. The upcoming IMO 2020 rules might subtract up to another 1% from effective fleet growth as many ships will be taken out of service to retrofit scrubbers and the higher cost of compliant fuel should encourage both more scrapping and more slow-steaming. Slower net fleet growth at a time of a weakening global economy is a positive development as future demand growth is put at risk by US-China trade friction that may raise the price of goods and lower purchase interest. The main reason that fleet growth is moderating is that there are fewer ships on order after many years of oversupplying the market. This moderation in the supply side is a product of many years of unexciting freight rates and time charter returns as well as a less supportive banking sector.

Orderbook

The order book for ships of 15,000-teu and larger was at 66 units totalling 1.32m-teu at the end of 2018, being 53% by number and 56% by capacity of the trading fleet in this size of 125 units totalling 2.34m-teu. However, at the end of 2018, the total cellular order book was at 2.86m-teu against a total cellular fleet of 22.01m-teu. This puts the total containership order book to fleet ratio at its lowest level in over 20 years at just 13%, but it is heavily skewed to larger ships. During the course of 2018, the fleet of ships of 15,000-teu and larger expanded by 33.5% with a much lower 10.5% expansion in the next size down of 12,000 to 14,999-teu. In the sizes below 12,000-teu there was negligible growth in 2018, with 3.6% growth in the 8,000 to 11,999-teu segment and 2.2% in the feeder sizes from 100 to 2,999-teu. In the intermediate categories spanning 3,000 to 7,999-teu there was no noticeable change. Given these supply side dynamics, there should be scope for an improvement in the earnings of sub 8,000-teu ships over the next few years.

Supply and demand balance

2018 saw supply and demand come into better balance with global container trade growing 4.3% year-on-year to 200.7m-teu from 192.4m-teu in 2017. Meanwhile, on the supply side, the cellular fleet expanded by a slightly larger 5.6% from 20.85m-teu to 22.01m-teu. Last year, trade growth was fairly evenly distributed across the main trade lanes. The Transpacific benefited from Q4 frontloading ahead of possible tariff increases and Asia-Europe showed signs of weakness, a foretaste of the weaker European economic data that is now coming through. The base case forecast for 2019 is for trade growth of 4.1% to 209.0m-teu against fleet growth of 2.9% to 22.65m-teu and, for 2020, trade growth of 4.0% to 217.4m-teu against fleet growth of 3.2% to 23.38m-teu. So, on average, we should see trade growth outpace fleet growth by 1% per year in 2019 and 2020. This should have a positive effect on freight rates, earnings and values although much will depend upon the micro supply and demand balances within each ship segment and the trade lanes upon which they operate.

TC rate and earning indices

The Clarkson Containership Timecharter Rate Index averaged 60 points in 2018, 28% up on full year 2017. The improvement in performance disguised what was a volatile year, good in the first half and poor in the second. It started the year at 54.4 in January and rose to a peak of 68.0 in June only to slide back to 52.1 by December. In timecharter equivalent terms (TCE) this represented a shift up from $10,148 daily in January to $13,732 per day in June and then back to $11,260 daily in December. In January this rose marginally month-on-month to $11,273 per day. The Timecharter Earnings Index saw average time charter rates rise 36% from $9,035 daily in 2017 to $12,311 per day in 2018. That is a step in the right direction and this should continue in 2019 and 2020 as the supply-demand balance improves. Better demand growth in regional and non main-lane trades should support improving TC rates for smaller ships of 5,000-teu and under, especially the larger feeder sizes.

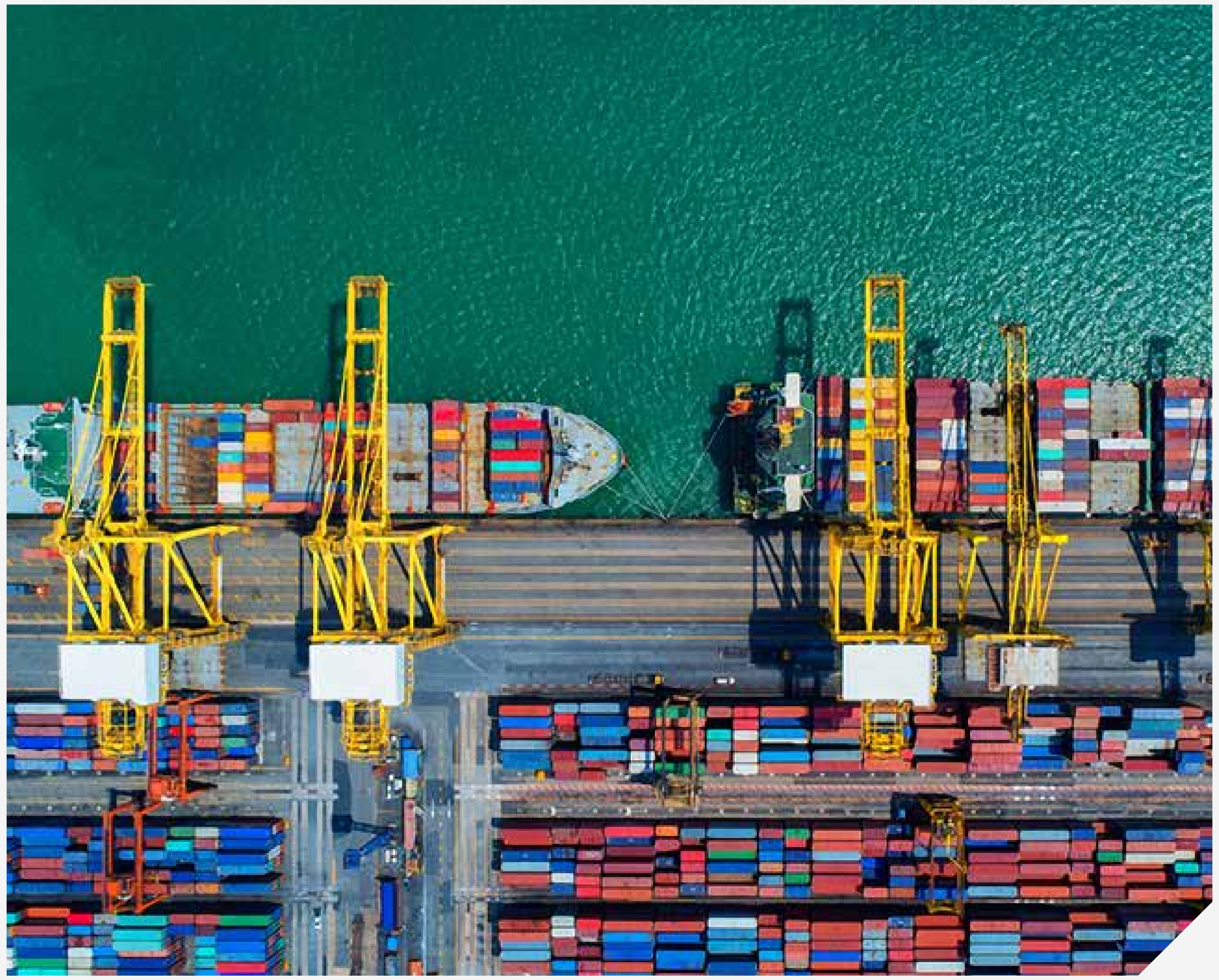
Segmental TC rates

Despite the poor end to last year, annual average time charter rates did improve year-on-year in 2018 in all of the tramp ship segments. The data shows that a geared 1,000-teu unit was earning 21.6% more in 2018 compared with 2017, up to $7,467 from $6,412 per day. A geared 1,700-teu vessel was up 33.6% to $9,675 from $7,242 daily. A gearless 2,000-teu unit was up 32.9% to $9,508 from $7,154 per day while a gearless 2,750-teu unit was 22.9% stronger to $10,813 from $8,800 daily. A classic 32.2m narrow beam panamax vessel of 4,400-teu was up 44.3% to $11,096 from $7,692 daily. This has been a remarkable recovery for a segment that was largely written off in the run-up to the opening of the new set of locks in the Panama Canal on 26 June 2016. Average annual earnings had slumped to just $4,979 per day in 2016 from $11,817 daily in 2015. However, latest fixtures in early 2019 suggest that a 4,400-teu classic panamax is now earning a bit under $8,500 per day while a wide-beam (37.0m) 5,000-teu vessel is being paid over $15,000 daily.

In the wide-beam intermediate size of 6,800-teu earnings rose 10.4% in 2018 to $14,542 per day from $13,171 daily in 2017. In 2019 year-to-date, average earnings have got off to a poor start with all segments trading down on the levels that they achieved last year. After the first two months of 2019 nominal 6-12 month charter rates are languishing at low levels. A 1,000-teu unit is averaging $6,039 daily, a 1,700-teu is at $6,994 per day, a 2,000-teu at $7,361 daily, a 2,750-teu at $8,639 per day, a 4,400-teu at $8,306 daily and a 6,800-teu at $12,844 per day. Some of the current weakness might be attributed to the rush of activity in the final months of last year as shippers tried to beat the anticipated rise in US-China tariffs that were scheduled to be applied at the beginning of 2019. The deadline for raising tariffs was then extended in early December to 1 March 2019 and, more recently, they have been put on indefinite hold as the two sides are allowed more breathing space to strike a deal.

Asset values and ship sales

The weak earnings market has temporarily blown off track the asset value gains of recent years. Taking nominal end year values, a 10-year old 1,700-teu unit rose from $5.5m in 2016 to $9.0m in 2017 and to $10.5m in 2018. This has now slipped back to $9.5m. A 10-year old 2,750-teu vessel increased from $5.8m in 2016 to $10.8m in 2017 and to $13.5m in 2018. This has now tracked back one million to $12.5m. A 5-year old 4,500-teu classic panamax rose from a lowly $7.0m in 2016 to $12.5m in 2017 and to $15.5m in 2018. This has since softened to $15.0m but it still represents a more than doubling in value since the low point of end 2016. Several buyers, such as Seaspan and KMTC, had the vision to buy in the dip of 2016 and they have profited handsomely, on paper, from buying at a time when this classic panamax segment was at its most distressed.



Despite depressed freight rates arising from the oversupply of megaships there is still no cessation of orders for such units, just a slowdown. It is made easier by the appetite of Chinese financial leasing companies to own such ships against long-term leases.

On the sales side, a series of 10,000-teu vessels that delivered from Dalian Shipbuilding in 2014 were sold in January this year for $267m en bloc. The CSCL Spring, CSCL Summer, CSCL Winter and CSCL Bohai Sea were sold by Cosco Shipping Development to Japan's Financial Products Group with an 8.5-year bareboat charter back worth $248m, equating to a bareboat rate of just under $20,000 per day. The charter-free value was estimated at $228m. CSD has an option to buy the ships four years after the leases commence and again after seven years and three months. CSD will continue to time charter the vessels out to Cosco Shipping Lines under separate arrangements.

In October last year, NYK was reported to have sold the NYK Aphrodite 6,492-teu IHI 2003 to clients of Cyprus Maritime for $13.0m. Last June, NYK was reported to have sold the NYK Terra 6,500-teu HHI 2008 for $25.0m to clients of Sea Consortium. A few weeks earlier, Diana Containerships was reported to have sold the similar Puelo 6,541-teu HHI 2006 to clients of Nissen Kaiun for $20.5m. At around the same time, Diana was also reported to have sold the Hamburg 6,494-teu Koyo 2009 to the MPC Group for $21.0m. And in April 2018, Nautilus Holdings was linked to the sale of its Texas and Washington 6,969-teu HHI 2009 to clients of MSC for $27.5m each.

In late October last year, Technomar was associated with the sale of the classic panamax Argos 4,250-teu New YZJ 2012 to clients of Borealis for $14.7m. Also in October, Pacific International Lines (PIL) was reported to have sold three classic panamax ships en bloc to clients of Mingsheng Financial Leasing. These were the Kota Karim 3,081-teu Toyohashi 2006, the Kota Lawa 4,253-teu Dalian 2008 and the Kota Lihat 4,335-teu Dalian 2013 for a total consideration of $88.9m. In July, Dioryx Maritime was reported to have sold its Patraikos 4,498-teu Hyundai Samho 2010 to undisclosed interests for $15.0m and, in the same month, NSC Schiffahrt was linked to the sales of the two classic panamax sisterships Bahia and Benito 4,308-teu HHIC-Subic 2009 to clients of Mangrove Partners for $13.9m each.

Back in June last year, Delphis was rumoured to have sold four wide-beam (37.3m) sisterships to Ocean Yield. These were the Barcelona Express, Detroit Express, Genoa Express and Livorno Express all 3,832-teu HHIC-Subic 2014 at an undisclosed price. Also in June, C-P Offen was reported to have sold the classic panamax sisterships ANL Warragui and CPO Jacksonville both 4,225-teu HHI 2009 to clients of Borealis for around $14.4m each. Borealis was also linked to the purchase of the Circular Quay 3,534-teu Shanghai Shipyard 2009 from the Schulte group for $11.6m. In May, Dioryx Maritime was said to have sold its Corinthiakos 4,498-teu Hyundai Samho 2010 to clients of Asiatic Lloyd for $15.0m.

In March 2018, Diana Containerships was linked with the sale of the Centaurus and Sagitta both 3,426-teu TKMS Nordseewerke 2010 to the MPC Group for $12.3m each. Last January, Diana was said to have sold the wide-beam (40.0m) sisterships Great and March both 5,576-teu Koyo 2004 to clients of Technomar for $11.0m each. There has been a lot of activity in the feeder sizes. In February this year, H. Schuldt was reported to have sold sisterships Independent Accord and Independent Concept both 1,574-teu Yangzijiang 2007 to clients of Contships for $6.0m each. In January, H. Schepers was linked to the sale of the Arian and Tammo both 1,345-teu Yangzijiang 2011 to clients of Contships for $8.5m each.

In December last year, the Navigia group was reported to have sold four sisterships to clients of JR Shipping for an en bloc total of $37.0m. These were the Aalderdijk, Akerdijk, Alsterdijk and Amerdijk all 1,440-teu Sainty 2011. Also in December, the Kalkavan Group was reported as the seller of the Cafer Dede and Ibrahim Dede both 1,878-teu Sedef Gemi 2008 to Greek buyers for $9.0m each. In November, Heung-A Shipping was linked to the sale of its Heung-A Laem Chabang 1,785-teu Dae Sun 2016 to Kotoku Kaiun for $20.0m. Back in October, Hartmann was reported to have sold four sisterships to clients of Pacific & Atlantic for $6.0m each. These were the Frisia Aller, Frisia Alster, Frisia Iller and Frisia Inn all 1,114-teu SP Dayang 2007 except the Frisia Inn 2008.

In June last year, NSB Niederelbe was reported to have sold its Buxharmony 2,702-teu Howaldtswerke Werft 2007 to clients of SITC for $14.25m while, in May, Thomas Schulte was associated with the sale of its Victoria Schulte 2,478-teu Aker Ostsee 2005 to MPC Containers for $11.8m. MPC was also reported in March as the buyer of five 1,200 to 1,500-teu vessels being the Sima Perfect, Sima Prestige, Sima Pride, Sima Sadai and Sima Sapphire all built at Peene Werft and delivered between 2004 and 2007. The seller was Simatech Shipping and the en bloc price was quoted as $41.9m.

In February 2018, MPC was the reported buyer of 12 ships from the Ahrenkiel fleet ranging from 1,300 to 2,800-teu that were built in China and Korea and delivered between 2006 and 2012 for an en bloc price of $139.5m. In January, MPC was linked with a trio of sisterships being the Camellia, Dahlia and Violet all 2,824-teu HMD 2006 from Nautilus Holdings at unit prices ranging between $10.5m and $10.9m each. Lastly, in early January last year, Reederei O. Marten was reported to have sold two sisterships to Atlantica Shipping for $7.5m each. They were the O.M. Agarum and O.M. Iridium both 2,007-teu SP Zhejiang 2008.

Newbuilding ordering

Latest news is that Maersk Line has secured lease financing for 13 new feeder containerships of 2,200-teu each. Five of these will be built at Jiangnan Shipyard in China and owned by ICBC Financial Leasing. The reported unit price is $20m each to be chartered by Maersk on unknown terms. Another five units will be built at Imabari in Japan and a further three units will be constructed by Zhoushan Changhong in China. The deliveries are scheduled from Q4 2020 to end Q2 2021. They are intended for Maersk Line's intra-Asia trade and will replace older less efficient chartered and owned tonnage that will be phased out over the next few years. As such, this move is intended as fleet replacement and ongoing optimisation rather than adding net new capacity. Maersk plans no new orders of large vessels before 2020 and it aims to keep its overall fleet size at around the 4.0m-teu mark. This order win for Jiangnan follows four 2,400-teu units that it secured in January. These were placed by Atlantic Geneva for charter to Sinokor Merchant Marine and are scheduled for delivery in 2021.

Regional trade changes

Maersk Broker's analysis of year-on-year growth in regional container volumes by import region shows an overall slower growth trend. European and Mediterranean imports were up 4.5% in 2017 and by a similar 4.3% in 2018. North American imports were up 5.2% in 2017 followed by a stronger 6.5% in 2018. East and South East Asian imports were up 4.5% in 2017 and by a weaker 2.6% in 2018. South and West Asian imports were 4.5% stronger in 2017 followed by a weaker 2.0% growth rate in 2018. Sub Saharan African imports were up 8.2% in 2017 followed by 5.9% in 2018. Oceania imports were steady at 3.3% in both years while Central and South American imports were up 6.8% in 2017 followed by 4.0% in 2018. In aggregate, this equated to 4.9% global import growth in 2017 followed by a slower 3.7% growth rate in 2018. Meanwhile, for 2019, Clarkson projects main-lane trade growth of 1.9% and non main-lane trade growth of 5.1%. This is all subject to change while we await the outcome of the ongoing Sino-US trade discussions.

Top ten trades

Maersk Broker's analysis of year-on-year growth in the top ten trades shows a similar overall slowdown. East and South East Asia to East and South East Asia was up 4.1% in 2017 followed by a firmer 4.8% in 2018. East and South East Asia to North America was up 4.8% in 2017 followed by a stronger 6.4% in 2018. East and South East Asia to Europe was up 4.5% in 2017 followed by a weaker 2.2% in 2018. North America to East and South East Asia grew by 1.7% in 2017 only to shrink 5.9% in 2018. Europe to East and South East Asia was up 5.7% in 2017 but contracted by 2.3% in 2018. East and South East Asia to South and West Asia was up 4.2% in 2017 only to shrink 3.3% in 2018. Europe to Europe was 4.0% up in 2017 followed by a firmer 6.5% in 2018. Europe to North America rose 8.3% in 2017 and 6.3% in 2018. Europe to South and West Asia was up 1.3% in 2017 and 2.2% in 2018. Finally, East and South East Asia to Central and South America rose 7.9% in 2017 followed by 3.5% in 2018.

Weakness was detected on the back-haul trades into East and South East Asia from both North America and Europe which were significantly affected by China's import ban on various types of waste. Otherwise, imports into India and West Asia from the Far East were also negatively impacted by weaker demand. Intra Far East trade remained strong, rising to 4.8% in 2018 from 4.1% in 2017, and head-haul Far East to North America rose to 6.4% in 2018 from 4.8% in 2017. There was a major boost to eastbound Transpacific trades in the last quarter of 2018 as US importers ramped up activity ahead of anticipated tariff hikes on a raft of Chinese goods. Head-haul Far East to Europe trade disappointed in 2018 as it halved to 2.2% after 4.5% in 2017, a forward indicator of weaker economic growth and lower consumer spending across most of Europe. For instance, German growth fell to just 1.5% in 2018 whilst Italy slipped into technical recession in the last two quarters.

Consolidation and oversupply

After consolidation, the top ten ranking of container operators has changed. Still in first place is Maersk Line, further enlarged having taken over Hamburg-Süd, with 4.04m-teu deployed of which 2.41m-teu is owned. In second place is MSC with 3.26m-teu deployed of which 1.29m-teu is owned. These top two carriers are linked via the 2M alliance. In third place is China Cosco which has shot up the ranks having taken over CSCL and OOCL. It has 2.77m-teu

In an uncertain demand environment, with protectionist trade wars threatening to escalate, it is important to keep managing net new supply down to a minimum. Consolidation amongst the mainline container carriers should help this process.

deployed of which 1.97m-teu is owned. In fourth place is the imaginative French carrier CMA CGM with 2.63m-teu deployed of which 1.15m-teu is owned. German carrier Hapag-Lloyd is in fifth place with 1.63m-teu deployed of which 1.04m-teu are on its own books. The next five places are taken by ONE (the long awaited Japanese merger of NYK, MOL and K-Line), then Taiwan's Evergreen and Yang Ming, next Singapore's PIL and finally South Korea's HMM. Hyundai Merchant Marine took over the mantle of quasi South Korean state carrier after the demise of Hanjin, but not before it narrowly avoided bankruptcy itself. Now it is busy expanding its fleet with the help of state financing. It has the largest order book of any carrier at 20 ships aggregating 398,400-teu. This is more than twice the size of its current owned fleet capacity of 192,291-teu.

In terms of ships on order, at the end of February and before the latest announcements Maersk had only three ships on order totalling 34,048-teu. It plans to keep its fleet at around the 4.0m-teu mark. MSC has 11 ships of 242,000-teu on order while Cosco also has 11 of 159,382-teu lined up. CMA CGM has 15 units totalling 214,500-teu while fifth placed Hapag-Lloyd has nothing at all on order. The top five charter owners are Seaspan with 0.91m-teu under ownership, Costamare with 0.49m-teu, C-P Offen with 0.47m-teu, Shoei Kisen with 0.40m-teu (and 0.48m-teu on order) and BoCom Leasing with 0.36m-teu. Maersk owns 2.6-times the capacity of the largest charter owner, Seaspan, proving that the carriers still have to carry a lot of assets on the balance sheet. The rise of the Chinese leasing companies sees BoCom Leasing appear in fifth place in the ranks of charter owners while compatriot Mingsheng Bank is in twelfth place.

Thematically, the containership sector continues to be over-ordered and over-tonnaged despite recent rounds of consolidation that have seen Maersk take over Hamburg-Süd, CMA CGM take over APL, and Cosco absorb OOCL. It is a case of top down oversupply whereby each carrier attempts to reduce unit costs by applying the largest possible ships to any given route. This cascades unsuitably large ships onto other trade lanes, depressing rates on those routes. The process inevitably involves ordering new and larger ships and the end result is lower unit freight on all the main trade lanes. Despite depressed freight rates arising from the oversupply of megaships there is still no cessation of orders for such units, just a slowdown. It is made easier by the appetite of Chinese financial leasing companies to own such ships against long-term leases. This enables the carriers to modernise their fleets without putting too much strain on the balance sheet. However, the availability of such financing is contributing to oversupply as it panders to demand for ever larger ships.

No.1 Chinese lessor, ICBC Leasing, is reported to have added $3.2 billion of new business in 2018 while No.3, CMB Leasing, is said to have added $1.5 billion of new business to its books. It is not clear whether such large 90% LTV loans are available in the conventional bank sector, without which these ships may not get ordered in the first place. Thus, one can see how the leasing companies, in their efforts to win new business and support Chinese shipyards, are perpetuating overcapacity and depressing future earnings. Recent orders generated some concerns at the Marine Money Shanghai conference in early March 2019. Minsheng Financial Leasing suggested that the lending parameters being applied do not match the real fundamentals, with the lessors actually exceeding the level that their credit status can support. The mainline carriers have recently endured some tough operating years of low earnings and yet they still have added capital expenditure, increasing pressure on their balance sheets. Maersk Line is the only carrier with an investment grade BBB rating from S&P.

It is reckoned that Chinese leasing companies have over $50 billion in shipping assets having entered the shipping sector as recently as 2007, although activity has really stepped up since 2013. The market leaders, ICBC Leasing and Bocom Leasing, pushed their shipping investment portfolios above the $10 billion mark in 2017 and 2018 respectively. After more than ten years of prolific growth, and the entry of non financial institutions such as hedge funds and private equity, traditional bank finance is about to return. Lending margins have risen to more respectable and competitive levels while the main shipping sectors are at a cyclical low point. Traditional shipping banks are likely to increase their lending to shipping at a time when Chinese lessors reduce their activity. Many early leasing deals kept all the risks with the lessors and almost none with the lessees. Typical operating leases involved high LTV financing, flexible charter periods, generous call options and an absence of put options. The optionality was all or mainly on the operator's side. This is changing as the leasing companies gain experience. As for traditional lenders, the cost and terms of borrowing are expected to rise which will act as a welcome deterrent to borrowers and help to diminish supply side expansion.

Shift to LNG

CMA CGM started the shift to dual fuel LNG propulsion, and is investing even more capital in leapfrogging IMO 2020 and looking further forward to new global carbon rules set to take effect from 2050. CMA CGM is fitting LNG membrane tanks to a series of nine 22,000-teu ships, with five being built at Hudong and four at SWS in China. Each will have an 18,600-cbm GTT Mark III membrane LNG tank and will be powered by Winterthur low-pressure, two-stoke 12x92DF engines whose 12-cylinders are rated at 63,840 kW at 80rpm. Total is contracted to supply 300,000 tonnes per year of LNG fuelling to these nine ships via a specially built bunker tanker that can be positioned in North West Europe on the Asia-Europe trade lane on which they will operate. The LNGBV will be 18,600-cbm and will be owned jointly by Total and Mitsui OSK, managed by MOSK and built at Hudong.

The latest example of dual-fuel ships also involves CMA CGM. ICBC Financial Lease and CMB Financial Leasing are reported to be finalising a series of ten 15,500-teu ships, to be built at CSSC shipyards, with five for each bank. Reports suggest that five units will be built by Hudong with an LNG dual-fuel option at more than $130m each and the other five will be built by Jiangnan with hybrid scrubbers fitted at around $110m each. The in excess of $1.2 billion order will be financed with a high 90% leverage ratio, meaning loans of over $1 billion and equity as low as $120 million. French carrier CMA CGM will be the bareboat charterer for a term of over ten years at which point it will be obligated to buy the ships at a pre-agreed strike prices. Such a financial lease structure removes the residual value risk from the lender and leaves it exposed only to performance risk.

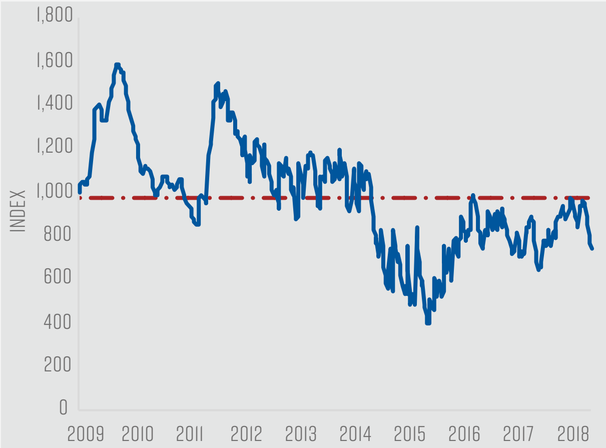
Cosco is said to be looking at even larger ships of up to 25,000-teu that would be deployed on east-west routes. The design side is being done by the Shanghai Ship and Shipping Research Institute (SSSRI) and it is regarded to be of strategic importance as it will support the maritime element of China's Belt and Road Initiative (BRI). There are two reasons why this upward shift may not happen. The first is in CMA CGM's backward step from 22,000-teu to 15,500-teu ships as per its latest orders. This may be tacit recognition that there is still a need for ships closer to the 15,000-teu size which can offer much greater operational flexibility as the 22,000-teu units are currently limited to east-west routes. The other is that the US-China trade conflict has changed the public perception of BRI. Chinese investment in and financing of infrastructure along the maritime route is good both for the recipient country and for China, as it facilitates resource extraction and exports. But if the borrowing nation fails to repay the loans from Chinese policy banks then debt for equity swaps can see the Chinese state become the owner of critical infrastructure. For example, in December 2017 a Chinese state-owned company, China Merchants, took control of the Sri Lankan port of Hambantota plus 15,000 acres of surrounding land. It was surrendered under a 99-year lease after the Sri Lankan state was unable to repay extensive loans from China. The port had been built by state-owned China Harbor.

An alternative to debt financing is equity financing in the form of foreign direct investment (FDI). A good example is Sri Lanka's Colombo Port City project that was started in late 2014. This is one of many examples of Chinese foreign direct investment flowing into Sri Lankan seaports, airports and highways using Chinese construction companies backed by state finance. Chinese FDI has also been flowing into Pakistan, the Maldives and Bangladesh which effectively encircles India with Chinese influence. For China, dominance of the Indian Ocean is a key part of its 21st Century Maritime Silk Road initiative. When finished, its Colombo Port City will rival Dubai to the west and Singapore to the east as a regional hub for finance, trade and tourism and it will enable China to access and work the markets of the vast Indian Subcontinent. The latest news is that Italy has now endorsed the BRI and this provides China with a gateway into Europe. This is a very sensitive issue as the US is threatening European countries that use Huawei 5G technology of being cut off from intelligence sharing. The US is concerned about the security risks of working with a Chinese technology provider, even one that is to all appearances a private company. Global trade is in the process of being heavily politicised.

The Containership Market

- The container market is still suffering from top-down oversupply despite consolidation. The carriers are still ordering ever-larger ships to reduce unit costs and gain market share.
- The Chinese financial leasing companies have deployed major capital to the container sector while state carrier Cosco seems determined to expand in support of its Belt and Road Initiative.
- The tramp sector looks more promising from a supply perspective, implying rising time charter rates. Overall, supply and demand balance is improving, but better on some routes than others.

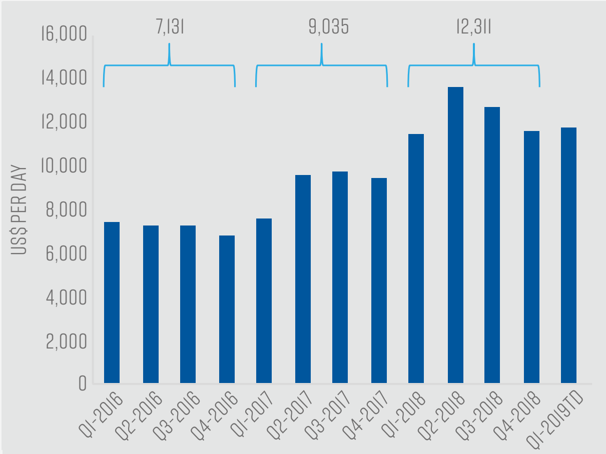
1. SCFI Comprehensive freight index : a poor five years...



SCFI Comprehensive index

SOURCE: CRS, HARTLAND SHIPPING

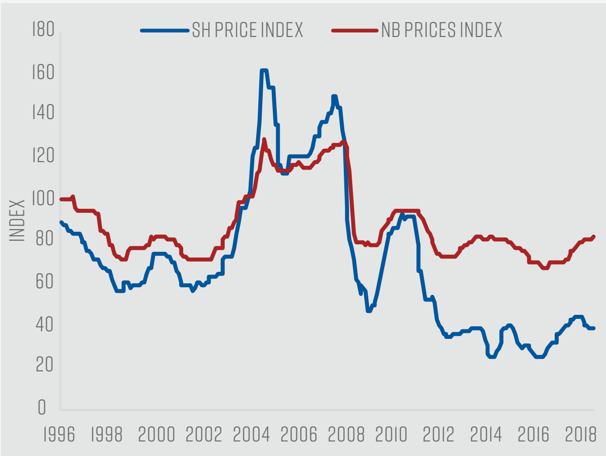
2. ...TC rates, however, have been increasing.



Clarksons containership earnings index

SOURCE: CRS, HARTLAND SHIPPING

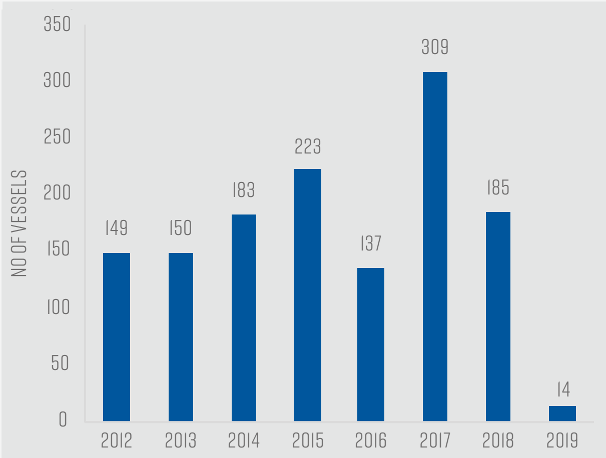
3. NB prices have become expensive relative to SH values.



Containership NB vs SH prices

SOURCE: CRS, HARTLAND SHIPPING

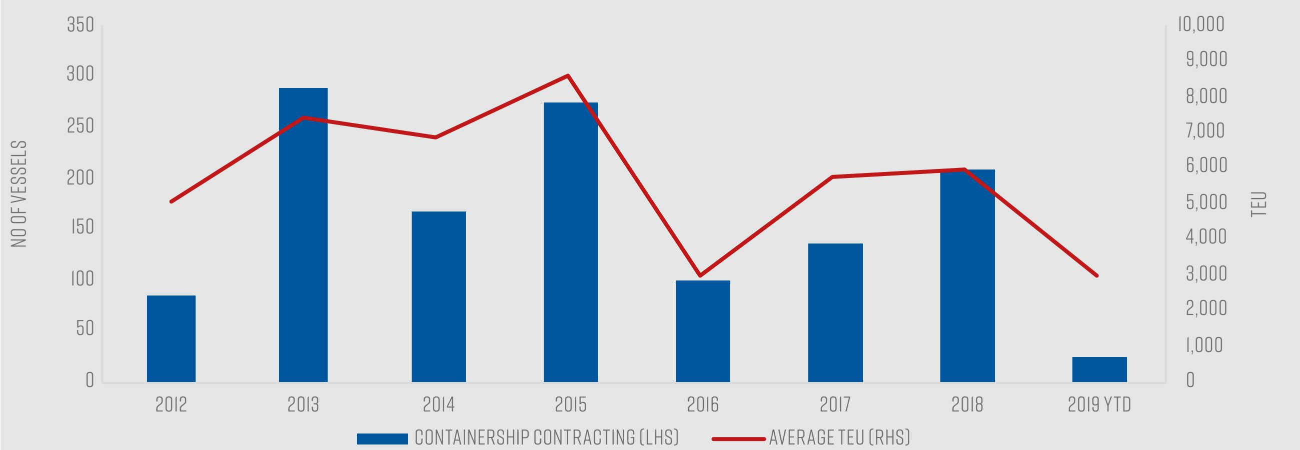
4. Last year, there were fewer SH deals compared with 2017...



Containership secondhand sales

SOURCE: CRS, HARTLAND SHIPPING

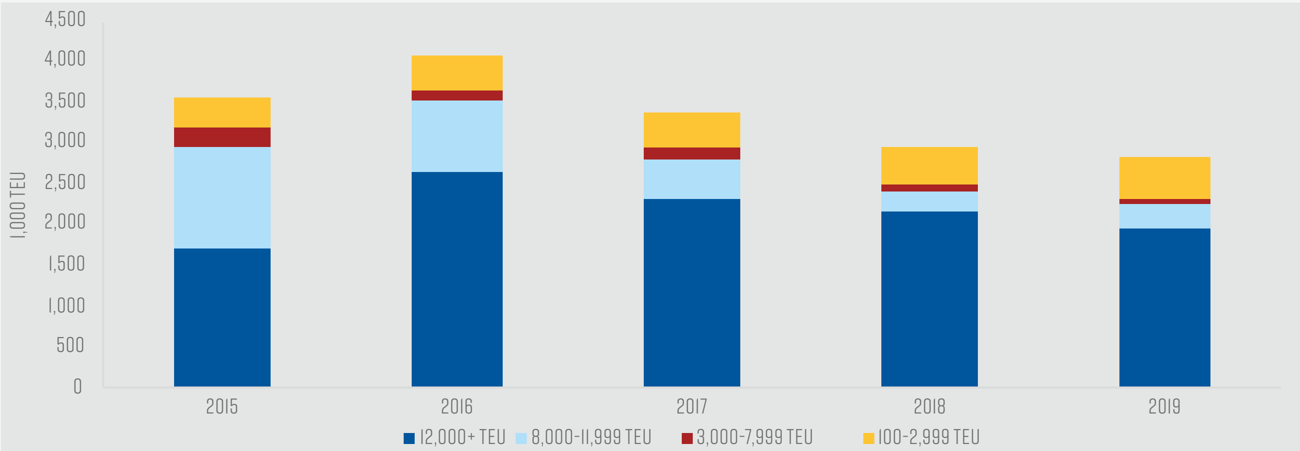
5. ...and NB contracting has been on the rise.



Containership contracting

SOURCE: CRS, HARTLAND SHIPPING

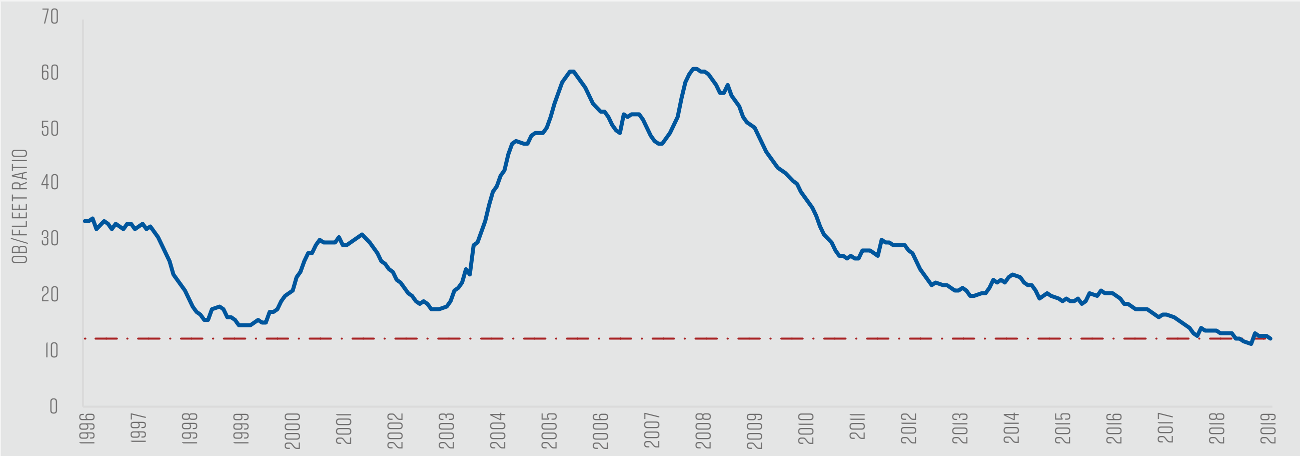
6. However, the orderbook has been in gradual decline...



Containership orderbook

SOURCE: CRS, HARTLAND SHIPPING

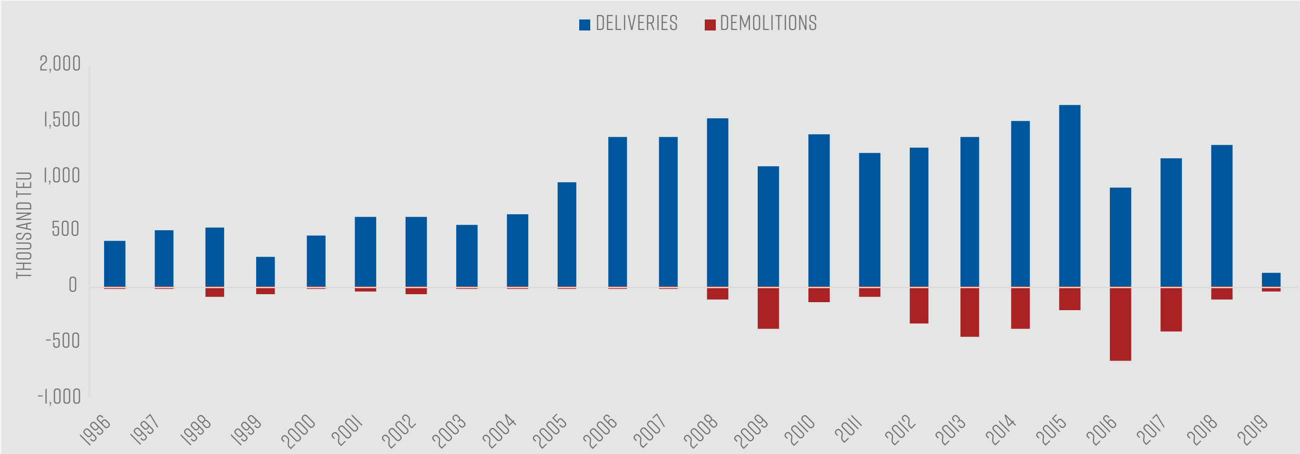
7. ...resulting in the lowest OB/Fleet ratio since records began.



The containership orderbook/fleet ratio

SOURCE: CRS, HARTLAND SHIPPING

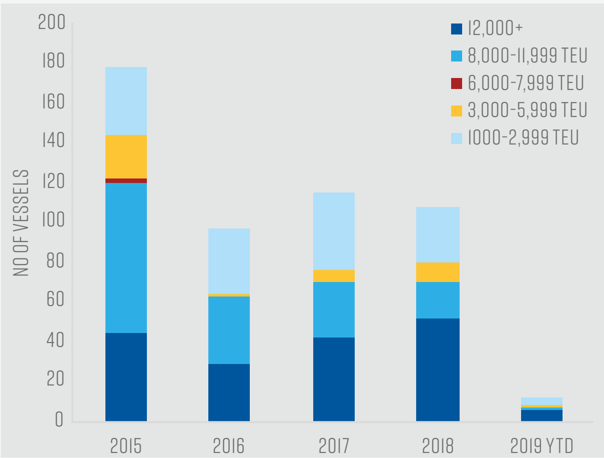
8. Demolition levels disappointed in 2018 with higher net deliveries compared with the last 2 years.



Containership deliveries vs demolitions

SOURCE: CRS, HARTLAND SHIPPING

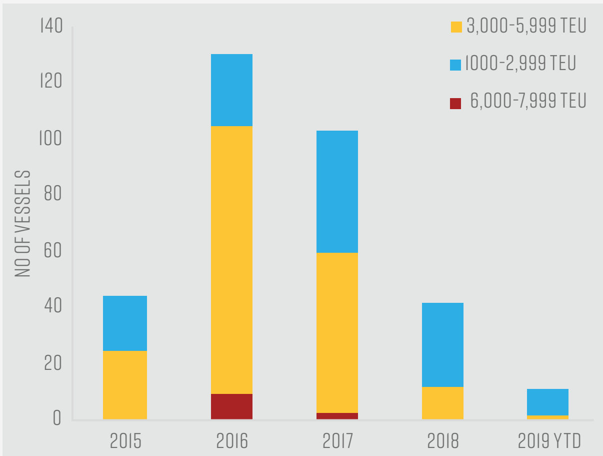
9. Most deliveries are the smaller feeder up to ULCV...



Containership deliveries by size

SOURCE: CRS, HARTLAND SHIPPING

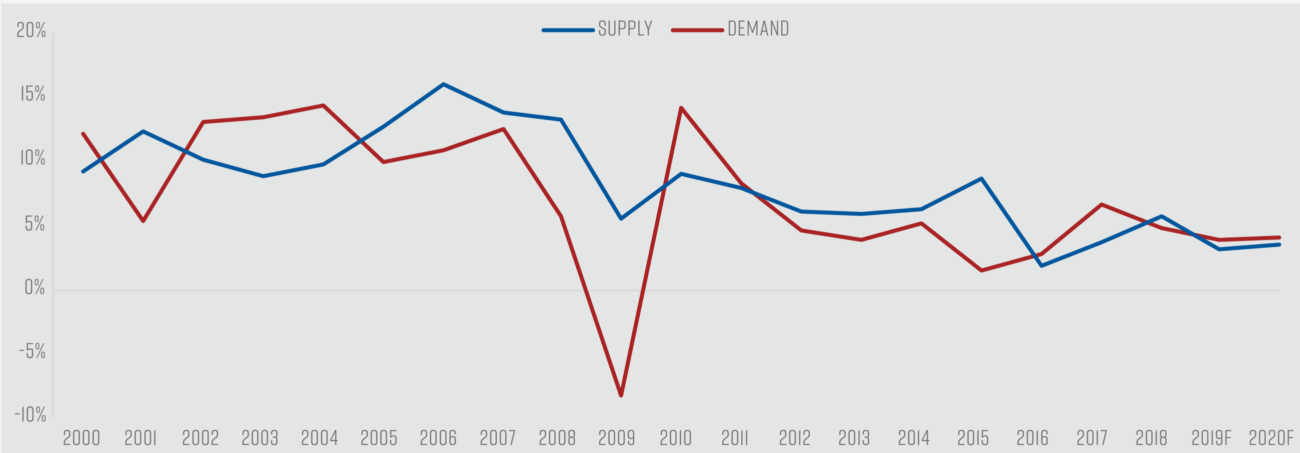
10. ...with demolition almost entirely below 6,000-teu.



Containership demolitions by size

SOURCE: CRS, HARTLAND SHIPPING

11. The supply and demand outlook is in balance, but the challenge remains embedded historic oversupply.



Containership supply and demand balance

SOURCE: ALPHALINER, HARTLAND SHIPPING

Chartbook

Our chartbook sets out a graphic illustration of how the container market has evolved in recent years.

The Shanghai Containerised Freight Index (SCFI), a measure of China export freight rates across a comprehensive basket of routes, has had a turbulent ten years. For the first six years from 2009 the index traded mostly above 1,000 points and then for the four years since 2014 it has traded almost entirely below the 1,000 point line. It is a good reflection of the supply-demand balance and in recent years supply, especially of the largest ships, has tended to exceed demand. Average timecharter rates, as measured by a basket of typical smaller tramp ships, have improved steadily over the past three years rising 27% from $7,131 daily in 2016 to $9,035 per day in 2017 and then up another 37% to $12,311 daily in 2018. The Secondhand Price Index has loosely followed the SCFI in a weakening trend from 2012. However, the Newbuilding Price Index parted company with the Secondhand Price Index from around 2010 when rising input costs were reflected in higher newbuilding prices despite the weakness in secondhand earnings and values.

The number of concluded secondhand containership sales deals has declined in recent years from a peak of 309 transactions in 2017 to 185 in 2018. Conversely, the tightening regulatory environment (IMO 2020, ballast water management and emissions controls) has encouraged investment in new ships that can incorporate compliant systems rather than address the complexity of retrofitting. The number of new containership orders has increased from 99 in 2016, to 141 in 2017 and to 204 in 2018. The average unit size of these orders rose from 2,984-teu in 2016, to 6,060-teu in 2017 and to 6,092-teu in 2018. In spite of this pattern of increased ordering, the total orderbook itself has been in gradual decline since 2016 as the pace of deliveries has exceeded the rate of new ordering. The total orderbook of cellular containerships has declined from 4.06m-teu in 2016, to 3.30m-teu in 2017, to 3.00m-teu in 2018 and to 2.76m-teu by end February 2019. The annual average containership orderbook to fleet ratio, at 12.8% today, is the lowest since records began in 1996, and is well down on the all-time peak of 60.8% in 2008.

Since 2015, deliveries have been rising while demolition has been falling. A total of 1.66m-teu of cellular capacity delivered in 2015, followed by 0.91m-teu in 2016, 1.17m-teu in 2017 and 1.29m-teu in 2018. Meanwhile, demolition fell from 0.65m-teu in 2016, to 0.40m-teu in 2017 and to 0.12m-teu in 2018. Given the more modern profile of larger ships, demolition has been limited in recent years to ships generally under 6,000-teu. In early 2019, 70% of the orderbook (2.01m-teu out of 2.89m-teu) comprised ships of 12,000-teu and larger while in the past three years the feeder sizes up to 3,000-teu have seen the highest number of ship deliveries of any segment: 67 in 2016, 78 in 2017 and 92 in 2018. In capacity terms this amounted to 96,180-teu in 2016, 126,784-teu in 2017 and 159,479-teu in 2018. This capacity increase in the smaller feeder sizes was dwarfed by the lower number, but much higher capacity, of ships of 12,000-teu and over: 29 units of 475,640-teu in 2016, 43 units of 732,013-teu in 2017 and 52 units of 895,705-teu in 2018.

The container market collapsed in 2009, only to bounce back very sharply in 2010, since when it has been a constantly challenging market. Supply growth has tended to exceed demand growth in most years apart from 2016 and 2017. In 2019 and 2020 we should see demand growth narrowly exceeding supply growth. However, we must bear in mind that some structural overcapacity exists that needs to be burnt off before earnings and values can really move up strongly from where we are today. In an uncertain demand environment, with protectionist trade wars threatening to escalate, it is important to keep managing net new supply down to a minimum. Consolidation amongst the mainline container carriers should help this process. There is probably not much scope for further consolidation after recent mergers, so the emphasis should now shift to improving service levels and raising returns. In what is still a fragmented industry, what is required and what is done are often two quite different things.

Conclusion

All three main sectors face relatively benign supply growth over the next two years. This delivers a perfect opportunity for supply and demand to achieve better balance and for earnings and values to rise.

The key feature is that orderbooks are at historically low percentages of the trading fleets. Regulatory change should further restrict fleet growth as ships are taken out of service to retrofit scrubbers and ballast water treatment systems. The cost of such retrofitting will be too much for certain sizes of generally smaller ships and that should increase the rate of demolition. The IMO 2020 rules on limiting the sulphur content in marine fuel are probably one of the biggest game changers in the history of shipping, although we are not yet entirely clear on the intended enforcement procedures or on the degree of flexibility that might be permitted in the early implementation stages. The higher cost of fuel will almost certainly extend and enhance slow steaming which will reduce effective tonnage supply.

The demand side is at present clouded by US initiated trade wars with its neighbours, Europe and Asia – and, in particular, China. A partial or total resolution will give a boost to the global economy and to seaborne trade. Regardless of this big issue, we are still expecting positive demand growth in all three sectors with the extent of that growth largely conditioned by US government policy. The current administration prefers playing to the crowd over getting things done. Playing to crowds brings us back to Paul McCartney. As we proceed along and up the Long and Winding Road we hope to reach, not his High Park Farm, but the fabled sunlit uplands of a better market. We hope to linger there for a while, and enjoy the warmth that this will bring, before we go over the brow of the hill and down the other side. Both the supply and demand sides of the equation face a dose of uncertainty but, if all works out in our favour, then we should have some good times ahead of us.

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Appendices

Appendices

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Information in this document was prepared as of 15 March 2019.

A Note on Sources

This report necessarily draws on a wide range of sources, including our own research and network of contacts and correspondents world-wide. A number of third party sources have also been used, including Argus Fundamentals, AXS Alphaliner, the Baltic Exchange, China Iron and Steel Association (CISA), CIA Factbook, Clarkson Research Services Ltd, Containerisation International, the Economist, Equasis, the Financial Times, FIS Iron Ore Swaps Report, HSBC Bank plc, HSBC Global Research, the International Energy Agency, the International Grains Council, International Monetary Fund (IMF), Lloyd's List, Lloyd's Shipping Economist, Lloyd's Register-Fairplay, Maersk Broker Container Charter Market Monthly, Money Week, Morgan Stanley, National Bureau of Statistics of China, Organisation of Petroleum Exporting Countries (OPEC), Petroleum Economist, Thomson Reuters Datastream, Thomson Reuters Eikon, United Nations Conference on Trade and Development (UNCTAD), US Department of Agriculture (USDA), US Department of Energy (Energy Information Administration), World Bank Global Economic Prospects, World Steel Association. We gratefully acknowledge all of these.

A Note from Clarkson Research Services Ltd

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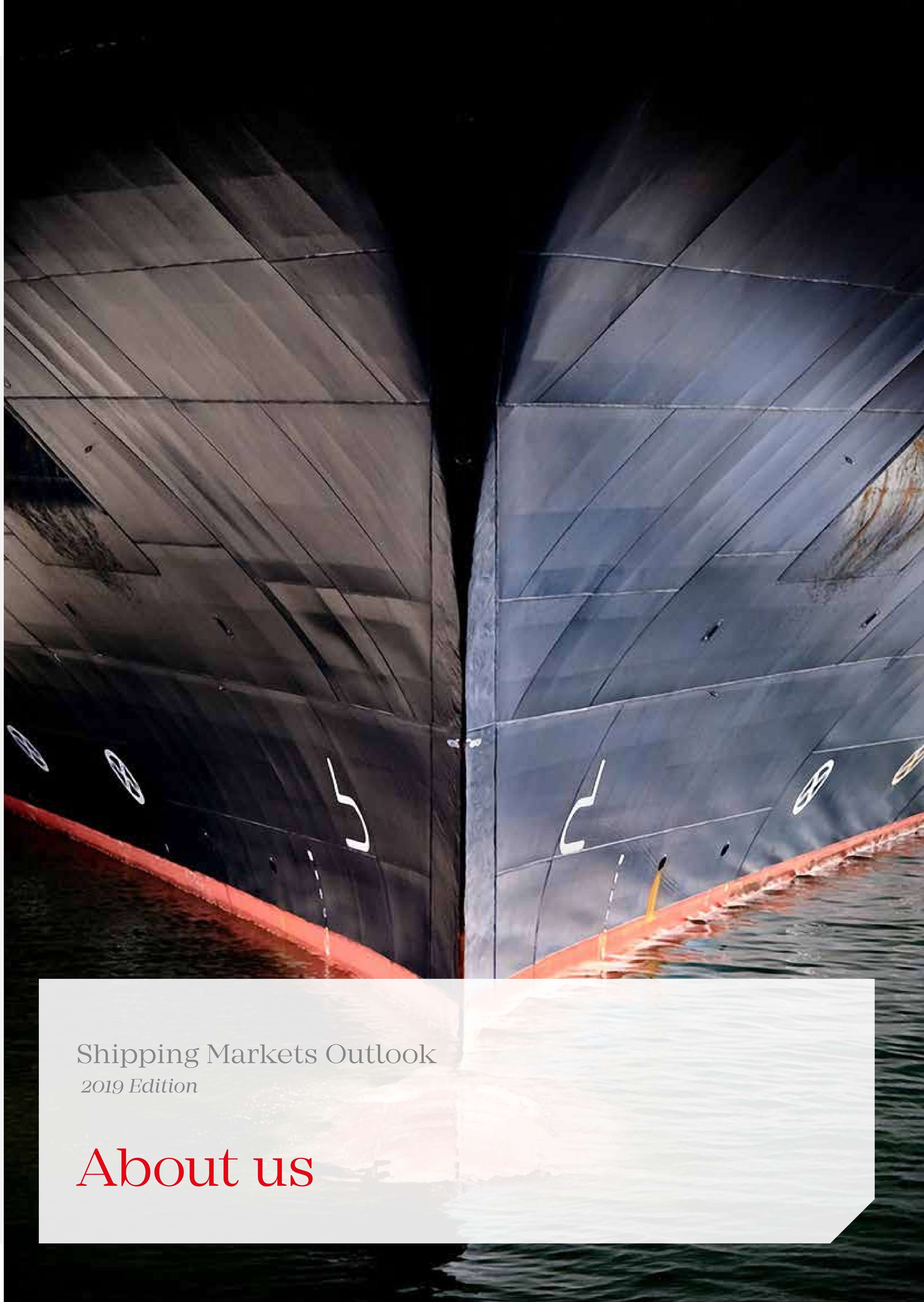

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About us

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We are Hartland Shipping Services Limited. We began in Hong Kong in 1981 as Wardley Shipping Services, a wholly owned subsidiary of Wardley Limited, the merchant banking arm of the Hong Kong and Shanghai Banking Corporation. In 2001 we became HSBC Shipping Services, a wholly owned subsidiary of HSBC Bank, one of the world's leading financial services companies. In August 2012 an agreement was reached with HSBC for the business to be sold to members of the senior management team, and the company was renamed Hartland Shipping Services Limited. As part of the sale Hartland has been retained to provide shipping consultancy services to the HSBC Group worldwide.

Our services

Our shipbroking services include:

- Newbuilding contracting
- Second-hand sale and purchase
- Dry cargo chartering
- Tanker period chartering

Our research and consulting services include:

- Market research
- Vessel valuation and fleet analysis
- Commercial due diligence, corporate and asset restructuring
- Feasibility studies and business risk assessment
- Bespoke consultancy projects

We welcome you to contact us with regard to any of the services we offer.

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