



Key Issues

# The Shipping Downturn Ten Years On

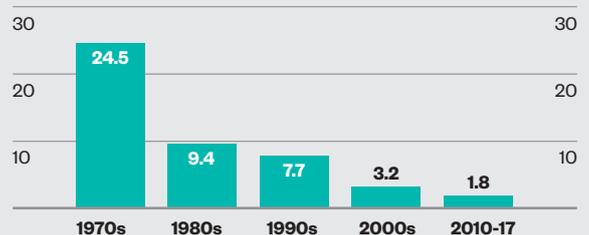
The primary function of ICS is to represent the global industry with its regulators, who may not always fully appreciate the very difficult economic circumstances in which many shipping companies continue to operate.



This lack of understanding among governments may in part be due to there being no evidence of any negative impact on safety or environmental performance which, despite the intense pressure to reduce operating costs, has continued to further improve.

### Reduction in Major Oil Spills

Average number of major oil spills per year (over 700 tonnes)



Source: ITOPF

Economic prospects in 2018 certainly seem brighter compared to 2016, which for many ship operators was perhaps one of the most challenging of recent years. Ten years after the beginning of the major shipping downturn which followed the 2008 financial crisis, there is a growing perception in many shipping sectors that the worst might finally be over. Shipping companies have worked hard to ensure their survival by delivering impressive efficiency improvements, dramatically slashing fuel consumption and using the latest information technology to further improve the quality of their service.

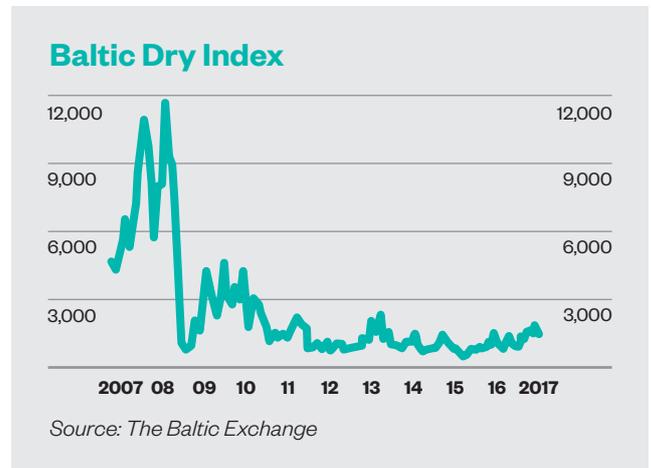


There has also been considerable consolidation through mergers, particularly in the liner sector. There were around 20 major containership operators in 2016, and this number will reduce to about twelve during 2018, with further mergers anticipated. While there is still far less market concentration in other trades, there have also been mergers in the tanker and dry bulk sectors.

The fortunes of shipping are inextricably linked to the global economy which, despite increasing political uncertainty, appears to be enjoying one of the best years seen during the past decade. GDP growth seems to be increasing in most major economies, with consumer confidence and the strength of purchasing managers' indices (including for the EU) being welcome signals. The outlook for 2018 therefore appears to be positive for the main segments of the industry – dry bulk, tankers and containerships – with the important caveat that shipowners must avoid their tendency towards over ordering new tonnage.

What has been positive for dry bulk and containership trades, in particular, is that freight rate improvements have been largely demand driven. But while the tanker segment has also benefitted from high demand, rate improvements continue to be held back by an excessive supply of tonnage.

Given the industry's difficulties, it is easy to overlook that demand for maritime transport has actually increased by around 30% since 2008, with the annual volume of cargo carried by sea now exceeding 10 billion tonnes. The problem is that the industry has continued to struggle with serious overcapacity.





The reasons for this chronic overcapacity are complex. Much tonnage was ordered when freight rates hit their peak before 2008. But the problem has been complicated by the understandable reluctance of many lenders to accept the dramatic impact on their balance sheets of uneconomic ships being sent for early recycling before their loans have been fully repaid.

The current and clear need to recycle a vast number of ships poses something of a dilemma. The shipping industry is an ecosystem, and to make the economics work those that order new ships need to be sure that there is a second hand market to which they can sell later on. If ships are routinely scrapped when they are only 15 years old, instead of at around 25 years, this will also do little for environmental sustainability.

National state subsidies to encourage ship recycling might have superficial attractions but they risk distorting global markets, and can be counterproductive if they are conditional on the recipients ordering more tonnage at national yards – which is the situation that prevails in major shipbuilding nations, such as China and Korea. The reluctance of governments in Asia, where the vast majority of ships are built, to address overcapacity in the shipbuilding sector remains a serious issue.

In many trades there is still surplus capacity. But while showing restraint might clearly serve the collective best interest of the industry, this may not always be the case for individual operators who will often see investment opportunities which rationally appear to justify ordering new vessels.

As well as the temptation to over order as demand begins to improve, decisions about when to recycle older ships are fundamental to the equation. The good news is that a number of important regulatory uncertainties which have complicated decisions about when best to dispose of older ships are finally being resolved. This includes the entry into force of the IMO Ballast Water Management Convention in September 2017 and the clarity at last provided by IMO with regard to its implementation dates. And while the precise cost of compliance with the IMO sulphur regulations is still unknown, the situation should become clearer after January 2020 now that IMO has confirmed that the implementation date of the global sulphur cap is irrevocable.

Although shipping has not yet fully recovered from the impact of the 2008 financial crisis, sluggish growth in many OECD economies was partly compensated by the impressive growth in demand for shipping from China and other emerging nations.

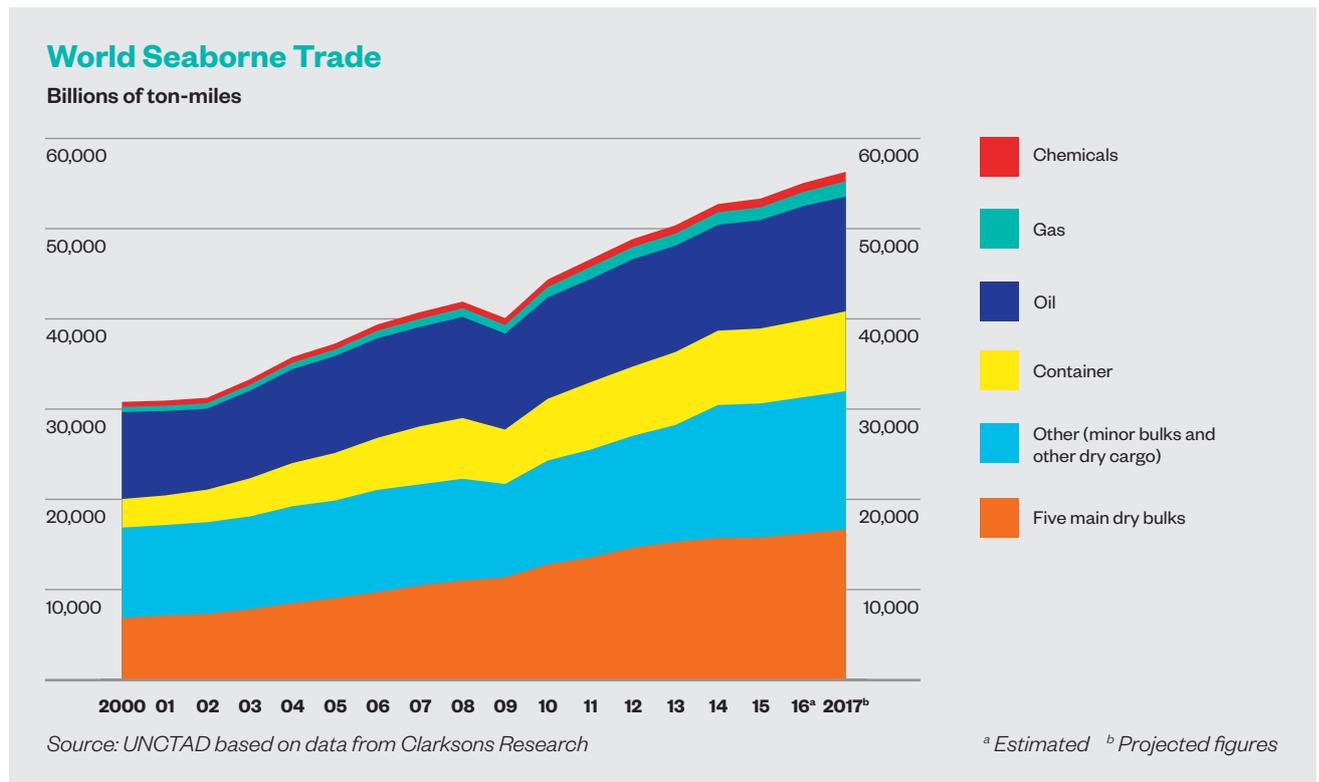
However, while GDP growth in China during 2017, at almost 7%, was a slight improvement on 2016, this is still significantly below the average growth of around 10% per annum recorded since 1989. Moreover, as the Chinese economy continues to mature, an increasing proportion of this GDP growth is actually due to the expansion of service industries, rather than manufacturing or infrastructure development which does not generate the same demand for shipping.

### Services as a Proportion of China's GDP

Service industries in China, which generate less demand for shipping, account for a rising share of the economy



Source: National Bureau of Statistics



Prior to 2008, the industry had become accustomed to increases in maritime trade being a significant multiple of global GDP growth. But this ratio between demand growth and GDP is now much smaller – especially when tanker trade growth due to changing patterns in the movement of energy cargoes is excluded (due to the impact of the U.S. shale revolution and the dramatic fall in oil prices since 2014).

Opinion is still divided on whether the rapid globalisation that has been experienced since about 1990 may have run its course, and whether the slower rate of trade growth seen since the 2008 crisis represents some kind of permanent structural change. It is unclear to what extent China’s ‘Belt and Road’ initiative – vaunted to include Chinese investment in about 70 nations approaching US \$4 trillion – will actually create significant additional demand for shipping services. It is also uncertain whether the massive infrastructure development promised by President Trump in the United States will ever materialise.

Fresh uncertainty was added in March 2018 with the announcement by President Trump of his intention to impose tariffs on steel and aluminium imports and – in response to immediate threats by the EU and China to apply retaliatory measures – his suggestion that these might be extended to automobile imports too. Whether this war of words between the U.S. and its major trading partners will develop into a genuine trade war, which could have damaging impacts on shipping markets, remains to be seen.

Leaving aside the possibility of a trade war, a structural change in the relationship between demand for shipping and global economic growth may not be insurmountable so long as the industry can manage capacity. But shipping’s recent record in this respect has not been impressive. Most importantly, shipping companies must show restraint with respect to ordering large numbers of new ships, in order to prevent stifling any new recovery just at the moment when it may be about to begin.