International
Chamber of Shipping
Shaping the Future of Shipping

Key Issues

Heading into Uncertainty: Economic Risks Ahead

Avoiding overcapacity and unsustainably low freight rates is a constant challenge.

Last year's Annual Review suggested that shipping companies needed to show restraint when ordering large numbers of new ships to prevent stifling any new recovery, just at the moment when it might be about to get started, ten years after the massive downturn of 2008. A lot has changed in the past 12 months. There are new clouds on the horizon and the avoidance of over ordering is more important than ever. However, while restraint will clearly serve the collective best interest of the industry as a whole, this may not always be the case for individual operators who will often see investment opportunities which rationally appear to justify ordering new tonnage.

Shipping is the servant of world trade and many of the factors which can affect demand for its services are beyond the industry's control. It is still 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 becoming increasingly less certain whether the infrastructure development promised by President Trump in the United States will ever materialise.

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. Prior to 2008, shipping 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 tonne-mile growth due to changing patterns in the movement of energy cargoes is excluded (an impact of the U.S. shale revolution of the 2010s).

In 2019, the outlook for the global economy and thus demand for maritime transport appears to be worsening. Given concerns over slowing growth in key economies, including China and the EU, and the possibility that the trade dispute between the United States and China could develop into a full blown global trade war, growth is expected to decelerate in 2019 and further still during 2020.

According to a recent assessment by The Economist Intelligence Unit, the possibility of the dispute between the United States and China having serious effects on the global economy stands at between 20-30 per cent. In May 2019, President Trump extended tariffs to a further US$200 billion worth of Chinese products. Although trade negotiations continue, fundamental differences on matters such as intellectual property rights make prospects for long term harmony unlikely. Indeed, the U.S. Congress (including the Democrat controlled House of Representatives following the 2018 mid term elections) is also hardening its attitude towards China in the run up to the Presidential election in 2020.

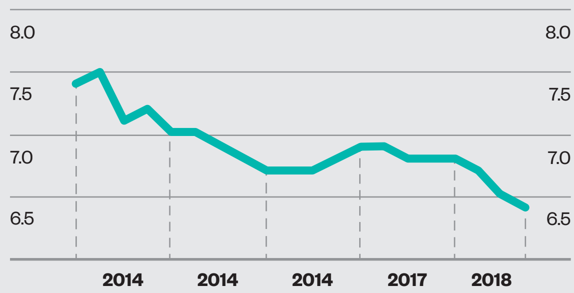
The U.S. is also still threatening to impose new tariffs on car manufacturers and there is a danger that the EU, in particular, may feel compelled to retaliate. Meanwhile, the EU and nations such as Canada and Australia have their own trade issues with China due to security fears about the involvement of Chinese companies in their IT networks.

There are other economic dangers on the horizon. Levels of U.S. corporate debt are at similar levels (almost 50% of GDP) to those before the 2008 financial crisis, and many of these debts are insecure. If a crisis develops, there is also the possibility of contagion of markets in emerging economies. In Europe, the impact of Brexit, while of importance to local ship operators, is often seen as a parochial issue. But a disorderly United Kingdom departure from the EU could have wider damaging impacts on the entire EU economy. The same applies to the growing risk of a possible banking crisis in Italy.

Last but far from least, there is increasing uncertainty with regard to China's economic performance. Although shipping has not yet fully recovered from the impact of the 2008 financial crisis, sluggish growth in many OECD economies was in large part compensated by the impressive growth in demand for shipping from China.

GDP growth in China during 2018, at about 6.5%, was the lowest recorded since 1990 and 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.

China Year-on-Year Growth Rate



Source: National Bureau of Statistics of China

A lot will depend on how China manages any slowdown, which could get worse in 2019 due to the impact of the tariffs which the U.S. has already imposed. In view of the high levels of debt that also prevail in the Chinese economy, there is a danger that if any downturn is poorly managed by the Chinese authorities this could actually develop into a recession. Indeed, if compounded by a full blown global trade war, the effects of the U.S. debt burden or other disruptive events (potentially even including military conflict in the South China Sea or the Korean peninsula) a repeat of the economic crisis of 2008 is not implausible.

The immediate risk to shipping, however, is the real possibility of a trade war. ICS is increasingly concerned by the attitude of the United States towards the continuation of a rules-based multilateral trading system under the auspices of the World Trade Organization (WTO), and the U.S. Administration's belief that trade is no more than a zero sum game. The ICS Chairman expressed the shipping industry's concerns forcefully at a major shipping event in Tokyo in November 2018, which was widely reported worldwide. The ICS Secretary General did the same at the biennial meeting between the U.S. Government and those maritime administrations around the world committed to free trade principles – the Consultative Shipping Group (CSG) – held in Washington DC in October 2018. A further meeting between ICS and the CSG is scheduled in the Netherlands for November 2019.

More positively, with respect to the one thing over which shipowners actually have some control, ship ordering (in deadweight tonnage) fell 14% in 2018 according to Clarksons, about 17% below the average since the 2008 downturn. This suggests that many shipowners may indeed be resisting the temptation to over order. In early 2019, the worldwide shipping order book appeared to be stable at around 10% of the fleet. However, 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.

National state subsidies to shipbuilding 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 applies in major shipbuilding nations, such as China and Korea. In 2018, Japan launched a complaint at the WTO against the Republic of Korea over the support measures for its shipbuilding industry. ICS awaits the outcome with great interest.

ICS is also encouraged by the decision in 2018 by the Organization for Economic Co-operation and Development (OECD) to resume negotiations on an agreement to remove market distorting measures from shipbuilding that contribute to overcapacity. However it remains to be seen whether China (which is not an OECD member) will take an active part.

As well as the temptation to over order as demand in certain trades may improve, decisions about when to recycle older ships are also 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. In particular this includes the implementation dates of the IMO Ballast Water Management Convention. While the precise cost of compliance with the IMO sulphur regulations is still unknown, the situation should also become clearer after January 2020 now that IMO has confirmed that the implementation date of the global sulphur cap is irrevocable.

Notwithstanding the risks of uncertainty in the immediate years ahead, in the long term there is always cause to remain optimistic. Whilst possibly not good for the planet, the UN has revised its projections for population growth upwards to 8.6 billion in 2030 from 7.7 billion in 2019. Combined with seemingly inexorable demand for higher living standards in emerging economies, this indicates that long term demand for international shipping should continue to increase significantly.