Pale winter sun for bulk

The past year has been devastating for the beleaguered dry bulk markets. **Barry Parker** assesses whether 2009 will be any better

The dry bulk market suffered a stunning drop during the second half of 2008, based on sharp declines in tonnages of major bulk commodities actually moving and a near cessation of activity by freight operators.

The wintry pallor of the credit crisis (and an unprecedented de-stockpiling by major charterers) overwhelmed expectations of any seasonal or post-Olympics bounce in charter market activity. Dry bulk's underlying raw material markets, closely intertwined with freighting, saw dramatically lower prices as demand plummeted. By November, the collapsing Baltic Dry Index had fallen more than 90% from the highs set six months earlier, reflecting the collapse in freight rates across a wide spectrum of different ship sizes.

Peering dimly into 2009, probability suggests that the market will rise, but the main questions are 'how high?' and 'what is the likely duration of any rise?'

Photo: Malushko Igor / Matt Ramsdale

The likelihood of an upward move is underscored by FFA prices, an imperfect indicator that is nevertheless a useful predictor of directionality. As November drew to a close, spot BDI was calculated to be 715 points, while estimates for Calendar 2009 FFAs stood at 2,225 points.

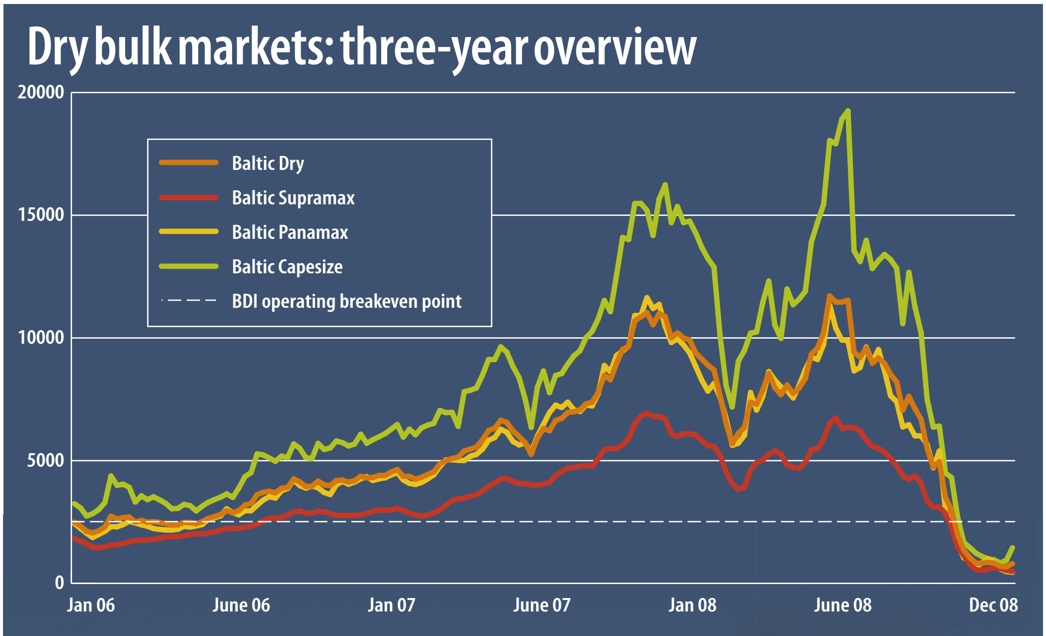
At the margin, the intersection of supply and demand will determine rates. Economic theory suggests that, in the short term, a business (in this context, a vessel) must cover its marginal costs – the daily operating costs of the vessel. Over the longer term, vessel revenues must cover capital costs as well – the cost of financing. Applying these theories sounds simple, but reality is more complicated because vessels have vastly different cost structures depending on the quality of the operation and variable vessel acquisition costs.

These inconvenient truths not withstanding, many analysts would agree that levels of $2,425/day, $5,021/day and $6,500/day (the equivalencies for Capes, Panamax and Supramaxes for a BDI in the low 700s) could not be sustained.

The market did not arrive randomly at the level of around 2,200-2,500 on forward BDI trades for 2009 (and the analogous $/day values on constituent routes). Traders in shipping markets, as in other commodity markets, will look at previous market behaviour to determine choke points that will impede later moves up (upside 'resistance') or down (bottom 'support'). Technical analysts looking at charts of the BDI would see important support in spring 2004 in the upper 2000s, and would also see three flirtations with bottoms around the 1,900-2,500 level from 3Q05 until 2Q06. These levels, corresponding with daily hires around $13,000, $11,000 and $9,000 for the main vessel groups, arguably represent the market's views of absolute minimum daily costs that need to be covered over a one-year time frame.

Based on traders' behaviour and vessel cost structures, it's likely that rates will move up towards those congested levels on the charts. The broader questions can be summarised as 'Okay – then what?' These projected levels are well below allocations of daily cost when capital costs of vessel purchases are factored in. If such low levels are expected to prevail, owners may consider anchoring and then laying up tonnage.

DRY CARGO



The collapse of dry markets is emphasised in this three-year overview. Any upturn in 2009 is likely to mirror 2006 – slow and steady

Photo: Dietmar Hasenpusch

The supply side of the equation is reasonably certain: deliveries for 2009 will likely go ahead as planned (with cancellations induced by the credit crunch impacting the 2010-2011 time frame rather than 2009). Bankers have suggested that most owners have sourced their 2009 finance requirements.

Some 60M dwt of dry bulk tonnage is expected to be delivered in 2009, about 27M dwt of which is in the Capesize category. When the new tonnage is added to the end-2008 supply of approximately 415M dwt and adjusted for a huge uptick in scrapping (to 10-15M dwt), the fleet is projected to grow by 460-465M dwt.

A note of caution concerns the ability of scrap buyers to obtain credit; these buyers may fall afoul of the same letter of credit issues bedevilling second-tier dry bulk cargo movers. Yard resales, where an owner stumbles on final payments, will not affect the overall balance.

The demand side of the 2009 equation is likely to show no growth from 2008, with even the most bullish showing only a very slight uptick. China, which has grown at double digit rates over the past few years, is now projected to grow at 7.5%, according to the World Bank. With plunging worldwide demand for steel products, major steel producers have announced substantial production cutbacks; the major impact will be to reduce iron ore (and, to a lesser extent, met coal) into China, Korea and Japan. Steam coal, another major mover, is tied to overall levels of industrial production.

Dry bulk demand is forecast to flatline in the coming year

In assimilating multiple sources, analysts at Morgan Stanley forecast a slight dip in the major bulks (iron ore and coal), counterbalanced by a small increase in other bulks. The coming year's forecast of flatlining bulk market demand is in marked contrast to double digit (12.5%) growth in 2007 and nearly 7% growth in 2008.

On paper, overall demand, reduced to an equivalent in dwt (factoring in yearly vessel deliverability), will slide below the all-important 90% of available vessel supply, a level that attracts the attention of shipping economists because it is the numeraire of a 'tight market', with symptoms including bidding wars for vessels and port congestion. Morgan Stanley puts utilisation at 86% for 2009 (versus levels of 95% in 2007 and 96% in 1H 2008).

Even though the bigger picture pits vessel supply growth of 8-9% against predictions of anaemic increases in demand, brought about by a worldwide recession, short-lived spikes upward will be likely. If Brazil and China work out a satisfactory pricing deal on ore, this is likely to cause a chartering flurry since stockpiles will have been depleted. If credit markets permit, speculative chartering by timecharter operators will bolster rates for a time.

But at lower levels of utilisation, upward spikes in rates, as the market tests the congestion zone on the charts, will be met with re-activation of anchored vessels, or simply with newly delivered vessels, throwing cold water on the rally.

A quicker resolution than anticipated of the world's financial difficulties would brighten the forecast, allowing for stronger underlying demand. A market more conducive to timecharter operation would provide an important multiplier, effectively creating additional demand for the same vessels. Inventory reductions throughout industrial production processes began in earnest during summer 2008. Restocking, in the face of a sunnier demand picture, could then push rates above the 'congestion zone' in the form of sharp spikes on the charts. A commodity price rebound might also brighten dry bulk prospects going into the new year. F