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MACRO TOPICS

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POLICY: INTERMINABLE TRADE NEGOTIATIONS

Is TTIP a treaty too far for weakened economies?

Germany's IFO Business Climate Index for April has come in at 106.6, a smidge below the 106.7 recorded in March. That is of less interest perhaps than the fact that both numbers are about one full point below the 12-month moving average of 107.75. The index is a reliable indicator of German industrial production and exports. This may explain why the mood among German exporters is flat despite the encouraging sentiments regarding the chances of successfully concluding the trans-Atlantic Trade and Investment Partnership deal expressed by Mrs Merkel and Mr Obama during the latter's visit to Hannover. Today they will be joined by President Hollande of France, Prime Minister Renzi of Italy and the court jester, David Cameron of the hokey-cokey-UK, to try to edge the trade talks along.

The trade deal talks are in their fifth year and are unlikely to be completed before Mr Obama leaves office. None of the US Presidential candidates are particularly pro-trade. Mrs Clinton is the biggest supporter of TTIP but knows that her blue-collar Democratic voters are currently exhibiting insular sentiments. Bernie Sanders has long been against trade agreements. None of Trump, Cruz or Kasich have expressed pro-free-trade feelings. The announcement of a Cruz-Kasich pact may throw all Republican policy debate overboard now anyway as the nomination debate becomes entirely about Donald Trump's character. Meanwhile there have been anti-TTIP demonstrations across the EU, where popular will has never been a reliable guide to what decisions EU institutions will make in the supposed best interests of their citizens.

The effects on shipping of the TTIP talks are as yet uncertain. The US has asked for four exceptions to the liberalisation of trade, one of which is coastal shipping, which will remain exclusively American under the terms of the Jones Act. The EU has asked for two hundred exclusions around its services industry as it attempts to protect its banking and insurance businesses from predatory US competitors. In agriculture, the powerful US farm lobby props itself against the EU common agricultural policy like two well-matched wrestlers sinking exhaustedly into the mud. All in all one wonders why the two sides are bothering when the barriers to a deal appear to be numerous and insurmountable. Credit the negotiators for their stamina and their ability to keep themselves in work for so long.

Another data point to watch out for this week is US new home sales, released later today. This data has traditionally been a useful leading indicator of transpacific containerised demand. The February number was 512,000, a 2.0 per cent rise, which was lower than market expectations of 3.2 per cent. From 1963 until 2015, new home sales averaged 654,000 per month, while a record low of 270,000 was reached in February 2011. Any movement back to the long term average will be a welcome sign that the US domestic economy is getting through a sticky patch. Voters, based on their support for fringe policies and politicians, appear to remain unconvinced that things are getting better. Trans-Pacific containerised freight indices suggest that voters are right to remain grim-faced. Maybe the housing data will surprise us.

TANKERS: WAS IT OBVIOUS ALL ALONG?

Oversupply continues to plague the market, while delays ease at Basra.

Oil prices dipped today with Brent at USD 44.62 per barrel, as traders cashed in after three weeks of gains. Open long positions are rising to levels last seen in June 2015. The dollar jumped last Friday on expectations that Japan will extend its aggressive monetary easing, which has also influenced the oil price drop.

Oil prices retreated after reaching their highest prices in five months over fears of the supply glut. Saudi Aramco will complete the expansion of its Shaybah oilfield by the end of May, adding 0.25 Mn bpd, which will support the Saudi plan to keep output at 12 Mn bpd. On top of that, Iran has already increased output by 1 Mn bpd since the sanctions were lifted in January, while Kuwaiti oil production is back to 3 Mn bpd after the strike ended, and is expected to reach 3.1 Mn bpd this week. On the other hand, the IEA restated last Thursday that it expects non-Opec production to decline by 0.7 Mn bpd, the biggest decline in 25 years. “We’re still in oversupply,” Wayne Gordon, executive director for commodities at UBS AG Wealth Management, said. So far the fundamentals do not support the oil price highs, although production cuts from non-Opec members continues with US oil rigs down to 343.

The failure to reach an agreement in Doha last week may cause a collapse in oil prices once again, at least until the next meeting in June. This week will have a big impact on countries like Nigeria, Venezuela and Iraq, which are suffering economically and losing millions in gross daily revenue every day at today’s oil price levels. In the longer term, Nigeria, Africa’s largest oil producer, has had its forecasted output revised downwards and is now expected to drop to 1.5 Mn bpd over the next decade versus previous estimates of 2.1 Mn bpd. This is due to the persisting low oil prices and lack of foreign investment after the drop in oil prices.

Iraq typically cuts Basra exports at times when a backlog of ships waiting to load is increasing exponentially, thus the fall in Iraq’s oil exports have served to reduce the traffic jam of tankers at Basra, with queuing falling by a third this month. Iraq’s exports from southern ports are set to decline to the lowest for the year at 3.1 Mn bpd in May. According to Reuters last Sunday, delays to load Basra heavy crude averaged 11-12 days, down from 18-20 days two weeks earlier. At the same time, the wait to load light crude was 5-6 days last Sunday compared to 7-8 days at the beginning of April. Basra’s loading schedule for May has very few heavy crude cargoes in an attempt to ease delays. Thus, once the queues have decreased, the heavy crude cargos will return at around the middle of May. Around 19 VLCCs and Suezmaxes are waiting to load at Basra, down from 30 ships on 6 April.

Sources: Reuters, Bloomberg, FT, Bernstein

GAS: IS CHINA REVIVING ITS INTEREST IN NATURAL GAS?

LNG still has plenty of potential in the Chinese market, despite 2015's slip.

While LNG production worldwide is ramping up significantly over the next few years, some observers are suggesting that new demand centres will have to open up as demand from "traditional" import buyers (China, Korea and Japan) wanes. There is some truth to this for sure; after all LNG imports decreased in all traditional markets last year, but recent figures suggest that, as far as China is concerned, this may just be a blip.

Forecasted natural gas demand for China has always been spotty at best. For instance, China consumed 35 per cent more gas in 2015 than the EIA predicted in 2010; total natural gas demand for the year in 2015 grew by 4 per cent. Now the consensus suggests that Chinese consumption will again continue to grow. The latest report from the Australian Department of Industry is now somewhat optimistic and states that the Asian nation may increase its LNG imports by 38 per cent by 2030! Great news for the LNG market, but will this prove true? Cynics will point out that this is less than three per cent annual growth. In reality any growth in demand will be welcomed by the LNG ship owning community.

China's appetite for natural gas is heading in the right direction and it is now China's fastest growing fuel. LNG imports to China increased by 27.4 per cent in March compared to the same month in 2015, as LNG imports to the country totalled 1.7 Mn T. China's piped natural gas imports also rose 37.7 per cent compared to the same time last year, totalling 2.72 Mn T. Growth, however, will be dependent on how quickly it can expand and develop its network. As of 2016, natural gas fuels only 6-7 per cent of China's energy demand, while the world average is around 22 per cent. Clearly, then, there remains plenty of scope for growth.

The latest five-year plan (2016-2020) sets the precedent for developing its network. They seek to replace its old and dirty coal-fired power plants with natural gas. China has also been busy expanding its pipeline network and LNG terminals over the last few years. Regasification capacity is set to grow by an additional 3.4 bcfd by 2019, an increase of 62 per cent from the current 5.4 bcfd. In fact Sinopec just recently received its first cargo at its new import terminal in Beihai, with plans to build a further three import terminals across the country.

As China transitions from a manufacturing based economy to one based in the service industry, there could be some downside. During this process we should expect some demand to wane as they shift away from energy intensive manufacturing, however this is likely to be only temporary. With the latest LNG import reports from Reuters signalling signs of growth maybe the industry can breathe a (slight) sigh of relief.

Sources: Forbes, OilVoice

DRY CARGO: MEET THE NEW MODEL. SAME AS THE OLD MODEL

As commodity prices keep soaring, questions as to real demand levels and the sustainability of China's growth model remain.

The recovery of the iron ore prices since the start of the year has been nothing short of spectacular, as prices soar to levels last seen over a year ago. While the increase in price is not exclusive to iron ore, with steel and soybean prices experiencing notable gains, the recovery is mostly observed in commodities with a close link to increased Chinese infrastructure expenditure. However, the surge in prices has caught many by surprise as it is, at first sight, at odds with the development in the steel producing sector, which is a key demand driver of iron ore.

The oversupply in the Chinese steel industry is far from resolved as problems with debt repayments and the reallocation of workers continue. While mills are operating far below their potential output, with small and large mills reporting capacity utilisation figures of 58 per cent and 87 per cent respectively, there remains a glut of steel which ought to keep downwards pressure on steel prices. While the capacity utilisation has increased for steel mills (large mills operated at 84 per cent capacity in January), increased demand is only a partial explanation as more efficient mills are likely to have absorbed the demand from some of the mills closed so far. As a result of the above, all signs point towards an increase in demand. However, while certainly an attractive hypothesis, the overall picture appears to be rather more complicated.

A push by Chinese policy makers to increase government spending on infrastructure projects is the key factor at play, and has been clearly felt in the Capesize sector as an increase in demand has pushed the BCI above the 1,000 point mark for the first time since early December. However, the freight market is unlikely to follow the same spectacular surge as commodity prices have over the past months for two reasons.

Firstly, some backpedalling from the US Federal Reserve on interest rates has provided developing economies with temporary relief by further deflating the dollar and, as a result, has aided the recovery of several commodity prices. Secondly, Chinese hedge funds and private investors appear to be making significant bets on the positive effect of increased infrastructure spending on commodity prices for steel and iron ore, boosting the volumes of traded futures on the Dalian Commodities Exchange and the Shanghai Futures Exchange. On the Shanghai Stock Exchange, the daily turnover of a single rebar contract last week was worth nearly 50 per cent more than the total traded volume on the exchange. These circumstances have led several exchanges to announce an increase in trading margins and transaction fees. More importantly, this highlights the level of speculative activity which will have contributed to the recent price developments.

The surge in commodity prices should, as a result, not be taken at face value to mean that all is well again in terms of demand though, while the final extent of China's increased expenditure remains to be seen, some room for optimism should be allowed. However, now that China appears to be back on its old and familiar path of expansion-driven growth, having partially failed to successfully implement a transition to a service and consumer driven economy, the question of how long growth will be sustainable on the old model remains a pressing one.

Sources: Affinity Research, Custeel, Reuters, South China Morning Post

CONTAINERS: ONE AFTER ANOTHER

Hanjin Shipping to walk the "Via Dolorosa" after Hyundai Merchant Marine.

Korea Development Bank seems to be the scapegoat as yet another South Korean company facing financial pressure. This time, Hanjin Shipping desperately requires the protection of its main creditor by granting the company's management to the bank. The bank requires a detailed plan on how the charter fees agreed could get cut, before accepting a new plan for restructuring the company's debts.

The conditions in the market, in combination with the size of both the company currently ranked first in terms of domestic container ship capacity and its debts, make the situation unbearable. As the market doesn't expect any significant recovery to be experienced in the short term, with demand remaining static and the strong orderbook further adding to overcapacity, freight rates will stay rock-bottom for longer than earlier feared.

Renegotiating rates with its ship charterers, just as its compatriot HMM, might prove difficult, as most vessels are scheduled to be returned to owners by 2017.

Last year, the company reported an operating profit of KRW 37 Bn (approximately USD 32 Mn), an improvement when compared to 2014's KRW 24 Bn. The market forecasts losses for the company in the current year, due to the severe weakness in the container trade fundamentals.

In the meantime, the company has suffered dramatic losses in its share price, which dropped by more than a quarter since the beginning of the current year. Concerns for the financial stability of the group further increased following the comments from South Korea's finance ministers, who suggested that most of the nation's shipping lines could face restructuring in the short term.

In 2014, Hanjin sold its dry bulk and liquefied natural gas divisions to Hahn & Company, a South Korean private equity firm. The latter created H-Line Shipping for managing these assets. Hanjin also sold its last VLCC and closed it London offices earlier in March. Container terminals, buildings and the remaining exposure to the dry bulk sector will be sold, trying to raise USD 360 Mn.

The financial situation of the company was the main reason behind the decision of the South Korean government to consider its merger with HMM in 2015, but with both companies facing dramatic financial pressure, the idea was never taken seriously by any of the sides.

Elsewhere, the gap between Rotterdam and Antwerp has narrowed, as volumes to the Dutch port dropped by 4 per cent y-o-y to 3 Mn TEU in the first quarter of 2016. Unfavourable economic developments in China, Russia and Brazil meant limited trade growth, if any.

Moreover, the port saw less empty containers repositioned, mainly due to the slowdown of Chinese exports. In contrast to that, 2016 has been a good year for Belgian ports, as Antwerp volumes increased by more than 4.5 per cent year-on-year in the first three months, with 2.46 Mn TEU handled in total. Part of the positive development is linked to Zeebrugge's decline, which is expected to further expand. The only remaining full container terminal "APM Terminals" of the coastal port will lose another direct line next month, as the Ocean Three had to shorten the rotation to allow ships detouring via the Cape back from Europe to the Far East, avoiding the fees of the Suez canal.

Sources: Alphaliner, JOC, World Maritime News

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Affinity Research London
Mark Williams
Charles Chasty
Jonathan Gaylor
Fotios Katsoulas
Sevita Kondyliou
George Nordahl
Lily Southgate

T. +44 20 3696 7110
E. research@affinityship.com