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Coronavirus casts shadow across dry bulk market

DRY bulk shipping margins are likely to remain poor in the absence of optimism for commodity demand and signals of a weakening Chinese market because of the impact of the coronavirus outbreak, according to Braemar ACM.

While activity in China's tertiary sector is rebounding, travel restrictions have kept construction and manufacturing activity muted, having a knock-on impact on the commodity markets.

"Though it is tough to isolate the effects of the virus from the many bearish factors that have hit freight in recent weeks, such as iron ore supply issues and the seasonal effects of Chinese new year, it has added to downward pressure on rates," the shipbroker said.

The Baltic capesize average over February so far is down by 61% year on year, hovering at below $3,000 per day for most of the month.

Rates on the smaller sizes, which are less exposed to Chinese demand, have shown signs of recovery this week, but are still being weighed down by poor fundamentals.

While the situation is evolving day by day making it difficult to predict exactly how the story would develop, Braemar paints two scenarios where China can either have a V-shaped or a U-shaped recovery in economic activity, which would in turn determine shipping rates.

Braemar analyst Nick Ristic noted that if China can get its population back to work relatively quickly, a V-shaped recovery in economic activity and shipping rates can be expected, led by 'pent up' demand in the Chinese economy.

This, however, relies on cases of the virus falling by enough for China to relax travel restrictions, easing labour shortages and supply chain bottlenecks.

"There are also hopes for a fresh round of stimulus spending to offset losses in economic activity this quarter, which could provide a meaningful demand boost in the medium term," he said.

But the outcome is now looking increasingly likely that it is a slower U-shaped recovery in economic activity, as the number of cases and death toll continue to increase around the world.

And even when industry resumes at full capacity, Mr Ristic says that the pent-up demand will first have to absorb the high stockpiles of semi-finished goods within China before it is felt as a boost in demand for raw materials.

WHAT TO WATCH

UK Club hails 'strong' renewal despite tonnage outflux

THE UK Club says it is satisfied with its 2020 renewal round outcome even though entered tonnage fell slightly in response to higher premiums.

But despite the firmer pricing, the International Group affiliate is also likely to find itself "just a little bit short" of the 7.5% increase in premium it was looking for once the numbers are definitively crunched, said chief executive Andrew Taylor.

His comments are broadly in line with feedback from brokers and other clubs, which suggests that P&I cover did get more expensive this year, albeit not to the extent that may have been feared.

Mr Taylor was speaking after the club described its performance in the renewal round as 'strong,' despite seeing its book fall from 144m gross tonnes to 143m gt.

"Historically, people would have looked at a renewal and called it strong if there was an increase in tonnage. But to my mind, a strong renewal is a renewal that leaves a club in a stronger position," he said in an interview.

"At this point in the cycle, rates at the moment seem low and perhaps insufficient. Is it 'strengthening' to be adding a lot of tonnage if rates are not sufficient to cover the cost of the claims?"

UK Club's strategy at this renewal was to improve its rating adequacy, and it was deliberately careful and selective in terms of adding new tonnage, particularly in the case of members where rates were challenging.

"That obviously led to some tonnage leaving the club, but overall, we came out broadly flat against last year."

The desire to grow in line with the market must be said against the objective of maintaining financial and underwriting discipline and ensuring longer term stability.

UK Club last year announced its intention of seeking around 7.5% more in premiums, in line with many other clubs, although not necessarily on the basis of a general increase.

"We deliberately did not call it a general increase, because we were not seeking to apply that increase to every single member. We are still running through the numbers, but at the moment I suspect we will have fallen just a little bit short of it."

The picture for the year ahead will be complicated by the coronavirus situation, he went on, with clubs on the hook for seafarer sickness and deaths should any arise, and also likely to see lower investment returns if the outbreak hurts financial markets.

"We have not seen much so far by way of claims. But of course, we do have a big investment portfolio," said Mr Taylor. "In the last week, there has been movement in a number of [financial] markets, and that's probably where the bigger impact is."

UK Club offices in Shanghai and Hong Kong are closed because of the virus outbreak, but service and response levels should remain unaffected.

IMO urged to consider market-based measures for emissions

BRITAIN is urging governments to consider how they can use economic incentives to decarbonise shipping, bringing the potential of market-based measures to the fore, according to a proposal seen by Lloyd's List.

Emissions levies, taxes or trading systems could be crucial economic tools in helping ships meet the International Maritime Organization's greenhouse gas targets. What is more, supporting measures such as subsidies or research and development funding would also help the shipping industry, the UK's submissions to the IMO suggest.

The IMO has committed to slashing total annual GHG emissions by at least 50% by 2050 compared with 2008 and it aims to decarbonise fully by the end of the century. Ships will also have to improve their carbon intensity by 70% by mid-century.

The IMO's environmental regulators are meeting in London for two weeks beginning at the end of March, first with a preparatory meeting followed by the Marine Environment Protection Committee that takes all the major decisions. The core focus of the discussions will be measures to reduce GHG emissions from shipping.

The negotiations — and perhaps the talks also scheduled for this autumn — will be preoccupied with the short-term emissions measures that are primarily geared towards energy-efficiency improvements rather than absolute emissions reductions. Some of those measures could potentially apply as early as 2022.

But looking ahead, various shipowners have publicly admitted that a levy on carbon emissions, bunkers or some other kind of charge will be necessary to meaningfully curb the use of fossil fuels by ships and encourage the development and adoption of alternative fuels and technologies.

The deployment of market-based measures, however, is among the most politically sensitive in the IMO given the implications for trade and transport costs and the questions it raises over the different responsibilities countries have in combating climate change.

The IMO's agreed schedule for GHG matters suggests governments would be deciding on potential MBMs sometime between 2023 and 2030, the timeframe for the adoption of what are called "mid-term measures" for emissions.

The UK has been among the more ambitious countries when it comes to shipping GHG emissions. Last year, the UK government enshrined in law its ambition to have net zero emissions in the country by 2050.

In its submission to the intersessional working group, the preparatory body for the MEPC, the UK does not call for an MBM to be adopted immediately nor does it favour any specific one.

However, the country's decision to raise an issue that the IMO is expected to act on in a few years' time at a meeting dominated by shorter-term considerations indicates that, for some countries, this conversation needs to start immediately.

"The UK understands that there is considerable interest among IMO member states and wider stakeholders in new and innovative emissions reductions measures, including economic incentives," the country said in its paper.

Green taxes

In the UK's view, the core measures that could set the industry firmly towards meeting the IMO's targets are emissions levies, emissions taxes or emissions trading systems.

With emissions levies, companies would pay a central authority a specific amount for each unit of emissions or related emission-generating activity they produce.

"Revenue generated by levies is earmarked for a specific use, such as to award rebates, provide grants, and address disproportionately negative impacts on developing countries. Revenue can be paid to either a state or an international body," the UK said.

Emissions taxes, on the other hand, would go straight to the relevant governments. The revenues would not be earmarked for a specific purpose.

Finally, the ETS, could take either of two forms; a cap and trade scheme, where companies trade emissions allowances among them based on a fixed ceiling of GHG emissions, or the allocation of

emissions credits to companies based on carbon intensity or efficiency baselines.

"An ETS can provide certainty over the reduction of emissions due to the gradual tightening of the number of permits or credits and can also raise revenue," the UK added.

The EU has an ETS, but international shipping is not a part of it. However, the new European Commission is planning on including shipping, a highly unfavourable prospect for the shipping industry, which claims an uneven playing field would ensue and other jurisdictions would be encouraged to develop their own regional rules, causing fragmentation and derailing progress within the IMO.

"A key challenge is setting a price or quantity at the right level to achieve the desired objectives and allowing that price or quantity to be periodically reviewed to respond to developments in technology, emissions rates, or unintended consequences," the UK said on the three options.

It also warned that the design of a measure would be a crucial factor in its success, acknowledging a trade-off between having a clear price over a period of time and having an absolute limit on emissions or a price adjustment to attain a reduction target.

"If appropriately designed, levies, taxes and trading schemes have a high ability to meet these targets. With the correct design elements, these core measures could contribute to meaningfully altering behaviour and decreasing emissions from the sector," the UK said.

Beyond the three main measures, the UK also suggests supplemental policies, such as subsidies for companies investing in emissions-reducing technology or competitions for research and development project funding.

The industry's largest lobbies have proposed the creation of a fund that would raise around $5bn over a decade to power R&D projects related to the decarbonisation of shipping.

OPINION

Industry viewpoint: Bob Sanguinetti

IN less than two weeks' time the new Chancellor of the Exchequer will deliver his first budget, *writes UK Chamber of Shipping chief executive Bob Sanguinetti*. The budget is a huge moment in every parliament and this will be no different.

It is the first such exercise since the December 2019 general election and the first since leaving the European Union. It is an opportunity for the new government to set out its spending priorities, demonstrate its levelling up agenda and show that Britain is open for business.

But the chancellor must tread carefully and consider the global economic and trade situation we face. We have all heard about the terrible impact the coronavirus outbreak is having. Stock markets across the globe are suffering their worst week since the global financial crisis of 2008.

The Dow Jones recorded its biggest one-day points fall in its history and the FTSE has dropped more than 3% on Friday morning. Gold is at a seven-year high and a recent report estimated the virus will result in $26bn a week in lost global exports. Businesses are now having to make quick decisions about how and where they make their products.

What many people may not realise is shipping moves 90% of global trade and brings in 95% of all the goods here in the UK. We as a nation rely on ships to bring us everything including bananas, iPhones and cars, and China — as the world's largest manufacturing nation — produces many of the goods we rely on each day. We know the virus originated in China, but this is now a global issue with countries in Europe and the Middle East affected. As the world tries to mitigate the impact of the virus, shipping companies are reacting to the changing situation.

In the leisure sector cruise operators have robust policies to ensure the health of both passengers and staff.

Commercially, shipping is an incredibly flexible business. It must be ready to meet geopolitical and social changes. But we have a record number of containerships sitting idle in China, the highest recorded number since the global economic collapse more than a decade ago. With manufacturing slowing down in China this could mean a rise in the cost of goods we all need and rely on.

The chancellor must consider what impact a continued slowdown in trade coming from China,

and the unstable situation in the Middle East, will have on the UK economy.

Last summer the UK Chamber of Shipping worked closely with the government during the illegal seizure of Stena Impero and it was just two months ago that the government looked at deploying the Royal Navy in the Strait of Hormuz to protect British-flagged vessels. The situation is calmer now, but should we see tensions rise again it is possible prices at the fuel pump could increase.

None of this will be news to the chancellor and we will all have to wait and see how the coronavirus impacts the budget. But one thing is for sure, shipping companies will continue to do all they can to keep trade moving during this incredibly difficult time.

ANALYSIS

Sulphur cap cost pass-through critical to carrier finances

THE ability of container lines to pass on costs associated with the new sulphur cap rules could be critical to some carriers remaining solvent, according to a report from AlixPartners.

The boxshipping sector saw its combined leverage ratio, as measured by debt-to-earnings before interest, tax, depreciation and amortisation, rise by 4% to 8.7 in the 12 months to the end of the third quarter of 2019, the consultant said in its 2020 Global Container Shipping Outlook.

Moreover, the Altman-Z score of bankruptcy risk had also deteriorated in the same period as industry-wide debt levels grew by $21bn as IFRS16 saw carriers take long-term leases on to their books as debts.

“On top of all that is a frustration on the part of shippers, freight forwarders and non-vessel-operating common carriers toward what they have long perceived as opacity on the part of the container shipping sector regarding its pricing, now compounded by the implementation of the IMO 2020 rule,” the report said.

This perception was likely to lead to additional pressure to contain prices and standardise industry pricing formulas, it added.

Report author Jim Blaeser said that while a significant amount of debt faced by carriers was a financial reporting issue from IFRS16, even on a comparable basis debt had risen across the container shipping sector from $89bn to $95bn over the year.

“One of the things that has changed is that in the past debt was largely driven by continuing investment in new ships,” he said in an interview. “What we have seen change is debt now being driven by merger and acquisition activity and some carriers have lingering debt burdens related to that activity.”

Against that background, carriers now had to face the price spread between high and low-sulphur fuels, which meant that costs were rising for carriers with limited scrubber installations.

“It is critical that they are able to pass that cost on via a fuel price mechanism,” said Mr Blaeser. “We think bunker fuel adjustment factors have been very efficient for carriers in recovering costs in the past, but as there is more scrutiny put on them and the cost to shippers rises, there is going to be a greater call for harmonisation of fuel surcharges and more transparency.”

From a carrier’s perspective, that was not necessarily a good thing, he added.

“The more they can keep it opaque, the more they can benefit in terms of recovering costs or making a profit from the surcharge.”

Box lines had traditionally done better when fuel costs were lower, so the increase in costs did not bode well for carriers.

“The way they recover fuel costs is going to be of paramount importance to retaining any profitability this year,” he said.

The confluence of IMO 2020 with the outbreak of the coronavirus would create a challenging environment for carriers to navigate.

“Clearly the coronavirus has had an effect on trade volumes,” said Mr Blaeser. “But as people come back to work in China, there will be a profound impact on freight markets as more freight seeks the capacity

that is out there. We could see tightness in the market driven by an influx of freight."

He added that the longer the outbreak affected shipping, the greater the pent up demand would be.

"The market could tighten very quickly and drive rates high," Mr Blaeser said. "But clearly the lack of volume for the past few weeks will put a dent in carrier financials."

Nevertheless, he said the chances of a Hanjin-style bankruptcy remained lower than in the past.

Mr Blaeser pointed out that the bankruptcy risk score was now worse than it had been in 2016 when Hanjin Shipping collapsed, but added that there were far fewer carriers competing now meant the situation had changed.

"National interests have historically supported carriers through hard times," he said. "It is hard to find a lot of markets where there is a proliferation of national flag carriers within one country anymore where there would be any line that is expendable. The numbers point toward a bankruptcy, but the politics is different this time."

Is it time to question the economics of US LNG exports?

THE global liquefied natural gas market is oversupplied, with increased production from new projects in Australia and the US more than offsetting demand growth, which has been hit by a mild winter as well as the coronavirus outbreak.

That is the view of Russell Hardy, the head of energy trader Vitol, who this week told the IP Week conference in London that global gas and LNG prices were approaching a level that could call into question the economics of US LNG exports.

"The market's got this feeling that we're not going to make it through 2020 with current supplies, and someone has to cut back," said Mr Hardy. "We are getting close to levels when it does not actually make sense to bring US LNG into the market because everybody is operating on pipeline gas," Mr Hardy told the conference.

Still, other people are prepared to weather those risks and keep their bets on the upside potential of natural gas and its liquefied form.

Just this week, Cheniere Energy, the leading US exporter of LNG, said it does not expect "significant or prolonged curtailment of US LNG production" even if low global gas prices cause some customers to cancel cargoes.

"While we acknowledge that some LNG on the margin may not be lifted... this year, we do not view significant or prolonged curtailment of US LNG production as a likely scenario," said Cheniere's chief commercial officer Anatol Feygin on an analyst call following the release of the company's fourth quarter of 2019 earnings.

Demand from China remains a key factor as the firm looks toward the future, said Mr Feygin. Even as he acknowledged a possible dip in Chinese demand because of the coronavirus outbreak, however, he also foresees a rebound farther ahead.

"While the impact of the outbreak on China's economic growth is uncertain," he said, "we see potential for Chinese gas demand to decrease in the near-term, followed by a rebound with the resumption of normal industrial activity and as a result of stimulus measures already being implemented by the Chinese government."

Besides Cheniere, Venture Global LNG also remains upbeat on the potential markets for LNG and they are looking toward Europe for their markets, not China.

Venture Global Plaquemines LNG this week signed a 20-year sales and purchase agreement for the supply of 1m tonnes of LNG a year to Électricité de France.

That builds on Plaquemines LNG's earlier deal, which saw it selling 2.5m tonnes a year of LNG under a 20-year sales and purchase agreement to PGNiG, a Polish state-controlled oil and gas company, headquartered in Warsaw, Poland.

But Venture Global LNG has an even greater bet on the table, with a total of three projects planned in Louisiana for a combined output of 50m tonnes a year of LNG: two in Plaquemines Parish and the third in Cameron Parish.

All of that adds up to a lot of capital riding on possible markets, a risky business.

To be sure, Venture Global experienced no shortage of potential investors at its most recent investment round last July when local media reported that the firm sought to raise $5.8bn for its Calcasieu Pass project, but global banks committed nearly twice that amount at $10bn.

Still, that was last summer and things have changed.

On Thursday, natural gas prices ended trading in New York 3.8% lower at $1.7520/mmBtu.

The Wall Street Journal called it "the lowest closing price since March 9, 2016", as the coronavirus "sparks fears" that overall global energy demand could fall considerably, creating a knock-on effect on the domestic gas market and US exports of LNG.

"Other bearish factors are also playing a role in gas' price demise, including the arrival of spring in a few weeks, which means the end to the peak-demand winter season," it said, adding that "weather forecasts signal a bullishly cold end to February, but followed by a quick warm-up in March".

Market forces are at work, the US Energy Information Administration says.

It expects US monthly natural gas production to decline from last year's record levels in 2020 "as lower natural gas prices reduce incentives for natural gas-directed drilling and as lower crude oil prices reduce incentives for oil-directed drilling and associated gas production".

Perhaps the time really has arrived to call into question the economics of US LNG exports. Mr Hardy could be right.

But the industry also could simply be facing the temporary dip predicted by Cheniere's chief commercial officer, Mr Feygin. If so, the questions are how soon and how large a rebound can be expected.

A lot of potential US LNG cargoes are riding on the answers to those questions.

IN OTHER NEWS

Scrubber retrofits put squeeze on MPC Containers

AN EXTENSIVE scrubber retrofit programme and other IMO 2020 preparations put the squeeze on MPC Container Ships' financial performance last year, but will pay off in the longer term, chief executive Constantin Baack has revealed.

His comments come as Oslo-listed but German-controlled feeder outfit reported a net loss of $14.2m for the final quarter and a net loss of $39.7m for 2019 as a whole

Total fourth-quarter revenue was $44.2m, down from $46.0m in quarter three. Utilisation came in at 95.7%, up from 92.9% in the preceding three months.

BW LPG to retrofit more dual-fuel VLGCs

BW LPG has firmed up its option to retrofit four more very large gas carriers with dual-fuel liquefied petroleum gas propulsion engines amid increasing charter revenues.

The move will bring the number of dual-fuelled ships in the company's fleet to 12, following an earlier four-ship option announced this month.

The project will begin as planned in 2020 and completed by the second half of next year, BW LPG said in a statement.

US Driftwood offtake pushed back in soft LNG market

US-BASED developer Tellurian has agreed to extend the execution of an agreement with India's Petronet involving supply of liquefied natural gas.

The two parties signed a memorandum of understanding last September for the sale and purchase of up to 5m tonnes per annum of LNG to be produced from the Driftwood export project being developed in the US state Louisiana.

The MOU also calls on Petronet to inject equity in the Driftwood Holdings, the Tellurian-owned unit driving the project.

Vale warns of oil risk from damaged VLOC Stellar Banner

VALE has said it is preparing for a potential oil leak from the stranded very large ore carrier Stellar Banner.

The Brazilian mining giant has asked domestic oil company Petrobras to dispatch oil spill recovery vessels to the accident site, according to a statement.

The 300,630 dwt vessel, owned by South Korea's Polaris Shipping, is stranded about 100km off the coast of Sao Luis, Brazil on the way out of the access channel of Ponta da Madeira maritime terminal.

Brillante Virtuoso decision highlights key role of master

THE Brillante Virtuoso insurance fraud decision provides that

masters must have full discretion to exercise good faith when implementing Best Management Practice anti-piracy guidelines in high-risk areas, according to a leading shipping lawyer.

The outcome will have practical implications for vessels operating in the Gulf of Aden and the Gulf of Guinea, which have witnessed high levels of hostile activity in recent years, says Stephen Askins of Tatham, who acted for owners in many ransom negotiations during the Somalia crisis.

Last year's high court verdict in Suez Fortune Investments Ltd & Piraeus Bank AE v. Talbot Underwriting Ltd & others [2019] EWHC 2599 (Comm) ruled that an ostensible pirate attack on a tanker in the Gulf of Aden had been instigated by a Greek owner seeking to defraud his war risk insurers.

Pioneer Marine's chief executive quits

PIONEER Marine's chief executive Torben Janholt has decided to leave the company that specialises in handysize bulkers.

"I would like to announce that my journey with Pioneer has come to an end," Mr Janholt said in a statement announcing the best-ever company results.

Mr Janholt, who was based in Norway, has been a member of the board of directors since 2013. He will be replaced by Dimitris Papoulis, who serves as the company's chief operating officer.

Trafigura and Phillips 66 announce Texas port joint venture

TRAFIGURA and Phillips 66 have formed a joint venture to build an offshore deepwater port to load very large crude carriers 21 nautical miles east of Texas' Port of Corpus Christi.

The Bluewater Texas terminal would have up to two single-point mooring bays for loading VLCCs for oil experts, the two companies said in a statement on Friday.

"The Bluewater Texas joint venture is working with the Port of Corpus Christi Authority to provide a safe and environmentally sustainable infrastructure for the export of crude oil to global markets while benefiting the regional economy," the statement said.

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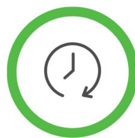

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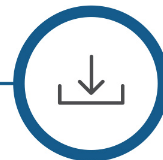

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