AFFINITY

MACRO TOPICS

19 December 2016

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POLICY: THE YEAR IN REVIEW

Our final post of the year looks backwards and forwards

There is no avoiding the political earthquakes that happened this year as voters in the US, UK, Italy and elsewhere took advantage of popular votes to voice their displeasure with current political and economic responses to the Great Recession and globalisation. The irony is that the major economies of the world – the US, the EU and Japan – have all enjoyed more economic growth this year than previously, while China's official growth rates are steady. OECD employment levels have improved and, until recently, low energy costs and historically low costs of credit have helped the large economies to battle through weak demand, low productivity growth and limited wage growth.

Wiser minds than ours, such as those at fund manager Pimco, forecast that US GDP will grow 2.0 to 2.5 per cent in 2017, twice the annual rate of Q1 2016 if a little below the 3.2 per cent recorded in Q3 2016. Pimco adroitly describes the world situation as "stable but not secure" with risks from "rising debt, monetary policy exhaustion and the populism-powered transition from globalization to de-globalization." Their outlook finds some positives, though, in "potential deregulation, awakening animal spirits and the accelerating transition from exhausted monetary to growth-supported fiscal policies." Certainly, Mr Trump's appointments to his cabinet reveal a focus on business and deal-making that may spark animal spirits in many places.

In the eurozone, the ECB has felt confident enough in the outlook to reduce QE by €20 Bn a month. The eurozone trade surplus has been reported as falling in October to the lowest level in eight months as exports fell 0.3 per cent and imports rose 2.9 per cent, which we take to be a sign of growing European consumer confidence. Meanwhile, IHS-Markit's eurozone flash PMI for November reached 53.9, its highest level for 2016, while an output price index reported by Reuters increased from 50.6 to 51.4, its highest since July 2011. Elections in Germany, France and the Netherlands in 2017 will go a long way to deciding the EU's economic policies, but the direction of travel is currently positive.

The Chinese Academy of Social Sciences has today predicted that China's GDP growth will slow in 2017 to 6.5 per cent from 6.7 per cent in 2016. A weaker yuan, capital outflows and an increase in debt to around 250 per cent of GDP according to CASS's figures all point to the "prudent and neutral" monetary and economic policies agreed by the country's leaders last week. Property prices in China's major cities have increased by 12.6 per cent in 2016, and the government may tighten credit further to keep the lid on property price growth while also wanting to support investment in industrial productive capacity and the one belt, one road policy.

In Japan, the government forecasts around 1.5 per cent GDP growth for the fiscal 2017-18 year, though the number is subject to revision before the official estimate is published this Tuesday, 20 December. The figure for the current financial year is estimated to come in at around 0.9 per cent. Japan's consumers have overcome the sales tax hike from earlier this year, though weaker than expected corporate spending that may hold back growth next year. Abenomics does not yet appear to have run its course.

There is then plenty to be optimistic about for 2017 from a macroeconomic perspective after a year which has, apart from bright spots for tanker markets, been a low point for most sectors of shipping. At this time, we can make one confident prediction for the coming year: politicians' inveterate appetite for fiddling with market processes and for intervening where they cause unintended consequences will continue unsated. For now, Season's Greetings to all of our readers and our best wishes for a peaceful and prosperous new year.

TANKERS: THE EVENTS WHICH TICKLED THE OIL MARKET IN 2016

We look back at the big happenings which defined the oil market this year.

Looking back at the year, the oil markets have been anything but dull, with far too many highs and lows to cover in any great detail here. But here are the events we feel are worth recalling:

Oil Bottoms Out in January

On 20 January, Brent crude fell to as low as USD 27.88 per barrel, its lowest level since 2003. Opec's (read: Saudi Arabia's) move to flood the oil markets was in full swing and the glut had taken hold, with wide-reaching consequences. Venezuela, already suffering, publicly called for an emergency Opec meeting, but this was swiftly rejected. The price collapse prompted the IEA to warn that the world could "drown in oversupply."

Iran Restarts Exports

In around mid-January, Iran and the UN came to an agreement to lift sanctions which had prohibited Iran from exporting its crude oil except to six exempt customers, much to Saudi Arabia's chagrin. In February, Iran's first shipments were delivered to Europe. According to the JODI-Oil World Database, Iran exported 1.55 Mn bpd in January, and this rose to 2.15 Mn bpd in September.

Militant Attacks in Nigeria Cripple Output

Nigeria began the year as Africa's largest producer of crude oil, but a wave of militant attacks targeting the country's oil and gas infrastructure in the Niger Delta region have hit the country's production severely. According to Opec's secondary sources, Nigeria produced 1.869 Mn bpd in January, but this slipped to just 1.424 Mn bpd in May, over 350,000 bpd below that of Angola. Output since recovered to 1.692 Mn bpd in November. This year, the oil markets have been particularly volatile and sensitive, and outages such as those in Nigeria, as well as in Venezuela and Canada, have been responsible for price rallies.

The production outages in Nigeria resulted in fewer cargoes available for tanker loading, impacting both VLCC and Suezmax trade out of West Africa.

Opec's Historic Agreement

It may have happened recently, but we couldn't leave this off the list. On 30 November 2016, Opec agreed a collective cut of production effective 1 January 2017. Each participating country (Iran, Libya, Nigeria, and the now-departed Indonesia are exempt) will reduce output by between 4.5 and 4.6 per cent from October's production levels. As a result, the group's production will be reduced by just under 1.2 Mn bpd to satisfy a ceiling of 32.5 Mn bpd.

Oil prices spiked by over 10 per cent on the news as Opec defied doubters to prove that it still holds great influence over the oil markets. Shortly after, 11 non-Opec producers agreed a similar deal, providing plenty of momentum behind prices. It is now a question of whether each country can keep their word in the New Year.

Sources: Opec, Reuters, Bloomberg, Wall Street Journal

CONTAINERS: TERMINALS IN N. AMERICA FACING OVERCAPACITY

There is still interest from companies to invest, but the required volumes have to be committed by ocean carriers before construction starts.

Ports America, the terminal operator based in New Jersey, announced its participation in the development project of a deep-water container terminal in North Sydney in Nova Scotia, a port on the Canadian Atlantic Coast. After being in the news again and again during the last decade, the proposed North Sydney terminal was being marketed as the "Novaporte" terminal, but never really took off. Ports America and Sydney Harbour Investment Partners recently announced an agreement for the promotion, development and management of Novaporte. This happened almost one year after the project promoters signed a preliminary agreement with the China Communications Construction Company Limited to discuss design-related arrangements, and the construction and ownership of the proposed deep-water container terminal.

SHIP (Sydney Harbour Investment Partners) holds exclusive development rights to a 200-hectare site in the port of North Sydney and, together with the Ports America and a specially formed development group, plans to build a dedicated, semi-automated, deep-water marine container facility capable of handling ULCS of 18 k+ Teu.

According to the terms of the agreement signed this week, Ports America will be responsible for the management and operation of the terminal for 40 years, providing services such as full stevedore and terminal labour management, terminal operating systems, and maintenance and repair.

Once the construction commences, it is estimated that it will take approximately two years to complete. However, of greater importance is the fact that the developers will only start building after having established sufficient customer volume commitments. As the market has been facing terminal overcapacity, this approach looks rather unusual. The current environment is not in favour of projects like this, with ocean carriers hardly inclined to commit that high volumes in advance to any port, and above all to a port that does not even exist yet.

The goodwill displayed by all parties involved in this project is there to be seen, but the announcement of this project is not enough to stop concerns over the project's viability. A business case for such a large new container terminal in Nova Scotia appears to be a difficult project at the moment, with similar projects in the region having failed to move forward for years. As an example, the competing project to develop a ULCS-ready container port in Port Hawksbury has been running for about a decade without any tangible progress to report, even if the developers have secured backing from a major US terminal operator.

In the meantime, the only established container port in the region, Halifax, gears up for another terminal expansion, which would make it fully-ULCS ready. Since the most recent investment projects and upgrades, Halifax has been well capable of handling larger deep-draft container ships.

It is a fair point that Halifax, at least under its current design, cannot handle next-generation jumbo vessels of 18 k+ Teu, but the port has had no issues with standard ULCS of up to 14 k Teu so far. Bearing in mind the smaller size of the overall Atlantic market, compared to the first-tier trade lanes such as Asia - Europe and Asia - USWC, it looks rather impossible that the trade will urgently need a purpose-built green field jumbo terminal in the short term.

Therefore, the market is sceptical with regards to the volume commitment being sufficient to kick-start the construction of 'Novaporte' at this time. Without it, the future of the project remains uncertain.

Source: Alphaliner, Affinity Research

GAS: IT'S COMPLICATED

Germanys relationship with coal continues, despite ambitious emission targets.

Germany has a mixed relationship with energy. On one hand, Germany is keen to promote its quick uptake in renewables with over one-third of energy being supplied though this method, whilst just around the corner out of sight it continues to burn coal at record levels. Germany has some of the most ambitious climate targets however its long farewell to coal and political involvement with employment in the coal mines means that it will be around for some time.

Germany's annual climate protection report was released this December and has declared that it will likely miss its self-imposed target of cutting emission by 40% in 2020. Its revamped figure expects to cut emissions by 37% in 2020 from 1990 levels. The minister has highlighted three areas in which to focus over next few years. Energy efficiency, coal-fired power generation and electrification of private transport. The final target may also get harder to reach as there is expected to be a slowdown in the adoption of renewables as the country moves away from the feed in tariff and incentives supplied by the government.

Lignite mines or brown coal mines are expanding and the Garzweiler mine continues to swallow nearby villages. It is by far one of the largest sources of electricity in Germany and some of this coal feeds three coal power plants in the country which also happen to be the most polluting in Germany. Elsewhere in Germany, coal continues to grow as Swedish Energy firm Vattenfall AB recently commissioned a 1.6 GW hard coal-fired power plant in Moorgbyg near Hamburg Germany, replacing a natural gas-fired power plant at the same site. It produces 90% of Hamburg's energy demand. Showing that even now coal continues to rise

Natural gas should be more on the agenda as an easier route to lower its carbon footprint, but is hampered due to its higher cost. Additionally, natural gas would not support the same employment drive as coal. Still, natural gas is finding some market share in Germany as will continue to rise. Gasunie is partnering up to develop Germany's first LNG terminal which will be a midscale LNG terminal in Hamburg. The capacity of the project will be around 2-3 million tonnes per annum and will have a jetty for marine bunkering and a small break bulk facility. But this is less likely to compete with coal for electricity generation and will be more of a push to use natural gas as a transport fuel. By far the largest push for the fuel will be the proposed Gazprom natural gas pipeline connecting Russia with Germany and bypassing Ukraine. Nord Stream 2 which would bring around 55 billion cubic metres of cheap natural gas. Still, even with the availability of cheap natural gas, politically coal is still so high on the agenda that natural gas will likely be left in the shadows.

Source: Platts, TradeWinds, EENews

DRY CARGO: HIGHLIGHTS FROM AN INTERESTING TIME

A short review of some of the key takeaways from the year gone by.

It is doubtful that 2016 will be remembered fondly by those with an interest in the dry cargo market. Yet for all its volatility, with historic lows and unexpected recoveries, there are lessons to be learned for those still afloat and ready to take on the new year. Perhaps more important is the notion that past events, for better or worse, always act as the foundation on which the future is built. The following is therefore not intended to shed light on a specific future, but merely to act as a reminder of some of the things we have got to work with going forward, and what got us there.

China:

The weakening of the Chinese growth driven model which became apparent in the second half of 2015, continued into this year contributing to the BDI falling to an all time low of 290 points on two consecutive days in early February 2016. In response, the Chinese government announced with vigour its intention to not only eliminate inefficient and loss-making capacity in its steel and mining sectors, but also to increase spending on construction. These were actions that immediately lifted the markets, despite concerns over China's ability to reduce enough capacity to bring supply and demand back on an even keel.

Chinese speculative activity also played a significant role in re-igniting optimism, as retail-investors and hedge funds alike bet on commodities and steel products such as rebar based on promises of increased constriction activity, creating a surge in prices. This, however, was not the only consequence of China's policies this year, though fundamentals would come to play a much larger role.

Coal and Iron Ore:

Undoubtedly the most uplifting story this year has been the development in the coal market. Firstly, the Chinese summer proved to be unseasonably hot resulting in record electricity demand. Naturally this gave a boost to thermal coal imports. Simultaneously, the latter part of summer saw flooding in several coal producing regions of China which restricted output. In addition, capacity cuts and production restrictions combined with disruptions in Australian supply led to a shortage of coking coal, which in September sent prices rocketing. This had a surprising secondary effect whereby the low steel price combined with the resulting high cost of coking coal drove demand for high grade iron ore as less coking coal is needed per tonne of iron. This drove demand for Australian and Brazilian iron ore, increasing tonne mileage significantly. Towards the end of the year, this fortuitous union of circumstances does however appear to come to an end as the supply constraints are easing.

The US Presidential election:

The victory of Donald Trump in the US presidential election, and his announced intention of increasing governmental spending on infrastructure projects, also lifted commodity prices and general sentiment. While any such projects would only materialise after the President-elect takes office, construction materials are likely to see a boost. The result of the vote has also brought with it a fair degree of uncertainty that is as of yet unresolved, particularly with regards to international free trade agreements and relations to one of the nations major trading partners, namely China.

These then are some of the key events and market drivers that shaped 2016, and which will carry over into the next year. This is however by no means an exhaustive list. Developments in the supply side have been and will continue to be key in any recovery scenario. That some future dismay is necessary for such a recovery seems pretty clear as much is left to be resolved, but hopefully this year has shown us that such changes are possible. Happy New Year. Hopefully.

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