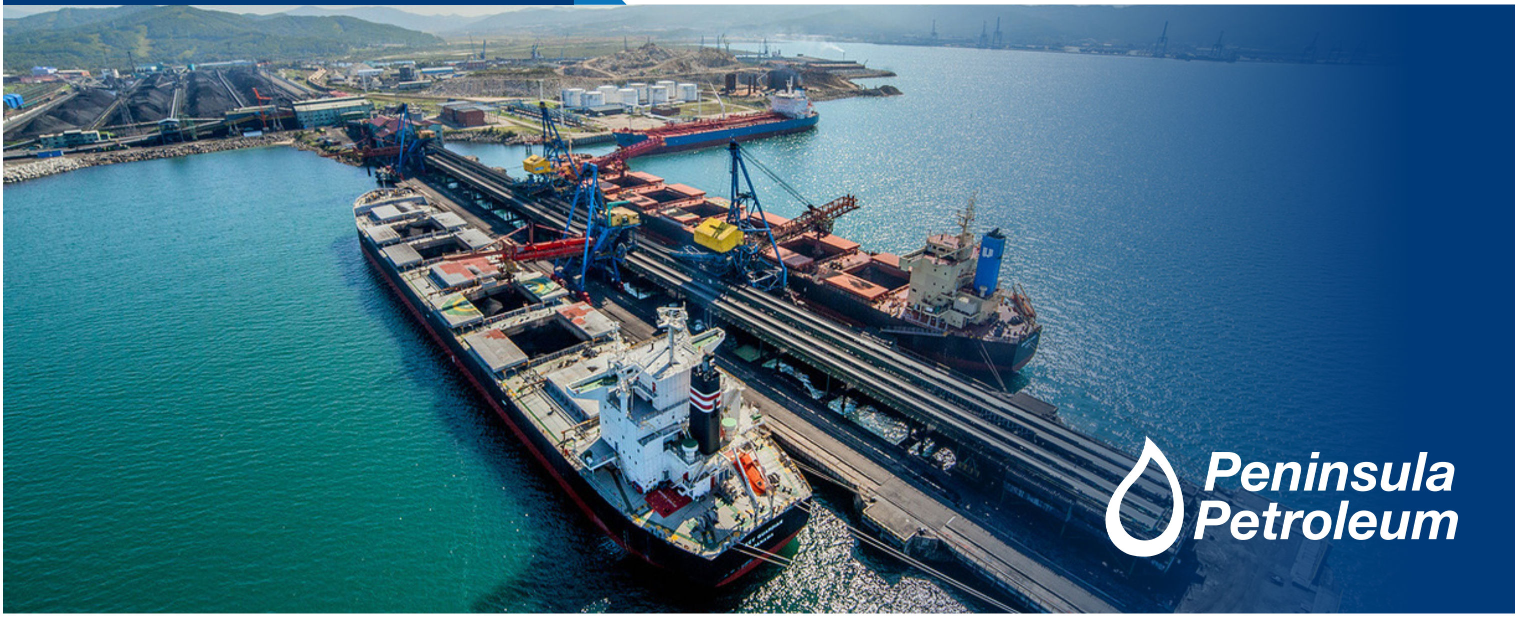


MARKET UPDATE: DRY BULK SCENARIOS

MICHAIL BEGLERIS, MARKET ANALYST

March 2020

1. EXECUTIVE SUMMARY

Fundamentally, the gradual recovery of China should favour a normalization in trading conditions, as China accounts for around 35% of world seaborne dry bulk imports. However, brokers report sentiment is softening in the dry bulk market and activity is down across all sectors. A Handysize owner said he expects severe operational difficulties moving forward, as crew changes and sending office personnel to visit the vessels is becoming nearly impossible (the last superintendent engineer that visited one of his company's vessels had to be quaranteed for 14 days upon his return to Greece). There has also been a marked slowdown in Sales and Purchase activity, indicating a lack of interest from owners amidst heightened uncertainty. As dry bulk earnings are already below OPEX in several sub-sectors, rates are expected to increase, but the scale of gains will be limited by high fleet capacity growth, while numerous downside risks have recently emerged. The situation is fluid and different scenarios may arise. However, even under the most optimistic scenario (Scenario 1 below), the performance of the dry bulk sector is expected to be weaker in 2020 as a whole.

Scenario 1. Containment measures do not impact production of major dry bulk goods (i.e. mine operations, etc.) and port operations remain intact. World economic slowdown is contained

Under this scenario, Capesize rates will be lifted from 2Q 2020 on the back of increased iron ore trade to China. This is supported by a normalization in iron ore production in Brazil and Australia. However, Capesize fleet growth is still expected to offset iron ore trade growth in 2020 and rates will trend lower year-on-year. Furthermore, even if economic slowdown is contained within the first half of the year, some permanent demand destruction cannot be avoided as global steel consumption is currently being hit. Panamax rates will start rising from 2Q 2020 due to healthier grain trade. There will be higher purchases from China as its soybean demand normalizes from swine flu while Indian grain import growth is also expected to be robust. China has also issued waivers on aggricultural imports from the US and US grain exports were forecasted to reach record levels this year. However, the US-China Phase 1 agreement has not been delivering its promise so far and the situation is unlikely to change in the midst of the coronavirus outbreak. Furthermore, Panamax fleet growth in 2020 is high enough to cap significant upside potential. Handymax rates increase from 2Q 2020 amid resilient minor bulk trade with substantial growth in Guinea bauxite exports to China, as well as support from grain trade. Additionally, fleet developments for Handymaxes are more favourable compared to larger sectors. However, downside risks exist, as production of minor bulks may be negatively impacted from virus-containment measures.

Scenario 2. Economic slowdown in regions outside China cannot be contained. Potential for virus-containment measures to impact production of major dry bulk goods

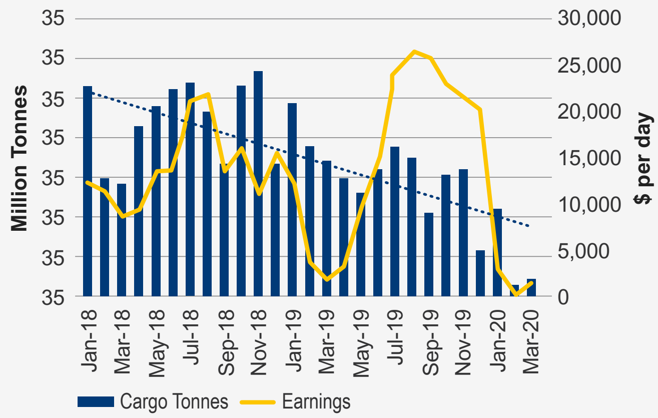
The more pessimistic Scenario 2 is shared by brokers, who suggest spot market activity is currently very low across all sectors and that further softening is expected moving forward. A global economic slowdown has pragmatically become the most realistic scenario amidst strict containment measures imposed by governments around the world. As the overall economic landscape deteriorates, although iron ore imports into China may grow as the country recovers, disruptions in global iron ore production and a slowdown in demand for steel products will eventually weigh. Furthermore, there has also been noticeable impact on steel consuming sectors. Data from China's Association of Automobile Manufacturers show that Chinese automotive sales plunged 79% y-o-y in February, marking their biggest-ever monthly decline. There have also been announcements regarding output disruptions. Chilean miners asked BHP to shut down Escondida copper mine or raise safety measures against the coronavirus. Slower economic growth would not only impact iron ore trade, but also that of on minor bulks and grains. Grains may prove somewhat more resilient due to the commodity's inelastic nature. Finally, opertional challenges will rise (crew changes, provision of supplies, etc.) and also impact shipping activity. With virus-pressure being added on top of pre-existing unfavourable demand/ supply fundamentals, the 2020 outlook would be weak.

2. DETAILS PER SECTOR

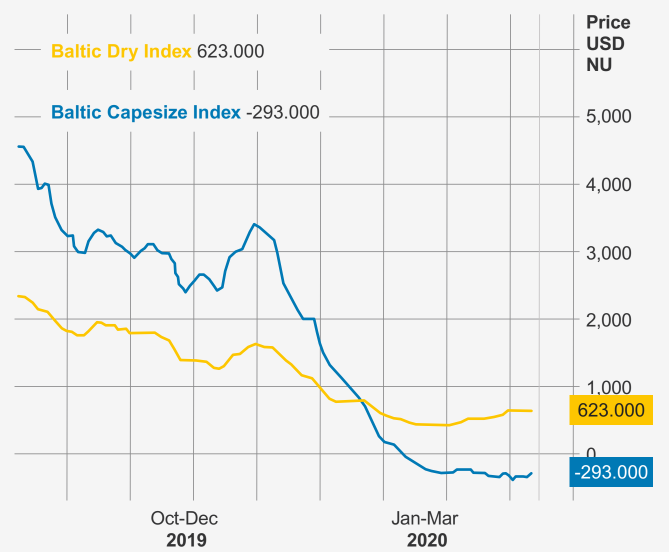
2.1 Capesizes

Clarksons data shows a downwards trend in spot Capesize fixtures since January 2018 (see chart below). This is not surprising since world seaborne iron ore trade also declined y-o-y in 2019. This was likely due to the tailings dam disaster on Brazilian iron ore mining and exports (which fell to a six-year low of 22.3 Mt in March 2019) and trade from Australia has been being disrupted by Cyclone Veronica. Reported spot fixtures also point to very low activity in early 2020. Brazil's iron ore exports in February were the second lowest in the past 7 years amidst flooding disruptions. There has, however, been a slight increase in spot fixtures in 1-13 March. The increase is very small but may be linked to gradual recovery as Chinese manufacturing comes back.

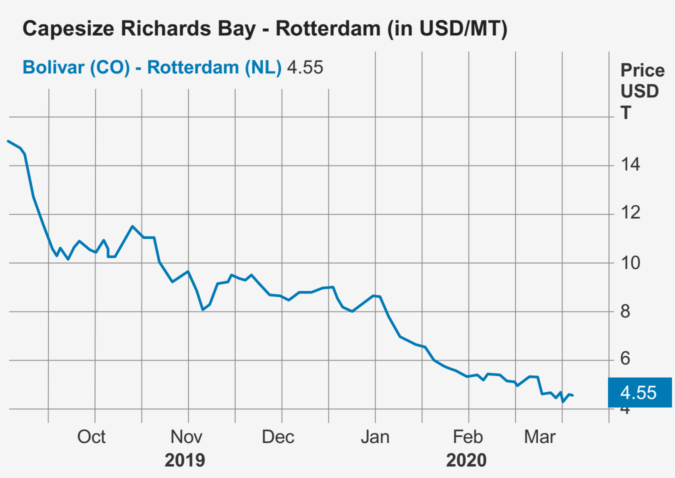
Chart 1. Capesize Cargo Tonnes Fixed vs Earnings

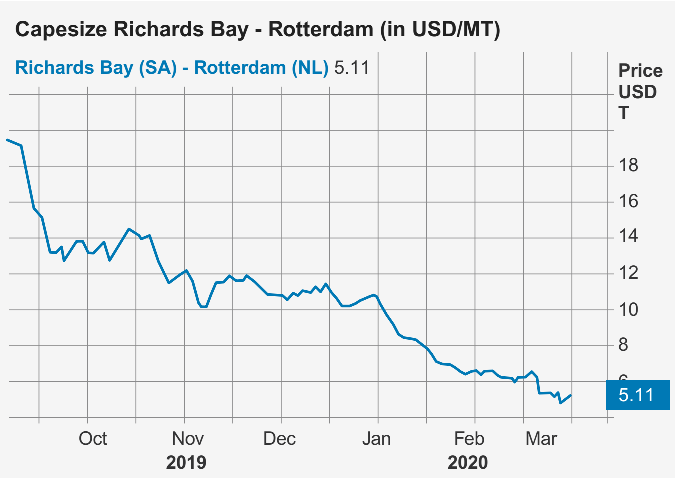


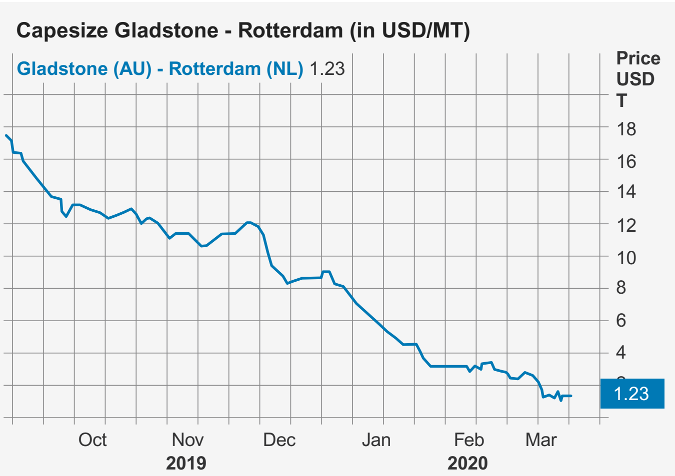
Capesize earnings have fallen steadily since the summer of 2019. Since January 2018, average earnings of about $13,500/day have been close to OPEX (of $10,000-15,000/day). There was no world seaborne iron ore trade growth in 2018 and 2019, while the Capesize fleet grew by 3.4% and 3.9% in each of these years. Earnings have averaged just about $2,000/day so far in 2020. In short, the longer-term weak Capesize performance is continuing. Weak Capesize performance has weighed on the BDI:



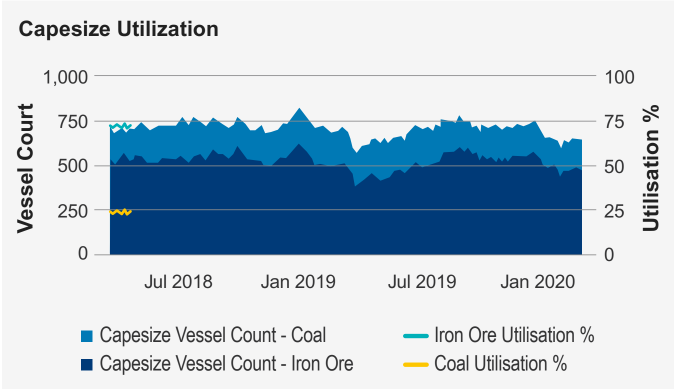
Capesize earnings fall across major routes:



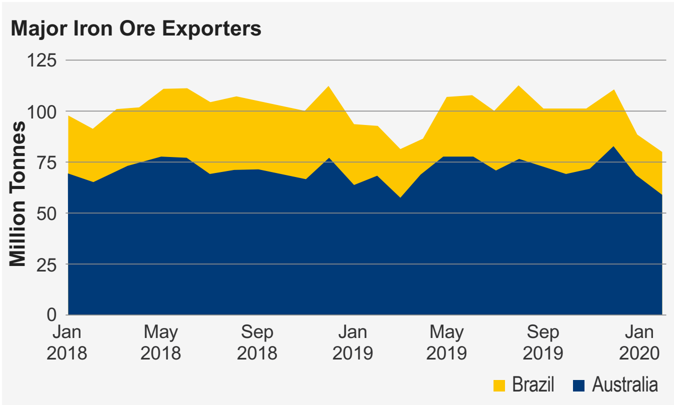




Capesize vessel count for iron ore liftings fell in January-February:



Iron ore exports from major exporters fell sharply moving into 2020:



Capesize fleet growth was already expected to outweigh iron ore trade growth in 2020 (data from Clarksons):

	Capesize Market Balance			
	2018	2019	2020	2021
Iron Ore Trade Growth	0.3%	-1.3%	2.2%	1.1%
Capesize Fleet Growth	3.4%	3.9%	4.4%	2.7%

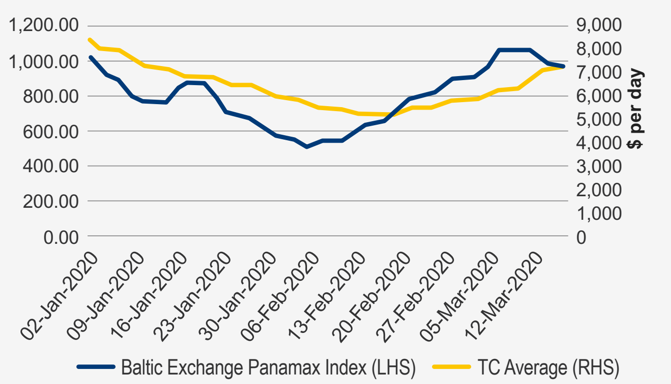
The coronavirus simply worsened an already challenging outlook for the Capesize sector. For the time being, earnings seem to have reached a floor, although they remain depressed and the BCI is still well into negative territory (-166 as of 19 March). Demand from China (over 75% of world iron ore demand), should gradually return and this could eventually be supported by government stimulus (which will show effects with a time lag). Iron ore exports from Brazil and Australia may also increase from 2Q 2020. February projections were for y-o-y growth of 1.5% in iron ore trade in 2020. The major downside risks are iron ore exports being disrupted by containment measures and the potential for lower demand as the coronavirus cuts demand from the rest of the world and takes a toll on steel-consuming industries. Although Capesize FFAs have priced in improvements from current conditions, brokers report that the fact that FFAs show so little improvement for 2Q 2020 is worrying.

The Capesize sector was already under pressure from unfavourable demand/supply balances in 2018 and 2019 and Capesize earnings have been relatively low since 2018 and below OPEX during the last 3 months. Earnings may see some gains moving forward as China recovers but upside potential is limited. With high fleet growth expected to offset Capesize demand growth in 2020, Capes will struggle to have a profitable year even if global economic slowdown is avoided.

Panamax – Kamsarmax

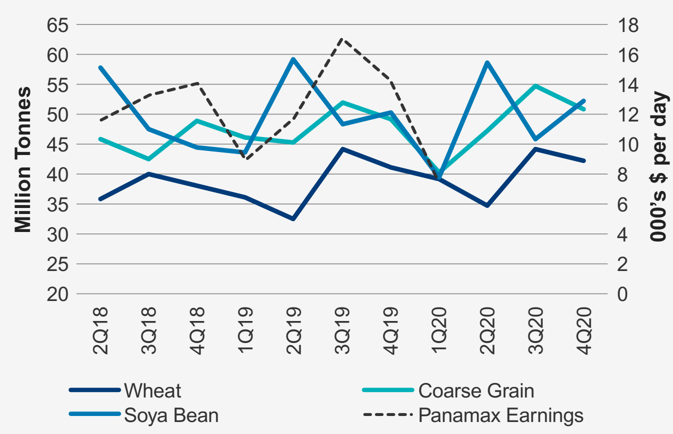
Panamax earnings have recovered since mid-February but TC earnings are still around $1,000/day lower y-o-y so far in 2020. There has been a strong start to South American grain exports which has insulated the smaller dry bulk segments from the effects of coronavirus.

Panamax TC rate vs Baltic Exchange Panamax Index



Grain trade was anticipated to increase from 2Q 2020, at least before fears of global recession grew. The US Department of Agriculture (USDA) has revised up its forecast for global corn trade in the 2019/20 market year (October-September) to a new record of 173.5Mt, up by 1.6 Mt year-on-year. Shipments of other coarse grains, such as barley, sorghum and oats, are also expected to register robust year-on-year growth.

A decline in grain exports from Brazil is expected to be outweighed by increases from the US and Europe. Notably, although Brazil's wheat exports will fall, soybean exports (main Asian grain import) will increase so Brazil-China long-haul trade will still be healthy. Overall, Chinese seaborne grain imports were projected to grow by 5% y-o-y to 107mt in 2020. India's grain import growth also seen robust at 19% y-o-y. With supply growth in the Atlantic and demand growth from Asia, long-haul grain trade is supported. Early indications already point to demand from South Korea for US grains. Reuters reports that three South Korean flour mills have issued a tender to purchase 136,700 tonnes of milling wheat to be sourced from the US. Corn imports from the Middle East are supported from expanding poultry production while China has issued waivers on tariffs of US agricultural products. SSY suggests Argentinian and Brazilian corn exports to the Middle East come partly at the expense of Russian exporters, thus benefitting tonne-mile demand.



Growth in coal trade is expected to be limited to around 1%, driven by gains in coking coal, as steam coal demand remains restrained from environmental policies. Coking coal export growth is driven by Russia, Canada and Mozambique with imports from Asia. Steam coal demand growth comes primarily from India and supply from Indonesia, thus steam coal trade is to be driven by the Pacific.

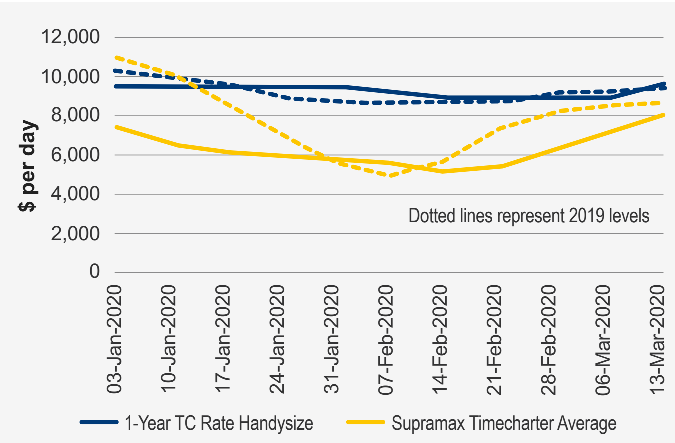
The extent of the virus-induced negative impact on grain demand remains unknown. Furthermore, current low oil prices weigh on demand for ethanol, which in turns pressures corn demand, while the US-China phase-1 deal has yet to deliver its promise. Chinese imports of US agricultural products have picked up only little from year-ago levels. Finally, on top of all the downside risks, Panamax fleet growth is also expected to be high this year, following a six-year high of 5.1% in 2019. Therefore, even in the most optimistic scenario, the upside potential for Panamaxes is limited in 2020.

	Panamax Market Balance			
	2018	2019	2020	2021
Total Coal Trade Growth	5.1%	2.1%	0.9%	0.7%
Grain Trade Growth	-0.2%	0.6%	2.3%	3.1%
Panamax Fleet Growth	2.7%	5.1%	3.9%	1.2%

Overall, Panamax earnings have fared better than Capesizes in early 2020 on the back of South American grain exports. There are fundamental factors to support long-haul grain trade as exports from the US and S.America were projected to increase and demand growth is primarily in China and India. China's soybean imports also expected to normalize from swine fever and tariffs on US agricultural goods have been waived (although Phase-1 deal is not delivering its promise). Going forward risks remain for Panamaxes from accelerated global economic slowdown. Panamaxes are more exposed to western markets (which are currently being hit) than Capesizes. Furthermore, the negative impact of the virus to grain trade is unknown while support is not added by high fleet capacity growth in 2020. Similarly, to Capes, Panamaxes are expected to have a rough 2020, even under the most optimistic scenario.

Handymax – Handysize

Earnings of smaller bulkers are roughly around year ago levels and have maintained an upwards trajectory since the middle of February.



Overall, a more favourable demand/supply balance for smaller bulkers:

	Handymax Market Balance			
	2018	2019	2020	2021
Total Minor Bulk Trade Growth	3.9%	1.6%	2.1%	2.7%
Grain Trade Growth	-0.2%	0.6%	2.3%	3.1%
Handymax Fleet Growth	2.5%	3.6%	2.4%	0.8%

Handymaxes also receive support from seasonally higher South American grain trade, while minor bulk trade seems resilient. Nickel ore trade will fall due to the nickel ore export ban in Indonesia in January. However, long-haul bauxite exports from Guinea to China are set to increase substantially. Beijing has had an agreement to loan Guinea $20 billion over almost 20 years in exchange for bauxite concessions. This is a trade that is expected to develop moving forward. Several Chinese companies have invested in Guinea.

As the situation in China normalizes, minor bulk trade flows could be lifted as trades of bauxite, cement, steel products and forest products are significantly exposed to China. China in general accounted for over 20% of global seaborne minor bulk imports in 2019. However, significant downside risks are also present here. In addition to potential virus-induced demand destruction, there are reports that production of minor bulks is already being affected from the crisis. Vale is reducing activity and output at its Voisey's Bay copper mine in Canada.

Overall, Handymax earnings have fared generally better than larger segments. Handymax trade could benefit in 2020 from growth in minor bulk trade with healthy long-haul Guinea-China bauxite shipments, while the return of China could see a normalization in several minor bulk trades such as cement, steel products, etc. There is also support from grain trade. Fleet growth for smaller bulkers is also more favourable compared to Capes and Panamaxes. However, same downside risks with other dry bulk sectors remain from a potential slowdown in the world economy, while there have already been reports of coronavirus containment measures impacting production of minor bulks.

Contact us for further information
analysis@peninsulapetroleum.com