

Outlook for the Dry & Wet Markets and Commodities

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The New Nature of Shipping (wet and dry): From a Fundamental Transport Industry to a Stock Exchange

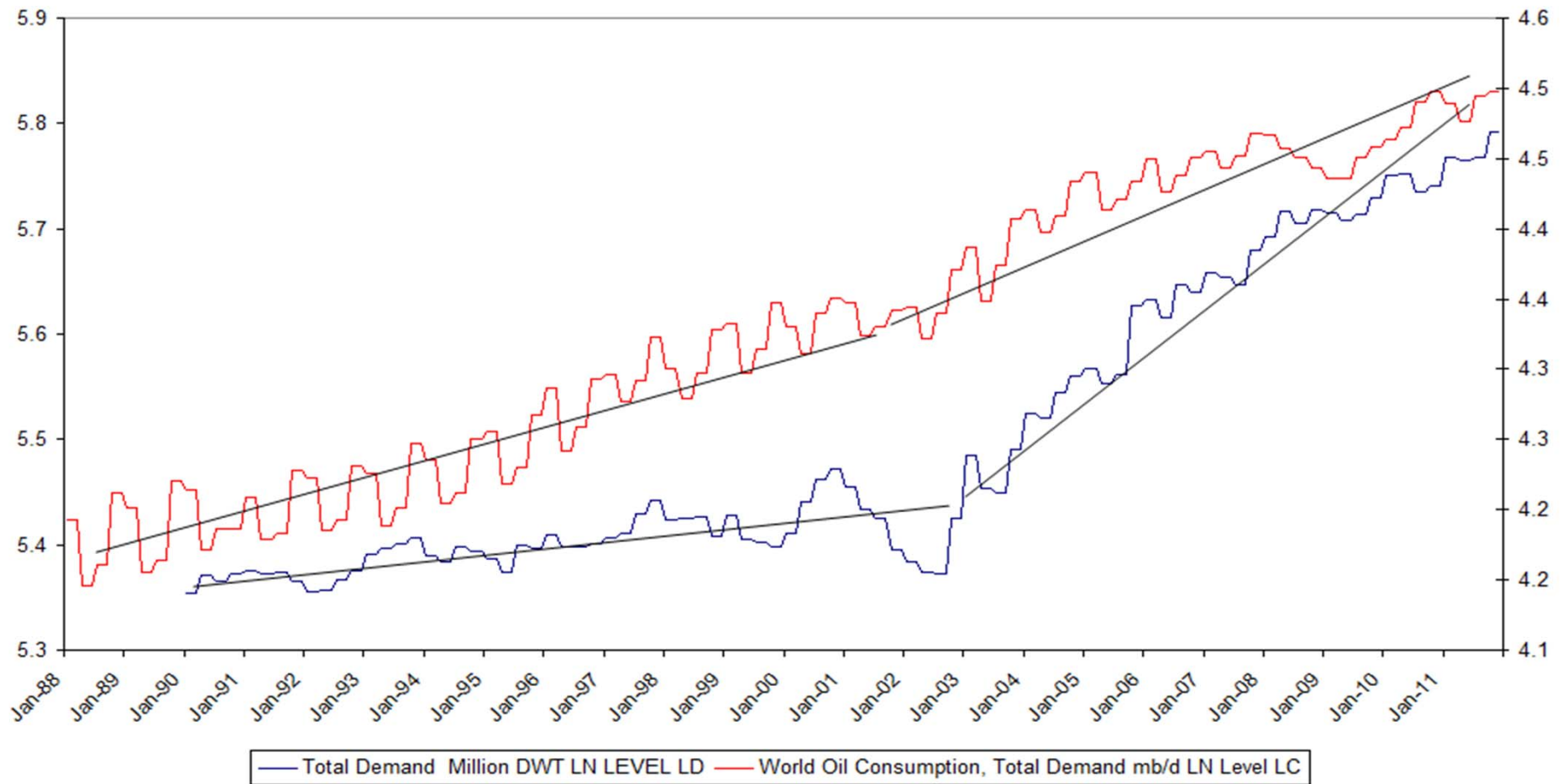
- In normal conditions commodity prices convey correct signals of demand-supply in shipping (until 2003), thereby contributing to an Efficient Allocation of Resources.
- From 2003 onwards, commodity prices give wrong signals, as they are affected by speculative flows, thereby contributing to an inefficient allocation of resources.
- Freight rates and vessel prices include premium/discount over economic fundamentals (demand and supply).
- There was a premium in 2003-2011 contributing to the boom. There is a discount now (from 2011 until 2015?) adding to the gloom.
- The channels of the structural changes
 - The US Dollar (both wet and dry)
 - The price of oil (wet); other commodity prices (dry)
 - Contango or oil-storage trade (wet)
 - Risk appetite, e.g. S&P 500, risk spreads, (dry)

The Oil-Tanker Market in the 2000s

	Percent change between 2003 and 2012	Average rate of growth over the period	Standard deviation	Max over the period	Min over the period
Demand for Seaborne trade	30%	4.3%	2.3%	8.1%	0.9%
Fleet expansion m dwt	40%	4.9%	1.2%	7.0%	3.3%
Average Earnings \$pd	-75%	30,423	12,103	44,591	13,907
Secondhand prices \$ per dwt	8%	583	157	794	405
Newbuilding prices \$ per dwt	28%	564	108	739	379

A Structural Change in the Demand for Oil-cargo

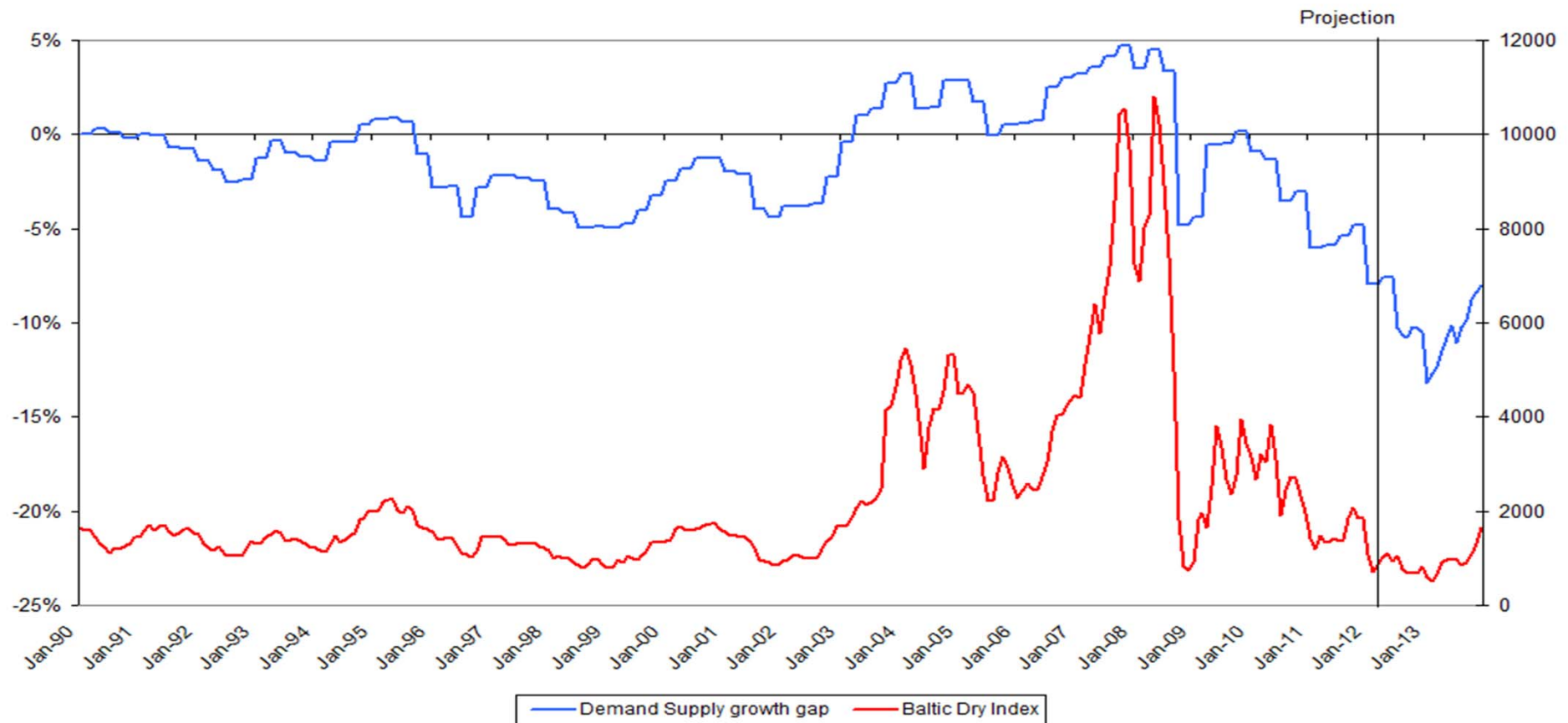
Figure 1: Demand for seaborne trade and demand for oil



Structural Change in Dry Freight rates (2003)

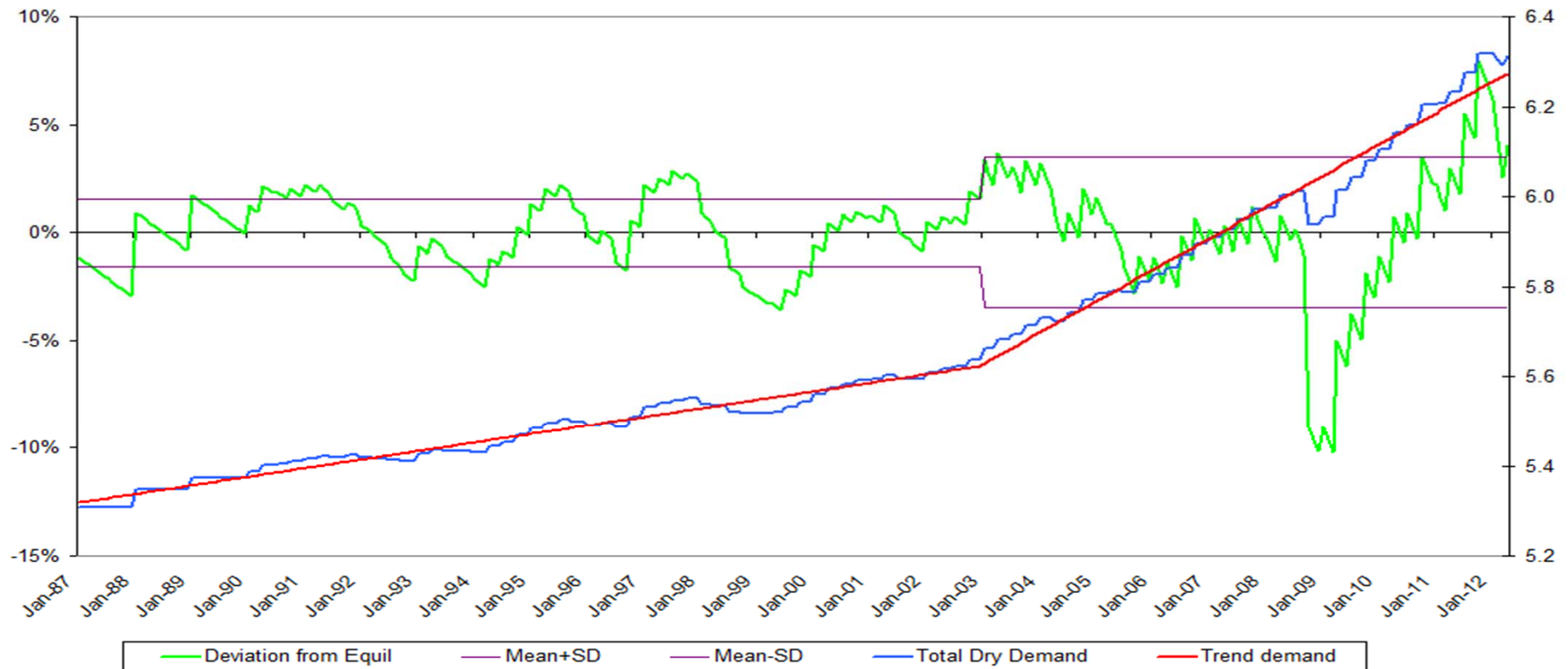
1. Increased sensitivity of BDI to DSB in post-2003 (11.3% to 21%)
2. The volatility of BDI has trebled (23% to 63%)
3. The importance of DSB in explaining the volatility of BDI has markedly increased (67% to 80%)

Figure 3: Demand Supply Balance and BDI



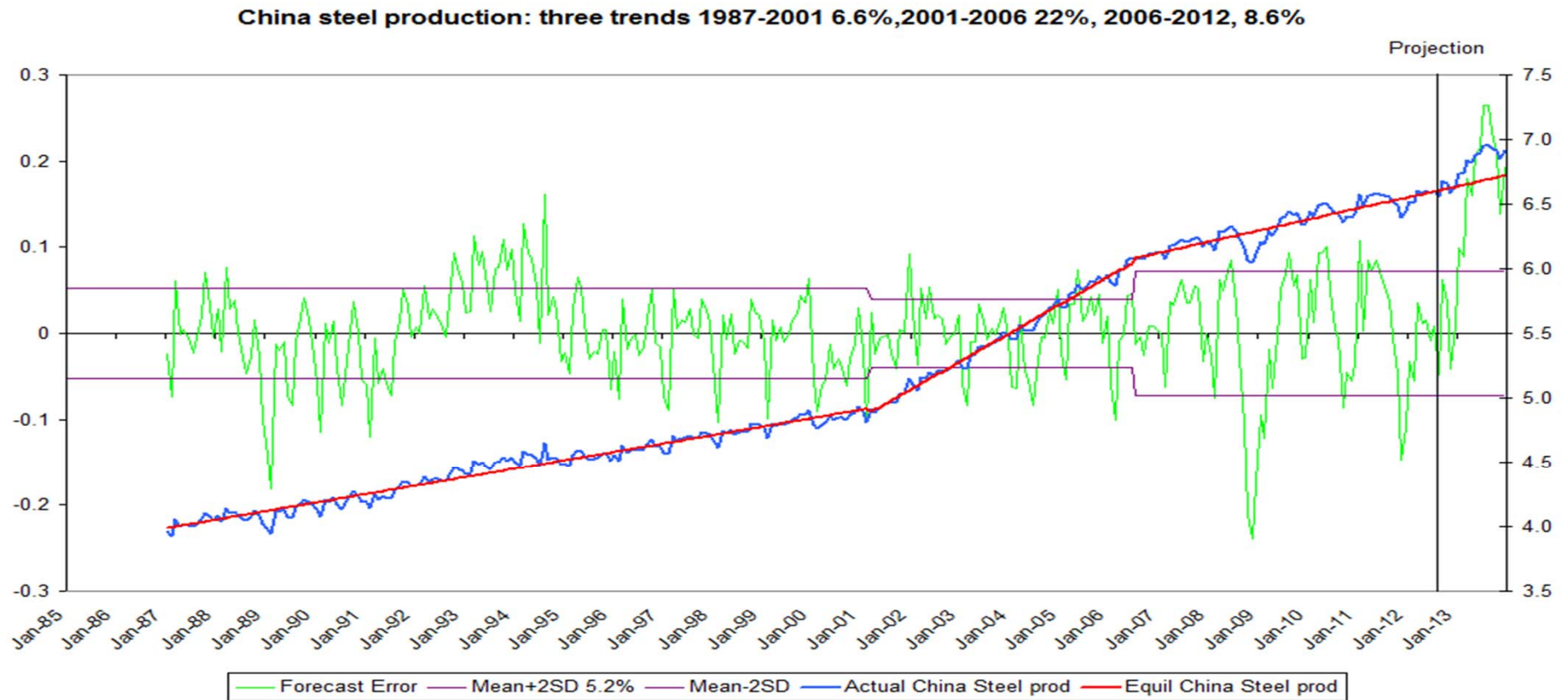
So, what accounts for the structural change in freight rates?
A simultaneous structural change in demand: a steeper trend since
2003 (7% compared with 2%).

Figure 6: The deviations of demand from a linear trend



The popular explanation is that these structural changes in the dry market are due to China.

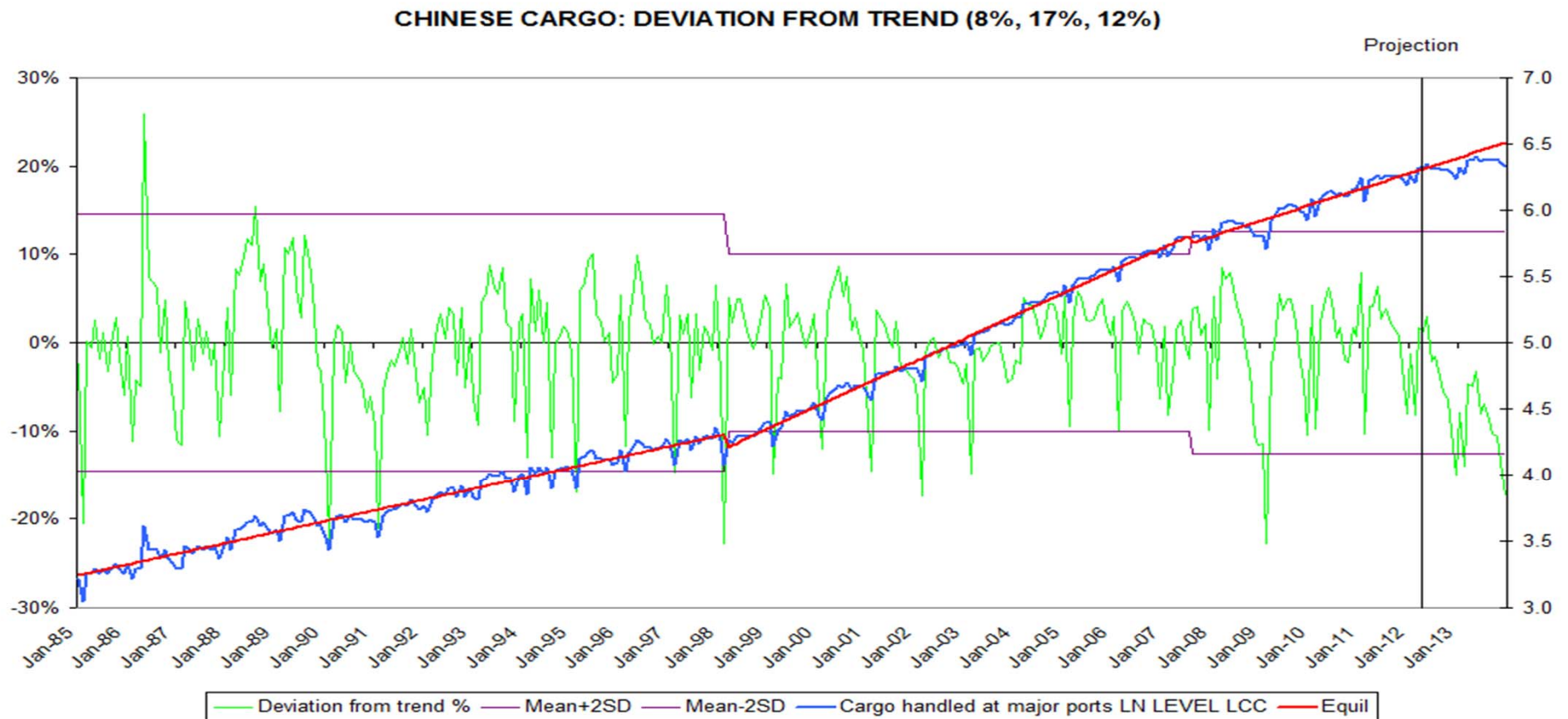
But the evidence shows that the boom in Chinese steel production started two years earlier in 2001 and finished in 2006.



Cargo handled at major Chinese ports also does not provide support for the role of China.

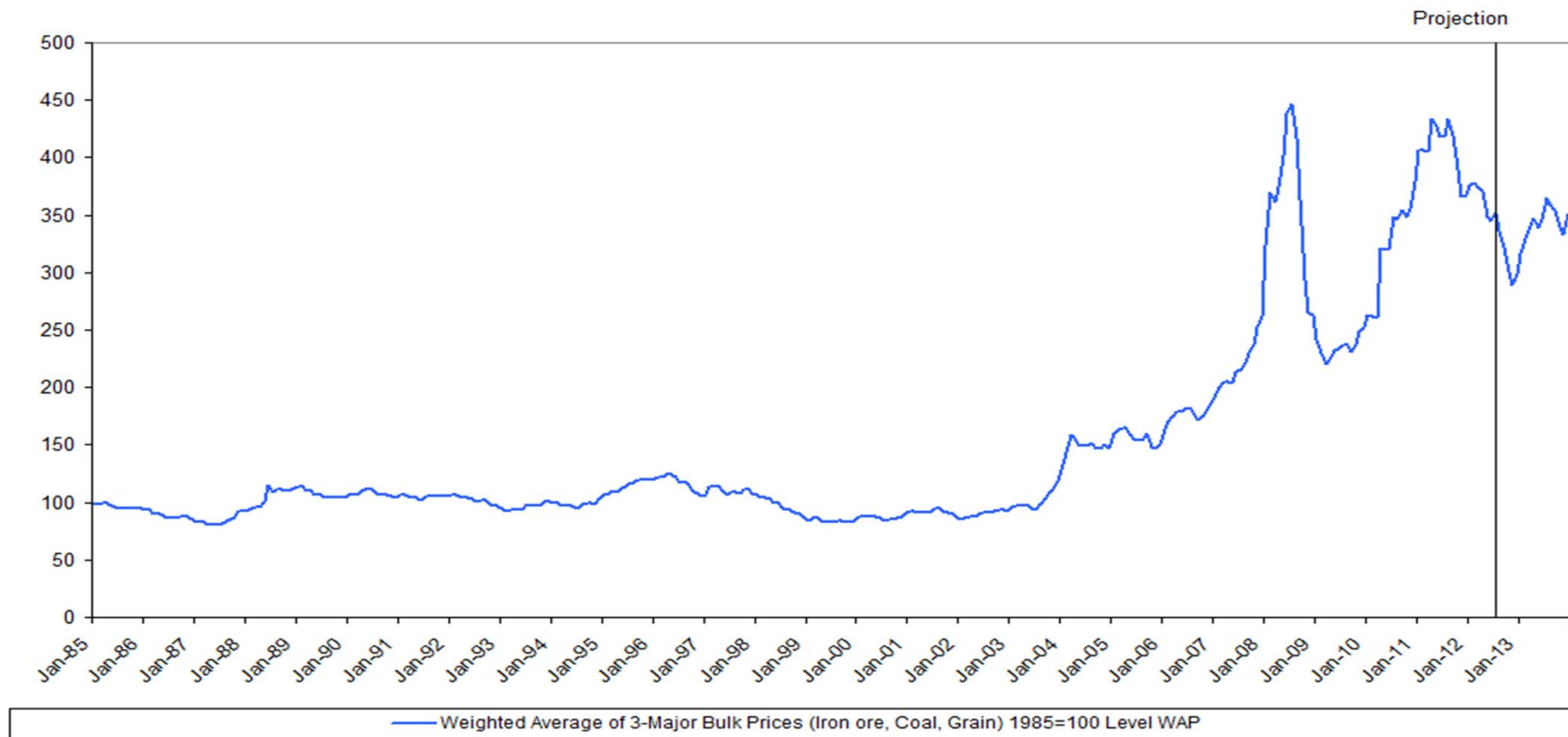
Two structural changes: 1998 and 2007

Three trends are discernible: 8%, 17% and 12%



What coincides with the structural changes in the dry and wet markets is the influx of speculative flows into commodities. Institutional investors entered in 2003 and retail investors in 2005.

Figure 33: Commodities



The channels of the structural changes

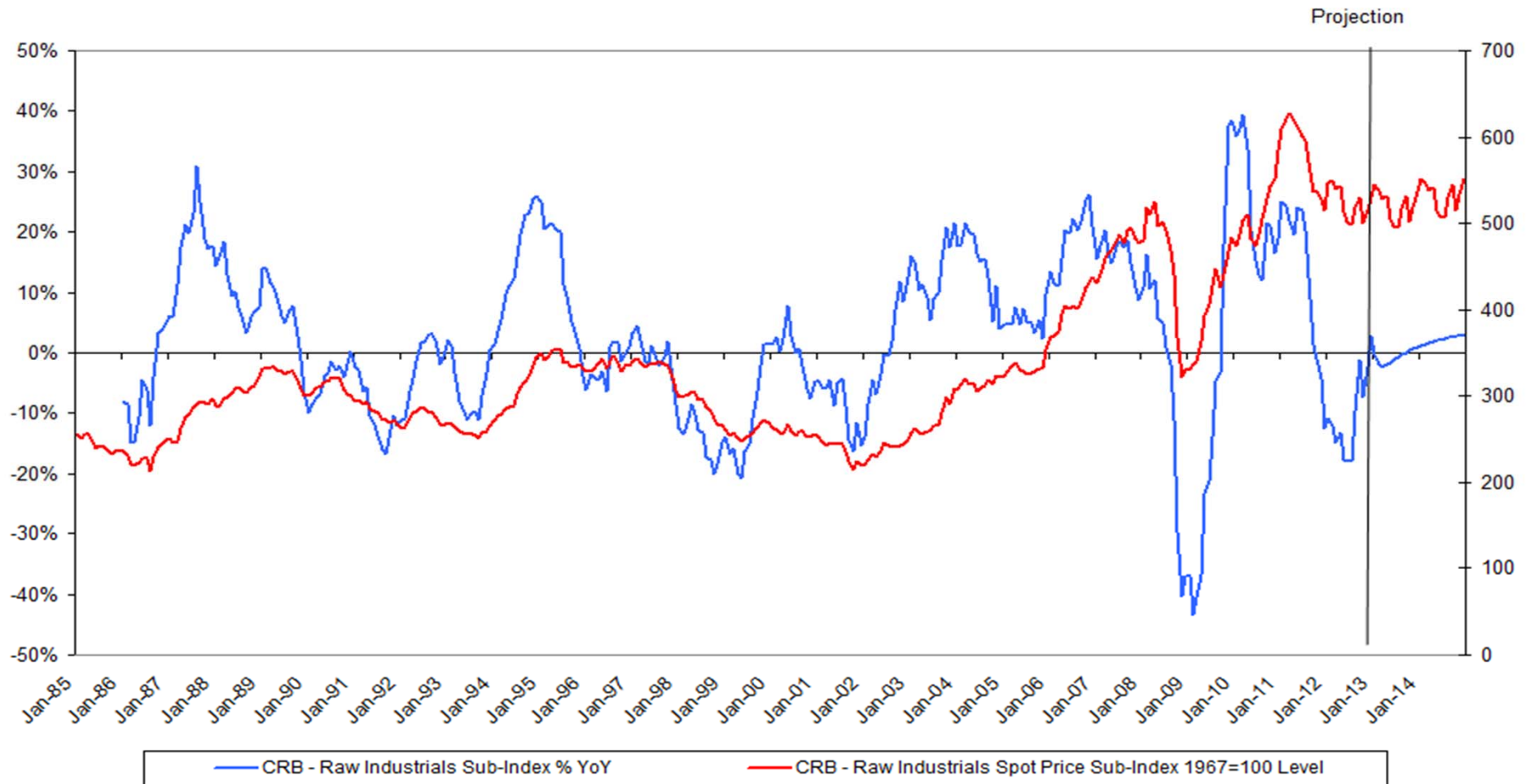
- The US Dollar (both wet and dry)
- The price of oil (wet); other commodity prices (dry)
- Contango or oil-storage trade (wet)
 - Buy physical (spot) and sell futures
- Risk appetite, e.g. S&P 500, risk spreads, (dry)

Accounting for the Structural changes in Demand for oil-cargo

Table 2: Accounting for Demand for seaborne oil trade in the last ten years			
Factors accounting for demand	Percent change between 2003 and 2012	Contribution to Demand growth	Percent Contribution to Demand growth
World oil consumption	11%	8.6%	28%
US dollar	-23%	8.1%	27%
Oil price	112%	8.2%	27%
Oil storage trade	3.6%	4.3%	14%
Other		1.1%	4%
Total demand change		30.3%	100%

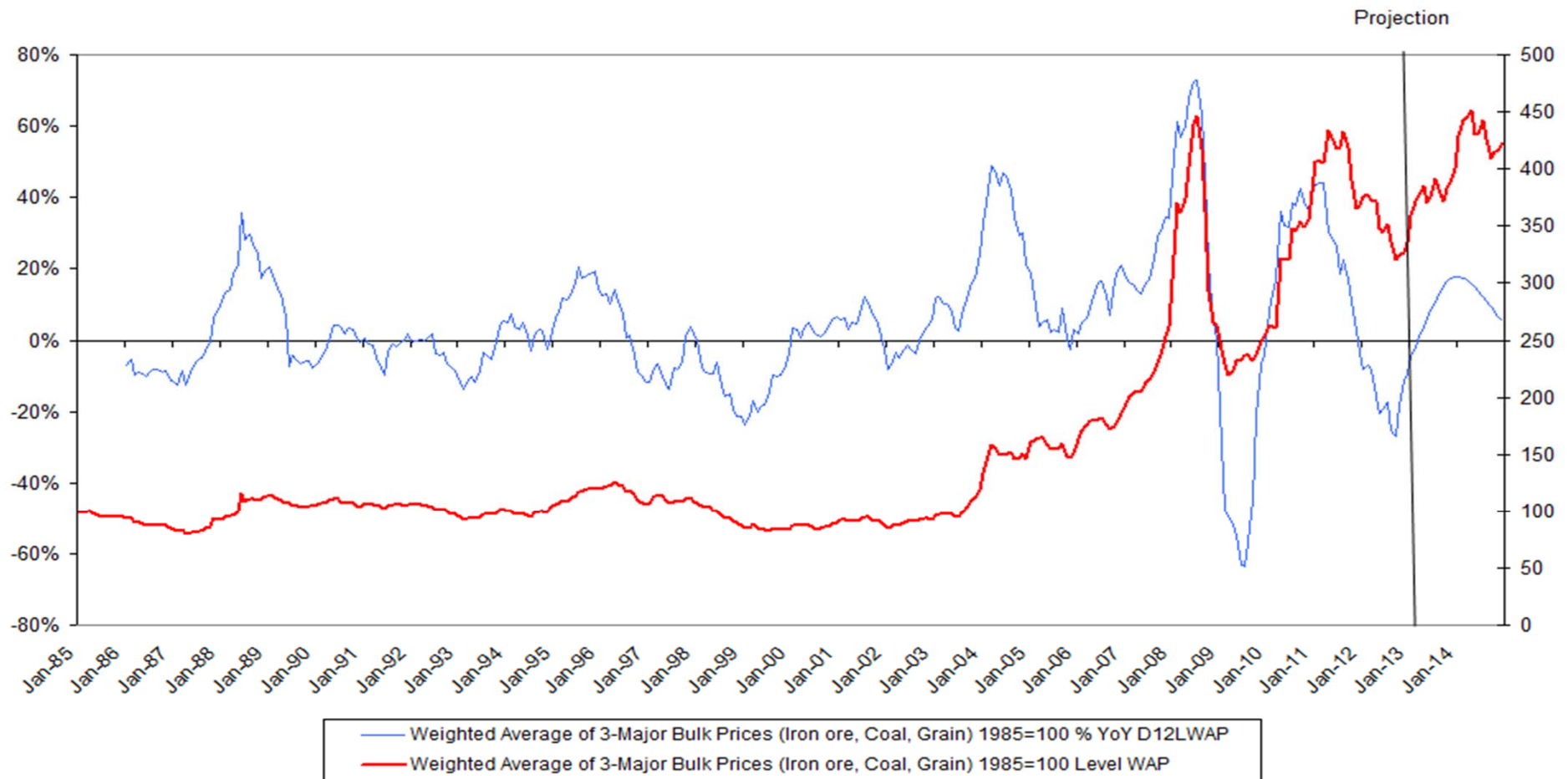
Commodity prices do not recover before 2015

Figure 5: CRB - Raw Industrials Spot Price Sub-Index 1967=100 Level



... but the prices of the three major bulks recover earlier

Figure 8: 3-Major Bulk Prices



The Shipping Outlook

- The oil-tanker market may not see a recovery before 2014. Earnings and newbuilding prices would move sideways until the end of 2013.
- Demand for seaborne oil trade will probably get a boost from higher world oil consumption.
- But speculative flows, which played such an important role in the first part of the post-structural change era of 2003, are likely to continue to act as a drag on the oil tanker market largely offsetting the impact of stronger world oil consumption.
- The outlook for the dry market is better. Freight rates and asset prices would remain depressed for most part of 2013. But they will recover from 2014 onwards as there is a squeeze between demand and supply.
- SH prices will outperform by a large margin NB prices (creating a premium), as NB prices are restrained by shipyard excess capacity.