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Lloyd's List Hong Kong Business Briefing

An event of the Hong Kong Maritime Industry Week 2016

What happens next? Finding opportunity amid uncertainty

Monday 21 November, 2016 at
Hullet House, 1881 Heritage, 2A Canton Road, Tsim Sha Tsui, Kowloon, Hong Kong

Key Themes and Discussion Points:

Hong Kong an obvious location for shipping businesses

Keynote speaker **Professor Anthony Cheung**, Chairman of the **Hong Kong Maritime and Port Board and Secretary for Transport and Housing** opened the Lloyd's List Business Briefing in Hong Kong on 21 November, 2016.

Professor Cheung said 2016 had been "eventful and challenging," but he sounded a positive note for Asia's short term future: "In addition to mergers and takeovers of liner companies there are talks of consolidation and formation of shipping alliance and in the aftermath of the Brexit surprise we had the Hanjin incident, but the economic outlook is not subdued across the board.

"More robust growth is envisaged in Asia with positive investment growth and strong production and manufacturing activities. GDP growth in the region is forecast at... 5.3% for next year, significantly higher than the global average."

Key Facts – outlined by Anthony Cheung, Hong Kong Secretary for **Transport & Housing** and chairman **Hong Kong Maritime and Port Board**.

- Mainland China still expects a full year 2016 growth rate of 6.5% – 7% growth rate despite a slowdown.
- Asia hosts nine of the world's top 10 ports, including **Hong Kong** which holds advantages: Beijing's steadfast support; being China's most open and international city; an effective gateway for international companies seeking access to the Chinese market.
- **Hong Kong** hosts 8,000 non-local companies and 1400 regional headquarters.
- China's Belt and Road initiative strategically connects **Hong Kong** via sea and air to most of the economies along the initiative's routes.

"More robust growth is envisaged in Asia with positive investment growth and strong production and manufacturing activities."
Anthony Cheung,
Chairman of
the Hong Kong Maritime and Port Board and Secretary for Transport and Housing

Anthony Cheung
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Structural change is the new norm

Panel chair **Richard Meade**, chief editor of Lloyd's List, summarised the outlook for 2017:

"Regionalism is on the rise. Protectionism, isolationist sentiments are eroding the very basis for global collaboration. Economies of scale, the bedrock of past cost reduction, well that's running out of steam. The challenge ahead requires the shipping industry to carry more trade and emit less pollution."

Henriette Brent-Petersen, managing director & global head of Shipping and Offshore Research, **DNV Bank**, gave her views:

"All shipping sectors are affected by structural changes on the demand side, impacting on the sectors in different ways. Even in sectors, structural change can impact differently on subsectors within the sector.

"In recent years there has been much agreement about too much shipyard capacity and excess supply. Now it is more important than ever to look into the structural change, how the demand side is going to evolve, how the sectors are going to rebound and what happens to the subsectors within the sectors.

"All shocks to the container demand side are affecting in a negative way. Dry bulk is likely the sector that will revert to traditional shipping cyclicality first, but there is massive structural change on the demand side, extracting the China factor, returning to the way shipping was done before the China boost to the dry bulk market. No one is ordering anymore on the back of an expectation of a rebound in dry bulk in the next two years."

"The challenge ahead requires the shipping industry to carry more trade and emit less pollution."
Richard Meade,
Chief Editor, **Lloyd's List.**

Richard Meade
CREDIT David Teng, Xcalibrephoto

China's One Belt One Road strategy will heavily impact shipping

David Beaves, partner at **Ince & Co.**, said shipping will continue to depend on China for some time to come.

"One Belt One Road is a policy which really was coalesced into a coherent form about two or three years ago and it existed long before that in terms of Chinese strategy. What One Belt One Road has done is to bring together those different threads, and what we're talking about in essence is road and rail networks across China, Asia to Europe, and we're also talking about the maritime roads and there are really two of these, one of which will service Southeast Asia and the Southeast Asian economies and the second maritime road will supply Europe up into Piraeus.

"According to Trump he's going to tear up (the Trans-Pacific Partnership), which means that at a stroke, Obama loses his Asian Pivot, so that means that a lot of the strategic worries which China otherwise had, to some extent, are lessened. A lot of the pressure will be taken off the South China Sea which has been a big concern for China and I think it will lead to a more unimpeded growth of the One Belt One Road strategy. The Chinese are talking about (an Asia Pacific) free trade area. The key pivotal country involved in that would be China.

"I think that the fact that whether Trump does or doesn't do what he says will mean that One Belt One Road will become even more important, strong and vital for long-term Chinese interest because you've got to look at the economic strategy behind it which is very, very far sighted.

"The Chinese are investing in ports around the world and one of the things they're investing in is to make the berthing so that you can get big containerships into ports where it was not possible before. China when it puts its mind to things does achieve it and the One Belt One Road is a really carefully thought-out philosophy which has been going on for many years and they've thought of every aspect, the ports, the money, the law, the ships, everything.

"For example, Gwadar, in Pakistan, the Chinese have put a huge amount of money into that. They will build up a free trade zone around the port, which again will seed economic activity in that part of Pakistan and it's going on in various ports all over Southeast Asia, so it will turn the focus perhaps more to the Southeast Asian side of things.

"Predictions are that by 2030, 85% of the world's middle class will be in Asia, $56 trillion worth of spending will come from the middle classes in Asia according to the OECD, and that is one of the things that One Belt One Road seeks to consolidate and take advantage of, very important and good for shipping in the long run.

"China managed to come through the economic crisis of 2008 by basically powering its way through with infrastructure projects, so come the present day excess of steel, excess of cement, all of these things, what do they do with it? Well they start building factories and ports around the world. It really is a question of how the rest of the world responds. Hong Kong, for example, is in a fantastic position to respond. In order of assisting we have port expertise, we have lawyers who are wonderful to say nothing, you have accounting services, you have bankers, there is a role for Hong Kong to play here.

"I go to Europe and I give talks about One Belt One Road and they at you like you've landed from Mars, they've got no idea of what is going on, and the key really is that we have to provide the expertise in order that it's not just solely a Chinese initiative."

"I think that the fact that whether Trump does or doesn't do what he says will mean that One Belt One Road will become even more important, strong and vital for long-term Chinese interest."
David Beaves,
partner at **Ince & Co**

David Beaves
CREDIT David Teng, Xcalibrephoto

Nigel Anton, Managing Director and Head of **Shipping Finance, Standard Chartered Bank**:

"We as a bank are very committed to One Belt One Road and I think it's very interesting for all the people in this region. It's going to be good for shipping. One Belt One Road is very important because, I think for people outside of the region, it's like a massive project finance. And so there's an RFP (request for proposal) and you sign here.

"No, it's not that whole concept, but I think very important and Hong Kong does have a great maritime tradition, the Hong Kong Shipping Association, a lot of good banks, a lot of good lawyers, all the expertise you need frankly is here in Hong Kong.

"Indonesian ports are booming. They are really developing the port network totally, so they think 'this is coming', and they will be very happy to receive it. And there are lots of things going on in Africa which we're part of, which again is associated with One Belt One Road."

Khalid Hashim, Managing Director of **Precious Shipping**:

"I think One Belt One Road is about the best thing that's happened to this world in a very long time and I'll tell you why. At the minimum spend of $1.4 trillion, it is equivalent to 12 times the Marshall Plan if it was brought into, inflated into today's currency, so it is 12 times larger than the Marshall Plan was ever. And if you take it at the $21 trillion mark, which is what people also talk about for the One Belt One Road when it really hits its full strength, then it is something like 15 times larger than that.

"It is going to cut across three continents, 65 countries, 4.4 billion people, obviously why would anybody want to resist this type of an infrastructure build out for you where your local labour is being used, and if you don't have the raw materials China will provide the raw materials at a very attractive price.

"If you don't have the finance, China will provide the finance at a reasonable price, so if you look at it from those points of view, there's nothing to argue against One Belt One Road.

It is something which will bring the world back into more of a normalised state that we've not had for the last ten years where basically we've been living in a deflationary environment.

"One Belt One Road (1B1R) will put a train network in place at maybe 300km per hour. Remember containerisation was born soon after World War 2, in a manner of speaking a boost to the Marshall Plan, so if you have a much larger Marshall Plan (1B1R) in place and that generates much more growth then, yes, containers will lose some market share to trains, but the overall market will grow to such an extent that you will still need maybe the giant ships that have been created."

David Beaves, Ince & Co.:

"The other thing you've got to bear in mind, you're talking about 65 countries here with differing legal systems, some Islamic law systems. You need something to pull all this together and it is most instructive the way that the Chinese have approached this. The PRC Supreme People's Court issued a ruling in 2015 where they were alive to the fact that you're going to need alternative dispute resolutions, arbitrations, you're going to need a system of law which can unify these 65 countries, and I'm delighted to say that the Asian Infrastructure Investment Bank has recommended that Hong Kong should be a place to be used for arbitration, but Singapore, other places in the region can equally try and take advantage of this."

Khalid Hashim, Precious Shipping:

"Just to add to that 57 countries have already signed up out of the 65, they've already signed MOUs with China, so it's not that it's being rejected by them or anything like that. Of the 57 that have signed up, (China's President) Xi Jinping himself had visited 37 of them. China is really going after this, and that's one thing about China, a country which once they decide they want to get something done, basically it's done."

"The container business is very much logistics business. A ship is part of that (logistics) chain, but if you control the whole chain then you can control the whole business."
Nigel Anton, Managing Director and Head of **Shipping Finance, Standard Chartered Bank.**

Nigel Anton
CREDIT David Teng, Xcalibrephoto

China's impact on the dry sector

Henriette Brent-Petersen, **DNV Bank**:

"On dry, the fundamental change is that China is rebalancing the economy. That will lead to slowing demand for iron ore, and that is a process that must happen, so that is built into forecasting, but it still shows a relatively strong growth on the demand side in dry bulk, so when we translate that down, how does that affect the subsectors?

"There will be pressure on the Capes, so the Capes have a very high market today, but with the very large vessels coming in and the rebalancing of the Chinese economy slowly happening, then the pressure is perhaps on some of the larger sectors, where we see the large capacity coming in. It's not adding tonnage to the market, it's more taking tonnage demand out of the market, so that will have a very different impact within the subsectors in the dry bulk market.

"And obviously as we have discussed also a positive impact on the container market, so that you can put numbers on but to time it is; and at what speed it will happen, and that's why we also see in the dry bulk market right now.

"We need to remember we have seasonality. We have volatility kicking in more or less at the same time every year. Let's not confuse that with a fundamentally supported rebound. We are in a fundamentally supported rebound but slowly; and we will see spikes, we will see seasonality and slow adjustment, but on annual averages we expect an increase from 2016 to 2017, though we might see a downwards correction in the beginning of 2017, again because seasonality kicks in.

"For Capes for example, we see that the seasonality is very strong (in 2016). With a very large capacity coming in, we could expect that the seasonality in a year's time would be less for the Capes, so seasonality itself is also changing.

"We also need to have a lot of shipyard capacity shutdown before we can get to a traditional shipping cycle, because the behaviour of the market is; like we saw it in crude (in 2015), a lot of temporary shocks, we had a lot of political shocks leading to changes in your expectation of the future oil price, leading to floating storage.... leading to this extreme volatility, again leading to contractual behaviour, over ordering on the back of these short-term factors and if it would not have been possible to order with a delivery time of 18 months, then you would not have been able to kill the cyclicality of the market, so that we're paying the price for it now because we are correcting towards fundamentals, because we are running out of short-term shocks and volatility to the market, so we are correcting towards fundamentals.

"The good part with all the shipyard capacity is also that lead time is very short, so the order book is being delivered in a very concentrated period of time, so with less ordering activity taking place now, it means that we have a very relatively short time before we can actually start thinking about a rebound."

"There's an extreme mismatch and that cascading process will be even stronger in 2017 than we have seen before, because the mismatch is enormous."
Henriette Brent-Petersen, managing director & global head of Shipping and Offshore Research, **DNV Bank**

Henriette Brent-Petersen
CREDIT David Teng, Xcalibrephoto

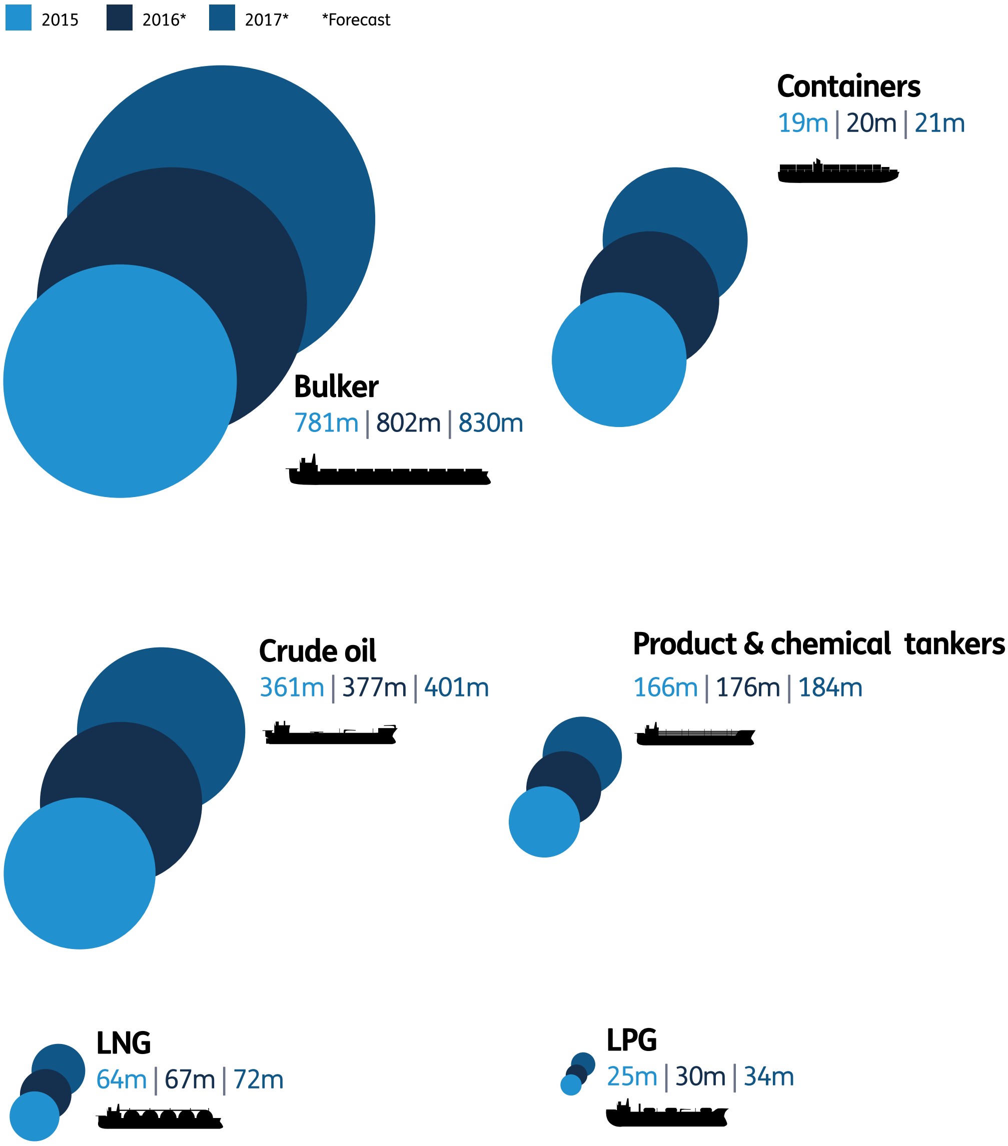
Nigel Anton, **Chartered Bank**:

"We've got to get the order today to look forwards, and I think there are signs (of that happening); the shipyards are closing, the demolitions now begin to rise, the ships have a shorter life. I think it will be a different world next."

Khalid Hashim, **Precious Shipping**:

"It is an over supplied market, there is no doubt about that. China has now reversed track on the number of days that they will allow coal mines to remain active and working. Now that of course will make a big difference going forward, so I don't know how 2017 is going to behave, but for 2016, I mean we began the year thinking that coal would come down by 10% in China. Actually it will end the year up, maybe like something between 17% and 18% up, so it's a huge swing."

Fleet development, capacity



Data supplied by Lloyd's List Intelligence

"The Chinese are talking about putting high speed rail networks that will get a container to Europe in three days, so the idea that there's only one way of moving goods around the world in huge quantities being shipping and containerisation is a little bit under threat."

Khalid Hashim,
Managing Director
Precious Shipping

Khalid Hashim
CREDIT David Teng, Xcalibrephoto

Medium term threats to container shipping

Henriette Brent-Petersen, DNV Bank

"My favourite example is Adidas moving production to the German customers, to Germany, in 100% robotised factories, same to the US. We see you can print soon your own goods in your own living room. It will have a tremendous impact on container trade, negative on the demand side.

"Furthermore, we have a market which is a charter market so we can almost put a date on when some of the subsectors will take the next hit, so it's very different to tankers and to product crude and to the dry bulk market.

"We are also having a business model which may be rethought, not necessarily by the industry itself but perhaps from players outside of shipping.

"There will not be many winners in the end. The whole business model in container may be up for a change, compared to the dry bulk market which is coming back to more the traditional way of doing shipping."

Nigel Anton, Standard Chartered:

"The container business is very much logistics business; the container starts in someone's house and ends up round the world in a new house. That chain is vital. A ship is part of that chain, but if you control the whole chain then you can control the whole business and I think the chartering business is difficult......so I think more consolidation (is likely)."

David Beaves, Ince & Co.:

"There's another factor that's going to affect the container market and that's railways. It is now possible to move a container from Chongqing to Duisburg in about two weeks. "Now the costs of doing that (by rail) are about double the costs of shipping it by sea and half the costs of shipping it by air, but the Chinese are talking about putting high speed rail networks that will get a container to Europe in three days, so the idea that there's only one way of moving goods around the world in huge quantities being shipping and containerisation is a little bit under threat because these railways are going to get more and more efficient and can move cargoes, high quality cargoes, perishable cargoes very, very quickly."

Henriette Brent-Petersen, DNV Bank:

"There's an extreme mismatch and that cascading process will be even stronger in 2017 than we have seen before, because the mismatch is enormous. The demand is not growing the most where the fleet is growing and the big vessels have been ordered probably more for competitive reasons than for actual demand, like we see in dry bulk markets and other sectors, and the supply side has been growing by more than demand for the last four to five years, so this has built up this enormous amount of hidden capacity where you have seen this invisible hand underneath, also again perhaps for competitive reasons, and that....... cascading will continue to process in 2017."

Dry bulk consolidation. Inevitable or illogical?

Nigel Anton, **Standard Chartered**:

"I think definitely that you'd think there'd be more consolidation in the dry bulk industry, you've got this ballast water treatment, there's more technology coming through. Cost's a huge pressure, sometimes bigger can be better in terms of costs control, a lot of owners have regional trades, they've regional relationships, I don't know, it would seem to make sense but I don't know if it's actually going to happen."

Henriette Brent-Petersen, **DNV Bank**:

"For the last ten annual reports every year I've written consolidation is going to happen, and believe me I am one for it, but I can tell you it's not going to happen and I've stopped writing about it anymore. The simple fact of the matter is that today with the very large ship management companies that are there, you don't need to have a management team, you can subcontract that work out.

"You don't have to behave like an old-fashioned ship owner like we are, you don't have to do everything in-house and the more of this that takes place, the less the chance of consolidation there is because it's just going to fragment the market. You just need a little bit of cash, buy one ship. Give it to a ship manager.

"From the banking point of view, yes, for a smaller ship owner it will be difficult, but I think for every other aspect, it's an easy market for you to enter into. You have a ship manager who can manage your ships for you, you have a pool, you can give the commercial management away. What do you need to do? Just have some money in your pocket, invest at the right time, you have a ship, why would you want to consolidate?

"Let's see what's happened, let's just take an example, Star Bulk, okay, it has gone and consolidated a lot, what's happened to the share price? What's happened to the value of the shareholder? Gone down the tubes, so what has consolidation earned them in any way? What have they done that has made them better?

"So I don't think that you're going to see consolidation coming in as a panacea to try to walk away from all your troubles. You think that it's going to get you more money? You think it's going to get you better rates? No, not in a million years. Maths can tell you straightaway, no customers like to pay you ten cents more than the next guy."

The inevitability of bankruptcies?

David Beaves, Ince & Co.:

"I would say it must be 'yes' because the industry has gone on suffering for such a long time.

"Bankers have been very forbearing for such a long time, it can't go on forever. Consolidation is something that is bound to happen and will happen by a lot of the smaller shipping companies.

"I'm not talking about the Hanjin size necessarily, but we're a law firm and we tend to see these things before, and there are a lot of shipping companies that are struggling out there. If I have to think about the most distressing aspect of the last few years, it's to see the second and third tier owners go to the wall because everything is mitigating against them; they can't borrow money because of the new banking regulations.

"Some very, very good owners really just can't survive, so I think it's inevitable there will be more, maybe not the size of Hanjin but it's got to happen. Maybe a positive blip in the bulk market will save some people, I don't know."

Hanjin Shipping applied for court receivership in August 2016 as a prelude to bankruptcy

CREDIT AP

The Trump effect

Panellists were reluctant to speculate too far on what **Donald Trump's** election as **US President** means for shipping, due to his unpredictability. However **Khalid Hashim**, managing director of **Precious Shipping**, observed:

"Trump will push the oil button really hard. It might keep oil prices low for a longer time but it will certainly make lots of more cargoes coming out from America, so I think that from an oil perspective (Trump's election) might be more positive.

"Maybe from the container side.... it might be marginally negative because (Trump's) going to try to put up some sort of trade barriers, but the fact that he wants to lower corporate tax which will make many of these American corporates which are parking their monies in places like Dublin and Luxembourg bring it all back home and spend it on capital expansion and that's what will drive inflation, that's what will drive interest rates, and I think we'll get back to a far quicker normal if these things happen.

"Though 9/11 was really iconic for America, the other 9/11 we can talk about is the 9th of November (2016) when Trump got elected and we might see another dramatic change, maybe, in the shipping cycles, thanks to this one man whom we all perceive in a different way."

Trump proposed during his successful US presidential bid to spend 1 trillion dollars on infrastructure refurbishment. By comparison, China spent 1.2 trillion dollars in just the first 9 months of 2016 alone.

"Just for scale, that's the type of strength that China brings to the dry bulk market." **Hashim** said

Panellists would not speculate too far on what Donald Trump's US presidency will mean for shipping, but said tanker and container markets will likely be impacted by his administration's policies.

Donald Trump
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