



2009 Forecast: Limping into 2010

9 January 2009

The following is our annual container outlook, which we regularly contribute to the HK Shippers Council

We have completed 1.5 legs of what could be a 3-leg downturn in global container trade, but valuation declines may have made one of their significant bottoms in Oct/Nov '08 due to the 2H08 credit blow ups. In 2009 we need to see how we test the valuation bottoms, while experiencing one of the worst global recessions in a century.

Opportunities are selective already; but we need to conserve fire power for later in the crisis as well. Global container trade, based on lack of momentum already in the system, is set for close to zero growth and significant physical abuse in 2009—including the build-up of nasty barnacles on idled hulls.

An understanding of central bank “save the cheerleader, save the world” policies is needed. There are two basic scenarios.

Scenario 1: Policies aimed at expanding money supply, lowering interest rates to record lows and bailing out large global companies work and end up reflating developed country consumer demand earlier rather than later, in which case 2010 may see a sustained recovery.

Scenario 2: Credit contraction, corporate blow ups and consumer belt tightening continue throughout 2009 and overflow into 2010-11, leading to more defaults in shipping and other cyclical sectors given weakened financial positions.

In scenario 1, the potential is that a global reflation works fast and we see a combination of lingering price pressures from the 2H08-1H09 demand collapse (lower priced goods in a box, therefore more volume for export) combined with some renewed buying interest from western consumers, which could set the stage for improved demand in 2010. The risk down the line here is runaway inflation. In scenario 2, the risk is we experience the deepest downturn in 100 years.

We have lived in a speeded up internet world for a decade and we have forgotten that the physical world still works according to rules of gravity. So even in a relatively positive “we have seen the worst” interpretation, there is no way to avoid more pain ahead in 2009, and perhaps also part of 2010.

As we have not seen a bottom in the physical market just yet, we can’t wave a magic wand and call the bottom just yet either—at least not based on current end-08 and what will be very weak 1Q09 data. And yet for those who know exactly what they want during this collapse, there are things to do.

Slowing trade activity: During end-08 and early-09 we have seen trade activity fall off a cliff, with perhaps the worst representation being the December 2008 42% YoY export drop reported from Taiwan. We are expecting Asia export data to be extremely challenging in 1Q09, owing to the now “high base” of 1Q08. Difficult in accessing Letters of Credit was often mentioned in 4Q08. But this was more a problem for dry bulk shipping, and even then was likely overblown as a cause of trade declines.

In mid-08, based on a normal downturn, it looked like slowdowns could bottom in 2H08 in the Transpacific and perhaps 2009 in Asia-Europe. Based on renewed rounds of blow-ups in 2H08, many trade data series have 1) become more unstable, and 2) most likely gapped down toward a new round of declines for 1H09, as we saw with the US ISM data for Dec 2008, which showed the ISM Manufacturing Index fall to a low of 32.4 – the lowest reading since June 1980.

Asia - US trades: Asia to US began correcting/consolidating as early as end-06, even though this was ignored until perhaps end-07. As such, end-08, in a “normal” correction, had the potential to find a bottom. One could try to lay the blame at the US government’s “mishandling” of Lehman, etc and conclude that global deleveraging accelerated after the September event, leading to the accelerated contraction in trade in 4Q08. But no doubt another event would have come along to produce similar effects. In December, the Madoff mega fraud showed that there were not just a couple of problems out there.

The 2008 decline in container volumes from Asia to the US will come in around -7% – against a long-term 15-year average of 8% and which has shifted down from a 10% average prior to current downturn. The potential for 2009 currently looks about -5% if 2H09 stabilizes a little.

The recovery of US to Asia stopped dead in its tracks in August 2008 after the dollar rebounded and the world slowed down some more. All this said, the Transpacific has recently been relatively stable compared to the chaos in Asia – Europe, even if rates weakened further in 4Q08 in the Transpacific.

Asia – Europe trades: The un-mitigated disaster that is Asia-Europe is now well known. But it was still a surprise to some in mid-08 that the market slowed so rapidly. Visibility will be lower in 2009 than in 2008 because of 1) the demise of the FEFC conference system in October 2008 (ELAA, or the European Liner Affairs Association, is to take over functions) and the subsequent loss of visibility of performances, and 2) difficulty in tracking the shifts in actual fuel surcharge components. Fuel made up such a large component of rates mid-08, only to decelerate rapidly thereafter.

The case for trade decline to Europe out of Asia in 2009 is about -9% (we have heard -3% to -12%).

Other trades: Intra Asia has often been heralded as a more stable trade. And no doubt it has been. But in 2009 it is expected to register 3% growth against about 5% growth in 2008 (against historically 8-9%). The Australia lead leg was expected to be about 7% in 2008, and could slow to zero growth in 2009

Container vessel capacity against demand conundrum: We've been on about problems estimating capacity for years. What we do now is also run a series that assumes a re-set to zero excess capacity at the top of a cycle (otherwise the accumulated excess capacity looks very high indeed). We can thus start with 2006-07 peak for the tight capacity case. With about 3-4% global demand growth in 2008¹, we are left with at least 10% excess capacity or about 1.2m TEU of slots (out of core fleet 12.3m TEU end-08). Taking into account some rise in scrapping (but not yet knowing the whole picture) we should also generate about 10% excess capacity in 2009, given trade growth should be around zero. So this leaves us with about 20% excess capacity of vessels by end 2009. In 2010 we are also looking for deliveries to be in excess of demand growth from the current perspective.

Our view (Oct-08) continues to be that 2-3m TEU of vessels will be excess in this downturn. As of December unwanted container vessels were put at about 0.5m TEU by Alphaliner and others. There is thus still some catching up to do in tallying and withdrawing excess vessels.

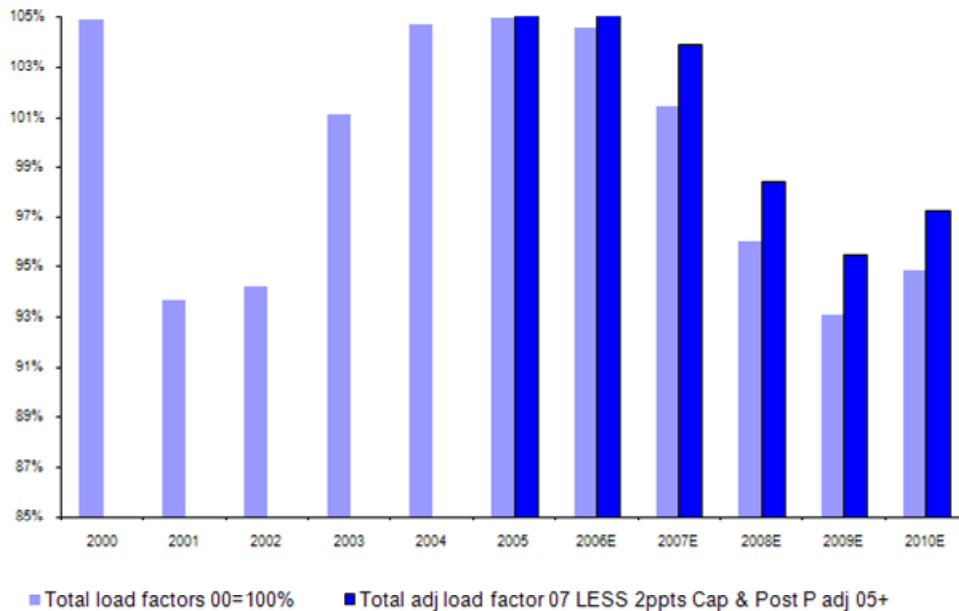
The first line of defense for many operators has been to idle vessels on a rotating basis. But as new vessels keep coming on line in 2009, choices will have to be made. Scrapping should rise above what we can conceive as of December 2008 (Clarkson postulates about 103,000TEU in 2009). It is hard to put an actual figure to the estimate, as Asia government involvement in rescuing yards will also likely be part of the equation.

The silver lining post 2009 is the credit crunch. This will help disadvantage how some new tonnage comes to market after 2009, implying some vessels in 2010-11 will vanish. This will be welcome and assist in setting the base for an industry rebound. Let's hope capacity withdrawals and scrapping are massive so we can get a firm bottom to the market.

¹ We think, unfortunately, 2008 global container demand growth is lower than many forecast in mid-08 end even end-08. Recall that long-term containerized growth is about 9%. Our view is that we shift down for a few years, with '08 at 3-4%, '09 at about 0.3% and '10 potentially rebounding to 6.5%. 2007 was recorded to be about 11.9%, following 9.7% in 2006.

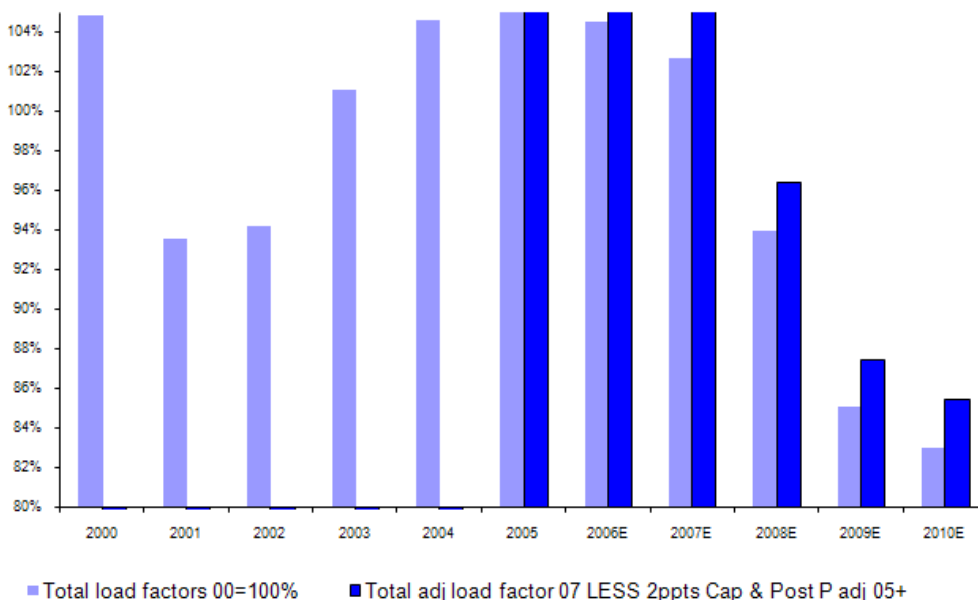
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Utilization forecasts Sept 08 before more financial blow-ups



Source: Transport Trackers

Utilization forecasts 4Q08 after financial blow-ups



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