

Euler Hermes: Rough seas for the shipping industry – consolidation wave still rolls

- Global shipping industry characterized by substantial losses and risks, and growing insolvencies
- Supply and demand are diverging, creating stress for some companies
- Freight rates are plummeting due to overcapacity and weakening global trade
- The industry consolidation wave rolls on, companies seek lifelines through alliances and mergers
- Smaller, thinly capitalized companies struggle to stay afloat; even large companies are taking on water

HAMBURG - 12 SEPTEMBER 2016 – The global shipping industry has been weathering rough seas for years. This situation, according to the world’s largest credit insurer Euler Hermes, is not likely to change soon, as evidenced by recent examples in the container segment. From January through May 2016, insolvencies in the sector rose by more than 10% compared to the previous year. The industry continues to feel the effects of overcapacity and record low freight and charter rates, especially as global trade weakens – creating a domino effect on the funds and banks providing financing. With container shipping firms counting on riding out the storm through mergers or alliances, there’s no end of the consolidation wave on the horizon.

The global economy should rise by only 2.4% in 2016, the lowest rate since the financial crisis. The growth outlook for 2017 is also modest, at 2.7%. For the sixth consecutive year, growth will be below the 3% mark and well below the 4% average annual growth rate of 2004-2007. The U.S. dollar value of global trade is forecast to contract once again in 2016 by -2%, after a -10% decline the previous year. While shipping companies benefited from the sharp drop in oil prices, these cost savings were not always sufficient to offset low rates. Industry risks therefore remain high, and some specific segments will see further insolvencies.

Supply and demand diverge – freight rates cause strain

“Maritime shipping is the backbone of global trade,” said Ludovic Subran, chief economist of Euler Hermes. “Some 80% of the global trade volume and 70% of the value of traded goods go by ship. For many years, the industry benefited from growth in the container shipping segment and ever-larger container ships, despite the seven-year shipping industry crisis. The positive trend was supported by low oil prices. But global trade can no longer keep pace with capacity. Supply and demand trends are steadily diverging. Shipping a container on the Asian route today costs about half as much as just four years ago. As a result, the container shipping industry now faces its biggest crisis. The situation is causing stress for some companies, especially if they have exhausted their buffers during the persistent crisis.”

Shipping companies are simultaneously confronted with persistent high risks, weakening global trade, overcapacity and recessions in many countries.

Self-inflicted harm: a construction boom meets weaker global trade

“Some of the industry’s problems are self-inflicted,” said Subran. “For several years, shipping companies engaged in a race for the biggest ships. This boom in new construction overtook the industry, with mega container ships launching one after another – and more will be delivered this year. Overcapacity has been building up over years, and freight rates are now plummeting. All this at a time when the value of global trade is contracting and the Chinese economy -- whose impact on shipping is enormous -- has at least temporarily run out of steam.”

Similar economic situations exist in several other Asian countries, along with recessions in Brazil and other South American countries, and Russia.



Perfect storm: alliances and mergers as a lifeline, shipping companies join forces

“It is almost a perfect storm that the large container shipping companies are trying to navigate, using alliances and mergers to improve capacity utilization, strengthen market power, reduce costs and thereby bolster profit margins,” said Ron van het Hof, CEO of Euler Hermes Germany, Austria and Switzerland. “Despite these measures, some shipping companies will incur heavy losses.”

To combat overcapacity, many ships are being decommissioned. This saves fuel costs but creates maintenance costs -- and subsequent, future recommissioning will be particularly costly.

Consolidation wave not yet over: smaller shipping companies struggle the most

“The recommissioning of mothballed ships is very expensive, so it doubles the pain for shipping companies,” said van het Hof. “The global consolidation and merger wave is not yet over. Through alliances and mergers, many chartered vessels are reverting to their owners. This unleashes a chain reaction and hits the smaller shipping companies particularly hard. Charter companies with only a few ships and lacking their own services or access to freight are suffering. Given the current record low charter rates, these firms can barely cover their operational costs and financial cover is often thin due to the lingering shipping crisis. A vicious circle ensues, and also adversely affects shipping funds and banks due to non-performing loans.”

Negative impact of the crisis on safety – especially when ships are recommissioned

The difficult economic situation also adversely affects safety in the shipping industry, according to experts at Allianz Global Corporate & Specialty (AGCS) in their Marine Safety study. Several industry segments like freight, container and offshore are already vulnerable and any further deterioration in safety standards is cause for concern.

The AGCS experts caution against a deferred safety mentality, in which necessary investments are postponed until potentially better times. The first tangible signs of this practice are already evident. Some shippers have stretched their maintenance schedules to the longest possible intervals, while others are decommissioning ships.

“The recommissioning of decommissioned ships in a market that has evolved technologically can be exceptionally difficult,” said Captain Jarek Klimczak, senior Marine Risk consultant at AGCS. “Standardized decommissioning methods need to be developed.”

Some shipping companies to go under unless capacity, global trade can move at the same pace

“These challenging developments naturally affect German shipping companies and Hamburg,” said Van het Hof. “Here, too, there will be winners and losers. As of today, virtually no new ships have been ordered - setting off alarm bells among shipbuilders. But it does offer some hope that capacity and global trade could once again move forward on equal footing in future. Until that happens, some shipping companies will go under. Financial strength and related endurance will be the decisive factors in navigating this storm and staying the course despite some losses.”

AGCS’s current Marine Safety study:

<http://www.agcs.allianz.com/insights/white-papers-and-case-studies/safety-and-shipping-review-2016/>

AGCS’s current Panama Canal / shipping study:

<http://www.agcs.allianz.com/insights/white-papers-and-case-studies/panama-canal-risk-bulletin/>

Infographic: Transportation industry (including shipping)

http://www.eulerhermes.com/mediacenter/Lists/mediacenter-documents/infographic_transportation_2016.pdf

A comprehensive study on global sector risks is available here (English), transportation industry (air, road and sea transport) on page 15:

<http://www.eulerhermes.com/mediacenter/Lists/mediacenter-documents/Economic-Outlook-Sectors-Games-1223-feb16.pdf>

Information on Euler Hermes’ transportation industry policy:



<http://www.eulerhermes.de/mediacenter/neuigkeiten/Pages/euler-hermes-schuetzt-spediteure-mit-branchenpolice-gegen-zahlungsausfaelle.aspx>

Brazil country analysis – a country between the abyss and hope:

<http://www.eulerhermes.de/mediacenter/neuigkeiten/Pages/euler-hermes-laenderanalyse-brasilien-zwischen-abgrund-und-hoffnung.aspx>

Why Brazil and Co. are suffering from the China flu:

<http://www.eulerhermes.de/mediacenter/neuigkeiten/Pages/euler-hermes-einschaetzung-lateinamerika-leidet-unter-china-grippe.aspx>

China country analysis – which problems await China in the year of the monkey:

<http://www.eulerhermes.de/mediacenter/neuigkeiten/Pages/euler-hermes-studie-welche-probleme-china-im-jahr-des-affen-erwarten.aspx>

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