

The Dry Bulk Market, October 2011

Market Review

Although there were some positive developments for shipowners during the third quarter, the market remained relatively weak. Most rates and prices continued to fall, but Cape rates were a notable exception, as both spot rates and period charter rates rebounded from their dismal second quarter levels.

Cape rates move sharply higher in Sept-Oct

Specifically, Cape spot earnings moved up from \$8,500 per day to an average of \$17,000 per day. The rally was enough to lift one-year TC rates as well, which rose from \$12,000 per day in the second quarter to \$14,500 per day in the third quarter.

In October, Capes gained further momentum, with spot rates climbing to \$30,000 per day and one-year TC rates moving up to \$18,000 per day. But the rally started to sputter as October drew to a close, with spot rates falling back towards \$25,000 per day.

In contrast to the volatility exhibited by Cape rates during 2011, Panamax rates have been more subdued, as they fell back at a relatively steady pace during the first three quarters of the year. After averaging \$14,600 per day in the first quarter and \$13,700 per day in the second quarter, Panamax spot earnings dipped to \$12,900 per day in the third quarter. Meanwhile, Panamax one-year time charter rates also lost ground, falling from \$14,500 per day in the second quarter to \$13,000 per day in the third quarter, their lowest level since 2003.

By mid-October, Panamax spot rates rose to \$16,000 per day and period charter rates increased as well, but by the end of the month, spot rates had fallen back to \$15,000 per day.

After holding up relatively well in the first half of 2011, rates for the smaller bulkers weakened in the third quarter. Supramax spot earnings edged down from \$14,500 per day to \$14,000 per day, while Handysize rates took a bigger hit, falling from \$11,500 per day to \$10,000 per day. In October, rates reversed course and moved moderately higher, with Supramax earnings rising to \$15,500 per day and Handysize rates topping \$12,000 per day.

SH prices down 25% over past year

Meanwhile, asset values for all bulker types, including Capes, fell back significantly in the third quarter of 2011. Dry bulk secondhand values have now fallen for four consecutive quarters, and have dropped by an average of 25% over the past year.

More specifically, the price of a 5 year old Cape was marked down from \$45 million in the second quarter to just under \$40 million in the third quarter, its lowest level since 2003. In October, the sharp rise in rates helped asset values to stabilize, at least temporarily.

Trade demand soars in 11Q3

As for dry bulk newbuilding prices, after edging lower in the second quarter of 2011, they fell by a further 5% in the third quarter. We estimate that the contract price of a new Cape fell from \$53 million to \$50.5 million, while Panamax newbuilding prices declined from \$32.5 million to \$31 million. Over the past year, most prices have fallen by 10%.

Sharply higher trade demand was the driver behind the third quarter increase in rates, pushing dry bulk fleet utilization up from 88% to 89%. After growing at a sluggish 4% annual pace in the first half of 2011, dry bulk trade volumes surged higher in the third quarter, rising by 5.8% relative to the second quarter and by 10.5% relative to the year-earlier level. In tonne-mile terms, trade grew even more dramatically in the third quarter, rising by an estimated 6.8% compared to the second quarter and by 10.8% compared to a year earlier.

Resurgent Chinese imports were responsible for about 60% of the rise in demand witnessed in the third quarter. Most of the gains came from a sharp rise in Chinese iron ore imports, which rose by 12% relative to the second quarter, despite the fact that Chinese steel production actually fell by 2.5% during this period. With Chinese domestic iron ore production rising as well in the third quarter, iron ore inventories increased significantly during this period. The combination of sluggish steel demand and rising ore inventories caused international iron ore prices to plunge by 30% from early September through the end of October.

Chinese steam coal imports also rose sharply in the third quarter, soaring by 36% relative to the previous quarter, as domestic coal prices remained well above international prices.

Elsewhere, imports into Japan also rebounded in the third quarter, after falling back in the second quarter due to the impact of the March 11th earthquake. Japanese iron ore imports were especially high, as steel production increased and inventories were replenished. Furthermore, Japanese steam coal imports also came roaring back in the third quarter. We estimate that imports rose 25% to a record high level of 112 million tonnes on an annualized basis, with almost all of the increase coming from Australian supplies.

Meanwhile imports into the rest of Asia, excluding China and Japan, rose by nearly 4% in the third quarter, due mainly to increased iron ore imports from Brazil.

Brazilian iron ore exports to the Middle East also soared to a record-high in the third quarter, up 50% compared to the first half of 2011.

In contrast, European dry bulk imports remained flat in the third quarter, with small increases in the region's iron ore and steam coal imports offset by lower grain imports.

Dry bulk fleet grows by 14% over past year

Turning to supply-side developments, the dry bulk and combi fleet continued to see the impact of record-high deliveries, growing by 3.3% in the third quarter alone and by 14% over the past year. The Cape fleet has

*Dry bulk ordering falls
to 3-year low*

continued to register the fastest growth over the past year, expanding by 19%, while the Handymax/Supramax fleet has grown by 17% and the Panamax/Kamsarmax fleet has expanded by 13%. Meanwhile, the Handysize fleet has grown at a much slower 4% pace over the past year.

Dry bulk deliveries have averaged 25 million dwt per quarter so far this year, up 21% from last year's pace. With deliveries holding at a record-high level while ordering activity slows, the dry bulk orderbook fell sharply during the third quarter. At 232 million dwt, the orderbook now represents 39% of the existing fleet size, its lowest level since 2007.

Although delivery slippage has been somewhat lower than we expected recently, it remains an important factor in the dry bulk orderbook, as we estimate that about 20% of scheduled deliveries have been delayed over the past two years. In addition, we estimate that cancellations, conversions and other deletions from the dry bulk orderbook have totaled about 10-15% over the past two and a half years.

After reaching a record-high 10 million dwt in the second quarter, dry bulk and combi scrapping fell back to 6 million dwt in the third quarter, as Cape rates rebounded.

Meanwhile, dry bulk ordering activity fell to its lowest level in nearly three years during the third quarter, totaling just 4.5 million dwt, with Panamaxes and Kamsarmaxes comprising 50% of the total tonnage, and Capes making up another 25%. So for this year, dry bulk orders have totaled 19 million dwt, compared to 62 million dwt in the first nine months of 2010.