2020 Container Shipping Outlook

The container shipping sector's credit outlook is stable. Scale, cooperation and efficiency remain crucial to cope with regulatory headwinds, capex and slowing global growth.

Corporates, Scope Ratings GmbH

info@scoperatings.com | www.scoperatings.com

Executive summary

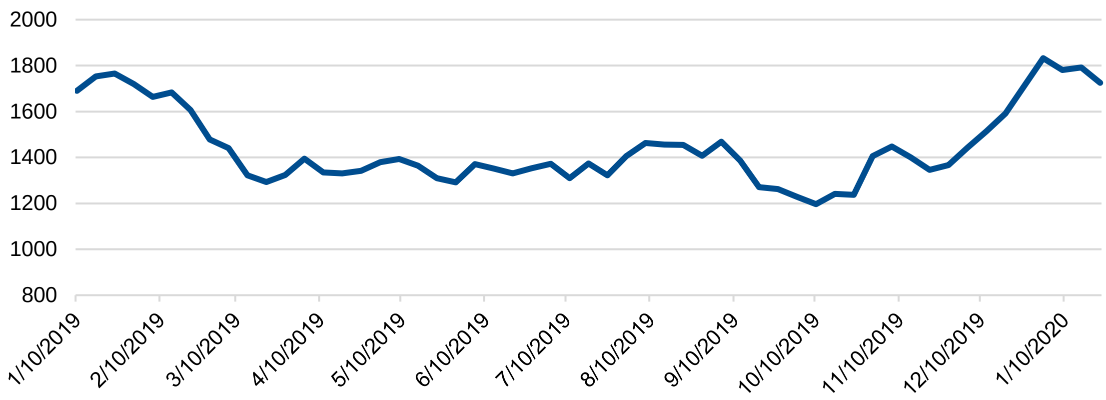
The credit outlook for the container shipping sector in 2020 remains stable. Improved cost structures and greater economies of scale should help larger operators cope with regulatory headwinds, capital-expenditure requirements and slowing global economic growth.

The gap in credit quality will continue to widen between the largest global operators which make up the three international shipping alliances[1] and the rest of the industry.

The main trends we expect for 2020 are:

- Higher-than-expected scrapping rates as the industry shifts to low-sulphur fuels should improve the problem of over-capacity.
- Spot freight rates will rise, given the uncertainty about shipping capacity, compared with average rates between 2016 and 2019.
- Growing economies of scale and efficiency will benefit the industry leaders as they take advantage of their international alliances.
- The defused US-China trade dispute may limit tariff-related disruptions to global supply chains though residual tensions between the world's leading trading partners remain a risk.

Figure 1: WCI World Composite 40ft Container Shipping Price Index



- Slowing growth in global trade volumes is a risk as the global economy cools, not helped by the economic impact, even if it proves short-lived, of the coronavirus outbreak in China.
- Excess container-shipping capacity continues to weigh down on freight rates.
- Environmental costs: operators need to fit vessels with scrubbers to continue using high-sulphur fuel to meet new emissions standards or switch to more expensive ultra-low sulphur fuel.
- Operators, particularly smaller companies, will find it difficult to pass on higher, more volatile fuel costs and/or additional capex costs to customers.

Scope Corporate Ratings

Denis Kuhn
Associate Director, Corporates
d.kuhn@scoperatings.com

[1] 2M (Denmark's Maersk Line and Swiss-based Mediterranean Shipping Co); Ocean Alliance (China's COSCO and OOCL, France's CMA CGM, Taiwan's Evergreen); THE Alliance (Germany's Hapag-Lloyd, Japan's Ocean Network Express, Taiwan's Yang Ming)

Key trends for 2020

The container shipping industry's operating profitability has held up relatively well in the past year despite the trade disputes between the US and its major trading partners – the EU and China – related tariff increases, slowing global economic group, and ship owners' preparations for the tougher IMO 2020 environmental regulations. The sector was also spared high-profile bankruptcies and liquidations in contrast with previous years. Uncertainty over the credit outlook for 2020 hinges on the continued strength of global trade - the determinant of container-shipping volumes - in the context of slowing economic growth, notably in China where the recent coronavirus outbreak will have at least a short-term impact on imports, exports and economic activity.

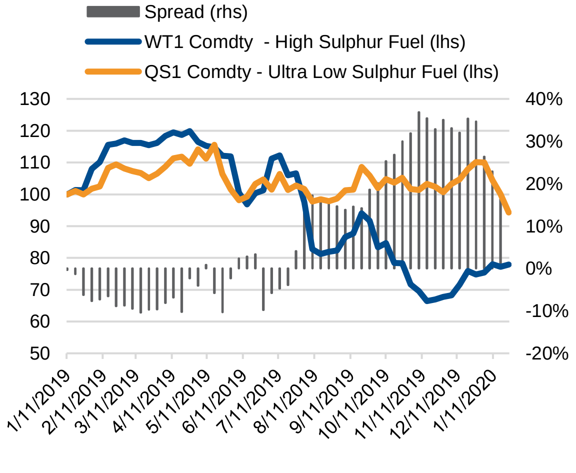
Consolidation: quest for critical mass

Consolidation remains at the top of the industry's agenda, driven by the attractions of economies of scale, bargaining power and diversification in as capital-intensive sector as container shipping.

The biggest shipping companies by container volume such as Maersk, Hapag Lloyd, Cosco and affiliate OOCL, and CMA CGM will continue to grow through investing in new vessels and through acquisitions as opportunities arise given easy financing conditions. This should improve credit quality in the long term.

The growing market share of the three biggest alliances sharpens the commercial edge that its members have over smaller competitors. As of 2019, circa 65% of the container shipping market was in the hands of the five largest players.

Figure 2: Fuel price spread: high-sulphur vs ultra-low sulphur (normalised)



Source: Bloomberg, Scope Ratings GmbH

Such dominance implies further downside potential in credit quality for smaller players which may struggle to compete with the industry leaders particularly if economic or financial conditions deteriorate.

Regulatory headwinds and capex

The long-awaited new global environmental regulation IMO 2020 that mandated a sharp reduction of the sulphur content of bunker fuel (from 3,5% to 0,5% maximum) became effective 1 January this year.

Shipping companies have chosen different strategies to cope with the new regulations. Some are switching to ultra-low sulphur fuels while other are trying to fulfil the new requirements via the installation of exhaust-cleaning systems, so-called scrubbers, which allow them to use the same cheaper high sulphur fuels as before.

Operators of scrubber-fitted vessels may be able to operate significantly cheaper than operators who rely on compliant ultra-low sulphur fuels judging by the surge in the price of low-sulphur fuels in late 2019 and early January 2020. The investment payback periods for scrubbers had shrunk to only 6-to-12 months for shipowners. Most recently, the spread has narrowed again as shown in figure 2.

Larger carriers that are part of an alliance have more bargaining power on two fronts: securing supplies of ultra-low sulphur fuels from oil companies at preferential prices and negotiating prices with end-customers.

The crucial question for ship owners – regardless of which approach they adopt to meeting the new emissions standards - is to what extent they can pass on the additional cost of technical compliance to the end-customer.

Access to capital is also becoming increasingly important to fund technical upgrades to existing vessels (scrubber retrofitting) as well as to purchase newer, emissions-compliant and more cost-efficient vessels. Companies with a larger portion of fixed charters, producing less volatile cash flows and contributed to lower financial leverage, are the best positioned.

Global shipping capacity - supply and demand; the coronavirus threat

Diminished volatility in vessel orders and deliveries – helped by better coordination between the major players – promises a relatively favourable supply outlook for the sector.

In contrast, the demand side of global seaborne trade equation remains heavily correlated to the health of the global economy and trade volumes. GDP growth is sluggish – our December estimate was for growth of around 3% this year, little changed from 2019 but down from 3.6% in 2018: see our Sovereign Outlook 2020 - while trade tensions persist despite the recent truce in the US-China trade war.

The recent outbreak of the coronavirus in China adds further uncertainty to the outlook for global shipping.

1. Supply chains face disruption because the city of Wuhan, where the outbreak began, is an important logistics hub in China.
2. Quarantining people suspected of infection, halted industrial production, travel restrictions and other consequences of the authorities' efforts to contain the disease will put a brake on growth domestically and internationally, at least near term.
3. China had already been struggling with structurally slowing economic growth, which we have estimated at 5.8% in 2020, after 6.1% in 2019 and 6.7% in 2018. We need more clarity on the extent of the severity and duration of the outbreak before we can assess the degree of downside risk to the 5.8% growth figure for this year (see Scope's China: coronavirus outbreak's longer-term policy side-effects more important than direct GDP impact 31 January 2020).

Trade tensions, at least over the long run, may be less of a threat to the sector than they look at first sight. Historically, tensions tend to bring forward or delay when goods are traded or divert volumes from one part of the world to another, without necessarily having a material impact on overall volumes of global seaborne trade. Near term, any escalation in tit-for-tat tariff increases and substantially lower growth have the potential to reduce container-shipping demand in 2020.

Annex II: Related research

"China: coronavirus outbreak's longer-term policy side-effects more important than direct GDP impact", published Jan 2020 available here

"Sovereign Outlook 2020: slow growth, political uncertainty, rising debt add pressure on policymakers", published Dec 2019 available here

"Corporates Outlook 2019/Shipping: Freight rates improve but trade tensions, fuel rules add to risks", published Dec 2018 available here

"Collision course: MARPOL new clear air rule for global shipping will put some firms under strain", published Nov 2018, available here

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris
1 Cour du Havre
F-75008 Paris

Phone + 33 1 8288 5557

London
Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Madrid
Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan
Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo
Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

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