

Maritime Summary Note n°220 – May 2020

« Global Pandemic, First Maritime Effects »

At this end of April 2020, it remains difficult to foresee what the consequences of the global Covid-19 pandemic will be. Looking strictly at the economy and maritime industries, the shock is severe. Crises are an inherent part of how the economy functions (1929, 1973, 1979, 1991, 2008), and examples of a collapse with heavy consequences for maritime transport are relatively common. It is often an opportunity to purge the dysfunctions generated by periods of cyclical economic growth. The globalized world already experienced a major challenge in 2008–2009, which was prolonged by the European recession of 2011. Yet this time, the crisis is different. For the first time in a long period, the crisis stems from globalized precautions to protect against a disease that, in this spring of 2020, exceeds human capacity to contain it. We attempt here to understand the atypical nature of this economic crisis and to see what its short- and medium-term consequences might be for international trade and the maritime transport that carries it out.

The Chinese moment (February 2020)

To find similar episodes of a major pandemic, one must go back to the cholera of the 1830s and the Spanish flu of 1920. For a hundred years, the world had not experienced such a formidable episode of human infection, and this is occurring in the age of globalization, with the accelerated movement of people and goods. The former facilitated the spread of the disease across all continents, while the latter is set to be disrupted by this event on a scale yet unknown in this month of April 2020.

Covid-19 originated in China at the end of last year, much like other epidemic episodes over the past two decades. The authoritarian Chinese regime managed the onset of the epidemic in its own way. Originating in a southern province around Wuhan, its initial consequence was to significantly disrupt the Chinese economy. Population lockdown measures resulted in a halt of national activity—a pause that is difficult to interpret statistically due to the traditional Chinese New Year holidays in February.

The first phase of Covid-19's effect on the economy and maritime transport is therefore Chinese. Starting in mid-January, China grasped the scale of the health crisis, and the government ordered measures that reduced the country's activity. The consequences then hit commodity prices (iron, bauxite, oil) and slowed Chinese demand for bulk cargo. Above all, it caused a slowdown in container flows related to China, which weighs heavily on maritime transport. Importing countries grew concerned about their supply chains, and containerized transport felt the effects. Yet, Chinese port figures were not apocalyptic, showing a 10% decrease for the first two months of 2020.

By early March, the dominant question was whether China would return to normal, especially since Beijing appeared to have contained the initial outbreak in Wuhan and limited the damage for the rest of the country. The world then had to deal with a sort of "delay" in its Chinese supplies. The question of dependency on Chinese manufacturing also began to arise here and there. What is an obvious vulnerability for the healthcare sector can also apply to all sectors where "Made in China" is a central element of the industrial and commercial value chain. China is also an export engine for other countries, notably in Europe. Since 2002, it has supplied the world in all fields with around 50 million full TEUs. The lesson of Covid-19 may therefore be to reduce this dependency. For a few euros or dollars less per piece, is it necessary to manufacture so many things in China? China may be an (authoritarian) hub of economic and social stability, but it is not without risk, and as it has just shown, it represents a health hazard for the third time (SARS, H1N1), and for the first time on a global scale. The very spread of the pandemic stems from the movement of economic actors linked to this globalized economy of China.

Trump's trade war against China was already intended to reduce its over-dominant grip. The result was one million TEUs shifted to other Asian countries. Will Covid-19 trigger nearshoring or reshoring? A shift in production that will have consequences for container transport. Very little if it is to achieve a spread

across the whole of Asia ("relocalization"). The fleet of giant container ships dedicated to the Europe-Asia route retains its relevance with a production spread over other Asian countries. This, then, is the question of this Chinese moment.

The European moment (March 2020)

In January, Italy was the first European country to be visibly infected. The initial paradox was a distancing of contaminated European States from one another. France, following Spain, grasped the severity of the infection and its rapid transmission among the population. Germany followed, and later, the United Kingdom. Europe became the second and largest hotspot of Covid-19. This time, within a democratic and liberal framework, European States embarked on population lockdowns, thereby reducing their economic activity.

This time, the whole of Europe was confronted with the pandemic and entered lockdown. The result was consequently an economic slowdown. The primary reason was the reduction in industrial activity, as in China, which became clearly visible in the spring. Within the European framework, lockdown resulted in an unprecedented phenomenon in continental economic history: an "impossibility to consume," rather than the lack of demand typical of a "conventional" crisis. This was reflected in all sectors: non-food retail, vehicles, and fuels. Services and administrations were also disrupted.

European tourism was itself forced to a standstill, which impacted air transport. Maritime links with the United Kingdom, Ireland, and all the continent's islands were from then on almost entirely devoid of passengers. The vital continuity of Ro-Ro (roll-on/roll-off) transport maintained a basic level of activity, but ferries and Ro-Ro vessels were anchored.

European phase one therefore corresponded to March and April—a freeze on part of consumption that impacted maritime transport, resulting in fewer containers, fewer Ro-Ro trailers, less refining, and less heavy industry. The maritime industry, which had experienced a ultimately short pause during the Chinese moment, faced a worse phenomenon from then on with the standstill of Europe. The lockdown period produced the second wave on the economy, impacting the trade of production, merchant, and service activities. For businesses, this meant a collapse in revenues, bankruptcies, and a terrible threat to employment. It was then that a true economic crisis hit the European continent. It then became a matter of waiting for the resistance capacity of States to manage it. One could then praise the presence of an interventionist State (fiscal, economic, social) attempting to navigate the hardest part of the total lockdown.

The American moment (April 2020)

For ideological and personal reasons of Donald Trump, denial was initially the attitude of the US government (a phenomenon that actually affected most countries). The question of the American moment was, in early April, twofold. The first was the level the pandemic would reach in the United States and the capacity of the American healthcare system to manage it. The second lay in the rapid destructive effect inherent to American crises, with the 2008 crisis still fresh in memories. The absence of a social welfare State and the harshness of economic operations in the United States created less of a buffer compared to Europe. By late April, the consequence in terms of job destruction was already heavy, with 30 million people without indemnified employment. The American benchmark was now the Great Depression.

The American recession was bound to have a consequence on the global economy, as the country imports 21 to 22 million full TEUs per year from all origins. The restarting of Chinese factories is useless without battalions of American consumers. In early April, the National Retail Federation communicated catastrophic forecast figures for March of -21.3%, and the other upcoming months were expected to follow suit.

The boomerang effect would then hit suppliers; China and its neighbors feed American mass retail (10 million full TEUs/year). Europe itself exports the equivalent of 5 million full TEUs to the United States. Similarly, European exporters need global clients. The risk was a house-of-cards collapse of foreign trade. In early April, the WTO made highly pessimistic initial estimates of up to a 30% reduction in global trade—a catastrophe for containerization.

Paradoxical effect on oil

The Chinese slowdown quickly had an effect on oil prices, dropping from \$65 a barrel in January to \$50 at the end of February, when it was primarily a Chinese problem. The globalization of the pandemic (lower refining and consumption) caused the barrel price to collapse to around twenty dollars—a level never before seen in the age of globalization. It must be said that the rivalry between Russia and Saudi Arabia (along with the UAE) accentuated the crash of crude (Brent) by refusing to limit production in February and March. The drop in price benefited neither American production nor the revenues of producing countries.

Maritime oil transport was expected to be affected by the decline in global activity, but, as in 2014, low prices triggered a speculation phenomenon that mobilized land storage tanks and the tanker fleet to the maximum, particularly VLCCs and Suezmaxes. Land storage limits were reached here and there; floating storage remained possible, but tanker charter rates reached high levels. As always, it was a speculative bet on crude and refined products for a limited duration. The exit from the crisis remains difficult to predict. On the futures market in April, speculation was caught in its own game with negative prices for American West Texas Intermediate (WTI), meaning buyers were paying to rid themselves of their futures purchases.

Dry bulk under various influences

The slowdown of the Chinese economy had an immediate effect starting in mid-January, with lower Chinese demand for dry bulk (iron, coal, soybeans), of which it accounts for—depending on the commodity—one to two-thirds of the global market.

The Baltic Dry Index (BDI), a composite indicator of shipping routes for bulk cargo, quickly showed signs of weakness, reaching a minimum level in March at around 600 points. Granted, this is a very low point similar to the 2008 and 2009 crisis; however, since then, overcapacity in the bulk sector regularly pulls the BDI down to very low levels. This record-low dip was temporary, and the London-based index recovered slightly during the month of April. Clarkson's monthly forecast for 2020 was then -4%; iron ore holdings remained steady in China, and coal was expected to decline by 5%, but bulk commodities driven by Europe as well as conventional cargo (steel, cement) were projected to plummet by at least 15%.

On the grain side, global trade is imperative, as nutrition in both developed and developing countries continues during times of crisis. The FAO is even paying close attention to the risk of shortages caused by disruptions to inland transport chains in many countries. Some nations are reportedly importing massively to protect themselves against risks in the coming months. Countries importing grain for livestock are also affected (Europe, China).

Containers in the storm

Container activity indicators can provide some signs of how things have evolved since the beginning of the crisis. The Shanghai Container Freight Index (SCFI) provides an indication of freight rate trends departing from China. Thus, to an initial decline linked to the "Chinese moment," a second drop was added due to European and American effects. Spring demand seems compromised, and summer consumption is under threat.

In April, the index toward Europe had contracted by 25% (\$725). The lowest point in January 2009 was \$1,020. On the American side, the decline of the transpacific SCFI is at a much lower point than in 2009. The rates indicate that the crisis is severe, with the reduction in Western imports linked to the European and then American lockdowns. The primary consequence is the cancellation of vessel sailings (probably around 500 from March to late April), followed by a reduction in the number of services in all directions. Operators are contracting their supply, which translates into vessels being laid up either by owner-operators or by tonnage providers. Non-operating shipowners (charter owners). This idling of vessels is reaching unprecedented proportions, notwithstanding the container crisis and the bankruptcy of Hanjin in 2016. To put this in perspective with the 2008–2009 crisis, idled capacity then reached 1.5 million TEUs, representing 12% of the fleet. In mid-April, the figure stood at 2.2 million TEUs, with a proportion of 10% laid up.

The container crisis is therefore here. Whether the decline in activity over the year will be 10% or 20% remains difficult to say at the end of April. Profits are collapsing, but here again, it is difficult to determine the exact level of losses. Everything depends on the maintenance of freight rates. Sustained demand

and the absence of a destructive trade war could help preserve container operators, collectively limiting losses to around \$7 billion. Otherwise, it could represent \$25 billion according to analysts. The only positive point is oil prices, which reduce the bunker fuel bill. The sector can hope for a restart in the second half of the year. Companies must hunker down, and the survival of some may be threatened.

The cruise industry deeply undermined

The pandemic very quickly caught up with the cruise industry, with the cruise ship Diamond Princess stranded in Japan with sick passengers on board. Gradually, several vessels faced the same issue, with the repatriation of passengers embarked until early March. Beyond individual ships, it is the cruise industry as a whole that is facing a three-stage crisis. The first involves the grounding of three hundred cruise ships and the cancellation of services for a period extending from spring to early summer. The second stage is a fundamental questioning of cruising as a tourism industry, much like aviation and vacation resorts, due to the relative confinement of spaces and leisure mobility. After 9/11, cruising was perceived as a risk that kept American and European tourists away for a few months. This crisis period could last until 2021; the cruise industry will therefore have to reinvent itself.

The third stage would be a profound disaffection for cruising. For now, the collapse in the stock prices of the sector's two giants, Carnival and RCCL, bears witness to the economic risk hanging over the sector (layoffs, bankruptcies). The economic threat is severe. The US government can assist the companies but questions the fair economic returns, as the economic spinoffs of departure port calls cannot alone justify public aid. This may be one of the elements of public sectoral stimulus packages worldwide, carrying demands for reciprocation.

Shipbuilding: future effects

Shipbuilding is paying the price of the crisis. The collapse in orders affects all maritime sectors and offshore industries. European and Asian shipyards can look to the future with concern. For cruising, this crisis period—much like after 2001 and 2008—is unfavorable for shipbuilding. Beyond the production halts linked to lockdowns, which will disrupt the production in 2020. The order book remains strong for the three European shipbuilders, and concern centers only on a worst-case scenario that would be too harsh and place shipowners in extreme difficulty. The sudden braking of the cruise industry thus threatens major shipbuilders, who will undoubtedly receive state support. Already, States are suspending loan repayments for cruise shipowners. Meyer Werft speaks of a difficult decade ahead. For France and Italy, state-ownership or public status will likely provide protection through civil and military public contracts, against the backdrop of energy transition requirements.

On the Asian side, consolidation will be mandatory. Japan can continue its endogenous operations, whereas China and South Korea, which are dependent on the global market, will undoubtedly have to restructure their naval sectors even further. Overextended by the momentum of the 2000s and undergoing little contraction during the 2010s, Asian shipbuilding will have to reduce its capacity. It may be tempted to further attack the remaining segments of the European industry (cruise ships, ferries). Europe will have to choose whether it wants to preserve this sector. The latter has already called on Europe to consider it a key sector to be protected.

Multiple questions for the maritime sector

The current situation triggers problems on an unprecedented level. The questions are numerous, as evidenced by the press day after day: how to organize the operation of ferry services and, beyond that, support the operators of European coastal States? How to manage crew changes for maritime transport and offshore industries on a global scale? With oil prices at this level, how can oil exploration be sustained to secure supply for the beginning decade? Is the Cape route an acceptable alternative? How will ports operate when faced with excess storage in a slowing economy? Will logistics demand even higher efficiency and reliability from the maritime sector? How will South Asian shipbreaking yards absorb the growing volume of scrapped redundant vessels, including relatively modern ones? Should European States bail out their shipping companies and take a step further into the concept of strategic fleets? Is flagging out a price to be paid? What will be the effect on emission reduction obligations (scrubbers, low-sulfur fuel) ?

De-confinement and beyond

The lockdown of populations in most countries corresponds to a method of resisting the onslaught of the pandemic and the need to limit rapid contamination. In the course of April, the choice of governments and the demand of populations are to emerge from this situation, which is impossible to sustain beyond reason for the proper functioning of individuals, societies, and economies.

The Covid-19 economic crisis is certainly atypical, but it can be contained within a relative timeframe because it is not based on purging a bubble or a cyclical end. It is merely a forced pause. A gradual and health-acceptable de-confinement is an economic imperative in the second half of spring or in the summer, while living with a latent threat.

There must therefore be a new "moment"—that of a world resuming its march but under health conditions. Behind this idea lies the resumption of the functioning of the economy, production, trade, and distribution. Even if gradual, even if imperfect, de-confinement will be a breath of fresh air for the economy. Non-food consumption will resume, and with it, international trade and therefore maritime transport.

Container transport, like sectors linked to manufactured and industrial goods, may suffer a brief but violent shock, but not a deep and prolonged crisis. The global industrial slowdown threatens, and inventories are accumulating. A return to normal, even partial, is an economic survival imperative. The threats of maritime bankruptcies are real, and States will also save shipping companies. We can then raise questions about profound economic changes in the future.

Perhaps we should question the nature of this crisis. It is not of economic origin. Its initial intensity will be terrible, mirroring 1929, 1973, and 2008, but it is not based on fundamentals that need correcting (monetary parity, overheating, bubbles, oil prices). One could imagine that the end of confinement within a reasonable timeframe could "liberate" the economy and jumpstart things quickly—certainly on unfavorable grounds, but recovery is possible.

Among the hypotheses, should we nevertheless envision a revisited globalization? Populations and politicians may demand less free trade and relocate entire segments of industry. Let us also not forget the environmental mandate, which remains powerful and forces change. The world after, in this spring, is an unknown and more of a projection than a reality. Maritime transport will remain an obvious necessity; the dispersion of resources and expertise feeds international trade and its maritime vector. Adjustments will likely not be that significant (less Far East, perhaps more proximity). In early May 2020, all of this remains hypothetical.

Paul TOURRET

English translation generated by Gemini AI