Article Side

Hypo Venture Capital Headlines: is the global economy back on an even keel? by Hypo Venture

Article published on January 14th 2012 | Business

Faisal al Yafai

Day rates for the movement of goods around the world hit their peak in early 2008, a few months before the global financial crisis. Which direction are these same prices heading in now, and can the shipping industry help predict the direction of the global economy?

A port in Singapore. Around 90 per cent of all the worldâ€™s goods are transported by sea, meaning that when economic activity is strong, the shipping industry is buoyant. Khalifa Industrial Zone Abu Dhabi, which is being constructed between Abu Dhabi and Dubai, is one of the largest infrastructure projects in the world.

Forty-two floors up, from the window of Mercatorâ€™s meeting room, Singapore stretches out, a landscape of order, dotted with trees and water. To the south, a haze of humidity hangs on the horizon, reducing the Indonesian islands to no more than an outline. Ships, trawlers and tankers sit between these two points, like toys in a bath, motionless in their motion. These are some of the worldâ€™s busiest shipping lanes, the blue of the ocean endlessly crossed by small black lines, keeping the economy of the world moving.

In the meeting room far above the sea, K Srivastava, a vice president of Mercator in Singapore, is explaining why the company he works for adopted a cautious approach during the heady days of the first half of 2008.

â€œWe could see the cracks,â€• he says, â€œWe could see the cracks very visibly because the day rates so high. That on a long-term basis with that kind of day rates, one wonders whether any business can be sustainable.â€•

Mercator is one of the worldâ€™s leading dry bulk shipping companies, a company that moves vast quantities of dry goods â€“ grains, coal, iron ore â€“ around the world, servicing the factories and industries that keep the global economy moving.

Back in 2008, in the months before the financial markets collapsed, the per-day price for moving a shipment was vast. Companies such as Mercator were making huge profits. By one estimate, the shipping industry made an estimated US$80 billion (Dh294bn) in profits in 2004. But something didnâ€™t quite add up.

â€œWe found the day rates were too high, [too] unrealistic. The day rates were about $80,000 (Dh294,000) to $100,000 in the peak of times. So everybody who has a ship was earning $100,000 per day. Now that has a couple of implications. Operating costs for a ship are typically in the range of $5,000 per day. If you were to say you are earning $100,000 and operating costs are $5,000 â€¦ itâ€™s still a lot of money. And therefore something had to be bizarre there.â€•

Mercatorâ€™s reaction to this situation was to hold fast, not taking on loans or debts. The day rates, notes Srivastava, were at their highest level for a decade. Other indexes were also high, at record levels. The Baltic Dry Index (BDI), a measure of the daily average cost to ship dry bulk commodities, was at record levels.

â€œIf you looked at the BDI, it went from a five-digit number then it came to a three-digit number,â€• says

Srivastava. â€œWhen you have volatility as much as that, you have to be really careful how you run the company.â€•

What happens on the high seas affects everyone. Analysts watch global shipping closely because it can predict the direction of the world economy. Around 90 per cent of all the worldâ€™s goods are transported by sea, meaning that when economic activity is strong, the shipping industry is buoyant. Raw materials need to be transported around the world and finished products need to be shipped to their final destinations.

At the same time, shipping can provide a sense of where the global economy is going, especially in an uncertain time. But it doesnâ€™t always predict the future very clearly.

In general, there are two main types of traffic that analysts look at: the shipping of bulk dry commodities â€“ such as coal or grain â€“ and container shipping, completed products ready for sale.

The usual measure of bulk shipping is the BDI, a measure of the daily average cost to ship bulk dry commodities. As the index moves in response to demand, it can provide an accurate reading of current global demand for raw materials.

It can also provide a look into the future. The raw materials transported usually take between six to nine months to be made into the end products and shipped to customers. The BDI can therefore offer an insight into what demand there will probably be for these products in the future.

Typically, companies will order raw materials in advance of when they expect their products to be needed, and in sufficient quantities. So the BDI is what is known as a â€œleading indicatorâ€• of economic activity. An increase in the BDI can signal an anticipated increase in global demand several months down the line. A decrease can indicate that demand is expected to drop, as companies cancel or donâ€™t place orders for raw materials.

Container shipping, on the other hand, is a â€œlagging indicatorâ€• of economic health because orders are placed six months ahead of when they are delivered. The container rates today reflect the outlook of businesses six months in the past, who will have placed orders for goods that are now ready to be shipped.

The high that Srivastava in Singapore was discussing came in the summer of 2008, when the global economy seemed to be riding high. Other indicators of global economic health â€“ such as house prices â€“ were strong and financial markets around the world were booming.

Hypo Venture - About Author:
Hypo Venture Capital Zurich
501 Broadway
12th Floor
New York City, New York 10036-5601
United States
+1 646 571 2000
info@hypoventurecapital-headlines.com
http://hypoventurecapital-headlines.com

Article Keywords:
hypo venture capital financial crisis, financial news, hypo venture capital, hypo venture capital zurich news, latest headlines economy