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Was Ocean Shipping the Biggest Bubble of them All?

One Analysis says Yes, as Baltic Dry Index has Fallen by an Astounding 90% from its Peak

SCDigest Editorial Staff

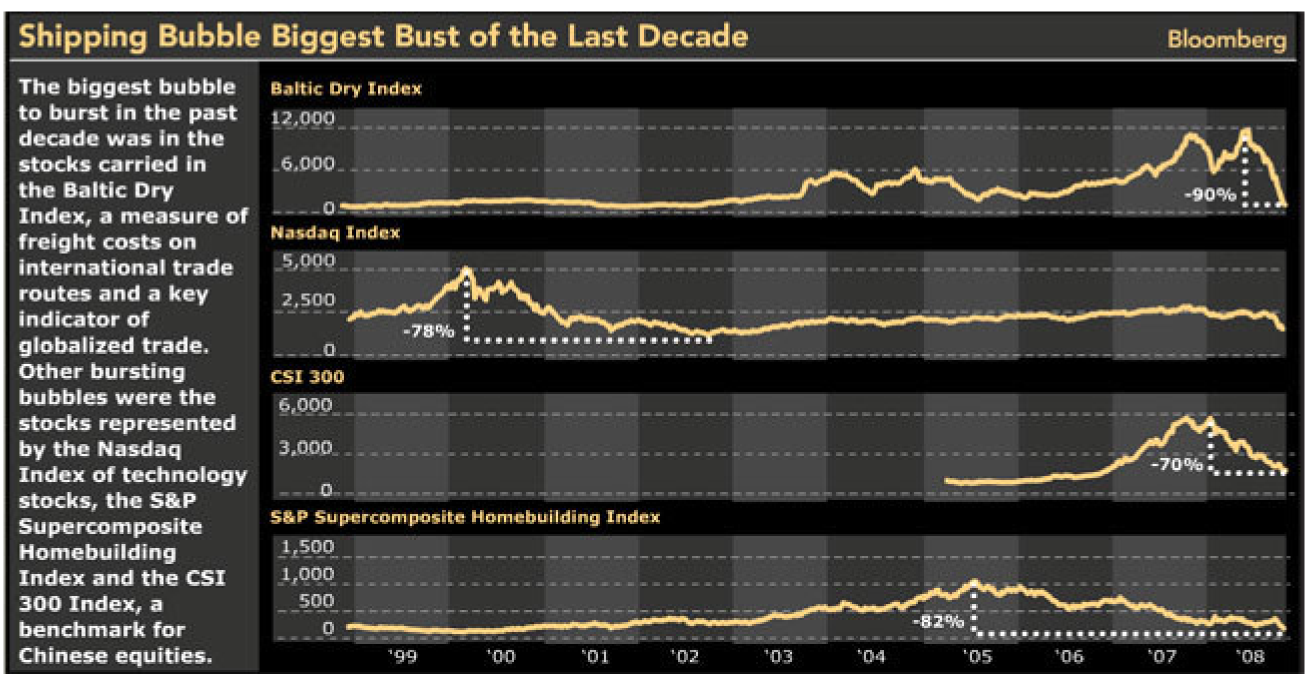
As we reported recently in Supply Chain Digest, ocean shipping rates have been in a free fall since the start of the financial crisis, in some cases dropping to the variable cost the carriers have moving the ship. (See [Financial Crisis Hits Ocean Shipping Too, as Rates Plummet](#).)

Now, some are calling the rise and fall of ocean shipping rates another "bubble," and maybe the biggest bubble of them all, even more than housing, oil, and other areas that rose fast and fell even harder over the past several years.

As shown in the graphic below from the Bloomberg news service, the Baltic Dry Index (BDI), which is used to measure the basic cost to ship various commodities across the globe, as of last week had dropped an amazing 90% from its peak levels reached this summer.

With the financial crisis, those letters of credit have been extremely hard to come by. When that happens, global commerce slows to a crawl, further reducing demand for ships and containers.

Is the index somehow not reflective of real changes in shipping rates? No, it appears that in



Source: Bloomberg New Service

Was Ocean Shipping the Biggest Bubble of them All? (Con't)

this market, spot rates really have plummeted to these sorts of levels from their peaks.

Writing in London's Financial Times, **John Dizard** found that "Ships really are that cheap. As one broker told me: "I just chartered a Handymax to go to the US Gulf from India for $1,000 a day. So the BDI really is pretty accurate." A Handymax vessel would typically displace about 40,000 deadweight tons. You would notice it if it dropped anchor near your dock. The cash operating costs are at least $1,500 to $2,000 per day. On top of that, figure another couple of thousand dollars a day for the capital costs."

How could this be?

Part of it is obviously general economic contraction, and the laws of supply and demand coming into play after several years of the ocean carriers adding tremendous capacity chasing what appeared to be never ending growth in global trade.

But there is something else going on as well. Global trade hinges hugely on the availability of letters of credit, in which one financial institution agrees that it will accept the credit risk of an individual importer or exporter, for a fee.

With the financial crisis, those letters of credit have been extremely hard to come by. When that happens, global commerce slows to a crawl, further reducing demand for ships and containers.

While in the end, a new supply-demand balance will be achieve, it may take some time, and the craziness of the recent past may not be revisited for years.

"As for freight rates, they will have to recover to the point where the owners can cover their operating costs," Dizard says. "That could take a few months longer than you would think, because the cost of mothballing a ship for that period could be higher than keeping it going at today's rates."