

## **China Factor in the Structural Change of World Shipping Industry**

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Good morning. On behalf of the organizers of the conference, I welcome you all to the conference. I appreciate your participation at a time when the weather in Beijing is as hot as in the shipping market. China's economy is booming, it drives the shipping industry. That is why the organizers choose China Factor as the main theme for this unique conference. I would like to take your attention to see how and to what extent that China plays in this dramatically changing market.

### **I. The Structural Change of World Shipping Industry**

Let me firstly say something about the structural change of world shipping industry. World shipping industry has been undergoing a structural change over last decade and the changed map has never been clearer nowadays. The feature of the change is that, Asia, notably East Asia, has overwhelmingly become the powerhouse of world shipping business as the largest importer of raw materials and the largest exporter of manufactured goods. Though Asia GDP figure is smaller than the US and European Union, and if excluding Japan the region's economic scale is much smaller, this region has consumed more raw materials and produced more manufactured products than either of them. In shipping, the volume rather than value matters.

Here are some figures of proof for the argument. According to Clarksons Research, Asia imported about 15 million barrels crude oil per day in 2003, accounting for 43% of world oil trade. As for the three major dry bulk cargoes iron ore, coal and grain, Asia imported over 1.3 billion tons, 57% of the world trade of these goods. In terms of container trade, Asia's port

throughputs were 152 million TEUs in 2003, 52% of the world total. Asia has taken the leading position in all of major shipping categories.

Along with the surging demand of Asia is the shift of shipping services and related industries from the West to the East. Nowadays, according to Lloyd's Register and Fairplay, Asian and Oceania shipowners controlled 43% of world merchant fleet in 2003. Obviously they operated more capacity, as a large number of their fleet are chartered in vessels. Two thirds of the world's top twenty container shipping carriers and container ports are located in Asia; over 80% of ships are built in the three major shipbuilding countries Korea, Japan and China; over half of ships are crewed with Philipinos, Indians and other Asian seamen. Other shipping related industries such as shipping finance, legal service, insurance, are increasingly moving to Asian shipping centers like Hong Kong, Singapore and Shanghai.

This does not happen in one day. Actually East Asia attracted world attention a few times in last few decades. Firstly it was Japan in the 1960s through to 1980s. Then the so-called Asian NIEs (newly industrialized economies), including South Korea, Taiwan, Hong Kong and ASEAN countries, surged in 1980s and 1990s. This time it is the turn of China. Given China's sheer size in terms of population and land, the market-oriented economic reform has created an even stronger influence on the world trade, again in terms of volume.

Many economists have given their explanations of the growing importance of Chinese economy to the world. But normally they look at the value term. Let me explain the volume term.

## **II. China- the Powerhouse of World Shipping Market**

After witnessing a consecutive strong growth in 1990s, especially after China joining WTO in late 2001, the country's foreign trade continues to grow at a surprisingly high rate of over 30 percent on an already big enough base figure last two years, and continue into this year. China's GDP maintains an average annual growth rate of 9.4% for the past 25 years. China's aggregate economy ranks 6th in the world.

China's foreign trade reached a record high of US\$850 billion in 2003, ranking the fourth in the world, and its over US\$ 400 billion imports ranked the third. Back to three years ago, China was ranked the seventh in the trading countries' list. In the first half of this year, China's foreign trade increased by 39%.

After the consecutive strong growth of years, China takes account of around 5% of world trade value. However, most of you would agree that China played a far more critical role than what we see from this figure, in the historical boom of shipping market starting from the second half of last year. The secret is with trade volume. Let's talk about what China factor brings to the international shipping market.

### **1. Container shipping**

The ports of mainland China handled 48 million TEUs in 2003, a net growth of 11 million TEUs from the previous year. Last year was not an unusual year in terms of the growth rate, as the rate of 30 percent was right at the average level of the past decade. But it made the Mainland China become the largest container shipping market for the first time. In addition, both Shanghai and Shenzhen joined the mega-port league of over 10 million TEUs throughputs. From January to May this year, the container throughputs in container ports in Mainland China hit 22.56

million TEUs, an increase of 26.7% year on year. China Ministry of Communications had a forecast last year that the country's container port throughputs would reach 100 million TEUs by 2007. With this speed of growth seen this year, I firmly believe that it is a reasonable prediction.

Plus those handled in Hong Kong, whose 20 million TEUs annual traffic were largely transshipments for Pearl Delta area in Southern China, China accounted for nearly one fourth of world total container throughputs of 280 million TEUs. However, if you know that half of the containers flowing into China are empty and nearly all of the containers leaving China are loaded with goods, China's share in world container export is obviously higher than this percentage, probably up to one third of the world total 80 million TEUs carryings.

As a result, on the two most important container trades from Asia to North America and to Europe, mainland China and Hong Kong take account of over 60% and 50% of market share respectively. No wonder a larger number of liner companies' service lanes start from Chinese ports, and Chinese market contributed to the major part of most liner companies' growth over last few years.

The other side of the coin is that, the industry's reliance on Chinese trade growth has come to a point that any change of Chinese demand will have an immediate influence on shipping market. It is quite obvious that the freight market usually calms down during three important Chinese holidays. Now shipping industries not only talk about Easter and Christmas, but also Chinese Spring Festival, International Labour Day (May 1<sup>st</sup>) and Chinese National Day (October 1<sup>st</sup>)

## **2. Dry bulk shipping**

It is even more obvious in the dry bulk business that China has brought in a structural change to shipping world. In the past decade, the annual growth rate of major dry bulk sea borne trade of China is 17.2%, Japan 5.4%, European Union 2.3%, and the US negative. The speed for China has been accelerating over the recent three years, with an average growth rate of 19%. Actually, China has contributed 50% of world dry cargo shipping net demand increase since 1999.

Take iron ore as an example. China consumed 260 million tons of steel in 2003, increasing by 30 percent from the previous year and accounting for 27 percent of world production. As a result, China's import of iron ore was 145 million tons, a net increase of 33 million tons. While the total net increase of the world's dry bulk cargo shipment was 91 million tons, China's increase in the shipment of iron ore alone took up 37 percent of the world's net dry shipping demand. In the first five months this year, China's iron ore imports saw a further increase of 34% to about 81 million tons.

Soybean is another bulk goods imported into China. Last year China imported over 20 million tons soybean, accounting for about half of world soybean shipment. This also represents a 90% increase from the previous year's import.

Obviously, the shipping world was not ready for this growth. Combined with other reasons such as strong economic recovery in US and Japan and serious port congestions, the dry bulk freight rates reached a rocket high in the first quarter this year. The highest point of Baltic Dry Index (BDI) was 5681 on February 4th, 2.4 times of the previous historical height in May 1995. But when some industries in China appeared to have signs of over investment, the BDI started to ease down. It dropped further when the China State Council released a series of economic restriction policies,

especially stopping the Tieben project, an 8 million tons steel plant project on the Yangtze River Delta. The BDI dropped by over 1000 points in a month following the event in late April.

Of course, as the overall demand for bulk trading is still high, the dry bulk freight market became stable in late June, and the BDI still keeping higher than the 1995 height in mid-July. And just two weeks ago, when China decided to start exporting grain products and importing soybean, together with the increase of Australian iron ore exports to China, the market recovered and became active again. The BDI rose to 4086 points at July 13.

Here I would like to propose some change of BDI index. As the demand from Asia, especially from China, have a much heavier influence on the dry bulk market nowadays, we can consider to put more weight to Asian trades in BDI index, especially in Capesize index.

### **3. Tanker shipping**

Robust economic growth fueled China's crude oil imports to increase 31 percent to record level in 2003. China imported 91 million tons of crude in 2003, or about 1.87 million barrels per day, up from 69 million tons a year earlier. The International Energy Agency forecasted in April that China would continue to lead world demand growth in 2004. China's oil demand would average to 6.28 million barrels per day this year, increasing by 14% and slightly overtaking Japan as the second largest oil consumer in the world. Of course, this is still far behind the amount of over 20 million barrels per day consumed in the US. In light of the fast growth of import demand, the Chinese government is seriously considering to build up a strategic oil reserve.

In the first five months this year, China imported about 50 million tons crude, increasing by 59%. Together with strong demand from other nations such as the US, India and Korea, the tanker freight rates maintained firm throughout the period from late last year.

Along with the huge increase of demand in container, bulk and oil shipping, is strong growth needs in port and logistics infrastructure and services. As the new China Port Act took effect earlier this year, a wave of investments in ports is quickly developing. And the big names of both domestic and international logistics companies are expanding their businesses in China substantially. To some extent, the China effect is felt across the world as the domestic economic policy changes are reflected in the stock markets in Hong Kong, Singapore, Tokyo and New York.

### **III. The Future Development of China Factor in World Shipping**

Just two years ago, people were debating if China would become a world factory. Nowadays nobody will doubt the fact that China has become the primary world factory, taking the advantages of its cheap and productive labor force and huge domestic market. This is reflected from the container trade volume going out of China. As I mentioned before, China may have provided one third of goods transported in container, which is the most important mode of international transportation for manufactured products in the world.

Looking into the future, I see little reason why this growth trend should change its direction. Actually, Chinese economy has stepped onto a new phase of long-term steady growth in 2003, after years of taking positive fiscal policy and other stimulating policy measures since the Asian Financial Crisis in 1997. Though the economy seemed to go too fast from late last year, we now see a good prospect for a soft landing after a series of steps to cool down the heated economic growth somewhat. In this

wave of economic up-surgings, the serious shortage of energy and transportation services supply have been the bottleneck. At the moment, the restriction policies on madly investment expansion in industries like steel, aluminium, cement and real estate have cooled down some heating sentiment in dry bulk freight market, but actually the demand for all shipping sectors is still in full wing. These policies effectively help keep the economy on the right track, rather than ruining the future growth prospect, thus maintain a healthy demand level for shipping services.

In fact, the basic factors supporting China's long-term growth have been enhanced last few years. Firstly, China's joining in WTO two and half years ago gives both Chinese companies' access to the world market and foreign companies' access to Chinese market. Though there are some abuses of anti-dumping clauses against Chinese companies by other nations, it now only affects a minor part of Chinese exports. On the other hand, foreign companies have increased their confidence in China. The FDI (foreign direct investments) has seen a solid increase in the first half this year, and will surely be over 50 billion US dollars the whole year. These will further strengthen China's production muscle.

Secondly, the recent economic reform policies from last year push the state-owned enterprises reform a big step forward and give the private sector a full wing to develop. The entrepreneurship of the nation is being released. On this background the international competitiveness of Chinese companies is strengthened further. As reported by Financial Times last month, manufacturing productivity in China is nearly one fifth higher than that of leading European countries and almost as high as in the US, according to an unpublished study by the McKinsey management consultancy. The McKinsey study finds that Chinese manufacturers have been more adept than many had thought in taking on advanced management techniques.

Thirdly, the endless source of Chinese human capital provides a strong backlog for long-term growth of Chinese economy. In next ten to twenty years, hundreds of millions people will migrate from the countryside to the urban areas and become workers in the plants. In addition, as Patrick McGovern, the respected chairman of International Data Group, said in a recent interview, the Chinese are putting tremendous emphasis upon education, graduating 700,000 engineers a year, compared with only 70,000 in the US. They traditionally save about 40% of their income. So China is going to have lots of talent and lots of capital to put to productive uses. He sees the rapid growth continuing for at least the next ten years.

In addition to the above basic factors, China's entry into a heavy-industry period, the ongoing historic movement of urbanization, and the coming 2008 Olympic Game in Beijing, are all creating huge demand for the economy.

In a word, such an economy will need to import more energy and raw materials like crude oil and iron ore, though a much more efficient use of them is very necessary, and will export more manufactured goods to the rest of world. The nationwide electricity shortage has fueled a new wave of investment in power station, the amount estimated to be over US\$ 10 billion. The number of cars sold in China reached 2 million in 2003, an annual increase of over 90 percent. A forecast further increase will consume more steel and oil. These are just a few examples of the potential demand increase for shipping needs. World shipping industry will continue to benefit from this continuous strong growth in China.

Of course, we will not forget the lessons we learn from the past business cycles on the other hand. The current boom will not change the basic rule of business. And we realize that the sharp up and down of market will do

no good to any party in shipping. The solution to the problem is closer cooperation both between us. We COSCO have forged a series of strategic partnership with our major customers in recent years, with an aim to reduce the uncertainty of the market. As for the cooperation among carriers, most of us will agree that over-optimism will usually lead to a disaster of the industry by building too many ships. We believe it will serve the goodness of everyone in the industry by keeping a reasonable response to market demand, especially because there are so many unpredictable risks in shipping world.

Finally, I wish everyone a happy stay in Beijing.