Debunking black swan mysteries

Mark Williams explains how shipping can be better prepared for 'unpredictable' events

Mark Williams

Nicholas Nassim Taleb's 2007 book *The Black Swan* introduced many of us to the notion of an unpredictable event that can have seismic consequences for individuals, nations or markets. The concept goes back to ancient times, black swans being a common metaphor for rare events in Ancient Rome.

The nature of unpredictability depends on one's perspective and on the available contextual information. What might be an unpredictable event for one observer may not be for another. For instance, a turkey may be surprised by Thanksgiving but the butcher is not. The tragedy for the turkey is that the bird doesn't even know that it doesn't know about Thanksgiving, so it cannot do anything about its predicament.

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The term 'Black Swan' is used to denote an unpredictable event that can have seismic consequences

A lack of information, or the wrong information, can create black swans. In the build-up to the US invasion of Iraq in 2003, most citizens in the West didn't know that Iraq had no weapons of mass destruction, but they didn't know that they didn't know that, having memorably been told the opposite in Colin Powell's address to the UN Security Council in November 2002. The consequences still play out in the Middle East and globally today.

Faced with incomplete information in an unpredictable world, the best we can do as individuals, organisations and nations is to build resilience, that quality described by sports coaches as 'bounce-backability'. Our best tool for building up resilience to unpredictable events is therefore information, either quantitative data or qualitative knowledge.

Following politics

What sort of information can we use in shipping to build resilience? One sort would be an understanding of previous unpredicted events and how the industry coped with those. The most common variety of black swan shipping industry has encountered has tended to be geopolitical. The freight markets don't account for politics directly, but they do react to political change like all markets do. The consequences can be highly beneficial or disadvantageous, or indeed both.

At the end of 2001, China was admitted to the World Trade Organisation, the international club that sets the rules of trade between countries. Very few of us realised the forthcoming extent of China's urbanisation process, with 400 million individuals, a third of China's population, migrating to cities. The demand for raw materials and energy to build those cities created boom conditions for shipping and made dozens of ship owners millionaires many times over.

What was more predictable was that the newly minted shipping magnates would speculatively build even more ships in anticipation of further rapid demand growth from China and other emerging markets. This could even have been seen as a rational decision by individual ship owners, though the emergent industry-wide decision to expand bulk carrier, tanker and container ship fleets rapidly became a form of mass delusion.

These great new fleets delivered just in time for the global financial crisis. Demand for ships collapsed and took several years to recover. Indeed, container ship demand growth has never since recovered the levels it enjoyed in the decade to 2008, and freight rates reflect this, averaging just over half in the ten years since 2008 what they did in the ten years previously.

Winners as well as losers

Black swans aren't always bad news for shipping. The LNG shipping industry has greatly benefited from changes to US environmental policy. Back in the early 2000s, it was thought that the US was going to have to import increasing quantities of natural gas to meet energy demand. Energy companies found it very difficult to get environmental permits to build gas import terminals on the US coastline. Some observers blamed local opponents – NIMBYs (Not In My Back Yard) for this situation. In fact, opponents were merely taking advantage of government policy which could be described as BANANAs (Build Absolutely Nothing Anywhere Near Anyone).

Then in the mid-2000s, shale oil and gas production in the US expanded massively. Natural gas prices collapsed as the US built up a huge surplus in gas inventories and new supply. The obvious solution to the surplus was to export it in order to support domestic prices. That made it economic to build export terminals, some of which were constructed on the site of on-hold import terminals. By 2015, 35 new LNG export terminals had been proposed in the US, with 22 approved by environmental regulators. The US is now primed to become a leading exporter of natural gas, unless Trump administration trade tariffs make the gas too expensive for overseas buyers.

The main geopolitical concern as 2018 turns into 2019 is the demise of the global trading system and its replacement by more bilateral and club deals. A parallel challenge to the global trading system is the combination of rising wages in Asia and rising automation in manufacturing. These undermine export competitiveness and encourage re-onshoring, shortening global supply chains. The clearest threat is to international container shipping demand, while rising trade tariffs may disrupt or reorganise trade routes for dry and wet bulk trades. If the 20 years to 2016 were characterised by globalisation, the coming decades may be characterised by deglobalisation.

Trade deal overhaul

Politically, re-onshoring and protectionism have been maxims of populists and nationalists, personified by US President Donald Trump. But the US is not alone in trying to renegotiate the kind of trade deals that have been of such benefit to shipping. Nor are Americans alone in being suspicious of the benefits of globalisation. According to an OECD study from 2017, 40% of OECD citizens consider globalisation as a threat rather than an opportunity, while only 26% think of it as an opportunity not a threat. In China and India, the OCED says, 60% and 52% of citizens believe that globalisation represents an opportunity.

Nominally communist China now promotes itself as the guardian of free trade contrary to nominally capitalist America which wants to undermine free trade. It's remarkably effective propaganda. As things stand, China is currently incapable of forcing globalisation onto the world. But it is not averse to changing the rules to suit itself and causing its trade partners to adapt. In November 2017, the Chinese government imposed regulations on steel production to reduce pollution in and around Beijing. At the same time, domestic iron ore production was reduced and iron ore imports became more focused on higher Fe content ore. Miners with access to higher quality product benefited while those with lower quality ores suffered. The overall trend of iron ore imports to China has increased slightly, but with selected beneficiaries. While a rising freight market for capesizes has made 2018 one of the best years of the decade so far for ship owners, the market remains vulnerable to further amendments to Chinese industrial and environmental policies.

End of a cycle?

The unpredictably wide scale of the global financial crisis and decade long years of austerity may now be coming to an end as the US economy leads global growth rates. If the economic and shipping cycles are on an upturn, then dry cargo freight markets are leading the way with container shipping and tankers lagging behind. The main reason for this is to do with the unplanned nature of shipping supply. The secret to resilience in the event that the global economy does not grow as expected lies as usual in the supply side response to demand. Too often in the past, short term improvements in freight markets have led to long term investment decisions, making downturns in the freight market deeper and longer than they could have been.

In 2007, buoyed by several profitable years and conscious of the looming 2010 phase out of single hulled tankers, oil tanker owners ordered over 700 new oil tankers from the shipyards of Asia, many at historically high prices. Most of these ships delivered in the midst of the global financial crisis. Tanker orders plummeted. When oil prices fell and oil demand increased in 2014, ship supply tightened and freight markets recovered. Another newbuilding splurge followed, with one VLCC delivering every week in 2017 and 2018. The result: tanker owners making operating losses again.

So, while we can't predict black swans for shipping in 2019, we can identify our weaknesses, learn to adapt, plan our investments in tonnage with a longer-term outlook, and become more resilient. Of course, if Planet X appears or virulent disease wipes us all out, then all bets are off. Barring such extreme events, we can only remember that to fail to plan is to plan for failure. ***SN***

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Credit: Cheniere Energy

After construction of 20+ LNG export terminals, the US is now primed to become a leading exporter of natural gas