THE BALTIC DRY INDEX

by Steve Brown

In addition to comments regarding our kitchen cleaning, we received multiple inquiries regarding our use of the Baltic Dry Index (BDI). Despite some reader's comments that it sounds like some Estonian deodorant or Russian Sherry, it turns out to be a pretty useful economic indicator. Given that the US economy is linked to the global economy, banks should have a way to track the global economic picture as a data point in their economic forecast. If you are in need of such a metric, may we suggest our favorite - the BDI.

The BDI can be found on Bloomberg (on their public webpage under the ticker "BDIY"), Reuters and our free "Monthly Asset-Liability Package." The BDI is a measure of shipping rates for dry bulk carriers that move commodities such as coal, iron, grains, fertilizers, animal feeds, etc. around 26 major ocean routes. As a result, the BDI captures supply and demand for raw materials across the globe. It takes into account shipping capacity, fuel costs, bookings and even piracy. The key part here is the fact that the BDI focuses on raw materials, as this is our first hint that demand is increasing (or falling) for product inputs. As such, the BDI is a nice leading indicator of future economic change. Manufacturers purchase more raw materials in times of growth, thereby sucking up shipping capacity and increasing rates. When these same producers stop buying raw materials, due to excess inventory or lower infrastructure building, rates fall.

As a result, the BDI is a compelling indicator because it is a simple, real-time measure and difficult to manipulate/influence (unlike indicators such as unemployment, currencies or oil prices). While the BDI hit a high of 11,771 on 5/22/08, it quickly hit a low of 663 on 12/05/08. Now, it is hovering around 1,478 after a recent drop. As an aside, shipping, as an industry, is said to be in trouble when the BDI falls below 4,000. It is here, where revenue falls below most companies' fixed and variable costs. To counter, ships take longer (to use less fuel), avoid places like the Panama Canal (it is sometimes cheaper to go around Africa) or get taken out of service. Ships, unlike airlines, need larger crews and more maintenance, so it is harder to change capacity quickly. As a result, supply changes slowly, adding to the stability of the index. Should the index drop below 1,000, it is said that every transport is a money loser and thus cannot be sustained.

In the chart above, we graphed the BDI (blue line on the bottom) against the S&P 500 (green line on top) to show the high correlation to equity movement. As you can see in recent performance, despite the run-up in equity prices, the BDI has continued to sell-off, foretelling a similar trend that should be coming in the S&P. In other words, BDI paints a weakening global economic picture.

Until the BDI gets above 4,000, we expect weakness in global demand to continue, hurting the US economy. By tracking the BDI, banks can have a sensitive, accurate and forward-looking measure of the global economic picture.

BANK NEWS

Bernanke

On the tape this morning and said there are signs that the "sharp decline" is slowing.

CPP For S

The Treasury has posed agreements for S Corp Banks on its website and included a set of frequently asked questions. Next up - Treasury is reportedly working diligently to release terms for 530 mutuals that do no have a holding company (could come as early as today).

Goldman Sachs

The bank reported a $1.8B profit for the 1Q and plans to raise $5B in common shares to repay the $10B in TARP money received in October.

Tax Refund

In years prior, tax refunds have boosted retail sales by up to 20%. However, according to an AP survey, 54% of those receiving refunds this year intend to pay down credit card, housing and utility bills (up from 35% last year).

TLGP Update

The FDIC released updated TLGP monthly data that shows March usage is skyrocketing. Debt outstanding jumped 25% month over month ($269B to $336B), while the number of issuers soared 33% (73 to 97).

Commercial Lending

The University of Southern California has released a report that indicates 15% of office space in the US is vacant and that it could rise to 18% shortly.

Doom & Gloom

Bank analyst Mike Mayo, who said last week that banks will soon face loan losses that will exceed levels reached in the Great Depression, expects losses to climb from 2.0% currently to 3.5% by the end of 2010.