This Week's News: A snapshot on the economic and shipping environment

Week ending 2nd September 2011

ECONOMIC ENVIRONMENT

The astonished U.S. debt downgrade seems to have been left behind and the economy has started to show some evidence of strength. The Hurricane Irene failed to shut the financial markets and the week begun with a positive note in the U.S. stocks market. The S&P 500 index experienced the biggest increase in almost two months following Federal Reserve Chairman Ben S. Bernanke positive announcements that the economy isn't weak enough to warrant immediate stimulus via a third round of quantitative easing. Furthermore, the U.S. consumer spending has shown its biggest growth in the last five months climbing in July by 0.8% with the U.S. savings rate falling to a four month low of 5%, according to figures from the Commerce Department in Washington. The rebound of U.S. consumer spending in July alters the weak outlook of the U.S. GDP growth for the second half of the year since the consumer spending accounts almost 70% of the economic activity.

The sentiment changed also in Greece with the benchmark General Index of the Athens Stock Exchange ending 14.4% higher from the strategic announcement between the country's second and third largest lenders, Eurobank and Alpha Bank to merge and create the Greece's biggest bank and eurozone's 25th biggest bank with assets of EUR 150bn and EUR 80bn of deposits. Finance Minister Evangelos Venizelos welcomed the movement stating that the decision by the two banks to proceed with a merger is a positive development and demonstrates that today's crisis could serve as a corrective opportunity and provide a boost in the financial sector as well as in the real economy. The deal includes a capital injection of EUR 500mil convertible bonds by the Qatar Investment Authority, which already holds 5% stake in Alpha Bank since 2008. The terms of the merger agreement include an exchange ratio of 5 new Alpha Bank ordinary shares for every 7 Eurobank EFG ordinary shares.

Even the positive outlook created in financial markets this week, the International Monetary Fund cut its growth forecasts for U.S. and eurozone. The Fund slashed its U.S. growth forecast for 2011 to 1.6% from 2.5% two months ago and for the eurozone to 1.9% from 2%, stating that the Federal Reserve and the European Central Bank must be ready to easy policy. The fund warned that with growth faltering and inflation risks diminishing in the eurozone, the European Central Bank should avoid raising interest rates and have room to ease monetary policy if downside growth risks persist. Furthermore, business and consumer optimism in the eurozone fell in August reinforcing fears for a weak growth in the forthcoming months as political leaders struggle to smooth the government debt crisis.

The overall weak environment in US and eurozone and the high inflation in both countries have also influenced the pace of growth of the world's two largest emerging countries, China and India. The faltering growth of China's top three trading partners, United States, European Union and Japan, has made the U.S. investment bank JP Morgan to revise its growth forecast for China below 9% with prediction for further reduction to 8.5% in 2012, after enjoying a double digit growth for more than a decade. On the other hand, India's economy grew by 7.7% in the second quarter, the slowest growth for 18 months compared with an 8.8% growth in the same period a year ago. The higher interest rates applied by Indian Central Bank to battle near double digit inflation have hit the expansion of one of the world's fastest growing economies after China.

SHIPPING MARKET

It is worth highlighting that the announced merger agreement between Greek's largest banks, Alpha Bank and EFG Eurobank, creates new opportunities for the Greek ship financing industry and enhance its competitiveness in the shipping finance industry. Experts of the sector commented on Lloyds List that the shipping portfolios of the two banks are likely to be complimentary, with the two banks generally having a different clientele from each other and the combined portfolio would currently surpassed only by Royal Bank of Scotland, Deutsche Schiffsbank and Credit Suisse in terms of lending to Greek owners.

In the **dry market**, a high level of iron ore fixtures from Brazil and West Australia contributes to the recent rally of the market with the BDI jumping in mid-week at levels above 1,600 points mark and surpassing even the 1,700 points level, posting a 38%growth since the end of July. Capesize earnings have been in a positive trend due to firm amount of iron ore Chinese demand, but there is still hesitation about the solidness of the market as China's port stockpiles are still high, despite signs of decrease the last weeks. According to Commodore Research, approximately 92.2 million tons of iron ore are currently stockpiled at Chinese ports, 500,000 tons (-0.5%) less than a week ago, but the amount remains close to the all time record of 94,4mt that was stockpiled at the beginning of August.

Spot and period chartering activity has shown signs of strength with earnings for all vessel sizes floating at levels above operating expenses. According to Commodore Research, a weekly average of 26 iron ore fixtures came to the market in August, 9 more than July's average of 17 iron ore fixtures. Capesizes are expected to be the most beneficiaries as Indian iron ore exports will be far below the 2010 levels due to ongoing mining bans in the states of Karnataka and Goa and India's government goal to boost its domestic steel production. This implies that more iron ore will be exported from Australia and Brazil, primarily carried in capesize vessels with panamaxes and supramaxes loosing ground. It worth mentioning that last week's iron ore prices hit a three month high above $180/tonne due to strong Chinese demand and supply outages, according to Platts data.

Despite the recent rally of the market and stronger signs on the demand side in terms of Chinese thermal coal and iron ore imports, there is still a pessimistic outlook on the market due to the dry bulk fleet growth. The second half of the year, particularly the third quarter, is usually the peak season but the industry is being prepared for a renewed pressure on the market. According to a recent BIMCO Report, the active dry bulk fleet has grown by 7.4% so far in 2011 with a delivery of 52.5mdwt vessels and predicts that another 450 newbuilding dry bulk vessels with an average size of 84,000 dwt will enter the fleet during the remaining part of the year.

The BDI closed today at 1,740 points, which is the highest level that the market has experienced since the beginning of the year. The index is up by 13% from last week's closing and down by 39.5 % from a similar week closing in 2010 when it was 2,876 points. The highest rate increase has been in the capesize segment, BCI up 27%w-o-w, BPI down 1.3% w-o-w, BSI down 0.6% w-o-w, BHSI up 0.4% w-o-w

Capesizes are currently earning $23,899/day, an increase of $7,183/day from a week ago, while panamaxes are earning $13,061/day, an increase of $153/day. At similar week in 2010, capesizes were earning more than $39,000/day, while panamaxes were earning more than $25,000/day. Supramaxes are trading at lower levels than capesizes by earning $14,415/day, down by $93/day from last week's closing, but are still 10.4% higher than panamax earnings. At similar week in 2010, supramaxes were getting region $20,800/day, hovering at discounted levels from capesize and panamax earnings. Handysizes are trading at $ 9,945/day, up by $75/day from last week, when at similar week in 2010 were earning $15,702/day.

In the **wet market**, the outlook remains pessimistic with crude freight rates hovering below operating expenses and asset values being squeezed at lower levels. The geopolitical events have influenced dramatically the tanker environment in conjunction with oversupply issues and the hopes for an early recovery of the industry are limited even now that the Libya's civil war has ended. Libya's oil industry will need at least $25 billion in investment to increase its oil production to two million barrels per day, said the chairman of drilling rig operator Challenger Ltd, since the Libyan oil industry needs a lot of revamping after the civil war. The armed conflict in Libya has reduced the nation's output to 100,000 barrels/day in July from the 1,6 million barrels/day before the uprising started in February.

The current environment pushes tanker owners for more lay-ups and scrapping to ease the ample available list of tonnage. Furthermore, owners have to be very selective in choosing voyages so as to increase wait time between cargo voyages and push the charter rates upwards. According to market sources from Tradewinds Press, there has been a large increase of VLCCs layups enquiries in Southeast Asia as owners consider putting their large tankers on ice in Asian lay up anchorages. Most of the enquiries are coming from independent tanker owners rather than oil majors. Returns from shipping Middle East crude oil to Asia, the world's busiest route for supertankers fall to the lowest level in seven days this week with daily rental income for VLCCs on the benchmark Saudi Arabia-Japan voyage falling to minus $207, according to the Baltic Exchange in London. According to a median estimate in a Bloombergs News Survey there are 14% more very large crude carriers to hire over the next 30 days than there are likely cargoes.

A major operator, Frontline has already reported second quarter net losses of $35,2mil in 2q 2011that were worse than expected, compared to net profits of $85,6 mil in the same period last year. Revenues fell to $219.4M from $356.1M over the same period. The company announced that that will aim to optimize its fleet utilization in the current weak market through super-slow steaming.

In the **gas market**, prospects seem very positive in terms of demand as the LNG demand recorded a 8.5% year on year in the first half of 2011 and is expected to grow by 12% for the whole year, driven by incremental demand from Japan, the United Kingdom and India, and continued growth from traditional buyer South Korea, according to Bernstein Research. Japanese LNG demand rose strongly in the second quarter of 2011 due to the lost nuclear power from the March 11th earthquake and tsunami. Japan's LNG import were up 8% year on year in H1 2011, or equivalent to 2,64 million mt/year of additional demand compared with the first half of 2010. Korea also recorded a 8% year on year increase in imports for the same period, or equivalent to 1.33 million mt/year of additional demand compared with H2 2010. Asian LNG demand growth, averaging 9% year on year in H1 2011, was the strongest in India and China, where LNG imports were up 26% and 10% year on year, respectively, the analysts said. Europe saw a 15% increase in LNG imports in H1 2011 compared with the corresponding period of 2010, with the UK, in particular, posting a 76% rise, which was equivalent to 4.73 million mt/year of incremental demand. The UK, Japan, Korea, India, China and emerging markets in Latin America such as Brazil and Chile would support the near-term demand outlook, the Bernstein report said. On the longer term, it is expected that the global LNG demand will grow from 218 million mt/year in 2010 to 310 million mt/year by 2015 and 410 million mt/year by 2020

In the **container market,** the secondhand ship purchasing activity is significantly subdued as it seems that there is big gap between sellers and buyers price expectations. The Shanghai Container Freight Index remained flat last week with the European route posting 0.8% week-on-week change. Europe normally imports more goods during the end of the third quarter, September, as shops begin stockpiling for the December holidays. However, the ongoing European sovereign debt is going to curb the amount of imports as consumer spending has been hurt also by a high rate of unemployment. Container trade on the Asia-Europe route, one of the busiest container routes, will expand by an average of 4%-6% this year, compared with a 15% growth in fleet capacity, according to Morgan Stanley.

In the **shipbuilding industry**, Chinese shipbuilding industry faces reduced ordering activity for the period January-July 2011 comparing with a similar period in 2010. Despite the low newbuilding prices offered by Chinese yards, the demand for newbuilding vessels in the main vessel segments, bulk carriers and tankers, has dropped significantly due to pessimistic outlook that the industry holds for both sectors given the overflow of newbuilding deliveries through 2013. South Korean yards have dropped their interest to more sophisticated newbuilding vessels, offshore units, LNG carriers, mega size containerships creating fuel efficiency technology for the shipowners to reduce operational costs and being more competitive in the industry under the current market fundamentals. According to the China Association of National Shipbuilding Industry's recent statistical data, newbuilding orders decreased 29.2% to 23.58m dwt during the seven month period, with many yards reporting not a single order thus far in 2011. Statistics data from IHS suggest that South Korean shipyards have won 231 ships (17,9 mil gt), in the January-June period, up 37% from the same period last year, taking the biggest share of large containership and LNG carrier orders.

In the **shipping finance**, even China's active participation in the industry from the 2008 financial crisis, its share of global ship finance deals is only about 5%, according to Ulrich Zhou, Deputy General Manager and Shipping Finance boss at the Bank of China in a Shipping Finance China Summit. He also added that even though Chinese banks hold a strong position among other global banks; their main focus is still the domestic business. He emphasized that this year is not a good year for foreign enterprises seeking Chinese money, because of the high cost involved from the appreciation of the Yuan and the dream of Chinese funding for shipping has to be put on ice.

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