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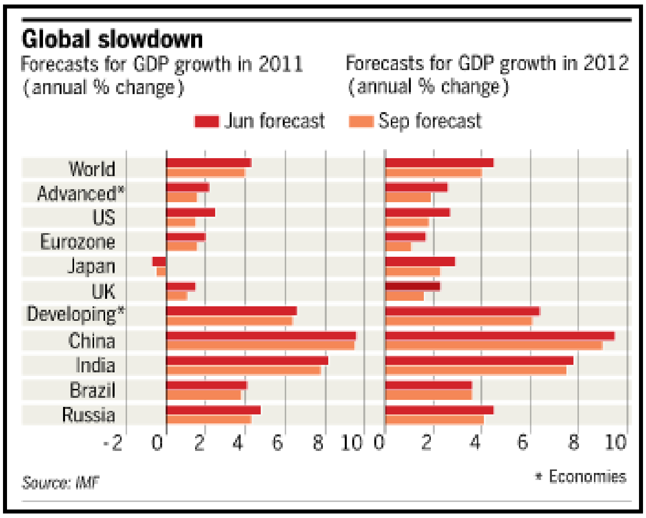
This Week's News: A snapshot on the economic and shipping environment

Week ending 23rd September 2011

ECONOMIC ENVIRONMENT

The world economy is in real danger with IMF warning for a serious slowdown in the world economy, world growth falling even below 2%, unless strong policies are being implemented to improve the outlook and reduce the risks. The real GDP is expected to grow by 6.4% in emerging and developing economies in contrast with only 1.6% in advanced economies.



The EURO future is still under a serious threat with countries in the zone suffering from austerity measures and slow economic growth with high inflation and borrowing costs. The astonished headline of this week came again the eurozone by Italy's S&P downgrade by one notch to A from A+ with a negative outlook on the country due to weakening economic growth prospects and higher than expected levels of government debt. Growth forecasts for Italy are also being cut. The IMF slashed its GDP projection for 2012 to 0.3 per cent from 1.3 per cent. S&P also considered a negative scenario in which Italy's economy would contract by 0.6 per cent next year. Italy's Parliament approved Premier Silvio Berlusconi's government's austerity measures, a combination of higher taxes, pension reform and spending cuts, in an attempt to save more than 54 billion euros ($70 billion) of the country's deficit over the next three years.

In Greece, the next tranche of EUR 8billion aid payment is still not confirmed with the German finance minister warning that no money would be forthcoming if the country doesn't meet its earlier obligations agreed in July. The Athens crisis was emphasized by the cancelation of Prime Minister's planned trip to Washington to oversee his country's fight for averting a potential bankruptcy. Greek officials estimate that they have enough cash for the remainder of this month, and perhaps the first 10 days of October. But after that "there will be big problems with meeting obligations, including pensions and salaries". A new set of fiscal consolidation measures were announced, which are expected to finalize next week after the EU-IMF-ECB officials resume their review on economy, so as Athens to satisfy the demands of its international lenders and secure the next bailout tranche. The measures are aiming at savings/ revenues of EUR 2bn for 2011 and EUR 4bn in 2012. Reportedly the focus of these measures is 2/3 on the expense side and 1/3 on the revenue side with the EC-IMF-ECB officials urging

Greece to implement its commitments by reducing the size and the cost of the public sector (layoffs of public employees, termination of public entities and cuts in public employee salaries).

In the U.S., President Barack Obama revealed a tax reform plan that is tilted against the wealthiest Americans and proposals to save more than $3,000bn over ten years. It will cut expensive health programs for the elderly and poor by about $350bn and save $1,100bn through the withdrawal of troops from Afghanistan and Iraq.

In Japan, the government has proposed about Yen 11,200bn ($146bn) in tax hikes over the next 10 years to fund post-tsunami reconstruction. It is estimated that the government spending on tsunami reconstruction will be at least Yen 19,000bn ($247bn) in total over the next five years, adding pressure on the country that has already gross debt equivalent to more than 200% of gross domestic product. However, there are worries in the ruling democratic party about the economic and political implications of raising taxes, arguing that Japan has still the capacity to issue long term debt to fund the reconstruction.

SHIPPING MARKET

There are serious concerns that European crisis will impairs China's dynamic role in the troubled shipping industry. China's economy is likely to slow next year and efforts to spur growth will be constrained by inflationary issues and government debt burden, said Wu Xiaoling, a former deputy central bank governor. The world's biggest exporting nation faces weakening global demand because of the European debt crisis and high U.S. unemployment rate. China's officials are facing serious side-effects from the 2008 and 2009 stimulus measures, including elevated inflation and the risk of bad loans for banks. China's economic growth is expected to remain at 9.5% this year after growing 10% in 2010, according to the International Monetary Fund (IMF). However, there are estimations for a significant slowdown next year and reduced overseas demand that could add further pressure downwards in the outlook of the dry and wet markets.

In the dry market, the BDI reached its highest level from the start up of the year closing today at 1,920 points with capesize earnings being 207% up from the end of July. The is up by 5.8% from last week's closing and down by 21.4% from a similar week closing in 2010 when it was 2,444 points. The highest rate increase has been in the capesize segment, BCI is up by 10.8% w-o-w, BPI down by 6% w-o-w, BSI up by 2.2% w-o-w, BHSI up by 1.4% w-o-w.

Chinese import activity and market sentiment remains still firm in terms of iron ore and coal, but our position is still conservative for the future stability of the market given also the worrying factors of the segment mentioned in our previous Report. Spot and period Chinese iron ore demand will continue to experience sporadic fluctuations, being revised either upwards or downwards, as long as Chinese iron ore is stockpiled at elevated levels. Approximately 94,1 million tons of iron ore is currently stockpiled at Chinese ports, 2% more than a week ago, close to the record of 94,4 million tons at the start of August, according to data from Commodore Research. The capesize segment is still sensitive in terms of vessel supply growth, but the increased demolition activity during the year to date, with around 50 capesize units estimated to have scrapped from 19 units disposed in the whole period of 2010, comforts at some extent the sub-segment in terms of vessel availability.

Capesizes are currently earning $28,888/day, an increase of $4,149/day from a week ago, while panamaxes are earning $13,142/day, a decline of $872/day. At similar week in 2010, capesizes were earning $29,002/day, while panamaxes were earning $21,840/day. It seems that Capesize vessels have started to regain its strength trading at levels only 0.3% down from last year's similar week's levels with earnings for panamax vessels being at substantially lower levels, less than $8,698/day. Supramaxes are currently earning $15,460/day, up by $335/day from last week's closing, down by 46.4% from capesize earnings and up by 17.6% from panamax earnings. At similar week in 2010, supramaxes were getting $19,644/day, hovering at discounted levels from capesize and panamax earnings. Handysizes are trading at $ 10,194/day; up by $124/day from last week, when at similar week in 2010 were earning $15,666/day.

In the **wet market**, the dreadful environment in the crude market persists with VLCC earnings being below breakeven levels, whereas there are market suggestions for the removal of single hull fleet earlier than 2015. It is critical owners to proceed to harsh measures to alleviate the oversupply growth and create opportunities in the charter market with tighter vessel availability in major loading zones. It is estimated that the number of single tanker fleet of above 25,000dwt is more than 200 vessels with owners appearing not so decisive to remove these units and give a short of breath to older double hull units in the charter market.

On the demand side, the sluggish economic growth in the OECD region will drop global demand for oil downwards with Asia's developed economies appearing as the savors of the wet operators. However, the prospects seem not so positive for China's oil demand growth in the third and fourth quarter of the year after signs of slowing down in August. Analysts from Bernstein Research and HSBC expect China's apparent oil demand growth in the August-December period to remain at the second quarter's level of around 5% year on year growth. Currently, U.S. is said to be importing the lowest volume of Middle East Gulf crude since the mid 1990's as oil demand weakens and domestic production increases, signaling that VLCC owners will continue to experience rough times._The world's biggest oil consumer bought 1.7 million barrels a day from Saudi Arabia and six other Persian Gulf states in the first half, the least since 1997, according to the latest Department of Energy data. Daily U.S. output averaged 5.58 million barrels, the most since 2004, the data show._The U.S. is boosting output of oil, shale gas and ethanol as President Barack Obama seeks to cut the nation's dependence on foreign fuel. Fewer cargoes from the Middle East to the U.S., the world's second-biggest tanker route, mean an expanding vessel glut. There are about 25 percent more supertankers than cargoes available in the Persian Gulf, the most since October, according to Bloomberg surveys of shipbrokers and owners.

The situation is so serious for the wet operators that many are investigating the possibility of laying up their vessels because of the fragile outlook of the market. An increase of enquiries is being reported by one of the main specialists at Labuan in East Malaysia that confirmed in Tradewinds that they are awaiting even the arrival of a new VLCC straight from the yard with one more to arrive shortly for cold lay up. Under the current market status, remedies of the sector will be the sustained economic growth, reduced ordering activity, more lay ups and scrapping to ease off the overcapacity issues. During January-August 2011, there has been around 73% drop of ordering activity in the crude carriers comparable with similar period in 2010, which leaves room for an earlier rebound of the market if this trend persists till the end of the year and the forthcoming 2012

On the oil supply side, OPEC production averaged 29,92 million barrels/day in August, a marginal increase of 75,000 barrels/day month-on-month taking into consideration the combined effect of output increase in Nigeria, Saudi Arabia, Kuwait, UAE and production decline in Angola and Libya. In Libya, the chairman of the National Oil Corporation stated in Reuters that the country will begin exporting crude oil from the eastern port of Tobruk within 10 days and could be producing 1.0m barrels per day (bpd) within six months.

In the **gas market**, LNG segment has emerged as one of the most appealing newbuilding investments of this year with South Korea shipbuilding industry being the leaders of the LNG ordering activity. According to data compiled by HIS CERA, Korean yards have won 53 orders of the worldwide LNG orderbook of 68 vessels with Samsung and Daewoo yards being on the frontline. The LNG newbuilding business is expected to remain firm as LNG imports are on rise and LNG spot rates have fetched $95,500/day in August from $37,500/day a year earlier due to rising shipments and insufficient tonnage. According to data released by the Ministry of Finance, Japan imports of liquefied natural gas and thermal coal rose to a record in August because of low utilization rates at nuclear power plants. The nation's LNG imports increased 18.2% to 7,55 million metric tons from last year, while thermal coal imports increased 7.1% to 10 million tons.

In the **container market,** freight rates continue to float at lower levels every week with the proposed rate increases on the Asia-Europe trade being now erased as spot rates fell 3.4% last week to US$ 793 per TEU. The Shanghai Container Freight Index closed at 1,020.38, falling by 20.88 points from previous week, while a negative trend in the freight rates have also been recorded in the other container routes, 2.8% week-on-week decline in Shanghai-Mediterranean route and 2.5% in the Shanghai-USWC. Rates are expected to be under continued pressure as the oversupply of vessels continues without any material pick-up in demand. What is noteworthy is the limited number of container vessels reported to have been sent to the scrap yards this year comparing with the levels of 2010 and the record number of demolition within 2009. During the year to date is estimated that around 27 boxship units have gone for disposal, whereas 68 during the whole period of 2010 and 187 in 2009. The current vessel availability seems that distresses the freight market along with signs of slower demand growth from European and U.S. economies. The percentage of idle fleet has started to grow again with Alphaliner reporting 270,000 TEU or 1.8% at the moment being in laid up from 1.4% at the end of August. The firm expects the idle fleet to be more than 500,000 TEU by early 2012, equivalent to more than 3% of the existing fleet. The market for post panamax vessels suggests for more layups in the future as several transpacific services (Asia – U.S.) are being cut as lines attempt to deal with falling cargoes, low rates and rising fuel prices.

In the **shipbuilding industry**, Japanese shipbuilding industry is still under a serious threat with domestic not even supporting its own shipbuilding industry seeking for cheap newbuilding prices in China and South Korea. Japanese shipbuilders are trying to find alternative ways to be more competitive in an attempt to bid with the strong yen appreciation. They have already started to build new technological designs to reduce carbon and other emissions and reduce the fuel cost for shipowners. The fall in Japanese export ship ordering activity continued in August, which is said to be the sharpest decline in the last 23 months. According to the Japan Ship Exporters' Association, Japanese export ship orders plunged by 74.4% year-on-year to 346,300 gross tons. Japanese shipbuilders received orders for 142 export ships of 2,690,124 compensated gross tons — 131 bulk carriers, five tankers, four general cargo vessels and two marine resource research vessels — between January and August.

In an attempt to battle with the fall in vessel export orders, Japan started to provide financial support in early 2010 through the government-affiliated Japan Bank for International._In September, JBIC signed two loan agreements worth a total of 184 million to support the export of vessels built at Japanese shipyards to foreign shipping firms. Of the $184 million, which were co-financed with private lenders, $62 million is to finance Turkey's YA-SA Shipping Industry and Trading S.A.'s purchase of two 83,000 deadweight ton bulk carriers. The remaining $122 million will finance South Korea's Hanjin Shipping's purchase of four 82,100 dwt bulk carriers.

In the **shipping finance**, Costamare has finalized the financing arrangements for three out of the five newbuilding vessels ordered from Sungdong Shipbuilding & Marine Engineering Co., Ltd. of Korea, with a consortium of European and US financial institutions for 80% leverage, which is above recent data points, or $380 mil in total. The Company has also accepted a firm offer from a consortium of European and Asian banks, which is subject to documentation, for the financing of the remaining two newbuild vessels. All five newbuild containerships, each of approximately 8,800 TEU capacity, have been time chartered to members of the Evergreen Group and are expected to be delivered between the first and the third quarters of 2013.

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