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

Week ending 30th September 2011

ECONOMIC ENVIRONMENT

The financial meltdown has already started to influence the expansion in global trade once more, since the collapse of Lehman Brothers, as the loss of economic confidence in the advanced economies and particularly in the Eurozone, has impaired export growth. According to data compiled by the Netherlands Bureau, the merchandise trade shrank by 0.5% during the second quarter of the year from the previous three months, with signs for a further slowdown as the European sovereign risk has worsened since summer. Meanwhile, the World Trade Organization has revised downwards its estimate for the global trade growth in 2011 to 5.8% from 6.5% warning that the slowdown in trade has been mainly concentrated on the Euro countries.

In the eurozone, circulating rumors for the exit of Greece from the zone have been denied once more with the European Union Monetary Affairs Commissioner Olli Rehn stating that the European Union will not allow this to happen. He emphasized that an uncontrolled default or exit of Greece from the Euro will not only cause an enormous economic and social damage on Greece, but to the European Union as whole with serious spillovers to the world economy. Greece is working with the EU-IMF-EC officials to strengthen country's competitiveness and meet its missed fiscal targets earlier agreed in July as a result of lower revenues and increased expenses. According to the Minister of Finance, the new set of measures that the government announced and presented to the IMF and World Bank meetings over the weekend, will amount to EUR6.6bn in revenues/savings. Furthermore, the Greek parliament approved the new unpopular property tax paving the way for the European officials to return in Athens for the fifth review of Greece's economic program and the release of the next installment. However, there has been a split in the eurozone over the terms of Greece's second bailout with as many as seven of the 17 Euro-members arguing for private creditors to swallow a bigger write down on their Greek bong holdings. There are mounting concerns that Athens funding needs could be over $172 billion estimated just two months ago.

European banks seem to suffer from the ongoing sovereign risk with the International Monetary Fund warning that the global financial system faces more challenges than at any point since the 2008 financial crisis as Europe's debt crisis is spreading to banks that hold shaky government bonds. Credit ratings agencies are downgrading banks in the eurozone's indebted periphery following countries sovereign debt downgrade.

Moody's Investors Service has lowered the ratings of eight Greek banks, by two notches with a negative outlook, citing the risk on banks' capital from the exposure to government bonds. The agency cut the long-term deposit and senior debt ratings of National Bank of Greece SA (NBG), EFG Eurobank Ergasias SA (Eurobank), Alpha Bank AE (Alpha), Piraeus Bank SA (Piraeus), Agricultural Bank of Greece (ATE) and Attica Bank SA to 'Caa2' from 'B3'. Emporiki Bank of Greece (Emporiki) and General Bank of Greece (Geniki) were downgraded to 'B3' from 'B1'.

In Italy, S&P has cut the long term credit ratings of seven Italian banks, following country's sovereign debt downgrade against the strength of Italian retail network, the main depositary for Italy's EUR 8,600 billion ($11,775 billion) private wealth, more than three times of its national debt. However, Italian banks will struggle with liquidity long before they have problems with capital base despite their strong retail platform, according to Anna Maria Benassi, head of research at Banca Leonardo. Italy's borrowing costs are about 100 basis points higher today than spring putting pressure on the banks' funding costs.

What is noteworthy is that the biggest US money market funds have slashed their exposure to Europe's embattled banking sector. According to a published report from Fitch Ratings, the 10 largest US money market funds have reduced their short term lending to European banks to just $284,6billion by the end of August, or 42.1% of their total assets, which is the lowest relative exposure since at least the second half of 2006 and lower than the level reached during the bottom low of the financial crisis.

SHIPPING MARKET

The economic gloom in European and U.S. economies pose a serious threat on the shipping industry not only in terms of slowdown trade, but also hampers the investment plans of many shipping players as the debt crisis has expanded to European bank lending causing restrains on obtaining ship finance for expansion over the next year. Dagfinn Lunde, member of the board of managing directors and head of shipping at DVB Bank told Lloyds List that there were only a handful of European banks actively undertaking new lending to shipping. He said that the big problem that many European banks are facing is their exposure to sovereign debt and the risk of having to take associated writedowns. That means that they have to recapitalize and face a high cost of funds, which restricts their ability to lend at acceptable rates. There are only a small number of European shipping financial institutions that do not face this problem to some degree. In the meantime, overall confidence levels in the shipping industry fell to their lowest level for three and a half years in the three months ended August 2011, according to the latest shipping confidence survey by leading accountant and shipping adviser Moore Stephens. Fears about oversupply and continuing uncertainty about the global economy were the main reasons for the decline in confidence. The rising cost of marine fuels was also a cause for concern. In August 2011, the average confidence level expressed by respondents in the markets in which they operate was 5.3 on a scale of 1 (low) to 10 (high), compared to 5.6 in the previous survey in May 2011. This is the lowest figure recorded since the survey was launched in May 2008 with a confidence rating of 6.8, which remains the highest rating achieved thus far.

In the dry market, the increased coal and iron ore volumes from South America and Australia continue to favor capesize earnings with panamaxes being out of this rally and only recently showed signs of more stronger earnings. Additional positive factors for the recent upturn in capesize market appear to be the tightness of vessels' availability in the Atlantic basin and the increased capesize congestion in Australian and Brazilian ports, approximately 95 capesizes are estimated to be currently anchored. In terms of coal, imports are expected to be firm in October as coal stockpiles at China's largest coal port have been under significant pressure by falling to 5.6 million tons, 21% less from a week ago, according to data from Commodore Research. As we move towards the fourth and final quarter of this year, global demand for dry bulk commodities is expected to remain firm with panamax, supramax and handysize earnings being more stable than capesizes.

The index closed today at 1899 points, down by 1.09% from last week's closing and down by 22.55 % from a similar week closing in 2010 when it was 2,452 points. On a weekly basis, the highest rate increase has been in the handysize segment, BCI down 5.97%w-o-w, BPI up by 5.18% w-o-w, BSI up 1.35% w-o-w, BHSI up 7.71% w-o-w.

Capesizes are currently earning $26,601/day, down by $2,287/day from a week ago, while panamaxes are earning $13,813/day, an increase of $671/day. At similar week in 2010, capesizes were earning $32,626/day, while panamaxes were earning $19,383/day. Supramaxes are still trading at lower levels than capesizes by earning $15,678/day, up by $218/day from last week's closing, but are still 13.5% higher than panamax earnings. At similar week in 2010, supramaxes were getting $19,272/day, hovering at discounted levels from capesize and panamax earnings. Handysizes are trading at $ 10,851/day; up by $657/day from last week, when at similar week in 2010 were earning $15,165/day.

In the **wet market**, the bleak outlook of crude carriers leaves less room for newbuilding investments in the future and allows more scrapping activity as spot freight rates continue to remain below operating expenses and there are forecasts that the slump could extend till 2014. The industry has been stunned by sources reporting that a just delivered VLCC was sent straight to laying up from the yard due to the negative environment in the spot market. OSLO investment bank Pareto has reduced its earnings forecasts for VLCCs, Suezmaxes and Aframaxes as the market is expected to remain oversupplied in the forthcoming three years. Pareto halved its VLCC earnings forecast to $15,000/d in 2012-13 from an earlier forecast of $30,000/d-35,000/d; Suezmaxes' earnings to $12,000/d from $25,000/d-30,000/d; and Aframaxes to $11,000/d in 2012-13/d from the previously forecast range of $20,000-25,000/d. The question is if an earlier recovery of the market is feasible under the current market status. Decisive actions have to be taken drastically for the rebalance of vessels' supply growth with the demand for oil transportation as the U.S. and European economies have slowed sharply their oil imports from the economic meltdown. Slow steaming policy, increased scrapping activity, reduced newbuilding activity, laying up tonnage seem to be the response to today's freight slump.

In the **gas market**, the LNG momentum holds optimistic with the Baltic LPG shipping rate of shipping petroleum gas from the Middle East to Asia fetching last Friday $70 per tonne for the first time in three years. However, energy research consultancy Wood Mackenzie warned about the possibility of a declining freight market with limited opportunities for newbuilt LNG vessels despite the positive near term prospects of the market reflected by higher charter rates and increased newbuilding activity. Furthermore, it emphasizes that 45 new LNG vessels have been ordered so far in 2011 compared with just 5 in 2010, and most of these have been ordered on a speculative basis without guarantee that they will have employment on their delivery in 2014-2015.

In the **container market,** freight rates continue to be on decline as vessel utilization is low with the Shanghai Container Freight Index closing last week at 991 points, down by 2.9% from previous week. The European bound cargo routes have showed again the sharpest decline among other routes, down by 4.9% in contrast with 2.7% fall in USWC and USEC route. The major risk for liner operators is still a potential double dip recession of the developed economies with side effects on the consumer confidence resulting in less container shipments in major container trade routes. On the transpacific route, Far East – North America, demand has fallen this year below of carriers' forecasts of a 7-8% growth with Alphaliner estimating that full year demand could fall by 1% compared to 2010 volumes. Carriers are finally taking action to withdraw capacity in order to battle with the plunge in freight rates as four FE-USWC services are due to be withdrawn in the next two months, removing over 17,000 TEU weekly, or 6% of the current capacity on this route. According to Alphaliner estimates, carriers' cumulative losses on the transpacific trade are expected to exceed $300 million this year and rates are anticipated to remain weak till the end of the year due to strong competition. The decline in demand trade growth coincided with the entry of several new carriers into the transpacific trade and the introduction of new vessel capacity.

In the **shipbuilding industry**, South Korea continues to hold its strength regained from the start up of the year in terms of winning new orders as the major shipbuilding nation proceeded to more LNG newbuilding units and mega container ships requested by shipowners as the most appealing types of investments under the distressed freight market condition that dry and wet markets experienced. China continues to loose some of its competitive advantage gained in the previous two years in terms of newbuilding prices offered as the Chinese yuan appreciation will trouble the industry even more till the end of the year. According to the China Association of National Shipbuilding Industry, orders won by Chinese shipbuilders dropped by 6.4% in the January-July period from a year earlier mainly due to prolonged uncertainties in the global economy. Zhang Changtao, a researcher at the China Ship Marketing Research Center, said China's shipbuilders need to raise their technical and management skills in order to stay competitive amid increased volatility in the world economy.

In the **shipping finance**, China's shipping finance industry in an attempt to bid the European bank lending, following its aid to Greek shipping community, has now started to support one more shipping nation Bangladesh. State-run China National Machinery Import and Export Cooperation is said to have offered to the government controlled Bangladesh Shipping Corporation extremely competitive financing arrangement to build up its fleet. The preferential loan offered charges 2.5% to 3.0% interest and is payable within 12-13 years with 2-3 years grace period.

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