GOLDEN DESTINY

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

Week ending 3rd February 2012

ECONOMIC ENVIRONMENT

The fears of eurozone credit crunch are growing as data are suggesting sharp slowdown in private bank lending and money supply growth. The European Central Bank estimated that loans to the private sector grew at a 1% annual rate in December, slowing from 1.7% in November and 2.7% in October, while money-supply growth, M3, the broadest measure of money supply, grew at a 1.6% annual pace in December, slowing from 2% in November. Loans to the corporate sector dropped 37 billion euros ($48.6 billion), the largest ever one-month decline, while loans to households shrank by €10 billion. Many economists believe that despite ECB's liquidity efforts banks will scale down significantly their lending to the private sector under the current fragile economic environment with the pressure to meet tougher capital requirements.

One warning sign for the delayed recovery of the euro prosperity is the record high unemployment rate. Data from the European Union's statistics office Eurostat show that eurozone unemployment rate reached the highest level, since June 1998, before the introduction of the euro in 1999. Joblessness in the 17 countries that use the euro rose to 10.4% in December, 0.1% increase from November's estimate compared with an unemployment rate of 9.5% a year earlier. Critics of EU efforts argue that Brussels has focused on fiscal austerity at the expense of growth.

The euro value has lost again ground this week on the fears of a Greek default and a treaty for tighter fiscal rules on eurozone nations after European leaders concluded a meeting in Brussels. Positive note is that Greece is on the way of sealing its PSI deal, but first a consensus is being required by the leaders of the three political parties supporting the coalition government on EUR 4,4bn extra austerity measures to address 2011 deficit target shortfalls along with projected 2012 deficit gap due to higher than expected recession. In the meantime, a proposal for EU to control Greek budget created fury with the German government wanting from Greece to give up sovereignty over tax and spending decisions to a eurozone "budget commissioner" to secure a second EUR130billion bailout. Greece's finance minister rejected the German plan by saying that EU leaders have already sufficient monitoring safeguards for monitoring country's bailout program. Nicolas Sarkozy, the French president, said that the German proposal for the EU to control Greece's budget decision making "would not be reasonable, democratic, nor would it be effective".

On the mounted fears of Greek default, estimates from economists and politicians that Portugal will need a second bailout otherwise will not be able to return in the markets for financing next year, created more confusion in the eurozone. Portugal's bond prices fell sharply since Standard & Poor's downgraded Portugal's debt to junk. Prime Minister Pedro Passos Celho said that country doesn't need any money or time to implement its program by acknowledging that pressure on Portugal is growing due to the instability among eurozone countries and the S&P's downgrade. However, the bailout program that has been agreed from last June, didn't improve Portugal's economy as rapid as it was estimated. Since then, the size of Portugal's economic expansion has been revised twice. At the end of last year, the government said that the economy should grow smaller by 3% this year compared with a 1.7% contraction expected in August.

In U.S., the economy expanded at a high speed during the final three months of the year, October through December. According to data from Commerce Department, U.S. GDP grew by 2.8% stemmed from increases in consumer spending, which accounts for at least two-thirds of U.S. economic growth, and business inventories. Consumer spending rose by 2.0% in the fourth quarter, from 1.7% in the

previous quarter. Economists surveyed by Market Watch expect growth to slow to 1.9% in the first quarter of the New Year.

In Japan, the government will nationalize Tokyo Electric Power (TEPCO), owner of the Fukushima Daichi nuclear power plant by injecting fresh capital of Y1,000bn ($12,9bn). TEPCO, Asia's largest private utility by sales, lost 90% of its market value since reactors at Fukushima melted down following Japan's devastating earthquake and tsunami last MarchThe government's cash injection comes along with a large amount of loans from TEPCO's private and public banks at relatively low rates in exchange of not writing off any of TEPCO's outstanding debt of Y7,800 billion. A key issue to be resolved is the government control over TEPCO's management. The current market capitalization of Y1,000 billion gives to the government a roughly two thirds control with TEPCO turning into a public sector entity for the near future.

In emerging countries, the manufacturing of China and India, Asia's two largest countries, showed strong signs amid fears for the impact from Europe's debt woes. In China, the official purchasing managers' index, an important measure of industrial growth, rose to 50.5 in January from 50.3 a month earlier, which indicates an expansion in industrial activity. "The Chinese economy has gradually stabilized. The rise in new orders and raw materials reflects the recovery for industrial companies", said Zhang Liqun, an analyst of China Federation of Logistics and Purchasing. However, latest government data showed that China's new export index fell to 46.9 in January from 48.6 in the previous month, as global economic uncertainty hurts consumer confidence, and imports index dropped to 46.9 from 49.3 in December. On the other hand, India's manufacturing grew at a record pace in eight months due to a surge on domestic and foreign demand. The HSBC manufacturing PMI, rose to 57.5 from 54.2 in December.

SHIPPING MARKET

The first days of February have been marked from historical lows in Baltic Dry Index and some interesting news that reshape the shipping environment and underline the weak freight market fundamentals:

- Commodity giant Glencore and Xstrata are said to be in advanced for a nearly $80billion merger deal that combines the forces of the world's largest commodities trading houses.
- Japan's big three shipping players, MOL, NYK Line and K Line, announced that they expect bigger losses than those predicted in October. Mitsui OSK Lines now expects Y29bn ($376,6m) losses, from Y4bn predicted in October, NYK Line Y26bn from Y18bn and K Line Y54bn from Y32bn. They said that the dark outlook of freight markets, the continued sluggishness in worldwide markets, the oversupply of vessels, the increased bunker costs are some of the key reasons behind the increased losses.
- Paragon Shipping announced the early termination of charter for its supramax vessel M/V "Friendly Seas", 58,779dwt built 2008, as the charterer Deiulemar Compagnia di Navigazione SpA has failed to provide payment since January 5 and provide the vessel with voyage instructions
- Fitch Ratings said that 2012 outlook for the shipping industry is negative and Indian shipping companies are likely to report reduced cash flows from a fall in revenues and profitability. Fitch expects charter rates in 2012 to be constrained in the main vessel segments, dry bulk, tankers and containers. Fitch believes that operating margins of shipping companies will be under pressure due to trading lows in the charter market and high bunkering costs.
- China's government announced that ports will no longer be the ones that decide if very large ore carriers will be allowed to enter in Chinese ports. According to China's Ministry of Transport announcement, Chinese ports currently do not have regulatory approval to receive ships more than 300,000dwt. The decision impacts directly the iron ore conglomerate Vale, which had been trying to gain permission for 35 very large iron carriers to call at Chinese ports. These vessels, some owned by Vale and some chartered from other ship-owners, were ordered to ensure that Vale could compete more efficiently with Australian iron miners when trading iron ore to China. China's ban is seen by analysts as a way to protect its shipping industry, which

has been hit hard by economic downturn and falling freight rates. Traders say that Beijing will gradually lift the ban on large vessels, since it would allow Vale to deliver iron ore at a lower cost. China Shipowners Association is opposed on the arrival of Vale's new giant iron ore carriers due to fears that Vale uses these vessels to monopolize the trade between Brazil and China.

In the **dry market**, the Baltic Dry Index is trading at historical lows, below 663 points seen on December 5th 2008, with growing uncertainty on revival of Chinese iron ore appetite after the end of Chinese festivities. The question is whether the index will fall even less than 600 points, fetching the record lows of July 1986, when the index had closed at 554 points. Chinese iron ore imports are regularly falling during the month of celebrations in contrast with newbuilding vessel deliveries that usually increase. It is common that a large amount of newbuildings that are scheduled to be delivered in December to be pushed for the New Year so the vessel's year built to be one year younger. According to IHS sea-web data, bulkers newbuilding deliveries is said to be 135, almost double of the 75 bulkers delivered in December 2011.

In February, the Chinese iron activity is expected to regain some strength, but the issue is whether will be so strong enough to drive the BDI above the 1,000 points and capesize time charter earnings to hover at levels excess of breakeven. Iron ore port stockpiles at Chinese ports are still at elevated levels, near to the record highs of more than 98 mil tons reached in mid-November, which is a warning sign that Chinese iron ore import market sentiment may not be so strong during the first quarter of the year given that Chinese steel production hovers at weak levels. The China Iron and Steel Association reported that daily crude steel production averaged 1,69 million tons from January 1 to January 10, which is an increase of 4% from the 1,63mt daily production occurred during December 21 to December 31, but down significantly from last year's record of 2,02mt average daily production during June 21 to June 30.

The month of January ended with the average value of the BDI standing at 1,039 points, 44% down from the average value of 1,869 points at the end of December and 77% down from October 14th, when it reached the highest level of 2011, 2,173 points. Time charter earnings for capesizes fell to $5,379/day at the end of January, 84% lower from the highest earnings, $32,889/day reached on December 12th 2011, while panamaxes to $5,759/day from $17,115 reached on March 11th 2011. Smaller vessel sizes are also experiencing significant falls, but there are hopes for a firmer recovery in the following days contrary to capes and panamaxes due to less strain from vessels' oversupply.

The index closed today at 647 points, down by 10.8% from last week's closing and down by 38% from a similar week closing in 2011 when it was 1,043 points. The highest rate decrease has been in the panamax segment, BCI down 1.9% w-o-w, BPI down 14.9% w-o-w, BSI down 12.5% w-o-w, BHSI down 10.3% w-o-w.

Capesize, panamax, supramax and handysize average time charter earnings fell by 5.6%, 15%, 12.5% and 9.2% w-o-w respectively. Capesizes are currently earning $5,251/day, a decrease of $315/day from a week ago, while panamaxes are earning $5,509/day, a decrease of $979/day. At similar week in 2011, capesizes were earning $5,161/day, while panamaxes were earning $10,786/day. Supramaxes are trading at $6,353/day, down by $915/day from last week's closing, but higher than capesize and panamax earnings. At similar week in 2011, supramaxes were getting $11,398/day, hovering at 121% higher levels than capesizes, whereas now are 21% higher. Handysizes are trading at $ 5,682/day; down by $582/day from last week, when at similar week in 2011 were earning $9,422/day.

In the **wet market**, the European Union ban on the imported Iran oil would contribute in the recent oil price hikes with wet operators experiencing high bunkering costs and freight market volatility. OPEC head stated in an interview in London that it would take some time for European countries to find oil replacements for the 500,000 barrels/day of oil that is normally imported from Iran. The International Energy Agency monitors the oil markets and agency's executive director stated that is currently no need to release emergency stocks.

Under the current oil price volatility, global floating storage of crude increased 5% weak-on-weak to over 68 million barrels, while VLCC earnings fell 15%, but they remain above breakeven levels, according to Wells Frago Securities. The increased intention in Iran could drive crude storage at even higher levels, which it is currently roughly 18% below its average for the past two years.

Overall, the crude freight market fell this week due to a lull in fixture activity amid the Chinese New Year holidays with the amount of vessels being more than enough to cover the modest cargo demand for transportation. As the number of VLCC and suezmax newbuildings to be added in the existing fleet tonnage for this year remains excessive, the decision from Japan's Mitsui OSK lines to move to additional scrapping of its crude carrier vessels brings some hopes that other owners will follow to help the market to breathe from the oversupply. Japan's Mitsui OSK Lines has now confirmed the disposal of four double hull very large crude carriers and one suezmax, rejecting an opportunity to sell the vessels for further trading at marginally higher prices as a step to reduce the overcapacity.

In terms of oil demand, statistics data reveal that it remains weak. Japan's crude oil imports, the third world's largest oil consumer, hit a record low in 2011, according to data from the Ministry of Finance. 2011 oil Japanese imports were estimated at 208,872 million kilolitres, which is the lowest level in 22years, since 1989, in contrast with imports of natural gas that reached record highs due to the Fukushima disaster. On the other hand, China, the world's second largest oil user, is said to import record lows of crude oil in 2012. According to estimates released by state-owned China National Petroleum Corp., the country may buy from overseas 266 million metric tons more crude oil than it exports. This is 5.9% increase from a year earlier and the slowest growth since at least 2006, according to Bloomberg news based on customs data.

In the **container market**, there were no available data for the Shanghai Container Freight Index due to the Chinese New Year. It remains to be seen what February will bring in the market as the oversupply is still there and the slow steaming policy seems to be no longer solution for the struggling liner operators. According to Alphaliner, ocean carriers have reached the limit of slowing the speed of their vessels and more idling is being required to rebalance the market. . The total capacity absorbed through additional slow steaming has increased slightly during the last six months with rising bunker prices. During most of 2011, the capacity absorbed by extra slow steaming mode fluctuated between 650,000 and 730,000 teu, based on Alphaliner estimates.

Worth mentioning that following Maersk Line's decision to not exercise its option of ten more ships of 18,000 TEU at the end of February, Zodiac also follow the same by letting its opportunity to exercise its option for adding four 16,000 TEU containerships at Korean Shipyard STX due to lack of interest from prospective charterers. Furthermore, intra-Asian liner company is said to have abandoned a contract for four 4,700 TEU containerships worth nearly $250mil after failing to conclude a charter deal with an unnamed Middle Eastern shipping company.

In the **gas market,** Nigeria Liquefied Natural Gas Company is going to raise $1 billion in international markets to acquire six LNG carrier ships. Siene Allwell Brown, company's general manager for external relations, told in Reuters that they are in the process of appointing financial advisers for the deal without specifying when the company expects to close the transaction by adding that the loan will be used for the expansion of its shipping subsidiary Bonny Gas Transport Limited, which currently has 24 LNG ships.

In the **shipbuilding industry,** European financial uncertainty that results in limited access to ship financing along with recession of dry and wet freight markets will be the major threats for newbuilding business. The Korean shipbuilding industry is targeting in offshore plants and LNG ships to diversify the losses from the retreat of newbuilidng business for dry bulk carrier and tanker vessels. The Ministry of Knowledge Economy said there will be constant orders for offshore plants and LNG ships citing major gas development projects under way in Australia and Russia and crude oil exploration in Nigeria. Korea's large shipbuilders have already the expertise to build more specialized vessels and they will be less affected than Chinese shipbuilders, which are going to experience serious restructuring as their business is rely heavily on tankers and bulk carriers.

According to the Ministry and the Korea Shipbuilders' Association, eleven of the country's shipbuilders (Hyundai Heavy Industries, Daewoo Shipbuilding and Marine Engineering, Samsung Heavy Industries, Hyundai Samho Heavy Industries, Hyundai Mipo Dockyard, Hanjin Heavy Industries and Construction, STX Offshore and Shipbuilding, ShinaSb Yard, Dae Sun Shipbuilding and Engineering, Sungdong Shipbuilding and Marine Engineering, and SPP Shipbuilding), expect $51 billion in new orders this year. Korea Shipbuilding Industry won 48.2% of the world's newbuilding orders last year, 13,55 million compensated gross tons, leaving Chinese shipbuilders behind with 9,2 million compensated gross tons and it is expected to maintain its first ranking also for this year.

In the **shipping finance**, the tight credit availability creates an uncertainty for the remaining newbuidling orderbook that still needs funding. Managing Director, Andrew Hampson, of asset-backed investments at Fund manager Tufton Oceanic stated in the Marine Money London Ship Finance Forum recently that $57billion of unfunded newbuildings are set to hit the water with an average shortfall of $49bn per year looking forward. Tufton Oceanic values the world fleet at $1,1trillion, which includes $841 billion of tonnage on water, of this 60% is owned by the private companies, 35% by public companies and 5% be goverments. The main issue is how the shipping industry will fill the gap to fund the remaining newbuilding orderbook, when European banks are in the process of reducing its shipping loan portfolio to minimize their losses.

Lloyds Banking group, 41% owned by the UK government, is trying to sell its $10 billion portfolio of shipping loans to a single buyer, but no deal has yet been reached. Banking sources revealed to Reuters that the bank is looking to sell blocks of the loans to single buyers; they are trying to parcel it off and sell it in bits. Furthermore, Italy's largest bank UniCredit is reducing its shipping exposure by renewing loans only very selectively. A source from the company told in Reuters that the bank has no plans to sell shipping portfolios or part of portfolios and the value of their portfolio is about $10 billion of shipping loans. Reuters added that France's two biggest listed banks, Societe Generale and BNP Paribas, are also planning to exit or shrink non-core business such as shipping.

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