GOLDEN DESTINY

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

Week ending 10th February 2012

ECONOMIC ENVIRONMENT

The week was highlighted with intense worries in the eurozone for Greece to secure its second bailout of $130billion by applying a new set of tough measures of EUR3billion in new spending cuts. Eurozone finance ministers dismissed the agreed budget deal by demanding EUR325mil in further cuts to this year's budget so as the country to seal a second financing package from the eurozone and the International Monetary Fund. The ongoing dispute between Greece and eurozone officials creates once more worldwide confusion and raises uncertainties about the commitment of Greece to the European Union. The nation has been criticized by top EU leaders for its lack of progress on necessary reforms.

Worrying issue for Greek economic situation is that international debt inspectors have discovered that the country still needs an extra EURO 15billion ($20billion), and the gap could be filled either through more help from eurozone governments or eurozone central banks. Furthermore, Standard & Poor's has warned that Greece will likely fail to achieve sustainable debt levels with a 70% reduction in the value of bonds held by private creditors. S&P, which currently rates Greece at CC with a negative outlook, said that it intends to downgrade the country to "selective default" temporarily, while the government concludes its swap deal. Following that, Greece's ratings should be upgraded to a "still low level", which will depend on whether the country's public debt is reduced to a sustainable level. S&P also warned that credit conditions continue to deteriorate in Italy and France after it downgraded both countries last month, despite the steps by the European Central Bank to boost liquidity in the market. S&P also joined other rating agencies in criticizing euro zone policymakers for focusing too much on austerity measures and not enough on policies to stimulate growth.

Europe's debt crisis, which rose to 82.2% in the third quarter of 2011 from EU's statistics agency data, threatens China's prosperity. The World Bank said last month that Europe's debts may not reach manageable levels till 2030. The International Monetary Fund warned that a sharp downturn in Europe would have serious side effects on China's economic growth. The IMF is forecasting 8.2% growth for China this year but said this could be reduced by up to 4 percentage points if Europe debt crisis worsens. "The risks to China from Europe are both large and tangible," and "China would be highly exposed through trade linkages," said the report, which was published by the IMF's resident representative office in China. In the meantime, China is investigating and evaluating concrete ways in which it can, via the IMF, get more deeply involved in solving the European debt problem through European Stability Mechanism/European Financial Stability Facility channels, Chinese premier, Wen Jiabao, said in a joint press conference with German Chancellor Angela Merkel in Beijing. The comment has revived hopes that China, which holds by far the world's largest foreign exchange reserves, could add some of this $3,2trillion cash pile to existing and future European bailout funds. European officials said that they believed Beijing had changed its position and more concrete terms of any Chinese contribution are likely to be discussed in two weeks at a delayed EU-China summit.

In Japan, the government confirmed that it intervened unannounced in foreign exchanges to weaken the yen last year, the first time that it had done similar movement since 2004. Finance ministry data released on Tuesday showed Japan carried out Y1.02tn ($13.3bn) worth of unannounced intervention during the first four days of November after selling a record Y8.07tn on October 31, when the yen climbed to a postwar high of Y75.35 against the dollar.

In China, inflation jumped in 4.5% during January, up from December's 4.1% consumer price index, breaking a series of five straight monthly declines. The main cause for the rebound was a shopping bombard before last month's Chinese New Year holiday, which pushed up food prices, an effect that has regularly been seen in the past and is likely to be temporary. “It is very likely that after the holiday, prices will come down, especially for food. Next month’s number should be lower and that will ease concerns,” said Ken Peng, an economist with BNP Paribas.

Indonesia’s GPG growth rose to a record of 6.5% rise in the fourth quarter, a level last seen before the 1990’s Asian financial crisis. The better than expected figures were largely due to continued investment and booming domestic consumption. Domestic consumption and investment has enabled Indonesia to grow faster than its neighbors’, such as Singapore, whose economies are more dependent on global trade flows and therefore more vulnerable to slowing export demand. “Exports certainly will be hit by the global downturn, but our domestic market remained robust,” said Suryamin, head of Indonesia's statistics’ bureau.

SHIPPING MARKET

The weak dry bulk and tanker freight market sentiment push shipping operators in distressed situations reconsidering their investment decisions and their strategy for the year ahead. Ratings agency Fitch said that it expects and increase in the number of distressed shipping credits over the next 12 months as worsening cash flows are leaving very few shipowners and operators unscathed. The Glencore and merger deal was sealed at the beginning of the week with ongoing worries of its impact on dry bulk trades allowing the world’s top commodities trader and the major mining company to exert even greater buying power over the dry bulk trades. Under the agreement, investors in the miner would receive 2.8 Glencore shares for every Xstrata share they hold. That ratio puts a greater relative value on Xstrata shares than most investors had expected, representing a 15.2% per cent premium over the closing share price on February 1.

In the meantime, Brazil mining giant Vale, announced the opening of a floating Philippines’ trans-shipment hub to accommodate its very large ore carriers as a strategic solution to previous week Chinese ban for allowing the entrance of its ships in Chinese ports. Vale’s decision may have a positive impact on the weak freight market sentiment for the very large capesize segment due to the increase of tonne mile demand, but this will be minor given the vessels’ supply related pressure.

In the **dry market**, sentiment remains weak following last week’s 25-year historical low of the BDI with a trend upwards, but the index hovels below the psychological barrier of 1,000 points mark. Delayed deliveries hitting the water in January with the amount of Chinese iron inventories reaching record levels of 100.12 following the Chinese New Year pushed capesize earnings to bottom levels with trading figures for coal being more promising than iron ore. China’s coal consumption by power plants is expected to grow by 150 million tones in 2012, according to data from China Electricity Council. China, the largest producer and consumer of coal, is expected to increase coal production and imports and reduce exports to ensure sufficient supplies for power generation, as the country heading for another year of power shortage.

The return of Chinese players in the market has not yet boosted the sentiment with capesize earnings fetching the levels of handysizes. An ongoing lull in Chinese steel production and robust iron ore port stockpiles have put additional pressure on dry bulk rates and utilization given the amount of newbuilding deliveries. Chinese steel production remains low and iron ore imports are likely to come under sustained pressure with thermal coal fixture activity showing firmer sings for a prompt rebound. Under the current market fundamentals, supramax and handysize vessels will face less risk of exposure since their freight market performance is not dependent on Chinese steel market.

What is noteworthy is that China is trying to import a larger amount of iron ore from smaller exporters in order to replenish loss in supplies from Indian iron ore exports and reduce its reliance on Australia and Brazil. According to Commodore Research, Chinese iron ore imports from South Africa in 2011 totalled approximately 36.56mt, 7.01mt (24%) more than imported in 2010. In December, China imported 4.15mt of iron ore from South Africa. This was the largest amount of iron ore imported from South Africa in any single month since June 2009.

The index closed today at 715 points, up by 10.5% from last week's closing and down by 39% from a similar week closing in 2011 when it was 1,178 points. The highest rate increase has been in the panamax segment, BCI up 1.4% w-o-w, BPI up 39.5% w-o-w, BSI up 6% w-o-w, BHSI down 4.1% w-o-w. It seems that the large percentage of overaged vessels of handysizes and handymaxes creates a significant drop in the freight earnings amid the slower Chinese demand.

Capesize average time charter earnings fell by 0.4% in contrast with a 40% rise in panamax, supramax are up 6.1% w-o-w and handysize are down 3.3% w-o-w. Capesizes are currently earning $5,227/day, a decrease of $24/day from a week ago, while panamaxes are earning $7,732/day, an increase of $2,223/day. At similar week in 2011, capesizes were earning $7,149/day, while panamaxes were earning $12,971/day. Supramaxes are trading at $6,746/day, up by $393/day from last week's closing, 27% higher than capesize earnings. At similar week in 2011, supramaxes were getting $11,837/day, hovering at 66% higher levels than capesizes. Handysizes are trading at $ 5,489/day; down by $193/day from last week, when at similar week in 2011 were earning $9,571/day.

In the **wet market**, the return of Far Eastern charterers from their festivities seems not enough to lift the market given the mounting levels of available tonnage. VLCC spot earnings fell for a second consecutive week to near breakeven levels as weaker AG activity and the oversupply of ships keep rates under pressure. Furthermore, Turkish Straits' delays fell to one day pushing suezmax and aframax earnings lower. Sources are suggesting about VLCC newbuilding deliveries hitting a 36-year record high in January and creating a build-up of vessels in the Middle East Gulf, the main loading area for VLCCs.

In terms of oil demand, the International Energy Agency may reduce its world oil demand forecast for 2012 due to weaker outlook for the world economy. The IEA's last monthly report on Jan. 18 said oil demand was falling for the first time since the global economic crisis of 2008-2009. The IEA reduced its 2012 demand growth forecast by 220,000 barrels per day (bpd) to 1.1 million bpd. In the meantime brent crude oil prices remain above $110/barrel with Barclays Capital expecting an increase in oil prices over the next few months due to geopolitical risks among producer countries. Amrita Sen, an analyst for commodities research, said the moves on Iran's oil imports by the EU, which is due to take effect over the next six months, could push up the crude price this year to slightly higher than last year at US$115 a barrel. The continued political instability in Iraq and civil unrest in northern Nigeria will also dampen oil supply at a time when spare capacity is at a record low. The sanction will push countries that rely heavily on Iranian oil exports to seek substitutes. The EU is a major consumer of Iranian oil, accounting for 32%. Asian buyers account for 64% of the share, led by China and India.

China is expected once more to be the main driver of oil demand in 2012 as the EU and US sovereign debt crisis has influenced oil consumption of major countries. However, China's net crude oil import growth is expected to slow for a second consecutive year in 2012 to 5.98%, according to China National Petroleum Corp., the country's biggest oil producer. Net crude oil imports could reach 226 million tons this year, while domestic output might stabilize at 220 million tons, as per China's National Petroleum forecasts. Net crude oil imports rose 6.3% in 2011, below the double digit level for the first time since such figures were released in 2006. In 2006, the increase was 16.9% according to China's Customs data. "We strongly believe that 2012 could be the most difficult year for China's economy within the past five years as a result of the expanding debt crisis in Europe and the fragile economic recovery in the US, which, clearly, will reduce domestic oil consumption," said Wang Jintao, an energy analyst.

In the **gas market**, the LNG sentiment remains buoyant with elevated levels of demand from the energy hungry countries, Japan and China. Chinese imports of liquefied natural gas will rise 42% this year, supporting high LNG spot rates, according to Arctic Securities ASA. The world's largest energy consumer will import 17 million metric tons of LNG in 2012, up from 12 million tons last year. On the other hand, Japan, the world's biggest buyer of liquefied natural gas, is said to more than double imports of spot LNG this month from a year earlier, receiving at least seven spot cargoes.

A major LNG partnership came to the surface this week with China National Petroleum subsidiary Petro China signing a deal with Ango-Dutch energy giant Shell to buy a stake in its Canadian shale gas business. The deal is said to be worth more than $1 billion boosting Canada's liquefied natural gas export industry, in which natural gas from shale rock will be liquefied and exported on LNG carriers.

In the **container market**, the Shanghai Container Freight Index posted a 1.2% decline since last's closing on January 20th. The Shanghai – Europe rates fell by 1.9%, while there was a modest decline of 0.3% in the USWC. Maersk and other major liner operators are proposing Asia-Europe rate hikes , in their latest attempt to recover from the losses experienced in 2011, scheduled for March and April that would double the current freight rates. The announced rates increases of between $300 and $800 per teu are the highest quantum proposed by carriers since the abolition of conferences on the European trades in 2008. If successful, they would bring spot rates from the Far East to Europe up from $700/teu to around $1,000-1,500/teu. Although rates have rebounded since late December from $500/teu to $700/teu currently, they remain below breakeven with the average bunker surcharge alone standing at $740/teu. What is noteworthy is a container fixture that came to light this week for a postpanamax unit of 6,500 TEU built 2010 owned by George Economy's Drytank that was fixed for 12 months at $12,000/day, when in October 2010 had been fixed for 12 months at a rate of $31,000/day. The sharp fall of the closing rate marks the current weak market fundamentals given the increasing number of vessel deliveries in the coming months.

In the meantime, the excessive container capacity growth combined with sluggish demand has pushed the global idle containership fleet to increase to 286 ships with a total capacity of 750,900 TEU as per Alphaliner estimates at the end of January, up to 10-fold since June when it hit a low of 75,000 TEU. The Shanghai Container Freight Index closed last week at $971/teu, from $1,105 TEU at similar week in 2011 with Shanghai – Europe rates standing at $723/teu, when in 2011 were at $1,316/teu.

In the **shipbuilding industry,** major South Korean builders, Hyundai Mipo Dockyard, Hyundai Heavy Industries and Samsung Heavy, announced a fall in their profits during 2011 due to lower newbuilding prices, lower volumes of orders, intense competition with Chinese yards and higher material costs. **Hyundai Mipo Dockyard** announced a drop of 48.5% year on year in net profits dropped to 227,864,445 won ($203.25M). **Samsung Heavy Industries** said that net profit fell by 12% year on year to KRW863,9 billion ($772 million) from KRW 976,5 billion. **Hyundai Heavy Industries** said that net income fell to 71,3 billion won ($64 million) from a restated 826,7 billion won a year earlier. Furthermore, DSME recently announced poor fourth quarter results as its net profit plunged 61.6% to KRW66,3billion ($59,1m). South Korean shipbuilders regained their first position in 2011 against Chinese due to their expertise in more complex vessels, drillship, LNG and postpanamax container units, and their strong competitive advantage will remain for 2012 as the slump in new orders for bulk carriers and tankers marked also the beginning of New Year.

In Japanese shipbuilding industry, a strategic merger deal came to light between Universal Shipbuilding and IHI Marine United, setting the vehicle for further consolidation among Japanese shipbuilders that are severely affected by the strong yen and the slump of new orders for bulk carriers and tankers.

In the **shipping finance**, the Export – Import Bank of Korea decided to expand manufacturing financing for South Korean Shipbuilders and loan-to-value of up to 100% due to rough conditions of shipping and shipbuilding market. Kim Yong-hwan, head of Korea Eximbank, announced that the bank plans to provide shipfinancing totaling KRW14,55trillion ($13billion) this year to alleviate difficulties faced by shipbuilders and shipping companies.

Under the tight financing conditions, GERMAN KG investments fell nearly 50% and hit a new low in 2011, as shipping funds collected just €506m ($667.6m) in fresh capital last year, according to industry association VGF. Of this, €104m was designated not for new funds but to inject cash into existing ailing funds. VGF's top 10 listing saw Nordcapital hold its position as market leader in 2011, followed by Conti, MCE, HCI and MPC. According to a survey from fund analysts Scope, the proportion of KG houses planning to issue a new shipping fund has fallen from one in three to one in eight within a year.

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