GOLDEN DESTINY

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

Week ending 6th July 2012

ECONOMIC ENVIRONMENT

The eurozone crisis contagion has already started to impact the slowdown of Asian and US economies, with manufacturing activity slipping to record lows and fiscal monetary policy being adjusted to stimulate economic growth. Central banks in Europe and Asia attempted to stimulate the sluggish global economy at the end of the week by loosening monetary policy and cutting interest rates.

China's unexpected move to cut rates for the second time in less than a month reveals how worried Beijing is about the declining domestic growth, below 8% for this year, showing that the economic slowdown extends beyond the euro are. The People's Bank of China cut its one year lending rate by 0.31% points to 6%, while the European Central Bank, as expected, cut its main interest rate by a quarter points to 0.75%, the lowest on record and the Bank of England restarted money printing and injected an extra £50bn into the UK economy, increasing the total to £375bn.

A factory slump in Asia's two biggest exporters, China and Japan, deepened in June, as export orders fell to a seven month low, highlighting increased worries that the health of the global economy is deteriorating. China's manufacturing activity fell to a seven-month low in June, according to official figures, despite government efforts to arrest a slowdown in the world's second largest economy. The official purchasing managers' index (PMI) slipped to 50.2 in June from 50.4 in May, the China Federation of Logistics and Purchasing said in a statement. June's figure marks the lowest level since November last year, when PMI hit 49, according to previously released data. A PMI value above 50 indicates expansion, while a reading below 50 means contraction.

In the meantime, unemployment in the eurozone hit a fresh record high of 11.1% in May, form 11% the previous month, according to EU statistics from Eurostat, while manufacturing Purchasing Managers' Index has been stuck at 45.1 in June, indicating contraction. May's unemployment rate is the highest since euro was launched in 1999 and adds further urgency to the eurozone countries' plan to create economic growth and cut excessive government debt. Unemployment rate in the eurozone is higher than the rate of 8.2% in United States and 4.4% in Japan and it is expected to rise further in the coming months as eurozone's economy slides to a further recession.

At Euro's summit last week, eurozone leaders have already agreed on a direct bank recapitalization from European bailout funds and a generally long term plan for a tighter budgetary and political union to prevent further expansion of the sovereign debt crisis.

In Greece, Deputy Finance Minister confirmed that Greece's new government intends to honor its commitments under the terms of its latest European-led bailout by adding that the government's aim is to revive country's economy without missing the MoU targets. IMF Managing Director Christine Lagarde said the current troika mission in Greece is not about renegotiating the terms of the bailout agreement, with Greece dropping its plan to seek softer terms for its second bailout falling warnings that it would be rejected by international lenders. The release of the EUR4.2bn tranche of the new bailout loan is postponed until EU officials publish a new report on the status of Greek economy.

In France, the government needs to make "unprecedented" cuts in public spending to reduce its budget deficit to 3 per cent of gross domestic product next year and eliminate the deficit by 2017, as the country is in the danger zone and the risk of a surge in the debt can not be excluded. Furthermore, Germany's, the euro largest economy, manufacturing activity showed its fastest contraction since June 2009, while eurozone's manufacturing activity has contracted each month since August 2011.

In U.S., manufacturing activity also contracted for the first time in three years reassuring that the global economy is already suffering seriously from the eurozone debt crisis and China's economic slowdown. In a shock to economists, who were expecting manufacturing growth to slow moderately, the Institute for Supply Management's survey on the US industrial sector reported a large decline in activity from 53.5 in May to 49.7 in June, its lowest level since the recession ended in mid-2009. The weak ISM data emerges from China's slow pace of industrial expansion, while eurozone manufacturing activity remains at its weakest level in three year.

SHIPPING MARKET

Under the adverse worldwide economic scene, shipping investments haven't lost their momentum amid the tight ship lending conditions from the eurozone sovereign debt crisis. Overall confidence levels in the shipping industry increased in the three months ended May 2012, to reach their highest level since February 2011, according to the latest Shipping Confidence Survey from leading accountant and shipping consultant Moore Stephens.This is the fourth successive quarter in which there has been an improvement in confidence, leading to an increased expectation of new investments on the part of respondents, despite an anticipated increase in the cost of finance over the next twelve months. In May 2012, the average confidence level expressed by respondents in the markets in which they operate was 5.7 on a scale of 1 (low) to 10 (high), compared to the figure of 5.5 recorded in the previous survey in February 2012, and to the 5.6 recorded one year previously, in May 2011. The survey was launched in May 2008 with a confidence rating of 6.8.

Interesting companies' news of this week was the filing of bankruptcy from Japan's oldest shipping firms, Sanko Steamships, after months of battling with ship owners over the restructuring of $2 billion in debt, while in the tanker segment a merge deal has been revealed between National Shipping Co of Saudi Arabia and Saudi Aramco's Vela division, both state owned, which will create the third VLCC owner in the world. The merger of the National Shipping Company of Saudi Arabia (Bahri) and Saudi Aramco shipping arm Vela International Marine is set to create a major new force in the tanker industry. Bahri signed a memorandum of understanding this week with Saudi Aramco in which the national shipping company would pay $1.3bn to take over the fleet of Vela. Bahri would then become the exclusive provider of VLCC shipping services to Saudi Aramco. The two companies said they plan to explore ways to expand their cooperation in the maritime sector.

"We strongly believe that the proposed transaction presents Bahri with a unique opportunity to further diversify its business model and reinforces our ability to satisfy Saudi Aramco's transportation needs as well as continuing to serve other customers," Saleh Al-Jasser, ceo of Bahri said. Saudi Aramco sees the merged entity creating a new force in the global shipping arena. "By creating a new global leader in shipping, Saudi Aramco hopes to build a strong company that can leverage its capabilities in the shipping sector and would meet its growing business portfolio," said Khalid Al-Falih, president and ceo of Saudi Aramco. "This company in turn will serve as a national champion that will promote the development of a thriving national maritime industry that creates jobs and other long term opportunities for the Kingdom." The deal requires regulatory approvals and the two companies said they would work towards having definitive transaction documentation by the fourth quarter of the year and completion in 2013.

In the **dry market**, the second quarter of the year ended with a positive sense as the Baltic Dry Index finally broke the psychological barrier of 1000 points from its continuous fall during May, by closing on June 29th at 1004, down by 38% from January 3rd at 1624 points, with capesize average spot charter earnings showing a fall of more than 80% by reaching levels of $3,988/day, from about $24,000/day at the beginning of the year. On mid June, capesize average spot earnings fell at their lowest point since December 2008, of less than $3,500/day, with panamax vessels showing softness at levels of less than $8,000/day from more than $13,000/day at the beginning of May.

During the first days of July, BDI continues its upward trend with capesize average spot earnings surpassing the barrier of $5,000/day and panamax earnings climbing to more than $8,000/day. Smaller vessel categories, supramax and handysize units are showing firmness at levels of more than

$13,000/day and $10,000/day respectively. The positive performance of smaller vessel categories has been supported by increased movement of grains and a number of minor bulk cargoes, while the fragile Chinese iron ore and coal demand impaired the demand for capesize and panamax tonnage. Chinese demand for imported iron ore cargo posed weakness in June due to a tremendous decline in steel production and a large amount of iron ore stockpiled at Chinese ports, despite the rise of Chinese iron ore imports in the first five months of the year to around 300.1mt, up 9% year-on-year.

The recent euphoria in the capesize and panamax segment has pushed BDI above 1,000 points, but the prospects for the second half of the year are not yet promising for the capesize segment and overall the performance of the dry market. Chinese steel production has not yet recovered, port stockpiles are elevated, above 96 million tons of iron ore and 8.7 million tons of coal, while Chinese iron ore demand is expected to show not significant strength in the coming weeks. Chinese demand for imported thermal coal is also poised to remain low on the short term, as power plant and coal stockpiles remain high and hydropower production continues to be on rise. However, peak summer electricity demand season is underway in China and a rebound in thermal coal fixture volume is likely for the second half of the year with stronger panamax earnings. Top grade iron ore price shows sings of weakness with the benchmark 62% iron ore content price falling to $135/tonne as Chinese steelmakers have reduced their purchases from declining steel production that has hit the iron ore supply chain.

Despite the recent negative picture of capesize ton mille demand, there is still faith in the segment as Chinese government's stimulus measures in the industrial sector may bring firmer iron ore demand, but it seems difficult the capesize average spot earning to surpass the levels of $10,000/day as they are struggling to perform in the current vessel's supply figures, when in December of 2011, they were floating at levels near to $30,000/day. Under the current fundamentals, shipping players prefer to move towards the scrapping of overaged large sized vessels, capesizes and panamaxes, with secondhand investments being on the frontline as more preferable type of investment than the construction of new units.

Secondhand asset prices have plunged from the first half of 2011, especially in the large sized vessel segments, capesize and panamax, with the BDI triggering further falls during the second half of the year. According to the Baltic Exchange's Sale and Purchase Assessments, the value of a 5yrs old capesize of 172,000dwt has dropped to about $33,4mil from $42,9 at the end of June 2011, while at end of June 2008 was more than $153mil. In the panamax market, the value of a 5yrs old vessel of 74,000dwt is now at near $23mil, from $30,8 at the end of June 2011, while at the end of June 2008 was more than $88mil. In the supramax segment, the value of 5yrs old vessel of 52,000dwt is now in the region of $22mil from $27,5mil at the end of June 2011, while at the end of June 2008 was at more than $75mil.

The BDI closed at 1,157 points on Friday July 6th, up by 15% from last week's closing and down by 20% from a similar week closing in 2011, when it was 1,443 points. BCI, BPI and BSI has shown an upward trend with the BHSI show some signs of mild softness.

The highest rate increase has been in the capesize segment, BCI up 25.4% w-o-w, BPI up 15% w-o-w, BSI up 3.1% w-o-w, BHSI down by 0.8% w-o-w. Capesize average time charter earnings showed an increase of 98% from last week, panamax earnings are up by 15%, supramax are up by 3.1% and handysize down by 1%.

Capesizes are currently earning $7,904/day, an increase of $3,916/day from a week ago, while panamaxes are earning $9,002/day, an increase of $1,167/day. At similar week in 2011, capesizes were earning $13,995/day, while panamaxes were earning $13,471/day. Supramaxes are trading at $13,556/day, up by $411day from last week's closing, 72% and 51% higher than capesize and panamax earnings respectively. At similar week in 2011, supramaxes were getting $13,443/day, hovering at 3.9% lower levels than capesizes versus 72% today's higher levels. Handysizes are trading at $ 10,309/day; down $105/day from last week, when at similar week in 2011 were earning $10,422/day.

In the **wet market,** VLCC earnings persist to be below breakeven levels from limited AG activity and oversupply of tonnage, while suezmax and aframax rates are weak as available tonnage was sufficient to absorb increased activity in West Africa. The crude tanker freight market remains in the doldrums from faltering U.S. and European oil demand, while vessel earnings are not expected to surpass the break even levels during the second half of the year. In the VLCC market, rates from Arabian Gulf to Japan for a 260,000dwt unit is now at WS42 with time charter equivalent earnings at $20,000/day, from WS60 at the end of January with time charter equivalent earnings at $35,500/day, while in 2008 earnings averaged at $96,900/day. In the suezmax market, rates for 135,000dwt unit in WAFR-USAC route is now at WS62.5 with time charter equivalent earnings at $15,700/day, from WS 80 at the end of January with time charter equivalent earnings at $21,100/day, while in 2008 earnings averaged at $60,200/day. In the aframax market, rates in North Sea-Continent are now at WS95 with time charter equivalent earnings at $21,100/day, showing a mild decline from end of January, when rates were at WS100, while in 2008 earnings averaged at $52,400/day.

The falls of the crude freight rates have also added in the downward spiral of secondhand asset prices with investors trying to exploit the price differentials and expand their fleet via modern secondhand units. According to the Baltic Exchange's Sale and Purchase Assessments, the value of a 5yrs old VLCC of 305,000dwt, is now at $57mil from about $82mil at the end of June 2011, while at the end of June 2008 was at $157 mil. The value a 5yrs old aframax unit of 105,000dwt is now at about $30mil, from $38,9mil at the end of June 2011, when at the end of June 2008 was more than $74mil. In the MR product segment, the downward revision of asset prices is softer than large sized vessel categories, the same with supramax dry bulk carriers. The value of a 5yrs unit of 45,000dwt is now about $22,5mil, from $29 mil at the end of June 2011, while at the end of June 2008 was in the region of $53mil.

VLCC spot market suffers as oil buyers are waiting for the crude price to fall further before resuming their consumption. During the first days of July, the brent crude spot price has moved near to $100/barrel, from the low record level of $83,23/barrel on June 21st, with IFO 380 fuel cost surpassing the level of $600/barrel in Fujairah this week. However, there is still a downward pressure on the price of oil due to the worldwide economic recession.

The Bank of America Merrill Lynch forecasts a price of $106/bbl for Brent crude and $97/bbl for US WTI crude oil in 2H 2012, while contraction in OECD Europe demand for crude oil on account of Europe debt crisis and excess supplies of crude oil, create downside risks on the oil demand. BofAML also said that the risk of $60/bbl for Brent crude won't go away soon due to the latest developments in Eurozone debt crisis and its impact on emerging economies. "Our oil price forecasts for 2H2012 incorporate a number of assumptions including (1) a more aggressive monetary and fiscal stance in emerging economies, (2) another round of quantitative easing by the Federal Reserve in September, and (3) reduced supplies from the Iranian oil embargo kicking in on July 1. But most crucially, without some degree of banking integration and ECB easing, the downside risks to oil prices in 2H2012 will grow," BofAML said in a note.

In the **gas market**, Japanese LNG trade growth remains supportive for the increased LNG contracting activity. Japanese gas utilities are considering expanding their participation in upstream developments for LNG as part of efforts to lower cost of importing the product, the Japan Gas Association Chairman Mitsunori Torihara told reporters. Speaking at a Tokyo press conference, Torihara said that the utilities were also diversifying their sources of LNG, extending from conventional gas-based LNG to unconventional gas sources such as coalbed methane and shale-gas based LNG. Japan expects to import 15 million tonnes of liquefied natural gas (LNG) from North America per year from as early as 2016 once the United States lifts restrictions on exports to the world's biggest LNG buyer.

In the **container market**, the momentum remains positive from an improvement in freight rates during the second quarter of the year, while there are still concerns on the overcapacity with hopes from an increased demolition activity in the period January-May. The newbuilding activity remains low from the previous high volumes of 2011 and 2010, while the low newbuilding prices still tempt owners for the placement of new boxships in the post panamax segment.

The week ended with a rise in the Shanghai Container Freight with a remarkable rise in the main trade from Shanghai to base ports of Europe and in the secondary trading route from Shanghai to Australia (Melbourne). The Shanghai Container Freight Index ended on Friday 29th June at 1460, up by 2% from previous week's closing at 1425, while is up by 54% from the end of December 2011, when it was at 948. July European General Rate Increases have added in the improvement of the index and could lead to further increase in the coming weeks and August.

On a weekly basis, rates on Asia-Europe and Asia-Mediterranean routes have shown an increase by 22% and 12% respectively by rising to $1888/TEU and $1892/TEU respectively, from $1549/TEU on Asia – Europe and $1685/TEU on Asia-Mediterranean. Rates on the Asia-Europe route are now 166% higher than this year's lowest level on February 17th, when they were at $711/TEU and 3% down from this year's peak of $1934/TEU on May 4th. The same outstanding increases have been also noted in the rates of Asia-Mediterranean by recording a 158% upward movement from this year's bottom low of $735/TEU on February 17th and 7% down from this year's peak of $2033/TEU on May 4th.

In transpacific routes, Asia-USWC and Asia-USEC, spot rates plus surcharges have posed softness, but they are still firm by standing 26% and 17% respectively above from the end of the first quarter. On a weekly basis, rates on Asia-USWC are now at $2571/FEU, 4% down from $2678/FEU on Friday 22ND June, while rates on Asia-USEC are at $3752/FEU, down by 1% from $2678/FEU. On December 9th 2011, rates on Asia-USWC route were 45% lower than today's levels by standing at $1419/FEU and on Asia-USEC were at $2524/FEU, down by 29%.

The positive sentiment of the container freight market is under uncertainty on the long term, as container trade still suffers from European economy. According to an independent container sector research house Global Port Tracker, all signs point towards another recession in Europe, which will drag down the container trade on the Continent. Global Port Tracker estimates that European imports will grow by only 1.5% over the course of this year, less than a third of the 2011 growth rate. Export growth will also fall by two thirds, reaching 3%.

In the **shipbuilding industry**, South Korea faces a slump of ordering activity from the headwinds in the shipping market and global economy. According to the Ministry of Knowledge Economy, orders won by major South Korean shibuilders halved in the first six months of 2012 from a year ago, by posting their first annual drop in 19years, due to the sluggish market in the midst of the European financial crisis. According to government data, South Korea's vessel exports totalled $25,5bn in the first half of the year, down 20.1% from a year ago. The country's three biggest shipbuilders - Hyundai Heavy Industries Co., Daewoo Shipbuilding & Marine Engineering Co. and Samsung Heavy Industries Co. - clinched orders worth a combined US$17.3 billion during the January-June period, down 50.8 percent from a year earlier.

In China, the severe slowdown of global shipbuilding industry has led to bankruptcy one more yard. A small private yard, Zhejiang Jingang Shipbuilding, based in Taizhou, Zhejiang province, filed for bankruptcy as it laden with debts of some RMB300m ($47,1m). Among the approximately 100 private shipbuilders in Taizhou, about 80% of them are inactive or are only operating at half the capacity. "During the first-half of this year newbuilding orders are only about 10% compared to orders seen in the past years," Chen Cunyu, chairman of Taizhou Ships Industrial Association and director of Wenzhou Hexing Shipyard, told reporters. Government officials of Taizhou also conceded that most of the shipyards are presently surviving on existing orders. But without fresh contracts coming in to sustain their businesses, there could be more cases of bankruptcy in the second-half of this year, the officials warned. The downturn is taking a heavy toll on small to mid-sized yards across China's major shipbuilding centres. In Nantong yards such as Nantong Huigang Shipbuilding and Nantong Qiya Ship Engineering have declared bankruptcy, In Zhejiang Mingxing Enterprise has filed for bankruptcy and Dongfang Shipbuilding is struggling for survival under a mountain of debt. In Zhoushan, Heng Fu and Lan Tian Shipbuilding Group have both declared bankruptcy.

In the **shipping finance**, the Export-Import Bank of Korea has decided to increase its lending to shipyards and shipping lines by more than Won1trn ($880.1m), as part of its efforts to rescue the South Korean shipping industry amid the current downturn. Korea Eximbank will provide funds totalling

Won16trn for shipping finance this year, compared to the earlier planned Won14.6trn, the bank said. The bank was originally planning to provide Won3.3trn of direct loans and Won11.3trn of guarantees, but later decided to increase its lending due to strong demand, a bank official told Lloyd's List. "Our bank's loans have almost reached the planned amount although there are still quite some guarantees available. Therefore, the incremental amount will be for loans," he added.

In terms of ship financing deals, Nanjing Tanker Corporation has placed two of its tankers as collateral to borrow RMB400m ($63m) from CMB Financial Leasing, the company said in a regulatory filing. The deal, involving panamax tanker Yong Xing Zhou and MR tanker Chang Hang Tan Suo, was agreed in the form of a leaseback with the financial institution over an eight-year period. Shanghai-listed Nanjing Tanker explained that the loan will support daily working capital and give flexibility to debt structure, enhancing the company's short-term repayment capability. In addition, marine fuels supplier Brightoil Petroleum has penned a three-year term loan facility with China Development Bank to borrow $50m. The facility, bearing interest, is repayable in full on the date falling 36 months after the first utilisation date of the facility agreement. In addition, Japanese owner K Line is planning to raise $735mil for fleet expansion. The company said it is taking out a JPY 30bn ($376.78m) loan over 60 years and selling JPY 28.61bn of shares to give it a "solid financial foundation" after last year's loss of JPY 41.35bn. Lenders include Mizuho Corporate Bank, Development Bank of Japan and Sumitomo Mitsui Trust Bank.

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