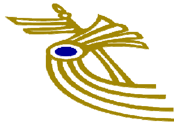

This Week's News: A snapshot on the economic and shipping environment

Week ending 21st September 2012

ECONOMIC ENVIRONMENT

Eurozone economy still pushes hard the wordwide economy with Spain being under great pressure for a new rescue program and unlimited bond buying by the European Central Bank. According to officials, the Spanish government and the European commission are in discussions for the measures that would be demanded by international leaders as a part of a new rescue program, ensuring that are in place before a bailout is formally requested.

In Italy, the government cut its economic growth forecast for 2012, saying that the eurozone's third largest economy is now heading for a contraction of 2.4%, twice than its previous estimate. Country's Prime Minister, Mario Monti, said that he expects the eurozone's third largest economy to recover in the second half of 2013 before acceleratin in 2014, partly due to structural reforms implemented by his technocratic government. Italy aims to cut its national debt from 123% of output this year to 116% in 2015.

In Greece, coalition government failed to finalize the EUR 11,7bn package of cuts for 2013-2014, but reports indicate that progress was made and final deal have to be concluded by Sunday in order the country to receive the next tranche of aid from its European and international creditors. In addition to the savings, troika negotiates EUR 2billion in additional tax revenues as a part of the Memorandum of Understanding. Greek Finance Minister said that Greece will meet its nominal 2012 deficit reduction targets, but it faces growing strain because of the deepening recession. He said that he expects that Greek economy would have shrunk by 25% from the start of the crisis until 2014.

Overall, eurozone's purchasing managers' index, an indicator of manufacturing and services output, fell for the 17-country area to 45.9% in September from 46.3% in August, which still implies recession for the zone. The slowdown is mainly driven from France, whose purchasing manager's index recorded the biggest fall in 41 months, whereas Germany showed signs of recovery with PMI rising to 49.7 in September from 47 in August. The eurozone's weak purchasing managers' index implies that gross domestic product will decline for a second consecutive quarter this year, pushing the region in its second recession in three years.

In Japan, exports recorded sharp fall in August by 6% year-on-year to Y5tn($64bn), the third constant fall, while imports were 5.4% lower at Y5.8tn, with a resulting trade deficit of Y754bn, which appears to be the widest since last March of Fukushima disaster. Provisional data from the Ministry of Finance showed that Japanese shipments to Western Europe fell by 28% year-on-year in August due to a big fall of 18% and 42% in exports to Germany and UK respectively. Japanese exports to China showed their successive decline of 10% in August, which was slightly less than the 12% slump in July.

In China, industrial activity continues subdued in September with some signs of stability as HSBC flash China purchasing managers' index, a monthly indicator rose to 47.8 in September from 47.6 in August. However, it remains below the 50 barrier indicating contraction and reinforcing market expectations for a further slowdown of Chinese economy in the third quarter from its 7.6% growth rate recorded during the second quarter of the year. International Monetary Fund Deputy Managing Director Naoyuki Shinohara said that China's economy certainly holds some risk of hard landing, but it is likely to avoid further decline from its recent 7%-8% range, even though a short term recovery is not expected in week Asian exports.

Despite the adverse economic growth, China appears stronger than Europe with news emerging that one of China's largest banks, China Construction Bank, the second-ranked Chinese bank by assets after Industrial and Commercial Bank of China, has set its target to European banks by being willing to spend as much as $15bn on a deal. "Some of the banks in Europe have been put up for sale and now we are looking for the right choice," Mr Wang, chairman of China's Constitutional Bank, said in an interview with Financial Times. He said CCB had Rmb100bn ($15.8bn) of capital available to acquire a whole bank or, at a minimum, to buy a stake of 30-50 per cent in a larger entity.

SHIPPING MARKET

The dreadful status of the freight market seems to have started influencing negatively the performance of some shipowning nations. Korean shipping industry urges the government to extend financial support offered to its shipbuilders to subsidize local shipowners to cope with the worldwide slump and the continuous fall on their revenues. "It is urgent to improve the vicious cycle of liquidity facing local shippers," said Lee Jong-chul, chairman of the Korea Shipowners' Association. "The shipping industry is very vulnerable to an economic cycle, which means shipping firms cannot survive without financial support. Faced with falling shipping rates and a decline in trade, most South Korean shipping lines, including Hyundai Merchant Marine Co and STX Pan Ocean Co, suffered losses in the second quarter, mainly due to lower shipping rates and falling trade volume alongside slumps in Europe and other major economies.

Shipping recovery was not feasible in 2012 with limited hopes for a full recovery in 2013 and more positive prospects in 2014, since demolition activity continues vigorous from last year's high levels and ordering volumes follow a declining trend in the main conventional vessel segments. Demand growth for main dry shipping commodities remains under uncertainty for 2013 as China's economic slowdown lowered also its trading strength in imports' volume of iron ore and coal, while in the liner industry, US and European debt crises hit consumer demand for goods exported from China putting downward pressure on the financial performance of Chinese shipping container lines.

China COSCO Holdings Co Ltd, controlled by the State-owned shipping conglomerate China Ocean Shipping (Group) Co and the country's largest shipping line measured by capacity, registered a loss of 4.87 billion yuan ($766 million) during the first half of this year, up from a deficit of 2.76 billion yuan during the same period a year ago, posting the company's sixth consecutive quarterly loss. China Shipping Container Lines Co, under the State-owned China Shipping (Group) Company, saw a loss of 1.28 billion yuan during the first half, up from a loss of 630.3 million yuan in the same period last year. The company's profit of 173 million yuan during the second quarter was offset by a loss of 1.45 billion yuan in the first. The third quarter of the year that is usually a peak season, as Western retailers begin placing Christmas orders, is expected to remain weak with container lines facing a tough second half of the year.

"We expect the global container demand to bottom out in the third quarter before improving somewhat in 2013," said Soren Skou, chief executive of Maersk Line, the container unit of the Danish shipping conglomerate AP Moller-Maersk Group. The company forecast that global demand for shipping containers will remain weak in the near future, a result in part of the world economy's slow growth. Compared with an average annual growth of 10 percent during the past 45 years, "we expect global container demand growth to stay at 5 to 8 percent in the next few years," Skou said.

Under the current conditions, overall confidence levels in the shipping industry fell in the three months ended August 2012 to the lowest level since the Shipping Confidence Survey from international accountant and shipping adviser Moore Stephens started in May 2008. The fall to 5.3 on a scale of 1 (low) to 10 (high) in August, comes after three successive quarters of improved confidence, compared to the figure of 5.7 recorded in the previous survey in May 2012, and identical to the figure posted one year ago, in August 2011. The survey was launched in May 2008 with a confidence rating of 6.8.

However, the current world economic and shipping crisis seems to have not yet diminished the strength of Greek shipping, since the total Greek fleet rose from 237,288,216 DWT in 2009 to 263,635,420 in

2012, demonstrating the continuous growth in capacity of the Greek fleet, according to Petrofin Research. In addition, the average age of Greek fleet is estimated to have fallen to 8.7 years, a remarkably low figure implying the solid performance of Greek shipowning under the current adverse market fundamentals.

Petrofin research emphasizes that Greek shipping industry's performance can be attributed to its ability to adjust and cope in the face of adversity via cost cutting, flexible solutions and proactive thinking with most owners supporting their fleets by using their liquidity reserves and / or the sale of older vessels or unwanted assets. The Report also adds that a main contributor for the success of Greek Shipping has been the quite support and flexibility shown by banks that they restructured a very high percentage of loans, by adjusting the nearby loan installments and waiving minimum asset cover and other financial covenants, either due to their own internal weakness or realizing that only through flexibility on their part would losses be averted.

In the **dry** market, BDI crawls to higher levels from a rise in capesize earnings due to an increase in the volumes of iron ore cargoes in the Pacific market, while panamax rates are still suffering with earnings 47% less than capesizes, from weak activity in both Atlantic and Pacific markets. Panamax shipowners of vintage are sending their vessels to the scrap yards with Vietnameze owner Vinashin Ocean Shipping scrapping its 1985built panamax bulker "VSP TITAN" of 66,000dwt for about $383/ldt - $4,2mil, when the vessel had been bought in December of 2007 for about $38mil.

Chinese iron ore inventories are on decline, approximately 96 million tons of iron ore is stockpiled, 400,000 tons less than a week ago. Iron ore price rebounded to reach $110/tonne from a firmer demand with capesize average time charter earnings nearing to $8,000/day, when in mid August, capesizes were earning less than $3,000/day before rising to today's levels. According to Commodore Research, 22 vessels have so far been chartered to haul iron ore to China, which is a large amount compared to 15 vessel fixtures last week, each of this week's Chinese iron ore fixtures have been for capesize vessels pushing average time charter earnings to higher levels on a daily basis.

The recent announcement for a new $150 billion stimulus plan from Chinese government seems that has boosted the dry bulk sentiment and the price of iron ore. There is a market confidence that the price of iron ore could recover to about $120/tonne backed by the recent $158bn stimulus package announced by the Chinese government.

In the panamax segment, average time charter earnings are still below $4,000/day with hopes that the upcoming maintenance to China's coal dedicated Daqin Railway on October 8th will bring some firmness from an increase in coal stockpiling at the port of Qinhuangdao. China imported 20,44 million mt of coal in August, 0.7% down year-on-year and falling 15.8% from July, according to data from Qinhuangdao Port. For the first eight months of the year, January-August 2012, China imported 185,42 million mt of coal, up 46.3% year-on-year.

Panamax vessels have been hit hard during the third quarter of the year from a lower demand in thermal coal imports due to an increase in Chinese power hydropower production. However, it seems that the hydropower production has peaked in July and there will be again an increase in Chinese thermal coal derived electricity production that could bring a recovery in panamax vessel earnings, given also the upcoming coal dedicated Daqin Railway's maintenance. Smaller vessel categories, supramax and handysize vessels, kept their stronger earnings from previous week with levels nearing to $9,000/day and more than $7,000/day respectively, with hopes for this increase to be remained in the coming days.

BDI closed this week, **Friday September 21st**, at 774 points, up by 15.6% from last week's closing and down by 60% from a similar week closing in 2011, when it was 1,920 points. Capesize earnings are on a constant rise with extremely gains during the last week, while the freefall on panamax segments seems to have ended as BPI showed no change yesterday with vessel earnings showing a minor rise of $1/day. For almost 11 straight days handysize vessels earnings are on rise and supramax vessels have started to resume their earnings from the end of last week.

BCI and BHSI index closed in green on Friday with declines in BPI and BSI. On a weekly basis,_the highest increase has been in the capesize segment, **BCI** up by 32% w-o-w, **BPI** down 6.9% w-o-w, **BSI** up 1.5% w-o-w, **BHSI** up by 1.4% w-o-w.

Capesize average time charter earnings showed an increase of 109% from last week, **panamax** are down by 6.7% week-on-week, **supramax** are down by 1.5% week-on-week and **handysize** up by 1.3%.

Capesizes are currently earning $7,664/day, an increase of $4,004/day from a week ago, while **panamaxes** are earning $3,719/day, a decline of $268/day. At similar week in 2011, **capesizes** were earning $28,888/day, while **panamaxes** were earning $13,142/day. **Supramaxes** are trading at $8,859/day, up by $134/day from last week's closing, 16% and 138% higher than capesize and panamax earnings respectively. At similar week in 2011, **supramaxes** were getting $15,460/day, hovering at 46% lower levels than capesizes versus 16% today's higher levels. **Handysizes** are trading at $ 7,047/day; up $95/day from last week, when at similar week in 2011 were earning $10,194/day.

In the **wet** market, very large crude carriers are still facing severe losses with AG-USG route gaining 1 point week-on-week by closing at WS28 with time charter equivalent earnings being still negative $(4,900) for 11th consecutive week, while in AG-SPORE and AG-JPN route WS posted no change from previous gains of 5 points with rates at WS40 at time charter equivalent earnings of $8,300/d and $8,500/d respectively. WAFR-CHINA route gained 1.5 points with WS rising to WS40 at $8,000/day and WAFR-USG route showed stability from last week with WS42.5 at $11,900/day.

In the suezmax segment, WAFR-USAC route is under a negative pressure as WS eased by 2.5 points to WS55 at earnings of $4,900, below operating expenses, as available tonnage remains sufficient pushing also Caribbean aframax market with CBS-USG route showing a 7.5points decline by falling to WS85 at $2,700/day time charter equivalent earnings. In the panamax segment, fixture activity in Caribbean remains subdued and WS in CBS-USAC route for 55,000dwt tanker units dropped by 7.5points to WS122.5 AT $12,300/day time charter equivalent earnings. In the MR segment, the deterioration of rates is also strong with WS in AG-JPN route for 75,000dwt tanker units falling to WS95, 4points less on a weekly basis, at $12,800/day and WS for 55,000dwt tanker units loosing 2 points by closing at WS118 with $12,000/day time charter equivalent earnings.

Compared with the highs of end June 2008, the crude and product tanker segments is high unlikely to experience again the rosy earnings of that period, when WS in AG-USG route for VLCC 260,000dwt was 155 with $128,454/day time charter equivalent earnings from today's WS28. In the suezmax segment, WS in WAFR-USAC route was at 198 with $67,285/day time charter equivalent earnings versus today's WS 55, while aframax tanker units in CARIB-USG route were trading at WS200 with $26,436/day time charter equivalent earnings against today's WS85. In the product segment, the slowdown is also severe with WS in AG-JPN route for 55,000dwt tanker units floating at 60% lower than the highs of end June 2008 of WS290 at $38,222/day time charter equivalent earnings.

The product and crude tanker supply distresses the overall healthiness of tanker operators with demand side for crude and oil products playing the key role on the full recovery and vessel removals via scrapping supporting a near term turnaround. However, tanker prospects remain bleak due to heavy oversupply with supply growth appearing more intense in the crude tanker segment than in the product.

According to a Report from DVB Bank's Research & Strategic Planning, the weak product tanker market is forecast to achieve only a slight recovery four years from now as continuing heavy supply will limit fleet utilization and the rise in asset values. The product tanker fleet is estimated at 2,990 vessels (121,1 mil dwt) with 334vessels (15,2 mil dwt) orderbook, representing 14% of the existing fleet, while 45 vessels of 2,6mil dwt delivered in the first half of 2012 from 205 vessel deliveries of 1,1mil dwt last year. "The relentless pace of vessel deliveries is likely to continue in 2013 as another 133 vessels of 6.4m dwt are scheduled to enter the fleet during the year," DVB's report said. A recovery of the product segment is foreseen from 2016 with fleet utilization rising to 88.5%, when it 2007 and 2008 was at 94.6% and 90.1% respectively, while for this year DVB forecasts that it will fall to its lowest level of 86.2% in the period 2005-2016.

In the crude tanker segment, this week's circulated news for a massive newbuilding order for up to 30 very large crude carriers by Dalian Ocean Shipping Co. at a trio of Chinese yards to be chartered on a long term to Unipec, a subsidiary of Sinopec and the largest crude trading company in China, indicates China's strategy to import strategic commodities on its own vessels and extend greater control over the supply chain. The newbuilding cost is said to be at around $90mil per vessel with a large portion of the cost being financed by the Chinese government. The large volume of crude newbuilding orders by Chinese players with Chinese media reporting that China Shipping Development, Dosco, China Merchants Energy Shipping and Nanjing Tanker, all state owned, are planning a VLCC pool of 50 newbuildings by 2020, adds additional strains on the crude tanker supply picture and its imbalance with vessels' crude demand.

In the meantime, the brent crude oil price is on rise from mid-June by falling below $110/barrel this week for the first time since end of July. The ongoing threat of increased fuel costs and bunkering expenses distresses further the troubled financial status of VLCC operators that are facing levels of vessel earnings below operating expenses. Most members in OPEC, including Saudi Arabia, believe that the ideal price for oil is around $100/barrel and would like to see current oil prices to fall further given the weak position of global economy.

In the **gas** market, recent announcement for Japan's phase out nuclear power by 2040, the biggest buyer of liquefied natural gas, creates more hopes for a stronger and prosperous LNG freight market environment that showed some weakness over summer season due to mited enquires from Japanese utilities. Japan becomes the second leading economy to turn away from nuclear power following Germany's last year's decision, since the disaster at Fukushima 18 months ago. The phase out of the world's third biggest nuclear generator will mean lower demand for uranium, but higher consumption of crude oil, thermal coal and liquefied natural gas, influencing on the long term positively the freight rates on the crude tanker segment, bulk carrier and LNG. Japan is the world's third largest importer of crude oil, after US and China, the largest importer of thermal coal at the same level of China's imports and by far the biggest importer of LNG. Before Fukushima disaster, Japan derived about 30% of its electricity from nuclear power and according to its previous long term energy strategy was aiming to increase the ratio to as much as 50% by 2030. Under the new official decision, Japan's 50 LNG remaining reactors built between 1970 and 2006 are to be shut once they reach an operating life of 40 years and no new reactors are going to be built. Japan's official announcement is estimated to provide long term cargoes for up to 30 LNG carriers to service Japanese demand by the end of decade, while Qatar, the world's largest LNG exporter, agreed to supply an additional 20m tones of LNG to Japan.

During August, Japanese utilities resumed their appetite by consuming 5.09 million mt of LNG in August, a record for the month and 5.7% year on year, when they had consumed 4.81 million mt last year, as per data released from the Federation of Electric Power Companies. The power utilities also used a total of 2.76 million kiloliters (559,000 barrels/day) of crude and fuel oil in August, up 45.8% from a year ago, according to FEPC data. Japan uses more LNG, crude oil and fuel oil for power generation and it bought 5.31 million mt of LNG in August, up 0.4% from a year earlier, while crude and fuel oil volumes recorded at 2.54 million kl (515,000 barrels/day), up 31.1% from 1.94 million kl recorded previous year. Goldman Sachs estimates that Japan will need to consume 76.4 billion cubic metres of liquefied natural gas this year and 72 bcm in 2013 to cover its energy needs from delays in getting its nuclear reactors back on line. Goldman's previous expectations for Japanese LNG consumption in 2012 and 2013 were 75.5 bcm and 69.8 bcm respectively. "A new nuclear regulatory agency is expected to be set up this autumn to replace Japan's Nuclear and Industrial Safety Agency (NISA) and review all of its current nuclear safety standards," the bank said. "As a result, we now expect no new nuclear restarts until summer 2013 and consequently raise our 2012 and 2013 Japanese LNG consumption forecasts."

Goldman said strong Asian demand ahead of the winter season as well as rising European competition for cargoes would likely lift spot LNG prices. "Asia may face increased competition for spot LNG cargoes from Europe, as Northwest Europe approaches the start of the winter with below-average natural gas inventory levels, potentially requiring increased LNG imports," it said.

Meanwhile, Fearnley Securities AS has lowered its LNG rates estimations for the fourth quarter of 2012 and the first three months of 2013, but it still retains its long term positive position in the LNG market.

Oslo-based investment bank predicted that LNG carriers will earn an average of $125,000/day in the fourth quarter of this year and the first quarter of 2013, from its previous estimate of $150,000/day. Declining LNG prices in Japan have narrowed the gap with costs in the Atlantic region, eliminating the profit from transporting the fuel to Asia, Fearnley said.

In the **container** market, the Shanghai Container Freight Index rose to 1285.63, up by 1.4% week-on-week basis from an increase in transpacific rates, 8.8% up in ASIA-USWC and 6.6% in ASIA-USEC routes, on a weekly basis. In Asia-Europe, rates are now down to $1218/TEU, $66/TEU or 5.1% less than previous week's levels, while is 37% down by from this year's peak of $1934/TEU on May 4th and 62% up from last year's levels of $754/TEU. From the end of the first half of this year, Asia-Europe and Asia-Mediterranean routes are facing consecutive falls with rates sliding to $1249/TEU in Asia-Mediterranean, 5.7% down on a weekly basis and 39% less than this year's record level of $2033/TEU on May 4th, while it is 22% up from last year's level of $1027/TEU.

In transpacific routes, ASIA-USWC route is now paying $2711/FEU, $221/FEU more than previous week, while it is down only by 2.5% from this year's peak of $2782/FEU on August 10th with a spectacular 71% rise more than last year's level of $1589/FEU. In ASIA-USEC, rates are now at $3966/FEU, $246/FEU more than previous week and 3.2% less than this year's highest level of $4098/FEU, while it is up by 27% from last year's rates of $3124/FEU.

Alphaliner reports that there are still downside risks for liner operators that posted an improved financial performance in the second quarter of the year, with average operating margins rising to a positive 1% from a negative 12% in the first quarter. Carriers benefited from an increase in freight rates and lower bunker fuel costs as IFO 380 prices fell by 9% compared to the first quarter. Despite the improved performance in the second quarter, only four out of 21 main carriers surveyed by Alphaliner managed to show a positive result for the first six months of 2012. In addition, the laid up fleet of boxships has risen to 260 vessels of 545,902 TEU or 3.4% of the existing fleet at the end of August, from 216 vessels of 466,720 TEU or 2.9% of the existing fleet at the end of July 201. At the end of August 2011, the laid up fleet was 55% less than the current levels with 116 vessels of 210,617TEU or 1.4% of the existing fleet estimated to be laid up.

In the **shipbuilding industry**, the global slowdown in newbuilding demand is still threatening the survival of small and medium sized shipyards with China facing serious threats of bankruptcy for its Ningbo shipbuilders. According to Ningbo Shipping Industry Association, the seaport city in Northeast of Zhejiang is home for 65 shipyards, most privately owned and established after 2000. In the first six months of 2012, new orders received at Ningbo shipyards totaled 380,780dwt, down 35% compared to the same period last year, while the existing orderbook totaled 1,21m dwt at the end of June, down 46.1% year-on-year. Despite the gloomy outlook of a stronger worldwide newbuilding demand, the chairman of China Association of the National Shipbuilding Industry (CANSI), Zhang Guangqin, remains confident about the future. He said: "Ocean shipping is still the most effective means of transportation and as long as the sea does not dry up, there will be shipbuilding business". Mr. Zhang estimated that China's actual shipbuilding capacity is at 70 million tones and major shipbuilders are still holding orders exceeding 100 mil tones by emphasizing that there is no panic as shipbuilders are not going to loose their jobs this and next year.

Korean shipbuilding, taking advantage the hard times of Chinese shipbuilders, is holding the first position in the global shipbuilding arena and is going to remain for the rest of the year and the forthcoming year 2013. On September 13, at '9th Shipbuilding and Offshore Day', Chairman Ko Jae-Ho (President of Daewoo Shipbuilding & Marine Engineering) of the Korea Shipbuilders' Association (KOSHIPA) said "Currently troubled shipbuilding market can be an opportunity for Korean shipbuilding industries to gain competitiveness." He emphasized: "With joint cooperation of the government, related institutions and industrial-academic collaboration for technical development and training high class manpower, Korea will be able to stand firm at its world first place." He added "I believe Korean shipbuilding industries are going through a temporal adjusting period, at present. Chinese face extensive restructuring crisis by past excessive investment and Japanese are also in trouble." He suggested "In particular, Korean shipbuilders should seize opportunities of increasing demand for fuel-

efficient vessels by intensified environmental regulation and high oil price, etc., as well as for offshore plant and offshore supply vessel."

In the **shipping finance**, Australian Fortescue Metals Group, the world's fourth biggest iron ore producer by volume, announced that it has secured an underwritten commitment for a Senior Secured Credit Facility of up to US$4.5 billion. This Facility will be used to refinance all existing bank facilities and provide Fortescue with additional liquidity. The Facility extends the earliest repayment date for any of the company's debt to November 2015 and removes financial maintenance covenants which applied under previous facilities. Credit Suisse and JP Morgan, two of the world's leading banks have together signed a full underwriting commitment for the Facility, providing funding certainty to Fortescue.

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