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

Week ending 9th September 2011

ECONOMIC ENVIRONMENT

The world economy is in real danger as the West is seriously suffering, the U.S. economy is under uncertainty and emerging countries are facing inflationary issues restricting their annual growth. What is amazing is the status of the overall outstanding debt worldwide that has more than doubled in the past 10 years to $158 trillion in 2010 from $78 trillion in 2000 growing faster than the GDP, according to a recent report by global consultancy Mc. Kinsey. The global debt of $158 trillion includes $41,1 trillion incurred by governments worldwide up to last year, accounting for 69% of global GDP, which is expected to rise to $46,12 trillion in 2012, according to the Economist Intelligence Unit (EIU).

In the eurozone, the "Athen's" issue influenced once more the European sentiment with the single currency loosing its strength after rumors suggesting failure of negotiations between Greek officials and EU-IMF-ECB in the country's international debt review. The Greek deficit to GDP is expected to be 1% higher than the budgeted of 7.6% with the EC-IMF-ECB team now asking for new austerity measures that would allow the release of the 6th loan installment in September and the approval of the second bail out package. The EC-IMF-ECB inspectors are emphasizing delays and shortcomings in the implementation of the MoU blaming Greece for not keeping up with its commitments, while there are doubts whether the government could achieve its privatization targets. Greece's Finance Minister Mr. Venizelos rejected reports for the break down of negotiations emphasizing that the country is accelerating the implementation of long delayed structural reforms agreed with the European Union and the International Monetary Fund.

Despite the non conformity issues that Greece faces, the country still has the support from the eurozone with EU President Mr. Van Rompuy and German Chancellor Angela Merkel ruling out the scenario of any EU country with debt problems leaving the Eurozone. The exit of any EU country with debt issues would provoke a dangerous 'domino effect. The head of the IMF Mrs. Lagarde said the organization is 'determined' to help Greece overcome its debt problems and gain competitiveness. The chief of the European Central Bank, Jean-Claude Trichet, suggested the creation of a central finance ministry for the continent so as European countries to follow the rules and keep their deficits and debts under the specific targets. After Greece, Ireland and Spain, the eurozone now faces one more threat as there are concerns that its third largest economy, Italy, will be the next to fall. The country has been already pushed to make drastic cuts in its budget in order to slash its deficit, but Premier Silvio Berlusconi's government has backtracked on some of those cuts. In the meantime, Portugal has announced its biggest cuts in the government spending for more than 50 years to eliminate its budget deficit to almost zero by 2015.

In the U.S., the unemployment rate remains steady at 9.1% with no new jobs added in August and fewer than initially expected added in July, according to the U.S. Labor Department Statistics. The current jobless data adds more pressure on President Barack Obama and the Federal Reserve to revive the declining labor market. U.S. unemployment rate is anticipated to remain high, at more than 8% till 2012, as consumer confidence has been hit dramatically from public debt in US and Europe and a series of worldwide shocks such as Japanese earthquake and higher oil prices. On the other hand, some light in the tunnel seems to be there for the U.S. economy as the White House budget office forecasts that the U.S. 2011 deficit will fall substantially below previous estimates due to a combination of spending cuts agreed this year and higher than expected revenues.

Under the current economic status, China also faces serious threats as the credit rating agency Fitch has warned that it may cut China's yuan debt rating from AA- due to concerns of rising loan defaults. In April, Fitch revised its outlook on China's local currency debt from "stable" to "negative". There are growing concerns of bad loans as Chinese banks lent record amounts of money in 2009 and 2010, issuing a combined of 17,5trillion yuan ($2,7 trillion) loans that raised the prospects of default. Although China maintained its pace of growth through the global financial crisis there are concerns that there will be a substantial amount of non performing assets given the volume of loans lent. In the meantime, the ongoing debt crisis has a serious impact on demand for Chinese goods, as country's economy relies heavily on export demand from Europe and North America, with analysts spreading worries about the

bad effects of Chinese loans on domestic manufacturers. Huang Guobo, the chief economist at China's currency regulator, the State Administration of Foreign Exchange, stated that the Chinese economy is facing serious challenges despite strong growth. The weakening global demand for Chinese exports will be a challenge as China's growth rate may fall below 9% for the first time in a decade unless there will be a revival on Chinese imports. The last sub 9-percent expansion was in 2001, when GDP rose by 8.3 percent.

SHIPPING MARKET

The outlook for the main shipping segments, bulk carriers, tankers and containers remains pessimistic for the rest of the year with players in the industry looking for alternative investment opportunities in the LNG and offshore segment, where demand prospects are very alluring. Asset prices in the secondhand market have started to offer a broad range of investment opportunities for willing buyers, whereas sellers are trying to digest the weak freight market environment and adjust their price ideas.

According to the head of shipping, Dagfinn Lunde, at the German's bank DVB, the shipping industry is facing a long-term disruption and not just a temporary sluggishness. The bank anticipates a further downward trend in the dry bulk market, in some of the tanker markets and also in the container market for the next 1.5 years with no turnaround before the end of 2012. He emphasizes the short of liquidity for some owners, under the current market fundamentals, which has led banks to allow the restructure of loans for their clients. It seems that the restructuring of loan transactions will be the key topic for the rest of 2011 and 2012 as the current freight market conditions do not offer a lot of comfort for operators who are already facing liquidity issues.

Under the current adverse market fundamentals there were some news that astonished the industry in the dry and wet market. Firstly, were the news from the Brazil's iron ore giant Vale confirming in Fairplay that they are analysing the possibility of selling or leasing its entire fleet of very large ore carrier newbuildings commenting that the rate situation has been changed since 2008 when the VLOCs were ordered and they do not wish to be an operator or shipowner. Vale global marketing director Petro Gutemberg stated in Reuters that they don't want to be a major freight operator or make money out of their shipping business, they just want to make sure that their freight cost doesn't shoot up and they welcome any person who wants to partner with them. In the wet market, rumours circulating that Chinese oil companies are preparing a mammoth VLCC newbuilding order for up to 80 vessels shocks the already oversupplied segment, when few days before the chief executive officer of Frontline was calling owners of ageing VLCCs to scrap up to 50 vessels to alleviate oversupply in the spot market.

In the **dry market**, the BDI holds its strength from last week's high momentum, driven by firmer coal and iron ore exports from Australia to China and rebound of coal demand from Japan as coal fired power stations have stepped up their activity to take over from the idling of around 16 of Japan's nuclear reactors. Demand prospects seem positive for September and October with strong Chinese iron ore demand boosting China's spot iron ore import prices. As of 31 August, average transaction prices for Indian-origin 63.5%/63% Fe fines stood at $187-188/tonne cfr China, according to Chinese and Indian traders surveyed by Steel Business Briefing. Import prices now edging very close to the peak of around $190/t cfr approached several times this year and there are market concerns about a possible decline of fixture activity in the coming weeks.

The chief executive officer of iron ore miner London mining expects price to remain high till 2015 as supply is not being added as fast as the industry thought it would be added and China's rapid rate of urbanization continues to drive robust demand for iron ore. Inventories of imported iron ore at major Chinese ports were standing at a record of 95.59 million tonnes last week, according to data from industry consultancy Mysteel on Friday with inventories from Brazil falling slightly, while there was an increase of iron ore deliveries from India and Australia.

It worth highlighting that China tries to diversify its overseas ore supplies by increasing imports from non-traditional countries. According to data from China mining Organization, iron ore imports from countries other than Australia, Brazil, India and South Africa reached 64.6m.tons in H1:11, while the country is exploring emerging regions such as Peru, Chile and Canada and tries to develop strategic relationships with iron ore exporters including Russia, Vietnam and Kazakhstan.

The BDI remains above the 1,700 points market and capesize earnings have more than doubled, after many months of struggling to surpass the $10,000/day earnings level. The index closed today at 1,838 points, up by 5.6% from last week's closing and down by 38.6 % from a similar week closing in 2010 when it was 2,995 points. The highest rate increase has been in the capesize segment, BCI up 7.1%w-o-w, BPI up 3.4% w-o-w, BSI up 1.6% w-o-w, BHSI up 1.9% w-o-w.

Capesizes are currently earning $26,463/day, an increase of $2,537/day from a week ago, while panamaxes are earning $13,534/day, an increase of $431/day. At similar week in 2010, capesizes were earning $41,006/day, while panamaxes were earning $27,312/day. Supramaxes are still trading at lower

levels than capesizes by earning $14,649/day, up by $234/day from last week's closing, but are still 8.2% higher than panamax earnings. At similar week in 2010, supramaxes were getting $21,395/day, hovering at discounted levels from capesize and panamax earnings. Handysizes are trading at $ 10,139/day; up by $194/day from last week, when at similar week in 2010 were earning $15,876/day.

In the **wet market**, the increased available tonnage and higher bunker prices distress every week the freight rates in the crude market, whereas there are some expectations for a rebound in September due to Middle East cargo loadings. According to surveys conducted by Reuters and Bloomberg, OPEC oil production is expected by analysts to have risen to a near three-year high, mostly led by a production hike in Nigeria and to a lesser extent by Saudi Arabia and other Gulf states. Given the usual lag between production hikes and ultimate export dates, this would suggest a stronger September VLCC cargo program. In the meantime, the fragile tanker freight environment has started to create severe losses for big and small operators pushing them on the brisk of bankruptcy.

The sector has been flooded by oversupply and the prolong slump in freight rates, far below operating expenses, have already pulled owners into bankruptcy protection with others to follow. Morten Arntzen, chief executive of Overseas Shipholding Group, said the most vulnerable companies were those that had entered the downturn with significant ship orders under way and poor corporate governance. The market has been depressed by the rapid expansion of the world tanker fleet, which is growing far faster than oil demand, as vessels ordered before the financial crisis are delivered. Bruce Chan, chief executive of New York-listed Teekay Tankers, said a range of sizes of companies would suffer. "Companies that have a significant amount of spot market exposure and a lot of debt will not have the cash flow capacity to weather a prolonged downturn," Mr Chan said.

There are worries about a firm rebound of the segment till the end of the year as there are also serious geopolitical exogenous factors that influence the wet operators. The Libyan oil production will not return to pre-war levels until late next year at the earliest, with many of the country's oil facilities having suffered heavy damage during the conflict, according to the newly appointed chairman of the country's National Oil Company. In addition, the EU has agreed a ban on imports of Syrian crude oil products as part of measures to place further pressure on the Syrian regime. Syrian oil makes the journey to Europe on aframax vessels, which carry about a third of that amount to ports of Syria's top customers in Italy, France and Germany. Those nations were already hit by the shutdown in Libyan oil production and as there are no hopes for a prompt renewed Libyan oil supply, the EU nations will probably try to replace Syria's crude supply with oil from the Gulf region.

In the **gas market**, Norwegian LNG shipping firms Awilco and Hoegh reported stronger freight rates this year than 2010 and LNG demand is expected to continue firm with short term charter rates to have topped $100,000/day for the first time since 2006.

In the **container market,** the Shanghai Container Freight Index lost 7points last week with a decline of 0.7% in the European route. Peak season surcharges are only being partially implemented, whereas oversupply pushes downwards freight earnings. Major liner operators refuse to lay up tonnage and loose their market share as they take delivery of new larger ships and planning newbuilding investments by trying to push out competitors with older and smaller tonnage. Under the current market uncertainty Evergreen Marine is keeping its options open on building large containerships of 10,000 TEU and above as they offer cost of competitiveness and flexibility, according to company's president Anchor Change interview in Seatrade Asia Week.

In the **shipbuilding industry**, South Korean shipbuilders are in the first ranking since February by winning 910,000 cgt, which is about 64% of overall newbuilding in August, whereas China ended up booking 330,000 cgt, which is 23.5% of new orders in August, according to Asiasis news.

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