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

Week ending 7th October 2011

ECONOMIC ENVIRONMENT

The world economy signals uncertainties and threats for the rest of the year with the developed economies being in a downward spiral of GDP growth, high inflationary pressures and loss of consumer growth. Goldman Sachs Group has cut its global growth forecast for this year and the next, predicting recessions in Germany and France, due to slow eurozone economic growth, and a significant risk of U.S. double dip recession. It predicts a 3.8% world growth for this year and 3.5% in 2012, compared with earlier predictions of 3.9% for 2011 and 4.2% for 2012.

The eurozone debt crisis has influenced severely the global markets this week. Global equities from Hong Kong to New York fell sharply on the news that Franco Belgian lender, which has EUR 20.9bn ($27,6BN) in sovereign debt issued by troubled eurozone countries, held talks to consider quarantining troubled assets in a "bad bank". The S&P closed on the start up of the week 2.9% lower at 1,099.23, the lowest since September 2010.

In Greece, the government concluded discussions with the EC-IMF-ECB officials so the country could achieve the next tranche of EUR 110bn loan. The Greek Cabinet approved a draft budget for 2012 submitted to the parliament that includes the immediate dismissal of thousand workers under the pressure from the international creditors. According to press, the Ministry of Finance agreed with the EC-IMF-ECB officials the disposal of 30,000 public sector jobs by the end of the year. The additional measures that have been announced for 2011 and 2012 amount to EUR6.6bn and these should enable Greece to run a primary surplus of EUR3.2bn next year. However, the vital tranche is not yet secured as Greece reluctance to comply with EU-IMF deadlines over the past year demands personal commitments from the Greek government to eurozone for the implementation of new reforms. Eurozone ministers have indicated that Greece will not get the next tranche earlier than the end of this month, once the international debt inspectors complete their review on Greece's reforms.

In the meantime, Moody's has also downgraded Italy's government bond rating by three notches to A2 from Aa2, after Standard and Poor's decision on September, holding a negative outlook due to high debt, weak global economy and political uncertainties. A brief statement by Premier Silvio Berlusconi's office said that Moody's decision was expected and the government's actions to balance the budget have been "positively received and approved by the European Commission." The Italian parliament has approved austerity measures to cut more than EUR 54 billion ($70 million) off of Italy's deficit over the next three years.

In Germany, annual inflation jumped to 2.8 per cent in September, up from 2.5 per cent in August, the highest since September 2008, as the country's statistical office reported. As a result, eurozone inflation could hit 2.7 per cent this month, while the ECB aims to keep inflation "below but close" to 2% over the medium term. However, European Central Bank announced that it would hold interest rates steady, despite a rapidly deteriorating economic outlook in Europe. The European Central Bank has already raised interest rates twice this year to ease inflationary threats. Furthermore, it announced a further extension of its policy for providing unlimited liquidity to eurozone banks, saying it would include 12-month loans this month and 13-month loans from December that will bridge two crucial year-end periods for banks to show strong financial figures. It also unveiled a €40bn program to buy so-called covered bonds – ultra safe investments issued by banks

In the U.S., some optimism has been emerged as revisions to data on growth and jobs advise that the country is away from a slide back into recession despite worldwide fears. Gross domestic product growth in the second quarter was revised upwards from 1 per cent to 1.3 per cent, led by a pickup in consumer and construction spending, according to government data. The GDP revision is encouraging for more positive growth till the end of the year, but the U.S. economy is still very vulnerable with the European debt crisis faltering the world economic expansion. The Federal Reserve said that there are "significant downside risks" to the U.S. economic outlook, including strains in global financial markets. Economists are forecasting a 2.0% growth rate for the third quarter and a 2.1% rate in the fourth quarter, whereas there is still debate on whether the economy will slip into a double-dip recession.

In Japan, the persistent strength of the yen and the worldwide economic slowdown pose threat on the economic growth of the world's third largest economy with Japanese manufactures being serious affected by the rising currency. Japan is high sensitive to the U.S. and eurozone debt crisis since the country remains highly dependent on exports for growth, which have been hit by the yen's strength. In a quarterly survey released by Bank of Japan, the sentiment among large manufacturers turned positive in September for the first time since the disaster, but managers expect small improvement in business conditions over the next three months. "The economy is recovering, but with the yen continuing to trade so strongly, at 70-80 to the dollar, the recovery is tenuous," said Yasumi Kudo, president of Nippon Yusen, Japan's largest shipping company. However, Japan's manufacturing sector has rebounded far more quickly than expected from the effects of the tsunami with the government preparing its third supplementary budget of the year, expected to worth around Y12,000bn ($156bn) to inject further economic growth. Cameron Umetsu, economist at UBS in Tokyo, says the extra spending should add two percentage points to gross domestic product growth in 2012, meaning Japan might well grow faster than any other G7 economy.

SHIPPING MARKET

Major shipping players have started to face financial difficulties under the current eurozone debt crisis and the gloomy shipping outlook from the oversupplied dry, wet and container sectors. Japanese shipowing groups seem to have been the first hit by the spiraling eurozone sovereign risk with the rising currency yen distressing their financial position. Japan's shipping player MOL has told in Fairplay that it expects losses this year of ¥17Bn ($221M), reversing its previous prediction of ¥1Bn in profits, as the freight market environment is not at all favorable under the threat of the constant appreciating yen that increases their operational costs. An official of Mitsui OSK Lines explained: "Mainline long-haul box freight rates have reached year-to-date lows, with the last week's Asia/Europe rate averaging $754 per teu, Asia/US West Coast $1,589/feu and Asia/US East Coast $3,124/feu. VLCC rates to Asia are hovering at Worldscale 40-41.5, translating into earnings of only about $1,000 per day – which is insufficient to cover crewing costs and loan repayments."

Furthermore, Japan's third largest shipping company, K LINE, warned that it expects losses to be 15 times worse than earlier predicted for the financial year ending 31 March 2012. It estimates ¥30Bn ($389.7M) in losses for the current financial year, from ¥2Bn yen in losses projected on 29 July, due to continued deterioration in the tanker and box sectors and slowing economic growth worldwide. K Line in its latest newsletter said that it is difficult to be optimistic about the future business environment under the current global recession adding that it is reviewing investment strategies to cut more costs and improve its short-term earnings.

Overall, the financial position of many shipping players, is very distressed with the leading law firm Norton Rose stating in Reuters that they anticipate their firm to be involved in lot of new restructurings, particular of US listed companies expecting at least four U.S. listed shipping companies to declare bankruptcy over the next 12 months.

In the dry market, the BDI reached this week the high base of 2000 points mark for the first time this year with capesize earnings floating at levels above $27,000/day and positive gains in the panamax market. The rise seen in panamax earnings during the last week, due to a large number of vessels being chartered to import Indonesian thermal coal to China, has kept the market sentiment positive. The ongoing maintenance in China's coal dedicated Daqin Railway, the low coal Chinese port stockpiles and the robust demand from Chinese to import more thermal coal have aided panamax vessel operators and the overall performance of the dry index.

In terms of iron ore imports, it is worth emphasizing the strong Japanese import demand in August followed by also record Chinese import activity that could justify the significant rally seen in vessel earnings and the performance of the BDI at levels not seen before since the start up of the year. According to iron ore imports statistics announced by the Japanese Ministry of Finance on September 21, iron ore imports into Japan reached in August 12.248 million tonnes hitting a high level for the first time since October 2008, when iron ore imports had been recorded at 13.328 million tonnes. The firm levels of Japanese import activity may also continue for the rest of the year as the country tries to replenish its losses from the massive earthquake and tsunami. However, there are still doubts for a firmer Chinese iron ore demand as iron port stockpiles at Chinese ports remain at near record levels, around 93 mil tons, and Chinese steel production has begun to decline under an ongoing stagnation in steel prices.

According to Rio Tinto, Vale and BHP Billiton, who controls more than 70% of the world Iron ore production, the demand for the commodity from China is expected to reach 1 billion by 2015 which is 60% more than 2010. The iron ore price in the international market is likely to remain above $150 a ton till 2020 as the demand from the world's largest consumer, China, remains firm. Jose Carlos Martins, executive director of Vale's marketing, said that global iron ore supply will be tight for the next few years due to strong steel demand in emerging economies. Martins stressed that his firm, the world's largest iron ore producer, had not received any requests from clients in China or Europe to delay iron ore shipments and Vale was on course to produce at full capacity in 2012, a reassuring sign for dry bulk owners.

On the other hand, negative factor is China's strategy to be more self-sufficient in iron ore and break the monopoly of the three major global miners, Vale, Rio Tinto and BHP Billiton. Zhang Changfu, China's Iron & Steel Association (CISA) vice chairman, has stressed that the central government policy is to ensure that the nation will achieve a self sufficiency ratio of domestic ore of over 50% by 2015, as well as seeking from suppliers other than Australia, Brazil, India and Africa. Imports from other suppliers account for 18.4% of total imports and are up more than 5% from last year, he said. "Those countries that have never exported iron ore to China are now listed among the exporting countries, such as Iran and Indonesia," he said. Finally, CISA announced it will publish its first China Iron Ore Price Index (CIOPI) on 10 October in a further bid to outmuscle the big three miners.

The index closed today at 2,000 points, up by 5.3% from last week's closing and up by 58,2% from the end of July, while is down by 32.5 % from a similar week closing in 2010 when it was 2,696 points. The highest rate increase has been in the panamax segment, BCI up 2.6% w-o-w, BPI up 10.8% w-o-w, BSI up 2.2% w-o-w, BHSI up 4.5% w-o-w.

Capesizes are currently earning $27,876/day, an increase of $1,275/day from a week ago, while panamaxes are earning $15,326/day, an increase of $1,513/day. At similar week in 2010, capesizes were earning $40,798/day, while panamaxes were earning $19,332/day. Supramaxes are still trading at lower levels than capesizes by earning $16,028/day, up by $350/day from last week's closing, but are still 4.5% higher than panamax earnings. At similar week in 2010, supramaxes were getting $19,805/day, hovering at discounted levels from capesize earnings and 2.4% above panamax earnings. Handysizes are trading at $ 11,270/day; up by $279/day from last week, when at similar week in 2010 were earning $15,100/day.

In the **wet market**, the distressed environment has pushed owners considering the slow steaming policy as a response to the persistent oversupply, especially in the very large crude carrier segment. There is a market belief that rates could not fall at even lower levels as they have already reached their bottom lows, with hopes for an upturn if shipowners move to drastic measures for the cooling of oversupply of supertankers. Even there has been an increase in the Middle East OPEC production during the past nine months; spot rates continue to stay below operating expenses as the number of available vessels is far more than the Middle East cargo loadings. BW Maritime, a Singapore-based owner of 15 supertankers, has temporarily idled two of the vessels and is planning a third for a longer duration as earnings plunge to the lowest since at least 1997.

Positive factor for the tanker operators seems to be the recent revision downwards of oil prices and the lower cost of bunker supplies. The end of civil unrest in Libya seems that has brought calmness in the oil market amid lower oil demand from U.S. and European economies. Brent crude has fallen some $15 since the start of August following the release of strategic consumer reserves and extra supplies from Gulf OPEC producers in June. The prospect of Libyan oil returning to the market is also beginning to weigh on prices. Libya is believed to restore full output in 12-15 months. According to an official from Gulf OPEC member, the price has come down, but it is till above $100/barrel, which is still high. Morgan Stanley has cut its Brent crude estimation for 2012 to $100 a barrel from $130 a barrel on the basis of returning supply from Libya, Canada, North Sea and weaker global demand.

In the **container market,** the weak freight market on a normally peak season has triggered a pessimistic outlook for the rest of the year and the forthcoming 2012. The SCFI closed last week at 973 points, down 1.8% week-on-week, the fifth consecutive decline, with rates for European bound cargo rates down 2.7% and USWC and USEC container rates down 2.1% and 2.2% respectively. The sharpest decline has been witnessed again on the European route. The utilization rate on Asia-Europe route is said to be 75% below the previously reported of 85% with larger liners seeing higher utilization at the expense of smaller liners.

The poor growth data of U.S. and European economies have a dreadful influence on the spot freight market, which is already under the pain of oversupply in major busiest container routes. According to data showed in Journal of Commerce, U.S. containersized imports fell last month 1.5% from a year earlier, due to lower shipments of home goods, clothing and toys. August data represented the third consecutive monthly drop in year-on-year volume, followed by 5% decline in July. According to Journal of Economist Mari o O. Moreno, the troubles of the U.S. housing market and the high unemployment rate have influenced the U.S. imports.

What is noteworthy under the threat of a late rebound in U.S. and European consumer sentiment is the scheduled deliveries of very large container vessels in the forthcoming years. According to Alphaliner, 48% of the containership orderbook is consisted by container vessels of 10,000 TEUs and 21% by vessels of 7,500-9,999 TEUs. Very large and ultra large containerships of above 7,500 TEUs will dominate containership deliveries over the next decade as carriers seek to achieve greater economies of scale and reduce the slot cost per TEU. The average size of new containerships in 2000 was only 2,900 TEUs compared with 6,100 TEUs this year, while the largest delivery reached 8,200 TEUs. By the end of next year, the size of the biggest vessel will double to 16,000 TEUs and increase to 18,000 TEUs by 2013.

In the **shipbuilding industry**, China Rongsheng Heavy Industries secured a loan of RMB35bn ($5.5bn) from China Development, which includes a basket of financing services including syndicated loans, liquidity loans, trade finance and financial leases. Hong Kong-listed China Rongsheng said the credit facility would replenish the group's working capital under the current economic conditions and fortify its operations. The slowdown of dry bulk ordering activity seen this year seems to have a detrimental influence on Chinese shipbuilding business, especially for Chinese Greenfield shipbuilders that are seeking to win business due to lack of expertise in building more sophisticated ships as their Korean shipbuilding rivals. According to a Citigroup report, some Chinese shipbuilders are accepting loss-making orders just to secure cash flow with average sale prices being below breakeven levels. However, Korea, which is the home to the world’s three biggest shipbuilders Hyundai Heavy Industries, Daewoo Shipbuilding and Marine Engineering, Samsung Heavy Industries, faces serious challenges of adding new more business in its yards for larger size dry and wet units (capesizes, VLCCs) as the slumping freight rates, especially in the crude tanker market, do not support new newbuilding plans for vessel sizes that appear now to be inflexible types of investments.

In the **shipping finance**, the European bank lending has become very tight as sovereign debt crisis creates serious difficulties for future cash lending to shipping players. According to the IMF, the risk of exposure in European banks has increased by EUR 300mil ($407 billion) under the current economic turmoil, which narrows the window opportunities in the traditional bank lending and syndicated loan market. According to Rodricks Wong, a financial analyst at Marine Money Asia, shipowners in Asia are looking at perpetual bonds, convertible preference shares, dim sum (RMB denominated) bonds and leasing as alternatives to finance their capex needs.

Under the current tight ship financial difficulties, NYSE listed Scorpio Tankers has secured a new $92 mil credit facility from Credit Agricole and Skandinaviska Enskilda Banken to fill a financing gap of its newbuilding product tanker program in Hyundai Mipo Dockyard. The facility covers four of its five 52,000 dwt product tankers on order with the $92 mil loan breaking in four tranches of $23 mil each unit, representing 61% of the purchase price. Loan facility will be made available once Scorpio Tankers pays the first 39% of the purchase price of each newbuilding units.

MARIA BERTZELETOU – GOLDEN DESTINY S.A RESEARCH DEPARTMENT

For more Research Services, please contact us:

GOLDEN DESTINY S.A.
Research & Valuations Department
Sofia M.Kokkinis & Maria Bertzeletou
Email: snv@goldendestiny.gr