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

Week ending 14th October 2011

ECONOMIC ENVIRONMENT

The Franco-Belgian lender Dexia disrupted last week the financial markets with fears for a rapid contagion of eurozone debt crisis. The week opened with European leaders laying out plans to strengthen region's banks and upcoming news for Dexia's nationalization. Brussels will pay €4bn to take over Dexia Bank Belgium, which includes a large retail bank in a group that is otherwise focused on lending to local governments, along with state guarantees worth €90bn ($120bn) to finance the rest of the group.

The week ended with one more downgrade in the eurozone with S&P cutting Spain's sovereign debt rating by one notch from douple A to douple A minus, holding a negative outlook on the country due to slowing growth, high unemployment, high level of debt and weakening financial system. S&P highlighted the financial profile of the Spanish banking system expressing concerns for the future solidness of the country's banking system as it foresees that Spain's banks will continue to accumulate problematic assets into 2012 with access to market funding being scarce and expensive. Observers have also noted that Spain is unlikely to meet its budgetary targets for this year for cutting the deficit to GDP ratio from 11.1% last year to 9.2% this year and 4.4% next year amid the slowing eurozone economic growth.

France and Germany, the two leading countries of the eurozone, have recognized that the sovereign debt crisis is spreading with signs for further infection, while they appear determined to reach an agreement by the end of October on a comprehensive package of measures to stabilize the eurozone, including the recapitalization of European banks. France is keen to use the euro zone's 400 billion rescue fund, the European Financial Stability Facility, to recapitalize its own banks, whereas Berlin insists that the Fund should be used as last alternative. European Commission President Jose Manuel Barosso, speaking before the European Parliament in Strasbourg, said that banks would be required firstly to seek private sources of capital with national governments providing support, if necessary, and if support is unavailable then recapitalization could be funded by loans from the European Financial Stability Facility. The International Monetary Fund (IMF) estimates that the European banks need 200 billion euros in additional funds to withstand the sovereign debt crisis and secure their cash liquidity.

Furthermore, in one more attempt to reinforce the banking system, global banking regulators will push banks to hold more liquid assets and restrain the industry's reliance on short-term funding, despite complaints that the rule changes could damage the broader economy, according to the new chairman of the Basel Committee on Banking Supervision. In his first interview in the Financial Times, he said that the Basel group plans to put uniform implementation of the Basel III reforms at the top of its agenda. That deal, which was struck last year by the 27 member countries, will force banks to hold more top quality capital against unexpected losses, but there are rising concerns that some countries will not stick to the agreement. Leading European banks say they would rather sell assets than raise expensive new capital to meet compulsory demands from the European Union for higher capital ratios, threatening a further contraction of credit in the eurozone economy.

In Greece, following lengthy negotiations with international lenders the vital aid of the next installment of country's EUR 110 billion bailout has been finally secured to be paid in early November. The European Commission, the European Central Bank and the International Monetary Fund completed their fifth review of Greece and agreed on the economic and financial policies needed to bring the government's economic program back on track. The officials said that they believe Greece will be able to meet its

2011-2012 fiscal targets, but the recession will be deeper than was anticipated in June and a recovery is now expected only from 2013 onwards. In the meantime, a lot of discussion has been emerged on the hair cut of Greek debt. In July, private holders of Greek bonds were asked to take an average haircut, or writedown, on their holdings of 21%, while now a group of countries led by German asks for a bigger haircut of 50%-60%. However, this haircut seems unlikely with the European Central Bank saying that attempts to involve private investor may put at risk the financial stability of the currency area as a whole.

The ongoing economic turmoil has already damaged the growth of Chinese trade as Europe and U.S. are the most important trading partners of the country. China's trade surplus narrowed for a second straight month in September to $14,5 billion with both imports and exports being lower than expected. September's trade surplus was smaller than Augusts' surplus of $17,8 billion and less than half of the $31,5 billion recorded in July. Exports increased 17.1% overall in September from a year earlier, down from a 24.5% increase in August, according to data released by Chinese customs. The slowdown was stronger in Chinese trade with Europe, as exports showed only a 9.8% rise in September from the last year, compared with a 22.3% rise in August. Chinese imports also slowed down as they increased by 20.9% from a year earlier, compared with a 30.2% rise in August. Overall, Chinese economy is under the threat of eurozone contagion as there are signs for a further significant slowdown in trade. According to National Bureau of Statistics, China's economic growth, which has averaged around 10% for a decade, slowed to 9.6 % annually in the first half of 2011. In the second quarter, its GDP rose 9.5 percent, a dip from the 9.7 percent growth in the first quarter. The Chinese Academy of Social Sciences, a major government think tank, forecasts China's gross domestic product will grow 9.2% in 2012 on condition that the domestic and international environments will not worsen.

SHIPPING MARKET

On ongoing fears for a significant slowdown in the worldwide trade from the economic recession, HSBC said in its latest quarterly Trade Connections Report that Asia's trade will almost double by 2025 as a key driver of the world trade growth despite current economic headwinds. Asia's trade volume will grow 96% to nearly $14 trillion by 2025, recording annual year-on-year growth of 4.8% versus an estimated of 3.8% for global trade. By 2025, world trade is expected to increase 73% from the current level, driven mainly by India, Vietnam, Indonesia and China. However, the report noted a dip in confidence among Asian importers and exporters about the trade outlook for the next 6 months, with 41% expecting the global economy to decline.

In the dry market, the positive sentiment persists with significant gains in the panamax and capesize segment as charter rates are hovering at the highest levels from the start up of the year, while the BDI keeps its constant rally standing above 2,000 points level. Capesize and panamax earnings are up by ..% and % respectively from the lowest level of this year, when capesizes were earning $4,567/day on February 28th and panamaxes $10,372/day on February 2nd. Global grain and coal demand remains strong favoring smaller vessel sizes, supramaxes and handysizes, whereas there are still expectations for further surge in Chinese thermal coal demand. The recent upturn of the market from the end of July seems to stabilize with the global demand for dry commodities showing signs of firm demand. However, the dry bulk shipping market is still being hunted by oversupply and there is some market disbelief for a rebalance earlier than the end of 2012 / early 2013.

The capesize segment is being supported from strong congestion at major Australian and Brazilian ports, around 90 vessels are calculated to be anchored, whereas panamax earnings from strong Chinese thermal coal fixtures due to extremely low coal port stockpiles at Qinhuangdao from the recent maintenance in China's coal dedicated Daqin Railway. Chinese iron ore port stockpiles have declined from the previous week, but are still high. According to Commodore Research, approximately 92.4 million tons of iron ore are currently stockpiled at Chinese ports, 700,000 tons less than a week ago. The amount of iron ore stockpiles threatens the recovery of the capesize segment with worries for one more slowdown in the fourth quarter of the year.

Strong iron ore and coal imports from China are the one of the main beneficiary factors for the recent buoyed dry sentiment. According to data from China's customs authority, China imported 60,57 million

tonnes of iron ore in September, the highest monthly volume since January, up 2.5% from August. Over the first three quarters of the year, Chinese iron ore imports sum up to 508 million tonnes, 11% more compared with the same period last year. Despite the increase, Chinese traders remain pessimistic about their prospects in the coming months due to economic uncertainties and tight domestic credit. In terms of coal imports, China's imports for the first nine months of the year reached 120 million tonnes, up 1.9% from last year, whereas imports on September are estimated to be at 15,6 million tonnes, down by 5.97% from 16,59 million tonnes recorded in August and much lower than traders' expectations of some 20 million tonnes.

The index closed today at 2,173 points, up by 8.6% from last week's closing and down by 21.3% from a similar week closing in 2010 when it was 2,762 points. The index has reached once more its highest level of this year standing 108.3% up from the lowest level of 1,043 points on February 4th. The highest rate increase has been in the capesize segment, BCI up 11.4% w-o-w, BPI up 8.9% w-o-w, BSI up 3.9% w-o-w, BHSI up 6.2% w-o-w.

Capesizes are currently earning $31,329/day, an increase of $3,453/day from a week ago, while panamaxes are earning $16,702/day, an increase of $1,376/day. At similar week in 2010, capesizes were earning $45,279/day, while panamaxes were earning $18,143/day. Supramaxes are trading at 47% lower levels than capesizes by earning $16,671/day, up by $643/day from last week's closing, but are 0.1% lower than panamax earnings. At similar week in 2010, supramaxes were getting $19,425/day, hovering at discounted levels from capesize earnings and 7% above panamax earnings. Handysizes are trading at $ 11,911/day; up by $641/day from last week, when at similar week in 2010 were earning $14,533/day.

In the **wet market**, crude freight outlook is still dark from the oversupply of vessels and the slowing growth of oil demand with average earnings for very large crude carriers on the benchmark Middle East Gulf to Japan route being at record lows. The prospects for the crude market remain bleak for the rest of the year with limited hopes for a recovery in 2012, while the slide in VLCC values continues and owners seem to be in middle of the decision of either sending their overaged VLCC units to the scrap yards or starting the laying up or applying the slow steaming policy to ease the oversupply pressure. The risk of bankruptcy of tanker operators is very high with almost two thirds of the industry believing that 15% of tanker companies will not survive from the downturn, according to the Lloyd's List Tanker Prospectives Survey.

The International Energy Agency in its monthly oil Market Report cut its forecast for global oil demand for a second month as the economic recovery loses momentum. The Paris-based organization reduced its estimates for world demand for next year by 210,000 barrels a day, to 90.5 million a day, which means that consumption will increase by 1.3 million barrels a day, or 1.4 percent, from this year. The IEA said that "there is still robust growth but it's being affected by this economic slowdown. Global oil demand has grown at a moderate, but stable pace in recent months. The picture could deteriorate, however, with a downward spiral in economic prospects". This year world oil demand will increase by 1 million barrels a day, or 1.1 percent, to 89.2 million a day, following a downward revision of 50,000 barrels, according to the agency.

The downward revision of global oil demand distress further the financial status of tanker operators, who are already facing serious glut of ships that drives them in a constant slide down of freight rates, below vessel's operating expenses. The dreadful economic conditions in U.S. and Europe narrows the opportunities for a fast recovery of oil demand that could match the available list of tankers seeking a profitable charter deal. Additionally, the crude demand has also slowed in China and India with signs of growth in Japan due to need for oil-fired power from the earthquake crisis. As per data from the International Energy Agency, China's oil demand grew 5.8% month-on-month in August, down by 6.6% from July's demand, while Indian oil demand rose by 2.7% in August, which is slightly slower than the 2.9% increase in July. In contrast, Japan's oil demand rose 4% year-on-year in August, underpinned by power generation.

According to the chief executive officer of the largest U.S. listed tanker owner, Teekay Group, tanker market is bottoming and demand for oil tankers will match supply by the Northern Hemisphere's next

winter, lifting charter rates for the vessels. He added that the smaller-sized oil tankers, which dominate Teekay's fleet, will recover before larger carriers. The combination of too many ships and the slow pace of oil demand growth could lead to about 6% of laid up fleet in a year, according to a Bloomberg survey of eight brokers and analysts.

In the **gas market,** the massive earthquake and tsunami in Japan continues to build LNG imports to replace nuclear power loss with forecasts that Japanese utilities will need to charter in as many as 15 extra LNG carriers in the coming couple of years. Chubu Electric Power, Japan's third biggest power firm is said to be in discussions with suppliers to secure an additional 800,000 tonnes of LNG in the six months to March 2012. The company is planning to use a total of 13million tones of LNG in 2011/2012, up from a pre-earthquake estimate of 8,4 million tones. The prospects for a stable strong Japan LNG demand are high since the country's nuclear power outlook remains unclear with just 10 of Japan's 54 reactors operating. The full restart of Japan's nuclear power utilities is highly dependent on the radiation risks due to the controversy that was created from the burst of nuclear power crisis.

A strategic partnership came to light this week in the LNG segment. Teekay's LNG subsidiary, Teekay LNG, has announced its joint venture with Japanese trading house Marubeni to acquire eight owned and partially owned LNG carriers from Maersk. Teekay and Marubeni JV acquired a 100% interest in six modern LNG carriers and a 26% interest in two additional LNG carriers for a total consideration of $1.4 billion, the transaction is expected to close in early 2012. Five of the carriers currently operate on long-term contracts (17-year average duration) and three of them are on short-term contracts.

In the **container market**, rates are unchanged from last week due to Chinese holidays with the Shanghai Container Freight index standing at 973 points and the momentum being negative from previous weeks' falling freight rates. The weak freight environment exposes major container operators at a high risk due to their massive expensive newbuilding programs for new vessel deliveries in the next two years. According to Alphaliner estimates, owners have added $27 billion of new containership orders (for 2,4 Mteu) to the remaining pipeline of $30 billion (for 2,1 Mteu) that was committed prior the collapse of Lehman Brothers on September 2008. The new vessel capital expenditures commitments of nineteen of the largest carriers amount to over $33 billion. Among the top-20 carriers, only two Japanese shipping lines, MOL and NYK, do not have any outstanding new vessel commitments. Yasumi Kudo, president of NYK, has stated that the company shall not endeavor to compete with other shipping companies on the basis of the containership fleet size, but will try to stay ahead by focusing on cargo collection capacity and volumes.

APM-Maersk is said to have the largest capex commitment, estimated at $6,5 billion due to its 20 Triple-E class 18,000 TEU orders, at a total cost of $3,8 billion in total, $190mil each unit, with option for ten additional units. It is worth clarifying that last week's rumors for CMA-CGM being in talks with Chinese yards to build up to 20 boxship units of 9,000-10,000 TEUs, have been denied by the company reassuring that it no short-term plans for new purchases or charter-ins, and is focused on reducing its debt load over the near-term as the freight rate environment remains weak

In the **shipping finance**, ABN AMRO is looking to expand its business by picking up shipping loan portfolios or rival banks. A senior ABN AMRO official, Joep Gorgels, head transportation West-Europe, said in Reuters: "We have a clear strategy that we want to grow in this market, we are thinking anti-cyclical here". "We are looking at buying loan portfolios in shipping and offshore," he added on the sidelines of a Capital Link shipping conference in London. Gorgels said lending conditions to the ship industry remained tough. "At the moment we are at the lowest point of ship finance available in general to the shipping industry," he said. "The typical shipping banks are deleveraging, are recapitalizing."

European bank lending has dwindled with DNB NOR Bank ASA expressing its pessimism for any prompt rebound on the ongoing eurozone debt crisis. Kjartan Bru, senior vice president of shipping, offshore and logistics at Oslo-based DnB NOR, said by telephone interview in Bloomberg that ship-finance deals fell to "slightly over" 20 in the third quarter from almost 60 in the second quarter, while rising costs for European lenders to borrow dollars and an interbank market that's "not functioning," are curbing the region's banks' ability to fund ship owners. "

Under the tough lending conditions, Star Bulk Carriers Corp., announced this week that it has entered into a new $64.5 million secured term loan agreement with HSH Nordbank, which has up to a five year term with interest at LIBOR plus a margin. The borrowings under this new loan agreement together with $5.3 million in cash were used to repay in full the Company's two existing loan facilities with Piraeus Bank as agent and lender, respectively. Furthermore, Hanjin Shipping of South Korea has sealed $80.5m of shipbuilding financing for its new ordered capesize bulkers for delivery at the end of 2012 in a syndicate loan Korea Finance Corporation and DVB Bank.

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