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

Week ending 11th November 2011

ECONOMIC ENVIRONMENT

The eurozone faces historical times for its future with Greece and Italy shaking the restored confidence that the last summit of Brussels brought in euro. The last week passed with all eyes of the word being turned on Athens and rising fears on rumors for a scared scenario of a potential exit of Greece from the euro, following Prime Minister's proposal for a referendum. Germany and France pushed Athens to decide whether it will stay in euro or not by applying the comprehensive package of EU summit. The criticism over the movements of Athens against the eurozone dipped the euro to new lows with the Greek government loosing its credibility and surrounded fears for its existence in the European Union. Athens's announcement for the creation of a coalition government and the resignation of country's Prime Minister satisfied the Eurogroup and gave an air of optimism for the conformity of Greece with the October 26th EU summit resolutions.

The formation of a coalition government by Greece has been welcomed as a decisive development for the country's political scene and a major breakthrough in its efforts to deal with the escalating debt problems. For the first time in several decades, Greece's two leading political parties will work under a common goal to provide stability growth for the country by implementing the eurozone agreements. The challenge for the new government will be to restore the faith of Eurozone leaders in Athens and provide prosperity for the country by meeting the deficit targets set for 2011 and 2012. The front runner of the new government is Lukas Papademos, a former vice president of European Central Bank who helped steer Greece into the euro as its central bank governor. Eurogroup president Jean-Claude Juncker said that Eurozone's finance ministers have asked for a signed commitment by Greece's both main political parties, stating that they will honor the October 26 EU summit resolutions. The written commitment will eventually allow Eurozone to approve the release of the next installment of the bailout loan to Greece's

In the meantime, the world is also watching the new political changes in Italy as Prime Minister Silvio Berlusconi is going to resign after loosing majority in a crucial vote on a financial bill at the parliament in Rome. Berlusconi pledged to step down after the parliament approves a budget law that includes reforms demanded by Europe for preventing the expansion of debt crisis in the third largest economy of the eurozone. The highlighted issue of the roughly times that the eurozone faces was the response of the European Central Bank to the escalating debt crisis with an unexpectedly interest cut from 1.5% to 1.25%.

In Japan, the Euro debt crisis and US economic weakness bring serious concerns for the country's recovery from the huge earthquake and tsunami given also the appreciation of the yen. Japan's Finance Minister intervened in the currency market to halt the rise of the yen against the US dollar, after it reached a new postwar high. The excessively gains of the yen against the dollar and euro since the beginning of 2008 bring concerns about the strength of Japanese manufacturers to shift their production overseas. Jun Azumi, finance minister, said that he will take bold measures against speculative moves in the market adding that the currency market is not reflecting the fundamentals of the Japanese economy.

US economic growth accelerated to 2.5 per cent in the third quarter as consumers, businesses and the federal government boosted their spending. The annualised increase in gross domestic product confirmed expectations that the economy had improved from the 1.3 per cent growth rate posted in the second quarter. But the 2.5% pace of growth—nearly twice that of the second quarter—is too slow to create enough jobs and bring down the nation's high unemployment rate in the short run. Growth would have to be above 3% to cut into the nation's 9.1% high unemployment rate, economists say. The US Federal Reserve slashed its growth forecast in 2012 to 2.7% from 3.5% in June with expectations for the unemployment rate to remain above 8.5% at the end of next year and the inflation to float between 1.5% and 2% in 2012, 2013, 2014.

In emerging countries, Chinese inflation fell sharply in October to 5.5 per cent year-on-year, the lowest in five months, which marks the third straight month of slowing inflation and opens the path for a slight easing in monetary policy to support growth,. Moderating inflation could allow Beijing to loosen its tight monetary policy since the debt crisis in Europe and U.S. threats the demand for Chinese exports.

SHIPPING MARKET

The slowing economic and trade growth from the European woes stimulate the volatility of the shipping environment amid rising vessels' supply outlook. The Word Trade Organization has cut its 2011 trade growth forecast to 5.8% from earlier prediction of 6.5%, while the IMF reduced its economic growth forecast to 4% in September for both 2011 and 2012 from 4.3% and 4.5% respectively. The shipping players will have to adjust their investment decisions under the threat of slowing trade demand growth and ample available vessel tonnage. However, China is a strategic partner for the global shipping market and its five year plan will play a critical role in 2012 for steady economic development and expansion in global trade transportation. According to China Cosco Holding Co. Chairman, Wei Jiafu, the global shipping market will improve in 2012 as China, the biggest customer for dry bulk operators enters the second year of its latest five year plan.

In the dry market, the capesize earnings follow a downward trend, falling from the highs of $30,000/day seen in mid-October, while the BDI is hovering below the 2,000 points mark, loosing 15.5% from the highest level of 2,173 points reached on October 14th since the beginning of 2011. Period fixture activity has shown significant weakness during the last weeks with Chinese traders slowing down their purchasing plans of iron ore. Spot iron ore import prices have come under substantial pressure from the recent lull in Chinese demand, down by about 30% this month standing around $120 per tone from the highs near $190. Brazilian mining giant Vale and its rivals BHP Billiton and Rio Tinto said that they are not planning to cut their production from the drop of spot iron ore prices and they believe that the dip is temporary as Chinese monetary policy easing should bolster the demand of their top customer, China

The sharp decrease of Chinese iron ore fixture activity may also continue in November and the capesize earnings may push the BDI again to levels seen at the beginning of the third quarter. The high levels of Chinese iron port stockpiles, approximately at 95 mil tons, do not support a firmer return of iron ore fixture activity in the coming days, while Qinhuangdao coal stockpiles are still at low levels suggesting stronger levels of thermal coal fixture activity and smaller losses in the panamax and supramax segment that would keep resistance against the BDI's slide. The announcement from India's Supreme Court for the release of mining operations in 24 iron ore miners of Karnataka, by the end of this month, will lead to an increase in Indian iron ore exports and provide further support for small vessel classes, since iron ore from India is mostly hauled on supramax / panamax vessels.

Under the current weak freight market sentiment, secondhand asset prices, especially in the capesize and panamax market, remain at lower levels from 2010 prices, with firm vessel purchases seen every week either for vintage or modern bulk carriers. Investors seem to not loose their appetite for grasping secondhand units and sellers are now more willing to commit at the current levels before prices falling to even weaker assessments.

The index closed today at 1,835 points, up by 2.8% from last week's closing and down by 21 % from a similar week closing in 2010 when it was 2,313 points. The highest rate increase has been in the capesize segment, BCI up 13% w-o-w, BPI down 4% w-o-w, BSI down 7% w-o-w, BHSI down 7.2% w-o-w.

Capesizes are currently earning $27,188/day, an increase of $4,249/day from a week ago, while panamaxes are earning $14,079/day, an increase of $865/day. At similar week in 2010, capesizes were earning $34,500/day, while panamaxes were earning $19,079/day. Supramaxes are trading at lower levels than capesizes and panamaxes by earning $13,844/day, down by $1,059/day from last week's closing. At similar week in 2010, supramaxes were getting $15,856/day, hovering at discounted levels from capesize and panamax earnings. Handysizes are trading at $ 9,574/day, down by $785/day from last week, when at similar week in 2010 were earning $12,098/day.

In the **wet market**, the support from Turkish straits congestion has started to ease off with suezmax and aframax earnings falling again to near breakeven even lows, while in the VLCC segment the situation remains dire with the AG-USG route still experiencing earnings in negative territory. Some firmness has been seen on the eastbound routes with WS rates near to 50, but this is not enough to push the solidness of wet operators unless the market experiences enough volume of scrapping tonnage in the crude market for double hull and single hull units. The lower oil consumption in U.S. and European economies will continue to add pain in wet operators as the International Energy Agency expects that combined crude oil consumption in the United States and major European economies will erode by 400 kbd and will fall an additional 190 kbd in 2012, supporting the big gap between vessels supply picture and the demand for oil transportation in the crude market. China will be the key driver for the growth of oil demand with the Organization of Petroleum Exporting Countries predicting that demand in China will increase by 21% to 11,6 million barrels a day, from 9,6 million this year. However, Chinese oil demand has shown signs of a slowing growth in September and October and there are worries for a firmer recovery in November.

In terms of crude oil supply, OPEC crude production rose in October to 30,01 million barrels per day from 29,91 million in September, according to International Energy Agency Monthly Oil Market Report. Rising production in Libya, Saudi Arabia and Angola counterbalanced oil production declines from other OPEC members. Oil production in Libya made an earlier recovery than expected in October as oil fields continued to restart following the ending of hostilities. According to International Energy Agency's November report, Libya's crude oil supplies rose from an average of 75,000 barrels per day in September to about 350,000 barrels per day in October, while by early November the figure reached 500,000 barrels per day.

In the **gas market,** the positive LNG demand outlook that sustains the buoyed charter market environment in the forthcoming years is also supported by the Japanese shipowner Mitsui OSK Lines. MOL anticipates that the industry will need over 100 additional LNG carriers in the next 10 years with the global LNG demand growing by about 140 million tones in the current decade to reach 384 million tones in 2020.

In the **container market**, the Shanghai Container Freight Index closed last week at $919 per TEU, down by 26% from similar week closing in 2010, when it was standing at $1,243/TEU, with the Asia – Europe route loosing $897/TEU from last year closing standing currently at $613/TEU. The Shanghai – US West Coast route is the only route that has shown a marginal increase for a second consecutive week with freight rates floating at $1,500/TEU, but still 30.5% down year –on-year. The U.S. and European economic slowdown keeps consumer demand weak with negative earnings for major container operators in main trade routes. According to Paris-based consultancy Alphaliner, losses in the Asia- Europe box trade could hit $1,6bn for this year and $800 mil in the trans-Pacific.

The growth of U.S. containerized imports during September was marginal, only 1%, with a 9% yearly dropdown in toy imports at a time when their volumes should be rising and not falling, according to Journal of Commerce Economist Mario O. Moreno. He commented that high unemployment, subdued growth in disposable income and rising import prices stemming from Asia have prompted toy retailers to be highly cautious with their inventory positions. Furthermore, data from Newark, New Jersey-based Piers, container volumes on the Asia to U.S. route, the world's biggest trading route, fell 3.8% during the third quarter, the first decline since the last three months of 2009. However, the current market fundamentals do not discourage some liner operators to follow the mega containership ordering trends. The chairman of Yang Ming Marine Transport Corporation, one of Taiwan's leading container shippers, said that he is planning to make a proposal to his Board of Directors to build 16,000 TEUs boxship units to compete better on larger Asia-Europe routes.

In the **shipbuilding industry,** Chinese builders are facing rough times as many yards have not received a single order this year and they have started to suspend their operations. According to a report from National Development and Reform Commission, Chinese newbuilding orders fell to 940,000 deadweight tons, the lowest monthly figure since June, with about 30% of China's shipbuilding enterprises receiving no orders. As a result of shrinking orders and rising costs, 249 enterprises suffered losses in the first three quarters of 2011, 37.9% more than a year ago. Their total loses stood at 2,66 billion yuan ($420 mil) at the end of August, according to the Report. The China Association of the National Shipbuiliding Industry projected the country's shipbuilding industry will continue to slow moderately in the fourth outlook, with a downbeat outlook for new orders and sharp declines in existing orders.

In the **shipping finance**, DryShips Inc. signed a $141 million, approximately 60% leverage, syndicated loan agreement with Export Import Bank of Korea and ABN AMRO to partially finance the construction of four tankers, two aframax and two suezmax vessels, for delivery in Q4 2011 and H1 2012. Furthermore, Costamare sealed a new $120M loan facility with an undisclosed European lender, with certain of its 17 unencumbered vessels serving as collateral.

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