GOLDEN DESTINY

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

Week ending 24th February 2012

ECONOMIC ENVIRONMENT

The week was highlighted by an astonished deal in the world of finance as Wells Frago is said to buying BNP Paribas energy lending business. According to industry related sources, Wells Frago has agreed to buy the energy loan portfolio from BNP Paribas with a historical value of $11 billion. The deal is one of the biggest disposals by a European bank of shrinking its balance sheet.

The eurozone economy is struggling to find a steady pace of growth with sovereign debt crisis dragging down euro prosperity. The European Commission has predicted that the eurozone economy will contract by 0.3% in 2012. In its previous forecast in November, it said that the economy would grow by 0.5%."The unexpected stalling of the recovery in late 2011 is set to extend into the first two quarters of 2012," the Commission said. The biggest drag on the eurozone economy is expected to be Greece, which is now expected to see a 4.4% decline in output in the current year. Greece and Portugal were the only economies the Commission expected to contract in their previous forecast in November. Belgium, Spain, Italy, Cyprus, the Netherlands and Slovenia have now been added to that list.

In Greece, eurozone finance ministers sealed a second EUR 130billion bailout with the country asking from its private bondholders to accept a cut of 53.5% on the face value of their Greek bonds. Fitch Ratings, as expected, downgraded Greece's credit rating to 'C' from 'CCC', since the new loan package includes a debt exchange which will force bondholders to take a loss on their holdings of Greek debt. In the meantime, Greek parliament has approved bond swap deal with private bondholders with the Eurozone demanding 38 specific changes in Greek tax, spending and wage policies by the end of this month to reduce Greece's debt to 120.5% of GDP by 2020. The European Commission hints that the contraction in Greece could be larger, by expecting to exceed 6%, given the lower business and consumer confidence and lower local demand.

In China, Central Bank has made a long waited move to boost liquidity and support lending in economy by cutting the amount of money, for the first time since November 2008, that banks must hold as reserves.The People's Bank of China said it would lower the reserve requirement ratio by 50 basis points from February 24. The cut will bring the ratio down to 20.5 per cent for the largest banks, and is expected to free up about Rmb400bn ($64bn) for new lending. China's gross domestic product grew by 9.2 per cent last year. But the growth rate dropped to 8.9 per cent in the fourth quarter, the slowest rate in 10 quarters, and is expected to slow further in the current quarter. Inflation has moderated after peaking at 6.5 per cent last summer, but rose again in January to 4.5 per cent – up from 4.1 per cent in December.

In the meantime, China and Japan have expressed their support for an expansion of the International Monetary Fund's resources to aid Europe's sovereign debt crisis. In a meeting in Beijing, Wang Qishan, Chinese vice-premier, and Jun Azumi, Japanese finance minister, said they were prepared to support the IMF's "important role" in combating turmoil in the eurozone. Christine Lagarde, IMF managing director, has been pushing for an extra $500bn in funding to contain the eurozone crisis and to protect economies around the world from spillover effects. Eurozone countries have so far committed $200bn, while the US has said it will not contribute additional funds and the gap is still large to be bridged. A senior Japanese official said that Japan and China both believe that it will be exceedingly difficult to fill that gap unless the cap on the European Stability Mechanism is removed."

In Japan, trade deficit has hit a record with Imports rising 9.8 per cent from a year earlier, while exports fell 9.3 per cent, resulting in a record monthly deficit of Y1,480bn ($18.6bn), according to the finance ministry. One comforting sign was that the yen weakened against US dollar by loosing more than 3% last Wednesday, for the first time since July, when the Bank of Japan announced extra monetary stimulus while adopting a firmer target for inflation. The downward decline of Japan's strong currency yen offered some sense of relief to Japan's troubled exporters.

SHIPPING MARKET

China and Brazil are negotiating access to Chinese ports for Vale's giant fleet to end the ban on its 400,000 dwt vessels. According to company's iron ore and strategy chief, Jose Carlos Martins, Chinese ports have the conditions to receive ships and it's a question of adjustment and licensing. During a meeting in the Brazilian capital, Brasilia, on February 14, the country's Vice-President Michel Temer discussed the issue of access for Vale's 400,000 dwt "Valemax" vessels - the world's biggest dry-bulk carriers - with China's Vice-Premier Wang Qishan, according to Marco Aurelio Garcia, foreign policy adviser to Brazilian President Dilma Rousseff. Jose Carlos Martins stated that the company is prepared for alternative solutions as China needs ore and as time goes on all this will be solved. Vale is already building transhipment centres in Philippines and Malaysia, which will be ready by 2014, for transferring the iron ore into smaller vessels for China. Martins told analysts. Vale has also announced that is moving to spot ore pricing and it will sell 80% of its iron ore at spot market pricing, a move that satisfies Chinese steelmakers by gaining from falling iron ore prices. Vale and its main Australia's rivals, BHP Billiton and Rio Tinto, moved away in 2010 from a decades-old system of setting prices annually through negotiations between global miners and steelmakers with contracts that set prices according to the average spot price of iron ore over the last few months.

Vale's decision to move to spot iron ore pricing and the announcement from the People's bank of China to ease monetary policy by lowering bank's reserve requirements by 0.5%, to be effective from February 24th, are two positive developments factors for the future strength of dry bulk market.

In the **dry market**, the sentiment is still pessimistic as normally January and February are seasonally weak months with Chinese buying less iron ore. However, 2012 has begun with severe rate declines compared to 2011 levels with a sentiment for improvement in March upon the return of normal demand from Chinese New Year celebrations. According to China Iron & Steel Association (CISA), China's daily crude steel output rose 1.9 percent in the first 10 days of February as traders replenished their stockpiles following the lunar year holiday encouraging steel mills to raise production in the hope that steel demand will pick up in coming months. China's crude steel production for January 2012 was 52.1 Mt, a decrease of 13% compared to January 2011. Inventories at key Chinese steel mills monitored by CISA reached 10.98 million tonnes by the end of January, the highest since the second half of 2009 and rising 24.5 percent from earlyJanuary, CISA said in its monthly report. "It will be difficult for demand to improve significantly during end February to early March, and inventories are likely to continue rising," CISA added.

Iron ore prices are dropping as China's stockpiles remain high with the benchmark iron ore price trading at $US140/tonne in recent months from a record high of $180/tonne seen last year Reports suggested that China would raise its standard levy on Chinese iron ore producers from 60% to 80% in a bid to hamper marginal producers of the commodity. The steel market fundamentals have brought very low earnings for all dry bulk carrier vessels, even for smaller ones handies/supras, which were outperforming last year when capesizes and panamaxes were suffering. Even with a recovery in the steel's industry demand of iron ore the current vessel glut does not leave a lot of optimism for healthier dry earnings above breakeven levels after the end of the first quarter. The move of China to cut banks' reserve requirement ratio may be positive for the future of dry bulk earnings.

The BDI has followed a negative incline this week sliding to levels below 710 points with panamax vessels loosing their strength, while capesizes will remain stressed as China's iron ore inventories do not stimulate strong import market sentiment. Approximately 99.3 million tons of iron ore are now stockpiled at Chinese ports, 900,000 tons (-1%) less than was stockpiled a week ago, per Commodore Research data. However, stockpiles are incredibly high and remain close to the 101.5mt record that was set two weeks ago. In terms of thermal coal fixtures volume of activity there has a been a slowdown from high power plant and coal port stockpiles combined with poor weather and striking workers in

Australia. Coal stockpiles at Qinhuangdao, China's largest coal port, currently stand at about 8.2 million tons, 300,000 tons (4%) more than a week ago. A prompt rebound it is unlikely to be seen due to soft iron ore prices and a fragile Chinese steel market environment that does not stimulate a capesize earnings' growth.

The index closed today at 718 points, up by 0.1% from last week's closing and down by 42% from a similar week closing in 2011 when it was 1,245 points. The highest rate decrease has been in the handysize segment, BCI up 2.9% w-o-w, BPI down 11.9% w-o-w, BSI up 3.2% w-o-w, BHSI up 4.2% w-o-w.

Overall average time charter earnings are still floating at low levels with an upturn in the capesize, a downward trend for panamaxes and a stronger performance in the supramax and hadysize segments. Capesize average time charter earnings are up by 7.8% w-o-w, panamax down 11.6% w-o-w, supramax up by 3.2% w-o-w and handysize up by 5.2%. Capesizes are currently earning $5,699/day at similar levels of handysizes, showing an increase of $413/day from a week ago, while panamaxes are earning $6,705/day, a decrease of $882/day. At similar week in 2011, capesizes were earning $4,653/day, while panamaxes were earning $14,530/day. Supramaxes are trading at $6,920/day, up by $219/day from last week's closing, 21.4% higher than capesize and 3.2% than panamax earnings. At similar week in 2011, supramaxes were getting $14,483/day up by 109% from the current levels and 211% higher levels than capesizes. Handysizes are trading at $ 5,980/day; an increase by $296/day from last week, when at similar week in 2011 was earning $10,215/day.

In the **wet market**, stronger West African volumes and an active Middle East program from February to March have improved VLCC rates in the Arabian Gulf, while strong activity in the Mediterranean pushed up suezmax and aframax earnings. One VLCC fixture revealed in the period market with South Korean Merchant Marine expanding its fleet with chartered tonnage by tanking the 298,000 dwt built 2011 FPMC C MELODY for up to 5 years from Formosa Plastics. The charter deals involves three firm perid year at a rate of $26,000/day with option for two more. The agreed charter rate is considered fair when one year VLCC rates are at region of $26,000/day and few owners are willing to charter their vessels for a longer period of time at these rates.

Oil wet operators are still very distressful since earnings have not surpassed the breakeven levels and oil price spikes from Iran tensions are adding additional strains in their operating expenses. The price of brent crude oil has reached an eight month high by rising to more than $120/barrel with European Union countries seeking to find new oil suppliers and Iran hunting new buyers for its oil. European oil companies including Total of France, Royal Dutch Shell, Repsol YPF of Spain and Eni of Italy have either stopped buying Iranian oil or have halted spot purchases, industry executives said. Sources reveal that Tehran is trying to sell an extra 500,000 barrels a day of oil, or nearly 23 per cent of what it exported last year, to Chinese and Indian refiners, while it may be forced to put unsold barrels into floating storage that could be beneficiary for very large crude operators.

Under the current geopolitical risks, the price of brent crude oil seems that will remain high pushing bunkering costs at high levels with wet operators already facing a glut of crude carrier vessels. The world's largest independent oil trader, Vitol, expects crude oil prices to maintain at the current high levels of $120/barrel for the rest of 2012 and even it is possible to pass $150/barrel set in mid 2008 because of growing tensions with Iran. Vitol said that revenues rose last year to a record $297bn, up 44 per cent from $206bn in 2010, on the back of rising volumes and prices.

In terms of oil supply, OPEC will raise shipments by 0.7% this month as Libya continues to restore its production. A government official stated that Libya's oil production is presently standing at 1,35 million barrels/day, 79% of pre-war levels boosting the number of cargoes heading to European refiners, while more West African crude is going to the Far East to substitute their purchases of Iranian crude. Asian refiners have boosted their imports of West African crude since the start of this year as a result of the resumption of Libyan production, refinery closures in Europe and the U.S., and rising tension over Iran. These factors are benefiting demand cargo loadings and the return of crude carrier earnings to more positive levels.

In the **gas market**, Norwegian Investment bank Pareto said in its latest report that if all LNG projects currently filed come to fruition an additional 352 LNG carriers could be needed by 2020. According to the bank, LNG trading volumes could reach 781bn cum by 2020, an increase of 455bn cu.m compared to 2011. The impact of new Australian projects expected to come on stream in that year will increase the demand for vessels to 438, up from 361 last year. Stena Bulk of Sweden is planning to expand its LNG fleet based on LNG projects coming on stream and rising LNG demand. Demand LNG projects are elevated following Japanese earthquake last March and the increasing demand to substitute nuclear power with long term sustainable gas products. China and Japan the most hungry energy countries support the buoyant LNG sentiment. Japan's LNG imports climbed 28.2 percent from a year earlier to 8.15 million metric tons, according to a preliminary report released today by the Ministry of Finance.

Chinese LNG imports will increase 42% this year, according to Arctic Securities. China will consume 17m tones this year, up from 12m tones last year, while Japan will more than double imports of spot LNG in February from a year ago. Estimated 60-70 LNG tankers will be needed to satisfy rising demand up till 2014 according to Stena Bulk.

In the **container market**, the Shanghai Container Freight Index continues to head south by closing on February 17th at 949 points, down by 2% week-on-week with the main Asia to Europe route falling to $711/TEU from $733/TEU on January 13th. On February 18th of 2011, the Asia-Europe route was at $1,246/TEU, up by 75% from the current levels. The other main linehaul routes face also declines with the Asia to Med sliding more than 3% to $735/TEU and 5% from January 13th at $772/TEU. The transpacific routes, Asia-USWC and Asia-USEC, show a better resistance with rates at $1,798/FEU and $2,943/FEU respectively, up down by 23% and 12% from the levels of November 18th 2011. Three months ago, the Asia-USWC route was paying $1,460/TEU and the Asia-USEC $2,626/TEU. The ongoing oversupply and the current economic situation, especially in Europe with a notable lack of demand are the two key factors that prevent a prompt revival for boxship units. There are hopes for some stimulus measures in China and US economy that will stimulate consumer spending, but a real recovery is not likely to be seen before the end of 2013 given the glut of new vessels hitting the water in the next two years. Furthermore, there is little hope for a relief from the scrapping activity since the percentage of overaged, more than 25yrs old, to the existing fleet is minor.

Maersk Line has decided to withdraw 9% of capacity it deploys in the Asia-Europe rate as a response to the dull freight market status when other major liner operators are deciding hefty freight increases to reduce their losses at the current increasing bunker costs. "With this adjustment, we are able to reduce our Asia–Europe capacity and improve vessel utilisation without giving up any market share we have gained over the past two years. We will defend our market share position at any cost, while focusing on growing with the market and restoring profitability," said Maersk Line's chief executive. On the other hand, OOCL said that it will raise freight rates on the eastbound backhaul leg from North Europe to Asia as of March 15th. The general rate increase will be $200 per container. The Hong Kong-based carrier said current rates "continue to be below the required level to cover basic operating costs or transportation costs on our North Europe to Asia Trade." OOCL had previously announced a March 1 rate increase of $800 per 20-foot-equivalent container on cargo moving on the headhaul leg from Asia to Europe. Furthermore, Mediterranean Shipping announced that it will increase freight rates in the transpacific route, from Asia to the U.S. and Canada. MSC said the general rate increase "is in response to the ever increasing bunker price and in order to further recover losses made in 2011 and is therefore of utmost importance to us."

In the **shipbuilding industry,** China's financial institutions are examining the opportunity to provide ship financing for South Korean shipbuilding projects. Bank of Communications of China has recently made an inquiry to the Export-Import bank of Korea about how to provide ship financing for projects that are under construction with Daewoo Shipbuilding and Marine Engineering. In addition, the Agricultural Bank of China is reviewing the ship-financing contract with one unrevealed Korean yard. A Seoul branch manager of Bank of China said that they are studying to draw up a plan to participate financing project in well developed Korean shipbuilding industry.

In the meantime, small shipyards in southeast China's Zhejiang are struggling with some being on the edge of bankruptcy due to lack of new orders. Liu Min, a senior director at Zhejiang Jingang

Shipbuilding, which is based in the East China city of Taizhou, noted that the yard didn't receive any orders since last year and orders in hand will be finished in July. Yang Zhonghua, executive deputy general manager of Zhejiang Qiligang Shipbuilding Co, in Zhejiang province also had a similar experience. Rising costs for materials and labour amid dull market conditions have worsened the situation for small shipping companies and shipyards. Industry insiders predicted that more than 30% of the country's small shipyards are likely to go bankrupt this year.

China's Sinopacific Shipbuilding has set up a Hong Kong based owning company Crown Ship to control ships under construction for its own account as a response to the dearth of new shipbuilding orders.

In the **shipping finance**, there are predictions that finance will remain more expensive in 2012 with spreads being two-to four times higher than the levels before 2008 under the current freight and economic uncertainty. Hans Christian Kjelsrud, head of shipping at leading lender Nordea, told Lloyd's List that the bank had taken the policy decision to keep loan volumes flat for the next year or two. Money will be available to its relationship clients at between 250-400 basis points over the London interbank offered rate, with pressure on the upside. "We have probably seen the average loan margin double between early 2008 and now. New loans are priced in the 250 bp-400 bp range and I think we will see the average margin on our loan book continue to increase throughout the year," commented Mr Kjelsrud.

In terms of **ship financing deals**, Precious Shipping, the largest Thai dry bulk shipping company, has signed a $100 million term loan with Export-Import Bank of Thailand to finance as much as 80 percent of the acquisition costs of new and second-hand vessels.

MARIA BERTZELETOU – GOLDEN DESTINY RESEARCH DEPARTMENT

For more Research Services, please contact us:

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