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

Week ending 15th June 2012

ECONOMIC ENVIRONMENT

The upcoming elections in Greece and Spain's bailout deepened the uncertainty in the eurozone, while worldwide scenarios for a potential exit of Greece from euro threaten the dynamic of the single currency euro. The week has been marked by Spain's bailout aid, being the fourth member of the euro area requesting rescue from European authorities, and worries for Greece not honoring its commitments agreed for the European structural funds. Despite the broad based support for euro membership among all major Greek parties and the general public, S&P is on the view that there is at least a one in three chance that Greece will exit from euro.

French president Mr. Hollande warned Greece that some countries in Europe would want the country to be forced out of the eurozone if the country does not respect its engagement to international creditors after the upcoming elections, while US President Obama underlined that a potential exit of Greece from euro would cause more harm on the worldwide economy.

In the meantime, Spain's $100billion euro's bailout created a negative sentiment for the eurozone's stability, while Moody's downgrade on Spain's credit rating to Baa3 from A3, one level above junk, citing the nation's increased debt burden, created more confusion in the capital markets. Germany stated that outside inspectors will supervise the eurozone's emergency loans for Spanish banks, just like other financial bailouts over the past two years, despite Madrid's insistence that it would escape the onerous conditions imposed on Portugal, Ireland and Greece. Moody's also lowered Cyprus's bond rating to Ba3 from Ba1 due to the increased likelihood of a Greek exit from the euro area and the amount of support that the government may have to extend to Cypriot banks.

In U.S., country's trade deficit shrank in April as exports retreated for the first time since November, as government data showed. According to Commerce Department, the monthly gap contracted 4.9% to $50,1 billion, while economists are worrying that European crisis could reduce demand for U.S. exports in the coming months as Europe accounts for one-fifth of US exports.

In Japan, the International Monetary Fund has renewed its pressure on the government to triple the national consumption tax to at least 15% for the country dealing with its huge public debt. The IMF said Japan's real GDP growth is expected to slow from about 2% in 2012 to 1.75% in 2013, thus it is urgent need for the country to tackle its huge public debt as the eurozone crisis threatens to damage further the global economic outlook. While more than 90% of Japan's public debt is held domestically, even a relative small increase in Japan's risk premium could have a spillover effect on global risk returns and growth, the IMF warned. Fitch Ratings has already highlighted the deteriorating economic conditions in Japan by downgrading the country's credit rating from double A to A plus.

In China, the People's Bank of China lowered its benchmark interest rate by 25bps to 6.31%, for the first time since 2008. The rate cut marks Chinese government's efforts to stimulate its economy, while it has lowered bank reserve ratios three times since December 2011 and increased lending up to 16% in May from the previous month. One more supportive factor is the rise in Chinese bank lending during May as an important indication that the government tries to support its economy. Chinese banks issued approximately 793 billion yuan ($125 billion) in loans in May, 111.2 billion yuan (16%) more than issued in April. During the first five months of this year, Chinese banks have issued 3,9 trillion yuan ($614 billion) in new loans, which is 400 billion yuan (11%) more than was issued during the first five months of 2011. The country will continue to apply stimulus measures until inflation returns to 2011 levels. China's producer price index (PPI), an indication that measures inflation on an industrial level, decreased by 0.7% in April and 1.4% in May compared with a 6.8% increase in April 2011.

SHIPPING MARKET

The second quarter of the year is near to end with the global economy being in a downward recession from European crisis and the shipping market industry fearing more the vessel supply and not the cargo demand. Dry and wet markets are still under serious risks with the recent lowering costs of bunkers offering an air of optimism in owner's operating expenses that are struggling to survive at the current spot rates, while the supply of vessels threatens their profitability. Scrapping removals, lower ordering activity and cold or hot lay ups of tonnage are the three key remedial factors for the imbalance in the freight markets.

Japanese giant shipwoner, Mitsui OSK Lines, announced this week its decision to scrap or place in cold lay up 10-20 capesize bulkers in response to the dire market. The general manager of Mitsui OSK Lines, Jun Hoshino, said Japan's biggest shipowner aims to reduce its exposure to the deteriorating Capesize spot market. Rates now average $4,100 per day, which is grossly below daily operating costs of $20,000/d. "We have about 100 Capesize vessels, and 20% of these are trading in the spot market," Hoshino explained. "We are trying to reduce our exposure to the spot market, especially when we have about 10 Capesize newbuildings that will be delivered from 2012-13 and it's too late to cancel the contracts." Hoshino said: "The number of vessels in warm lay-up is always changing, depending on market conditions." Until now, MOL scrapped Capesize ships that were 23 years or older but will now scrap ships that are 15 or older. MOL plans to scrap five vessels by the end of March 2013 and is considering the disposal of others. MOL is weighing measures to rejuvenate the fleet and increase vessel quality by accelerating scrapping, aiming to provide the highest quality transport services.

In the **dry market**, the BDI has shown some signs of improvement by standing …. Points above from last week's closing. Panamax activity led to a stronger momentum, but capesize earnings are still subdued by floating below $4,000/day pushing the BDI below the psychological barrier of 1,000 points. Capesize average time charter earnings fell to 15 month lows, while the reached levels of November 2008, from dried Chinese demand during the first days of June. However, Chinese iron ore imports grew by 19.7% year on year in May with China importing 63,84 million tons of iron ore, up 10.7% from the previous month, as per data from China's customs authority. Furthermore, iron ore shipments from Port Hedland, the world's largest bulk export facility, hit record high volumes last month. According to figures compiled by port Hedland, shipments to China were 17,4mt, almost 40% up on the 12,5mt exported from Western Australia port a year ago.

June seems to be one more fragile month with smaller vessel categories, panamax and supramax units finding a greater support in average time charter earnings by moving to more than $7,000/day and $10,000/day respectively. Chinese industrial production continues weak with hefty iron ore and coal port stockpiles delaying the early recovery of the spot freight market.

Chinese demand for imported iron ore is expected to stay low in June as steel production is under pressure due to the weakening in Chinese steel prices pushing capesize average time charter earnings to dreadful levels. The high iron ore port stockpiles are one more issue for the low Chinese import activity. According to Commodore Research, approximately 96,7 million tons of iron ore is stockpiled at Chinese ports, 200,000tons (1%) more than a week ago. The imported demand for thermal coal is also low due to the very large amount of vessels being chartered in April to haul thermal coal to China and the large amount of coal stockpiles. Coal stockpiles at Qinhuangdao, China's largest coal port, currently stand at approximately 8,9 million tons, 1mt (13%) more than a week ago. Generally, there is a positive outlook for a firmer Chinese demand as Chinese government is stepping in stimulus measures to ease further monetary restrictions and stimulate growth.

The BDI recorded this week a five days' straight increase with the BPI and BSI recording gains and the BCI being on a free fall, while panamax average time charter earnings are currently yielding twice the levels of capesizes, more than $8,000/day.

The index closed today at 924 points, up by 5.3% from last week's closing and down by 34% from a similar week closing in 2011 when it was 1,405 points. The highest rate decrease has been in the capesize segment, BCI down 6.1% w-o-w, BPI up 16.5% w-o-w, BSI up 6.1% w-o-w, BHSI up by 7.5% w-o-w.

Overall average time charter earnings are floating at lower levels than 2011, despite stronger signs for smaller vessel categories, panamax and supramax units. Panamax, supramax and handysize average time charter earnings increased by 17%, 6.1% and 6.7% respectively, while capesizes fell by 18.4%.

Capesizes are currently earning $3,471/day, a decrease of $784/day from a week ago, while panamaxes are earning $8,469/day, an increase of $1,203/day. At similar week in 2011, capesizes were earning $8,842/day, while panamaxes were earning $15,867/day. Supramaxes are trading at $11,097/day, up by $644/day from last week's closing, 220% and 31% higher than capesize and panamax earnings respectively. At similar week in 2011, supramaxes were getting $13,840/day, hovering at 57% higher levels than capesizes versus 220% today's levels. Handysizes are trading at $ 9,549/day; up by $606/day from last week, when at similar week in 2011 were earning $10,961/day.

In the **wet market,** the brent crude price has fallen below $100/barrel for the first time since October 2011 and bunkering prices dipped below $600 per metric tons in June, providing a comfort to crude tanker operators who are still facing weak freight rates. At the end of last week, IFO 380 bunker fuel closed below $600/ton in Singapore, Fujairah and Rotterdam, marking the first time bunkering costs falling below $600/ton since February 2011. OPEC, which supplies 40% of the world's crude, normally responds to a sharp drop in prices by curbing production, but Saudi Arabia's current policy objective is to prevent crude price from rising to more than $100/barrel in order to mitigate the risks of the high oil price that posed to the global economy.

OPEC's oil surplus in an attempt to cushion the impact of US and EU efforts for imposing sanctions on Iranian oil exports drove brent prices to record lows from the highs seen, excess $120/barrel, during the first quarter of the year. According to OPEC's oil market reports, the group's monthly crude output has exceeded 31milion barrels/day for much of this year. Estimations by the International Energy Agency show that OPEC production in May stood at 31,87million barrels/day, 1,4m barrels/day higher than December and 2,8 million barrels/day more than May 2011. The increase is driven by Saudi Arabia with its country's oil Minister, Ali Naimi, stating this year that he wants oil price to be in the region of $100/barrel. Gulf Oil Review showed that Saudi Arabia supplied the market with 9,9 million barrels/day in May, the highest level seen for this year. Although oil prices have dipped below double digit figures, OPEC's president made clear that new individual quotas for countries are unlikely to be agreed as long as the prospects of sanctions on Iran exist.

The lower fuel cost is a positive factor for the beleaguered tanker operators, but the weak freight market environment has not returned yet in euphoria. The prosperity of crude tanker segment is heavily dependent on China and US oil demand, when eurozone sovereign debt crisis has overshadowed economic growth curtailing oil demand. China remains the lying factor behind more intensive demand for very large crude carriers as crude imports into China hit 6m barrels/day in May, up by 18% from the same month last year, according to preliminary data from Chinese customs.

However, DNB NOR Markets Research is posing a positive outlook for the tanker industry by raising its tanker rate forecasts to a 23% increase for 2013 and 13% for 2014-2015. DNB is seeing to a zero fleet growth over the next 12 months, 2% growth in 2014 and 1% growth in 2015 as owners are resisting in tanker ordering and excess vessel supply seems to get balanced with demand. DNB forecasts tonne-mile demand growth of 2.7% for 2012, 2.5% for 2013 and 2.2% for 2014. Tonne-mile demand growth will be particularly impressive in the second quarter of this year, according to DNB. It forecasts an 11%

year-on-year increase in sailing distances for crude tankers, while the crude tanker orderbook, as a percentage of the fleet, is said to have been halved from 51% in 2009 to 25% today.

In the **gas market**, strong Asian LNG demand has supported prices for liquefied natural gas tankers of 160,000 cubic meters in the region of $200mil compared with the plunge of values in the main conventional vessel segments, bulk carriers and tankers. Japan, the world’s biggest buyer of LNG, increased imports by 12% in the first four months with estimations for the country requiring as much as 90 million metric tons of LNG a year by 2025, according to Shigeru Muraki, the chief executive of Tokyo Gas Co.’s energy solution division. In the meantime, Qatargas has signed a long term contract to provide $1million tons of LNG per year to Tokyo Electric Power Company, which is considered to be the first agreement between the two companies. In addition, China may increase natural gas consumption by 2030 to 600 billion cubic meters, according to Wood Mackenzie, because of economic growth and a move to reduce its reliance on coal.

Pareto Securities is seeing that an additional 175 LNG carriers are needed by 2020, while Fearnley Fonds said this number would be required by 2017. Pareto Securities also forecasts a rise in rates to $140,000/day in 2013, while current rates at $130,000/day have already exceeded forecasts of $120,000/day.

In the **container market**, charter market is moving upwards with the Shanghai Container Freight Index ending up by 2% in last week, following four consecutive weekly declines, due to 14% and 9% weekly freight increases in the Shanghai-USWC and Shanghai-USEC routes respectively. Freight rates on the Shanghai-Northern Europe and Shanghai-Mediterranean routes have fallen by 4.5% and 3.4% respectively from the end of May, but they are standing 90% and 86% above from June 2011. Freight rates are now $1,634/TEU on Shanghai-North Europe, from $860/TEU in 2011, and $1,783/TEU on Shanghai –Mediterranean, from $956/TEU in 2011.

According to Alphaliner, the China Container Freight Index, one more overall indicator of the container shipping market, reached a record of 1,336 points in mid-May, the highest level since the index was introduced in January 1998, but the carriers’ revenues in the first quarter failed to reflect the full extent of index’s increase. According to Mr. Andersen, Chief Executive of AP Moller Maersk Group: “If the upward trend proves sustainable, it may be enough to pull the shipping industry out of a four year slump from an oversupply of vessels and weak demand. The recent rate increases indicate that most container shipping lines are probably operating at break even levels. This is a dramatic change from last year when Maersk Line and its rivals were dragged deep into the red.”

In the meantime, Maersk Line has announced its plans to implement freight rate increases, as this is the normally busy period where liner operators are raising its fees to benefit from European retail activity with the placement of more orders for Christmas. The company intends to charge an extra $350 as a peak season surcharge for every container transported on the Asia-Europe route from June 15. “Rates have firmed up during 2012 but they are not at a satisfactory level yet that enable carriers to make sustainable returns, thus we believe that this is the right time to bring rates further up. “

In the **shipbuilding industry**, China Shipbuilding Industry Co (CSIC) has proceeded to the sale of convertible bonds worth RMB1.3bn ($204m) to invest in shipyard upgrades and construction of more offshore vessels. The Shanghai listed yard is seeking to expand in the offshore newbuilding business and increase its profitability due to lower demand for main conventional vessel types, bulk carriers and tankers.

Mitsubishi Heavy Industries is seeking to expand its shipbuilding activities outside Japan, particularly in India by acquiring a stake in the shipbuilding arm of India’s Larsen & Tourbo within a few years.

In the **shipping finance**, the tight ship lending status has affected shipowners for expanding their business with private equity investment firms showing their intention for investing in the shipping industry under recession at the current low asset prices. According to Frankfurt based DVB Bank, European banks, which provide about 80% of the shipping industry’s financing are retreating their lending because of a lack of dollar funding and stricter EU capital requirements. However, China welcomes more lending with policy makers reducing the amount of cash that banks must hold as reserves for the third time in six months as per announcement from the central bank on May 12th. Export-Import bank of China, China's state controlled export credit financing agency, is looking to increase funding support to overseas shipowners willing to build in China, where yards are struggling to secure new business. CEXIM is also actively seeking new tie-ups with existing ship financing banks to increase its exposure to syndicated shipping loans. "We are actively looking for new opportunities and good clients with financial transparency, accountability and a willingness to co-operate with China. We are also looking for banking partners willing to co-operate on syndicated loans", Cexim deputy general manager for transport finance Chen Bin told Lloyd's List in an exclusive interview. Cexim officials are aiming to extend the bank's existing exposure to shipping that stands at around $12bn, of which $5bn is already committed.

Ship financing is more easily accessible for offshore newbuilding projects with Norwegian drilling company, Fred Olsen Energy securing a five year $1,5 billion credit facility for fully financing its newbuilding drillship Bolette Dolphin. The facility will be provided by 12 unnamed international banks and Norwegian export credit agencies. Furthermore, the Export-Import bank of Korea (Korea Eximbank) announced last week that it will provide $300mil of final instalment for a Brazilian shipowner Petroserv's semi-submersible drilling rig, constructed by Daewoo Shipbuilding & Marine Engineering of South Korea, through Brazilian local bank Banco Itau BBA.

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