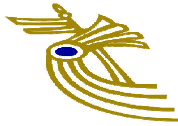

This Week's News: A snapshot on the economic and shipping environment

Week ending 14th September 2012

ECONOMIC ENVIRONMENT

Fears for eurozone crisis eased this week with euro currency against dollar rising at four month peak of $1.29 following decision of German's constitutional court to allow Berlin to ratify the European Stability Mechanism. The court ruling on eurozone's €500bn rescue fund was greeted by Angela Merkel, German Chancellor, as making "a good day for Germany and a good day for Europe." Germany had sent a "strong signal" of its determination to resolve the eurozone crisis, she told the Bundestag in Berlin.

Greek economy remains a serious headache for the eurozone stability with Greek Prime Minister trying to pass the package of EUR11.5bn spending cuts to be implemented in 2013-2014. Greek Prime Minister has met with ECB President Mario Draghi to discuss ways the European Central Bank could support Greek debt sustainability. According to Der Spiegel magazine, German Chancellor Angela Merkel has decided that Greece must not be allowed to leave the Eurozone in the autumn and therefore is prepared to grant the country more flexibility over its bailout payments The magazine report also notes that German Chancellor wants to avoid extending a third rescue package to Greece, because of the difficulties she could have to get it passed in the German parliament.

In USA, the economic recovery seems not reachable with US Federal Reserve announcing that it will extend its quantitative easing programme into a third round in its latest effort to increase the pace of US economic recovery. US trade deficit and poor figures for jobs' creation remain adverse factors for a rebound. Commerce Department figures showed that US trade deficit widened in August by 0.2% to $42 billion, smaller than projected, from a revised $41.9 billion in June. Reflecting the global slowdown, current figures showed that US posted a record $29.4 billion shortfall with China, while the deficit with the European Union increased 42% to $12 billion, the widest since October 2007. US exports to Germany were the weakest since February 2010. In addition, there is still a lack momentum in US labor market as US created only 96,000 jobs in August, below market expectations of 130,000, but unemployment rate fell to 8.1% in August from 8.3% in the previous month.

Eurozone sovereign debt crisis and China's slower economic growth are serious obstacles to US export growth. Moody's rating agency has threatened to downgrade America's triple A credit rating and join with its rival Standard & Poor's, which cut US top rating last year, if Congress fails to reach a deficit reduction deal by the end of 2013.

In China, news for the approval of a stimulus plan worth of $157 billion for 60 infrastructure projects by China's National Development and Reform Commission along with a surge in Chinese bank lending are providing a sense of optimism for a stronger economic growth for the world's second largest economy. Chinese banks extended Rmb703.9bn ($111.07bn) of new local-currency loans in August, the People's Bank of China said on Tuesday, beating market expectations of Rmb600bn and giving hope that the economy could get a boost from new credit. The move comes following cuts of interest rates from Central bank twice this year, in June and July, and lowering of banks' reserve requirement ratio (RRR) by 150 basis points in three steps since November, but these policy actions seemed that failed to halt the slowdown of China's economic growth as there are fears that the country may miss its official 7.5% growth target for 2012..

China's Prime Minister, Wen Jiabao, has promised Beijing will do more to boost growth in Chinese economy in the economic months and he insisted that his government still had the ability and the will to

stabilize the economy, albeit at lower levels than the annual average 10.7 per cent growth seen throughout his time in office. Investment banks have already downgraded their outlook on China's economic growth for 2012 and 2013. Barclays Capital has cut its forecast on China's annual economic growth for 2012 to 7.5% from 7.9% and its 2013 growth forecast to 7.6% from 8.4%.

In the meantime, Chinese trading figures for August are disappointing with much of the weakness stemming from eurozone crisis, China's biggest trading partner, with exports to EU falling almost 13% in August from a year earlier. According to latest figures released, China's imports dropped 2.6% in August from a year earlier, while exports increased just 2.7%. The export growth was higher than July's 1%, but far below the double digit growth rates that China was used to show over the past decade.

Other Asian countries are also suffering with Japan slashing its second-quarter growth estimate and South Korea unveiling $5.2bn of fiscal stimulus measures to boost its economy. Japan's output increased by 0.2% between April and June, lower than the initial reading of 0.3% from mainly weaker government spending and private-sector investment. In South Korea, the government responded to weak export data, 6.2% fall in exports from last month, with a new set of fiscal measures worth $5.2bn, three months after a package worth of $5.7bn.

SHIPPING MARKET

Outstanding news for the construction of valemax berths in China against the official ban on Chinese ports accepting 400,000dwt ultra large bulkers supports Vale's expansion plans, while it creates concerns for the struggling capesize owners that are hoping on a rebound of iron ore trading growth and higher demand for transportation from Brazil to China. China's National Reform and Development Commission confirmed that the Ningbo-Zhoushan port complex has begun initial works to construct two iron ore berths for the giant vessels after receiving final approval. "The project will have positive impact on the integration of Ningbo and Zhoushan. China is seeking to improve the iron ore transshipment operations at large ports across the nation and this project can meet demand from steel plants in central China", according to port's website.

Positive development for the current pessimist outlook in the dry bulk segment is the approval of a stimulus plan for 60 infrastructure projects worth of $157 billion by China's National Development and Reform Commission as an injection to the country's economic slowdown, similar to the $630 billion stimulus program applied in 2008-2009. The infrastructure project focuses on building ports, highways and airports that could spur demand for iron ore and other dry bulk imports in the world's second largest economy and push freight market rates again to profitable healthy levels.

In the **dry market**, BDI keeps its constant fall with levels below 700 points from the beginning of September by falling to 661 points on September 12th, before rising to 663 points on Thursday from a rise in capesize average time charter earnings to more than $3,500/day. The BDI reached the lowest level of December 5th of 2008, when it had closed again at 663 points, while the continued weakness in capesize and panamax segment pushes the BDI downwards to reach again the 26year historical bottom low of 647points on February 3rd 2012. Supramax and handysize vessels are trying to resist with a soft rise in average time charter earnings during the first days of September, but their rise is not enough to pull the BDI out of its crisis.

The fall in the panamax segment seems tremendous with average time charter earnings floating at levels below $4,500/day, when capesize average time charter earnings finally surpassed the barrier of $3,500/day, for the first time since August 14th. Supramax average time charter earnings have reached levels above $8,500/day, while handysizes are hovering below $7,000/day. Supramax segment seems to be the healthiest under the current market fundamentals of oversupply growth, with panamax orderbook showing the strongest volume of ongoing vessel deliveries, but US drought is still a headwind for grain trade and firmer earnings. Projections for global grain trade have been reduced again with USDA releasing lower new projections for 2012-2013 as it estimated that global grain will total 287.64 million tons, when one month ago it projected that it would total 289.37mt.

The price of iron ore fetched again levels above $100/ton this week as benchmark iron ore with 62 percent iron content rose 5.5 percent to $100.20 a tonne last Tuesday, the first time in three weeks, based on data from information provider Steel Index. "Iron ore prices could continue to gain over the next week or two, but I still question the long-term sustainability of this given the weak steel fundamentals," said Rory MacDonald, iron ore broker at Freight Investor Services. The announcement for a new stimulus plan for 60 infrastructure projects played a key role for the increase of iron ore price with prospects for a firmer Chinese iron ore demand.

Despite the rebound in iron ore prices analysts remain cautious as the infrastructure projects are to be implemented over several years. In the short term, China's steel mills are expected to continue to use their iron ore inventories and actual demand for steel is likely to remain relatively weak. Although China's August imports of iron ore were strong, rising 5.7 per cent year on year at 62.5m tonnes, showing a 5.7% year-on-year increase and 7.9% from July, analysts said September shipments were set to decline. Thus, prospects for a robust short term recovery in the capesize segments with average time charter earnings above $10,000/day seem not yet near feasible.

A positive short development for the capesize segment is the recent announcement from India for suspending iron ore production at all ore mines in the Indian state of Goa due to illegal activities by forcing the country to import a large amount of iron ore, since Goa is capable of producing roughly 55 million tons of iron ore per year. The duration of the ban will determine its magnitude of influence on the dry bulk environment as a result of an increase in seaborne iron ore trade and ton miles.

BDI closed this week at 662 points, down by 1% from last week's closing and down by 64% from a similar week closing in 2011, when it was 1,814 points. The highest decline has been in the panamax segment and the highest increase in the handysize, BCI up by 1.5% w-o-w, BPI down 16.1% w-o-w, BSI up 0.2% w-o-w, BHSI up by 4.1% w-o-w.

Capesizes are currently earning $3,660/day, an increase of $208/day from a week ago, while panamaxes are earning $3,987/day, a decline of $771/day. At similar week in 2011, capesizes were earning $24,739/day, while panamaxes were earning $14,014/day. Supramaxes are trading at $8,725/day, up by $22/day from last week's closing, 138% and 118% higher than capesize and panamax earnings respectively. At similar week in 2011, supramaxes were getting $15,125/day, hovering at 39% lower levels than capesizes versus 138% today's higher levels. Handysizes are trading at $ 6,952/day; up $267/day from last week, when at similar week in 2011 were earning $10,070/day.

In the **wet** market, better volume of fixture activity in the AG has diminished the levels of loss of earnings with WS in AG-USG route rising to WS27 from WS22 last week, but equivalent time charter earnings are still negative. The forward supply of VLCCs in the AG is now estimated to be 62 vessels, from the increase in fixture activity, the lowest since May. In AG-SPORE route, WS is now up by points to WS40 at $9,900/day and the same rise has also been viewed in AG-JPN route. In WAFR-USG route, WS is now at 42.5 with $12,900/day from WS41.5, while in WAFR-CHINA is WS38.5 with $6,900/day from WS36 in the previous week.

In the suezmax market, limited enquiry in both Mediterranean and West African keeps WS rates at extremely low levels. In WAFR-USAC route, WS is steady at 57.5 with $7,300/day for six consecutive weeks and in the B.SEA-MED route WS has shown no change from last week at WS55 with time charter equivalent earnings below zero levels. In the aframax segment, Caribbean aframax market remains stable with WS in the CBS-USG route being at 92.5, the same as last week, with time charter equivalent earnings of $15,200/day.

In the product segment, WS in AG-JPN route rose by 1point for 75,000dwt units to WS99 at time charter equivalent earnings of $15,300/day from WS98 in the previous week, while WS is unchanged at WS120 for 55,000dwt units at $13,300/day time charter equivalent earnings. In the CBS-USAC route, WS for 38,000dwt units gained 2.5 points by rising to WS107.5 with $4,100/day.

Spot brent crude oil price is above $115/barrel with fuel IFO 380 cost in Fujairah hovering below $700/ton from more than $700/ton during the first quarter of the year. Brent crude oil prices have risen from OPEC last meeting in June, when they were below $100/barrel with Saudi Oil Minister stating that the world's largest oil producer is worried about high oil prices and would try to moderate them. Iran managed to increase its crude exports last month and rebound to pre-sanction levels by doubling its August crude exports from 570,000 barrels/day in July to nearly 1,2 million barrels/day illustrating that Iran is trying to fight sanctions imposed on its energy industry by US and EU. However, the rise seems to be temporary as USA and Europe are preparing to tighten sanctions on Tehran over its nuclear program.

The IEA said reduced supplies from Iran had partially been offset by increased production from other big oil exporters, such as Nigeria, Angola and Iraq. Iraqi oil output exceeded 3m b/d in August, its highest level in more than three decades. In addition, oil output by the big three Gulf producers posted a net increase of around 400,000 barrels/day in August from July as a sharp rise in Kuwait output eliminated cuts of production in Saudi Arabia and United Arab Emirates, according to Gulf industry sources.

In terms of oil demand, some positive signs emerged as the IEA increase slightly its estimates for oil demand this year and 2013, but said a sluggish global economy and high crude prices would keep demand growth modest. The agency predicts that global demand for oil would grow at a steady rate of about 0.8m b/d this year and next, with total demand averaging 89.8m b/d in 2012 and 90.6m b/d in 2013. Compared with earlier IEA projections, that represents an upward revision of 100,000 b/d for each year. However, US economy's target for eliminating its dependence on crude oil imports by 2020 by increasing its production has already posed its side effects on VLCC earnings. US has already reduced its long-haul imports from the Arabian Gulf in favour of cheaper near sourced oil (cheap shale oil and North and Central American production) and dragging VLCC earnings below opex for more than one year.

Data from Opec's latest monthly report shows that US crude oil imports dropped in August for the second consecutive month by 296,000 barrels per day, to average 8.6m bpd, a 3.3% decline from the July levels and the lowest since April 2012. In addition, US crude production is going to average 6,3m barrels/day in 2012, an increase of 600,000 barrels/day from last year and the highest level since 1997 and it is estimated that will rise even higher to 6,7m barrels/day in 2013, according to data from the IEA.

Furthermore, Chinese crude oil demand is on decline with Organisation of the Petroleum Exporting Countries estimating that demand for OPEC crude oil will decline by 400,000 barrels/day and China will play key role to this decline. China imported 18.4 million metric tons of crude oil in August, or around 4.35 million barrels a day, the lowest volume since October 2010, preliminary data from the General Administration of Customs showed Monday. The figure represented declines of 15.7% from July and 12.5% from August 2011. In its August report, the International Energy Agency revised down the growth of Chinese demand to 240,000 bpd for 2012, sharply lower than its previous estimate of 363,000 bpd.

In the **gas** market, Japan's July LNG imports increased by 10% to 6.4mil metric tons, the first increase since the peak of 7.7million metric tons in January. Asia is the largest demand center for LNG exports with Japan leading as the world's largest LNG importer and there are expectations that the global growth of LNG imports will continue to come from Asia region with the potential for a firm growth of Chinese LNG imports being a significant future demand key driver for the profitability of LNG's spot freight market environment.

One interesting agreement came to light between Total Gas & Power Limited and South Korean company Kogas (Korea Gas Corporation) that underlines the positive outlook of the LNG segment. Total announced that its gas trading affiliate Total Gas & Power Limited has signed an agreement with South Korean national company Kogas (Korea Gas Corporation) for the purchase of 0.7 million metric tons per year of LNG from the Sabine Pass terminal in Louisiana for a duration of twenty years. "The agreement will enable us to meet the needs of our customers worldwide as effectively as possible," said Philippe Sauquet, Total's President of Gas & Power. "With this agreement, we are consolidating our leadership in a growing LNG market and taking a position in an LNG export market that is emerging in the United States. The execution of this new long-term agreement between Total and Kogas also strengthens the

ties between our two companies. It follows on from the recent acquisition by Kogas of an interest in the GLNG project in Australia and the execution of a sale and purchase agreement between Total Gas & Power and Kogas for 2 million metric tons per year of LNG."

In the **container** market, the Shanghai Container Freight Index keeps its constant fall for fifth consecutive week from significant declines in major Asia-Europe and Asia-Mediterranean routes. The index closed on Friday 7th September at 1267, 2% down week-on-week and 13% down from the peak of June 29th at 1460. However, it is still above 2011 levels, when on September 7th of 2011, the Shanghai Container Freight Index was at 1041 with Asia-Europe rates standing at $793/TEU against $1284/TEU today's levels and Asia-Mediterranean standing at $1128/TEU against $1325/TEU today's levels.

During the last week, Asia-Europe rates fell for sixth consecutive week to $1,284/TEU, 3% down week-on-week and 32% down from the highest 2012 level of $1888/TEU on June 29th, while it is up by 62% year-on-year. Rates to Asia-Mediterranean keep also their downfall for tenth consecutive week by slipping to $1325/TEU, 3.3% down week-on-week and 30% fall from 2012 peak of $1892/TEU on June 29th, while it is up by 17.5% year-on-year.

The softening of freight rates during the summer season seems to continue the downward direction for the autumn period with transpacific routes posting a firmer performance with smallest falls. Rates in Asia-USWC gained $5/FEU this week by rising to $2490/FEU, up by 0.2% week-on-week and 9% down from the peak of $2739/FEU on June 15th, while Asia-USEC is on decline for fourth consecutive week with rates falling to $3720/FEU, 0.4% down week-on-week and 9.2% less than the recent high level of $4098 on August 10th.

In the period market, rates remain depressed with a large amount of vessels in the subpanamax and small panamax segment looking for employment. In the segment, 3,000-4,000 TEU sources suggest that around 109 vessels will become available for employment, while in the range 2,400-2,900 TEU the number is even bigger for about 180 vessels, while rates are being squeezed below $7,000/day, from more than $12,000/day last year. According to Alphaliner, the current weakness and expectations for lower rates in the coming months have shortened charter periods with flexible periods becoming increasing popular with charterers, such as 4-12 months period, 6-9 months period, 2-6 months period. This flexibility allows carriers to adjust quickly their fleet with an early redelivery or to retain the ships at current low rates until the ultimate redelivery date.

The capacity growth remains a serious headache for liner operators with Alphaliner estimations for a 6.6% growth in the global cellular containership capacity for the last 12 months to reach 16.17mil TEU at September 1st. The year-on-year net growth stands at 1.015 mil TEU, with 1.25mil TEU of new vessel capacity delivered and 235,000 TEU deleted.

Under the current weakness of the freight markets, some players have boosted their performance during the second quarter based on stronger spot freight environment and the question is if their firm position would be kept also in the third quarter. French container line, CMA CGM posted a $178m net profit for the second quarter, from $248mil loss reported in the previous quarter. The positive figures reflected a sharp acceleration in business growth, according to CMA CGM management, who confidently predict a repeat performance for next quarter. The number of teu carried during the period was 2.7m, up 8% from the second quarter of 2011.

In the **shipbuilding industry**, China is facing severe difficulties from the slump of the newbuilding demand with local sources revealing that the number of China's operating shipyards fell to some 300 from around 3,400 in 2008. Dongfang Shipbuilding, the first Chinese yard listed on London's AIM Exchange in August 2011, was delisted and banks are rushing to seize its assets, while China's largest private owned shipyard Rongsheng Heavy Industries has financial difficulties from lower contracting volumes. An official from the China Association National Shipbuilding Industry (CANSI) said: "The biggest problems are low ordering volumes and financial difficulties. Also, structural problem of high proportion of small and medium shipyards, reaching 60%, is problematic".

There is a belief that the status of Chinese shipbuilding nation is so serious that is not at all unlikely for Japan to surpass China, according to Analyst Park Mu-Hyun of E*Trade Securities in Korea, and regain the second place in the global shipbuilding industry.

In the **shipping finance**, state owned Bangladesh Shipping Corporation revealed that it had been granted a $171m loan to build six ships at Chinese yards on very preferential terms by the China National Machinery Import and Export Corporation.

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