Chinese Ship Finance for Greek owners – reality and promise

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Nafs, November 2011

It is three years ago that the US subprime crisis triggered the 2008 international banking crisis, and witnessed the collapse of Lehman Brothers and the financial bailout of top US banks (i.e. Citibank and Bank of America, etc.) and financial groups (e.g. AIG) by the Fed. The crisis spread like wildfire throughout the world's banks. Massive bank exposures to toxic products was discovered, e.g. RBS, which led to an acute loss of confidence both by depositors, as well as between the banks themselves. The above loss of confidence manifested itself in the collapse of the inter-bank market, the, until then, corner stone of bank funding. Thus began a bank de-leveraging process, which still continues, as banks sought to downsize their balance sheets due to lack of funding.

Bank regulators reacted by scrutinizing bank capital adequacy and ensuring financial transparency of banks' exposures as well as adequate loan provisions.

The above series of events hit western banks and left Far Eastern banks largely unaffected. The latter were operating in fast growing economies offering good loan opportunities and had better loans to deposits ratios. Moreover, Far Eastern banks had less reliance on and a reduced exposure to toxic products.

The re-trenching of western banks gave Far Easterners a great opportunity to assert their strengths and encroach into sectors of the international lending market in which, until then, they had been largely absent.

A key example of such a market is ship finance. Both global ship finance, as well as Greek ship finance, came to an abrupt halt and reversal in 2009/2010. In accordance with Petrofin Bank Research © Greek ship finance, which had risen by an average annual 23.7% between 2001 and 2008 to $73.23bn, fell in 2009 to $67.02bn and in 2010 to $66.23bn. It should be noted that in accordance with the end 2010 ship finance bank exposures, Chinese banks had a total of $650m in Greek ship finance or approximately only 1% of the Greek ship finance totals.

Increasingly, in 2009 and 2010, western bank fresh ship finance ground to a halt. Far eastern banks in general and Chinese banks in particular, were seen as 'rays of hope'. To a capital hungry and starved shipping industry, over-committed with newbuilding orders, the prospects of obtaining inexpensive finance from the Far East was most alluring.

The development of sovereign risk exposures, affecting European bank capital adequacy, in 2011, the increasing problem of the EU banks in relation to Greece and other EU countries, e.g. Ireland, Portugal, Spain, Italy, etc. and the need to increase capital adequacy to 9% as of 2012 in accordance with Basle III, have all led to the further retrenchment of European banks in the second half of 2011. According to Petrofin Bank Research ©, about to be published this month, approximately 90% of all western ship finance banks, are currently reducing their ship finance exposures. Consequently, the past 3 years, have represented an enormous opportunity for Chinese banks in particular to build up their Greek ship finance presence, based on previous and new shipbuilding orders at Chinese shipyards.

The first question to pose is what has been the progress made in 2009-2011 by Chinese banks in Greek ship finance?

The short answer to this is that such progress has been painfully slow.

According to mid-2011 XRTC information, the total new Chinese Greek shipping loans were approximately $825m. These consisted of a solitary $74m Credit Development Bank (CDB) loan to Cardiff and 6 China Exim (CEXIM) bank loans to Diana, Angelikoussis, Costamare, Danaos, Toisa and Laskaridis of which 4 were syndicated with DNB and two with Citibank.

Although there were many other loans being mentioned in the pipeline to Prokopiou, Veniamis and others, in relation to the size of the Chinese order-book by Greek owners and the size of Greek ship finance lending, the above new loans are below expectations, as currently the above Greek orderbook in China stands at over 273 vessels, or 43% of the total Greek orderbook, out of which 199, or 73%, are bulkers. (DATA from CLARKSON FLEET REGISTER – as of 31st October 2011)

Readers may recall the October 2010 announcement by Chinese Premier, Wen Jiabao, of a $5bn loan pledge to Greek shipping to finance Chinese shipbuildings. Indeed, there were reports in March 2011 that the above figure had doubled to $10bn. Moreover, in June 2011, AB Bank reported a co-operation agreement with CDB, which, however, has since bogged down and has produced no tangible results, thus far.

Lastly, we have been informed by Bank of Cyprus, that a memorandum of Agreement has been signed with CDB for shipping loans to Cypriot owners and that the first Cypriot joint deal is approximately $65m and expected to be concluded within this year.

Thus far it has been 'the policy banks' of China, i.e. CDB, CEXIM, China Everbright Bank, that have shown the most interest in Greek ship finance, whilst Bank of China has not lent to Greek owners yet.

We now come to our second question, namely, "what have been the reasons for the slow start in Chinese ship finance of Greek owners?"

The slow start has not been due to unavailability of risk appetite or bank related problems of any kind. Instead, the reasons can be summarized as follows:

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- Chinese banks' investments have been linked to new shipbuilding orders placed by Greek owners and not to existing orders or second-hand purchases of Chinese vessels.
- New Greek orders in Chinese shipyards slowed down in 2011 as the emphasis by Greeks shifted towards container and tankers placed primarily in Korea.
- The fall in the dry bulk market in 2011 has lead to a reduced interest in new orders for drybulk vessels in China which is the leading drybulk builder in the world.
- Chinese yards, having a relatively full 2011/2012 order book, have not felt the need to price levels to sufficiently interesting levels to Greek owners for 2013/2014 deliveries.
- Although interested, Chinese banks found themselves unfamiliar in dealing directly with Greek owners. They lacked the know-how and expertise to respond swiftly and effectively to new enquiries.
- Being largely unfamiliar with Greek owners' credit risk profiles, Chinese banks concentrated on only the biggest private or publicly quoted Greek owners, thereby excluding numerous middle-size potential owners, who had an even greater need for such finance.
- Reportedly, the Chinese banks' \due diligence' required was so demanding and intrusive into Greek owners businesses that many enquiries ground to a halt.
- The distance and linguistic barriers have been distinct hindrances in the development of more Chinese-Greek business in 2011.
- Increasingly in 2011, Chinese banks' requirement of credit insurance (Sinosure) in support of local finance has been unduly expensive. This amounted to approximately 2% of the newbuilding price.
- As the Renimbi (RMB) is an appreciating currency whereas the US dollar is a depreciating currency over time, Chinese bank lending in US dollars had to face this foreign exchange devaluation cost effect, as they had an insufficient US dollar deposit base and needed to fund new loans via RMB/US dollar swaps
- As a matter of policy, Chinese banks appeared to follow central directives and considered shipping loans in support of orders placed with state and not private Chinese yards.
- Some Greek owners have remained skeptical as to Chinese banks' long term commitment to international shipping, as well as how they might react to a crisis or a difficulty by an owner to meet loan obligations in the future.
- Chinese owners have increased their Chinese owner loans, thereby absorbing a greater share of Chinese ship finance capacity towards the local market.
- Greek owners have been reluctant to accept loans in RMB and not US dollars, as such RMB financing requires PRC flag and PRC ship mortgage, which exposes owners to greater delays, costs and risks.

As the reader can see, the obstacles to Chinese ship finance for Greek owners have been higher than originally anticipated and may explain the slow build up in 'done deals'. As reported to Petrofin Research by S&P brokers and lawyers, there have been a very high number of initial discussions between owners and Chinese banks, the vast majority of which, however, have been abandoned at an early stage. Better progress has been achieved, where the discussions were held via a western bank, e.g. DNB, Citibank, as such banks do overcome a number of the barriers reported above.

The third question to be answered is 'what if anything is being done by Chinese banks to overcome those factors restricting Chinese-Greek shipping co-operation is ship finance?"

Chinese banks have not been idle or unaware of the need to adapt and become more competitive.

In terms of organization, Chinese banks have acquired and are developing shipping specialists with a very good knowledge of English, as well as how western clients differ from Chinese or Far Eastern clients. Indeed, CEXIM has opened an office in Paris for their European business and CDB has concentrated its non-Chinese ship finance out of its Nangxia branch. Moreover, there are reports that CDB will develop a 'standalone dedicated export ship finance division' that would have the marketing, credit and approval ability to process business swiftly and competitively.

Chinese commercial banks have increasingly stopped requiring costly credit insurance guarantees, although the US dollar funding issue still represents an issue.

As securing fresh Chinese orders shall be required in 2012, Chinese banks are expected (together with Chinese shipyards) to become more competitive.

Lastly, other Chinese state banks, such as Industrial and Commercial Bank (ICBC), Construction Bank of China (CBC), Bank of China and Agricultural Bank of China, are expected to commence offering ship finance to secure a Chinese policy shift towards assisting export industries, such as shipbuilding, at a time of a global slowdown.

What of the future?

Greek or German owners have until now been in the focus of Chinese bank interest. This is expected to remain as both countries' owners are facing a problem in securing ship finance. The collapse of the German KG model and the withdrawal of Greek banks from ship finance, have exacerbated the problems. Consequently, the demand for Chinese ship finance is increasing.

Chinese bankers have come to realize that they need to become more client-aware and flexible in their dealings with Greek owners. As know-how improves, it is anticipated that the heavy bureaucratic approval process often lasting for six months or more, shall become more competitive.

As a consequence, the 'learning' curve by Chinese banks shall expand and more potential loans shall reach successful drawdown. Once banks develop a 'Greek loan portfolio', repeat business based on satisfactory experience shall lead to a substantially higher loan exposure. In addition, bilateral deals are expected to commence which shall be a sign of a maturing industry.

The above evolutionary process from infancy to maturity, is expected to take at least 5 years. However, the process has already begun and we expect that it will accelerate over 2012/2013 on account of the 'financing gap' for Greek shipping anticipated over the period. In consequence, although, the progress in Chinese bank financing for Greek owners has been slower than anticipated over the last couple of years, it is expected to pick up substantially and this render Chinese banks the main beneficiaries of the western bank crisis. Chinese banks have not been slow in recognizing the enormous potential benefits of a symbiosis between Greek owners – Chinese shipbuilders and Chinese banks

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