

Shipping prospects given the changed financial economic liquidity and investment fundamentals

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In these crucial, volatile and unhappy times, we need to stop, think and review the situation in which we have all found ourselves.

Thanks to the concerted and deep reaching action by the world's governments and central banks the patient (i.e. the world economy) did not die of (financial) asphyxiation. The patient is still in intensive care and his breathing is technically supported. But he is alive.

Still, the effects of the near death can only now begin to be fully assessed and analysed.

Banks across the world have either stopped or severely curtailed all lending. This does not only include fresh lending but also banks not renewing credit lines, cancelling or withdrawing from commitments and in general pulling down the shutters.

The effect of this was instantly felt on a worldwide basis. All business (as were banks) stopped whatever spending, inventory orders, or investments they could to conserve cash. World trade which relies on letters of credit and inter-bank trust ground to a virtual stop.

In shipping (especially in the over-extended dry cargo segment) freight rates fell by up to 90%. Ships were redelivered early by charterers and older vessels found themselves without any business. A large number of old vessels (about 50) were trying to be scrapped but absence of finance for vessel breakers only led to plummeting scrap prices. For transactions concluded earlier but will later vessel deliveries, a number of buyers have already defaulted losing their deposits.

On the sale and purchase market we had the phenomenon that there were no buyers as finance was almost non-existent and buyers postponed their decisions hoping for even lower prices.

The very rapid 'riches to rags' story caught everyone by surprise. The first casualties have been some Far eastern shipyards, newbuilding cancellations and some defaults by over-exposed charterers.

As the world's leaders, bankers and businesses, as well as owners, shipyards and charterers are still holding their breaths and wonder what the finance will bring, let's look at the world situation in terms of the following:

- International banking
- World economic growth
- International trade
- The prospects for shipping
- Ways to weather the storm
- The future

International banking

Following the 'Gordon Brown' concerted financial / banking rescue, confidence has begun to return to the international financial markets. It will be a slow process. To start with, banks' depositors will start to feel safer. As banks' capitalizations improve and their balance sheets are cleared of toxic products and until recently undisclosed risks, interbank confidence and liquidity will start to improve. It will be a very slow and painful process. Banks, urged by the need to re-start lending and earn income / fees to justify their very existence and pushed by governments to do so in order to lessen the extent and length of the coming recession, will start to use their increasing liquidity to positive effect instead of hoarding it in order to survive.

The effects of this thawing process will start being felt within the next few months. However, it will take years before the world's international banking industry can start flying again. The era of abundant and cheap money and low risk / rewards premia will not return for a long while. Still, the recovery should be at least based on a more solid and better regulated banking system which will consist of fewer, but stronger banks.

International banking should cease to be a drag on the economy within the next 2-3 years and it is possible that it may recover sooner as governments start pumping money into the world's economy to overcome recession.

World economic growth

The recent financial / liquidity shock has been so great that forecasting is extremely difficult.

One thing is certain. The world's western economies are in a recession of increasing severity and there is slowdown in the growth of Far Eastern economies including China, India, etc.

It is unlikely that the world economy as such will slip to negative growth figures, but it is possible.

Whether it will be a shallow and quick recession or a drawn out and deep recession, will depend to a large extent on how quickly the world's economies adapt and react to the new situation. For political, humanitarian and self-survival reasons, everyone has an interest towards an economic recovery as soon as possible. The question is when will investment confidence return and when will the international banks,

central banks and governments be ready to support a concerted effort towards an economic recovery.

The writer believes that self-awareness of a problem represents 50% of its solution and there is plenty of self-awareness of the negative impact of a prolonged and deep recession and the need for this to be overcome.

Consequently, I do not follow the Cassandras of this world and believe that by 2010 the world's economic prospects shall be totally different to today's.

International trade

Everything depends on international trade and on producing, exporting and importing countries continuing to do just that, so that cargoes continue to move, bought, sold and transferred around the globe. The recent cash injections in the banking system and the methodical, Brown-designed, plan to gradually control the banking sector until it shall be fully revived and much better regulated, are yet to bear fruit. The markets immediately felt a surge of confidence, as they normally tend to do, after a prolonged period of bad news, but as the party dust subsides, they will be more cautious. And indeed they should be. It is time for less frivolity, better judgment and more controlled appetite for immediate risks / profits.

As inter-banking lending is gradually and slowly resuming, it would be unreal to expect that levels of finance will immediately rise to the standards we have been accustomed to. However, it is all western governments' immediate priority to get the business lending flowing, so that trade does not stall. I believe that soon we will have evidence of credit lines resuming and businesses of all kinds beginning to feel slightly more confident regarding their present and future.

International trade growth has normally been higher than would economic growth by a figure of 50-100%. Consequently, although international trade may indeed display negative growth at the moment, over the next year it should recover and outperform economic growth by rising at a modest level.

As the world economy begins to recover in the next 2-3 years, so will international trade.

Although it may well be a few years before we see growth levels of 6-8% p.a. again, once the world's economy, banking and international climate recovers, the turnaround prospects may well be strong.

The prospects for shipping

The worst case scenario for shipping would be tying up the vessels, as cargoes disappear and little moves. We have seen it before and never want to see it again. This scenario encompasses the theories that China and other big importing / exporting nations shall also slowdown significantly and will hold back importing /

exporting, especially as its clients, the world that is, suffer from recession. This is consistent with rapidly falling energy and commodities prices.

The main question for shipping is how quickly will the recession / sluggish growth be overcome, so that demand for shipping can start resuming its upward trend.

On the other hand, the effects of the crisis and recession on the supply side will be beneficial for shipping.

Already, shipyards have started to fail on account of lack of finance and most of the green field shipyards will remain green fields. Moreover, many orders are now being abandoned as a result of lack of finance and the changed prospects for chartering.

Conversions of single hull tankers to dry cargo vessels have also stopped.

The consequences of the above are quite therapeutic for the supply side as the enormous new vessel order book may reduce substantially. The percentage of cancellations are estimated from 10% of the order book to as high as 35%. To some extent, the shipping industry is fortunate that the crisis developed before the vessels were built as the effects after their construction would have been far reaching.

Regarding the newbuilding vessel situation, which are finding it more and more difficult to get funding, it has even be suggested that China may even buy the vessels ordered in its yards which could not be financed due to the credit crunch and, thus, flood the market with cheaper Chinese custom-built vessels (Paul Slater at the FT conference in October in Athens). Such an event, would offset some of the benefits of other cancellations.

So we might end up with a combination of a large supply of new Chinese vessels and few cargoes!!

This is obviously not a good scenario for international shipping. But we believe that although international trade may slowdown, it cannot possibly suffer such a seizure to the extent that we wait for unbuilt vessels to be built and bought by the Chinese state and then thrown in the sea to take all the work available, while in the meantime there is no sea traffic. After all, one could buy cheaper tonnage by buying the depressed quoted shipping stocks instead.

Although the worst case scenario seems fairly unreal, it has become evident that parties are beginning to feel the stress of each other's cash flow squeeze and, as stated above, will want to re-negotiate terms. This can manifest itself primarily in charters, where charter parties signed at the height of the market are very likely to be reviewed and re-negotiated downwards / extended by charterers.

Ways to weather the storm

It is important to observe that any market, however abysmal, provides its players with challenges and opportunities.

The main challenge is to stay alive and ride the crisis through. This is easy to say, but for an owner who is beginning to feel the brunt of charterers' unwillingness to part with cash and the international trade's slow down, the question of how it can be achieved is the most crucial one.

In this case it is important to keep the channels of communication with banks and charterers open. A compromise may be the only way out but it will be crucial for the owner to strike the right balance between an income compromise or a loan repayment compromise.

The opportunities in an unknown climate are hard to work out. Fortunately, many owners are found with liquidity in this market. Planning a strategy ahead, incorporating all worst possibilities, as well as average and fairly optimistic scenarios is of prime importance and will clear the owner's thoughts in this hazy and headache inducing economic climate.

The future

The 18-month crisis-exit theory

This is what I believe. In 18-months' time we will start coming out of this, battered but much the wiser. The longer term fundamentals for international trade, goods production, growth and financial stability are good.

I do not think, however, that we will go back anytime soon to the heady levels observed until some time ago. But a deep recession is avoidable, since for the first time all the governments of the financially strong states are together working to defuse such a possibility.

In the meantime, however, we will face difficulties and see charters and vessel prices being severely reduced. Many owners are under obligation to pay heavily front-loaded instalments for their highly borrowed new vessels. The banks may ask for owners' liquidity to be put forward as substitute for renegotiated charter revenue, and it will be times for long negotiations with banks on this matter.

I believe that banks, although in a hard position themselves, will be ready to listen and work with the owners to get through the next year and half smoothly. After all, everyone was caught unprepared for such a crisis that arose suddenly and so dramatically. Overcoming its effects will require co-operation, understanding and working together.

The 4-year crisis-exit theory

A prediction for a long, deep recession lasting 4 years is, I believe, an unrealistic one. The new order of things, such as the co-operation in a fundamental way between governments, the new US presidency and the change in attitude expected soon to take place in the White House, the beginning of the recovery, finally, after the worst has already happened, and the fundamental robustness of the emerging giants in the Far East render a 4-year recession an extreme scenario.

CONCLUSION

The bubble has burst and what spewed forth was not nice. Cleaning the mess has already started and we should all brace for lower incomes, potential disputes, and major headaches. What makes me fairly confident of a relatively short-lived crisis, is that the influx of newbuildings has not happened yet, and most probably now will not happen, that owners are still liquid, and that the fundamentals of international trade in view of the demands of China, India, etc. are basically healthy and still there and will re-assert themselves.

What will be interesting will be to see what will follow the banks' salvage operation by their governments / central banks. Now that many of them are mainly state – owned, we will see a new order of how money flows. As unlimited greediness is something that has been identified as at the root cause of our presently ailing economies, we will see a changing attitude towards less laissez-faire economic procedures and much more accountable banking and stock market ones. What this new modus operandi brings we shall have to wait and see. In the meantime, owners need bankers and charterers, charterers need owners and bankers and bankers need owners and charterers and sound businesses. In order to survive this and still be afloat when it is over, we need to find ways of communicating with each other. It will be difficult as we speak and bad news will be expected on a daily basis, but I believe it will be feasible, and that is how we will live with each other for the next year and a half.

It all boils down to trust!!!