Policy Document on the Current Crisis of the Maritime Industry

As at mid-March, the AXS Alphaliner industry service reports 484 container ships laid up without business. The report says this corresponds to almost 12% of the world container ship fleet. That number is rapidly increasing. One month ago, about 300 vessels were without business compared to just 70 in October 2008. The fear is that until the end of the year laid-up tonnage will be rising to 20% world-wide.

More facts:
About 90% of world trade is transacted by sea transport. In order for that world trade to be transacted, the supplier, the recipient and also the goods carrier need to be sure that the deliveries will be paid for.

According to the WTO, 90% of the 13.6 trillion USD worth of goods traded annually world-wide are secured by letters of credit (L/C) or other payment bonds. The procedure is that a bank either guarantees an exporter that his delivery will be paid for, which payment will then be effected against presentation of certain documents, or delivery is guaranteed if an advance payment has been made. Last but not least, L/Cs received by the exporter are usually presented to the house bank and the house bank routinely provides financing to the recipient on the basis of the payment promise, for example for the goods to which the L/C relates.

However, the global financial crisis has apparently also led to a collapse of trade financing because in these transactions one bank enters into an obligation to pay to another bank which, as we know, is a problem at the moment, even seemingly to a large degree independent of either bank's creditworthiness.

It is a fact that international trade is almost not happening because there are no financing possibilities (letters of credit).

Lack of raw material deliveries forces the industry to reduce production and, as a consequence, to cut jobs.

Now, on 24 March 2009, the WTO announced that world trade had slumped by 9%, a decline not faced since the second world war. At the latest now, all those involved should realise that finally something needs to be done against the root cause of the present crisis. The causal connection between lack of letters of credit and trade slump can be clearly seen. The consequences are dramatic, just as it is when an external event hits the economy unexpectedly. We are no longer talking of a normal economic cycle, not of simple economic stagnation, possibly triggered by the the shipping companies themselves by an excessive amount of orders.

Of course, too many vessels have been ordered, but that would never have led to this epochal crisis. Certainly it would have resulted in a stronger decrease in rates. Although institutions such as ISL Bremen in May 2008, Nord LB in September 2008 etc. had always spoken of a strong growth of the container ship fleet, they had also spoken of a dynamic growth of container volumes.

However, this is not a normal recession. We face an existence-threatening crisis triggered by external factors and is legitimate to ask the government to help alleviate the symptoms, just as the shipbuilding, the automotive and many other industries do at the moment. Besides, dozens of Lufthansa airplanes are laid up, as do 10% of China Airline, 35,000 goods wagons of Deutsche Bundesbahn, hundreds of heavy goods vehicles along the motorways and on the car parks of the motorway services. And this is not because too many goods wagons, airplanes, HGVs have been produced in these transportation sectors. Therefore, too, the crisis talk of "you're to blame yourself, you've built too much" is not realistic. The present crisis has been caused by the financial world.

What is also dramatic is the speed of the downward spiral that increases with every passing day. Immediate attempts at revival are essential but not enough is happening, one feels.
Due to the constant exchange of information with traders and many industries all over the world, we perceive, we learn every day how freight volumes continue to reduce. And that is the reason why ships are laid up.

Approaches to solution:

One approach is to alleviate the symptoms of the present crisis — interest and redemption break, indemnity bonds etc. — e.g. by presenting claims for state aid and sureties.

However, the second line of action must be to eliminate the root cause — and that is definitely the lack of letters of credit and the speculation with raw materials!

Claim:

The lack of letters of credit is the cause of the trade and transportation crisis. There would be no crisis if credit operations were functioning!

Politicians would have to solve the following important tasks to stop the dynamics of the downward spiral and produce a reverse thrust:

1) All important nations that participate in world trade (they are more than the G20 that have attended the most recent summit in Washington) provide state guarantees for the financing of letters of credit which will be issued exclusively by commercial banks (that are subject to banking supervision).
2) Probably, the actual amount of money needed for this measure would be considerably lower than the cost of boosts to the economy because these credits are based on actually existing goods. A deficiency guarantee for loans would have to be exercised only if the debtor became insolvent.

3) Although, according to AGA report no. 174 of February 2009, the government has announced securities for letter of credit risk, this has not yet been implemented.
4) At the same time, financial institutions which are not subject to banking supervision, including hedge funds, would have to be excluded from trading in commodities to prevent the creation of new speculation bubbles.

This would have to happen quickly, so that world-wide trade can be resumed.
After that, internationally valid rules would have to be established to control the entire financial world.

Conclusion:
The measures described above should as quickly as possible enable the banks to grant trade credits again and in this way increase demand for means of production and raw materials which would also give some relief to shipping because more demand for transport would increase. If trade financing is revived upon the massive bank support measures taking effect, then long overdue deals will probably be transacted first. While the financial markets have not recovered and money is made available at calculable conditions, the real economy will not recover.

Excerpts from international press commentaries

Crisis has reached the transport industry

The combined credit and economic crisis has long reached the transport and logistics industry. This is not only indicated by the trend to the Dow Jones Transportation Average that has lost 35 per cent of its value since May, despite being stabilised by relatively robust railway shares.

However, even more extreme was the drop of the Baltic Dry Index which serves as a measure of the international freight charges trend. During the same period, it fell by a massive 86 per cent and reached its lowest level since February 2002 on Wednesday.

Decreasing demand for transportation capacities

Shipping companies expect lower demand for transportation capacity for coal, iron ore and other commodities. The reason was that banks are extremely reluctant to grant financing for trade transactions. "Letters of credit and trade credit lines are currently frozen", explains Khalid Hashim, managing director at Precious Shipping, Thailand's second-largest shipping company. "Nothing is being shipped because no dealer is willing to risk loading freight onto a ship and then see that no-one can pay for it."

At Pacific Basin Shipping, Hong Kong's largest bulk freight shipping company, they also are sceptical about the prospects of the freight market. "A lack of letters of credit which are used by banks to guarantee payments in trade could become a "major problem" for world trade", says Klaus Nyborg, deputy chief executive officer of Pacific Basin. The more restrictive bank lending also is a reason why the Baltic Dry Index has slumped by 85 per cent this year. About 90 per cent of world trade is transacted by sea transport. […]

Many ships ordered are not yet financed

[…] German banks asked about 200 base points on top of Libor for loans, that is double the normal markup, reports Tobias König, managing partner of König & Cie. issuing house in Hamburg, but shipping companies were in general unable to take up capital, he explains. "There is no interest rate because the banks do not make transactions", he states. "Some financial institutions stand by their best customers, but that's just about it." […]

(Source: FAZ.net on 16 October 2008)

Effects of the crisis

China runs dry of orders

By Christoph Hein

13 November 2008

[…] Like a stone dropped into the water, the crisis creates ripples. It first hit Wall Street, then main street America, the man in the street whose home came under the hammer. Europe's bank were quick to follow. Then, the first countries threatened to collapse, such as Iceland, Hungary or Pakistan. The next wave is now reaching the exporting countries. Companies cannot get letters of credit and if they do, then at horrendous charges: they have soared from 25 base points to 300. Ratan Tata, chairman of India's largest group of companies, therefore has just forced his managers to put on ice all take-over plans: "Some of our subsidiaries with a big foreign business are facing giant problems to take up capital and be granted credit lines", he warned them.

"If loans are unavailable, then the economy has no lubricant — the oil in the gears of exporters. Then the industry reduces its stocks, shortens shifts, buys less machines, does no longer keep plants up-to-date. That alone is dangerous, but now buyers are also lacking — in the three big markets America, Europe and Japan. Therefore, the volume of cross-border trade of goods and services will probably shrink for the first time since 1982", Robert Zoellick, the president of the world bank, has just warned. […]

[…] However, the crisis will not be limited to China. It also spreads to the entire region because if someone can no longer sell goods to countries abroad, he also does not need raw materials, machines, airplanes or ships for transport. Shipping companies can tell you a thing or two about this. Neptune Orient Lines in Singapore have laid up more than a dozen of their container ships — less than one kilometre away from the Malacca Strait, world trade's most important traffic artery. Considering the slumping exports, the ships are no longer needed. At the same time, Chew Choon Seng, the chief executive officer of Singapore Airlines (SIA), thinks aloud of parking his superfluous airplanes "in the desert". His colleague at China Eastern already is one step ahead: The Chinese have meanwhile grounded one tenth of their fleet. […]

[…] However, not just small ones suffer. A report by the government of the world's second largest national economy, Japan, will probably state on Monday that economic growth in the third quarter was just 0.1 per cent. "That minimal growth rate, however, is just the calm before the storm", warns Kyohei Morita, chief economist of Barclays Capital. From Toyota to Sony, from Canon to Nissan, the terrible news have not stopped coming since the end of October. Not just the West, but also the Asians stop buying. The Mastercard credit card company has just found out that

"Automobiles and electronics do no longer range among the three most desired consumer items". This means that regional trade also crumbles. This is felt, for example, by Singapore. Sales of electronics, the wealthy tropical island's most important export article, record a slump that equals a meltdown: From plus five per cent in summer to now minus 15 per cent year-on-year.

"Asia is at the centre of the hurricane. Being not coupled to the rest of the world always has been a myth. The crisis proves this again", says Rajat Nag, managing director of the Asian Development Bank. Manu Bhaskaran, chief of the consultants of Centennial Asia Advisors, speaks even more plainly: "The outlook for Asia is much worse than politicians and most analysts believe at the moment. Trade financing has been interrupted — but it is Asia's artery."

(Source: FAZ / Christoph Hein on 13 November 2008)

Column

Two years of crisis to follow

By Wolfgang Münchau

Despite rescue packages, markets will not yet stabilise because now economic slump is threatening.

What distinguishes this financial crisis from others that have come before is its wavelike structure. There was hysteria in the acute phases, irrational optimism in the calm phases, including the prediction that the peak of the crisis had been crossed. If you do have to criticise the head of Deutsche Bank, Josef Ackermann, then for his always too optimistic crisis prognoses. That this man is always present at almost any rescue campaign launched by the Chancellor troubles me very much for that reason alone. Both Ackermann and Angela Merkel have underestimated this crisis at each point in time.

So far, the crisis has had five more or less dramatic peaks. In August 2007, in November/December 2007, in March 2008, in July 2008 and, the strongest eruption so far, in September/October 2008. A good seismograph for the present crisis are the spreads in the money market rates, for example the TED spread in the US, the difference between the interest rates of three-month US government bonds and the three-month Libor money market rate, based on which banks lend out money among themselves. Normally, that difference is very small. Naturally, it should be all the same to any creditor whether he grants a three-month credit to the state or any good bank. However, if banks distrust each other, these two interest rates diverge. Thus, the TED spread is a measure of lost confidence. Roughly speaking, the next major wave of the crisis has always started when the spread exceeded on percentage point.

Only one half managed

A comparable good indicator for Europe is the interest difference between the three-month Euribor and the three-month EONIA swap. The first is the money market rate, the latter the swap rate between call money market rate and call money market interest rate three months after date. The difference between the two has strongly increased during the last phase of the crisis and has little decreased since. In the US, the money market seems to calm down somewhat faster than here.

The current, very intense phase of the crisis will probably continue about one month and then lead to another period of rest. The crisis has not been overcome for a long time yet. Do not let yourself be bullied, neither by Mr. Ackermann nor by anyone else. I would be surprised if even half of the crisis had been overcome by now.

Because ahead of us lies an extreme and probably long recession of the global economy. The US will be hit especially by the slump. Even the economic stimulus package now discussed by the US Congress will not change that. I expect the new administration to put together another economic stimulus package but these packages merely prevent a descent into depression. The worst recession since the end of the second world war will probably come nevertheless.

In Europe as well, growth forecasts are still too optimistic. Before the most recent phase of the crisis broke out, I was relatively optimistic that the European banks will continue to be able to provide sufficient loans to the economy. The crisis has changed this now. We are now hearing ever more often of credit bottlenecks. Even letters of credit are no longer generally accepted, a fact that could lead to substantial problems in world trade. The Baltic Dry Index (BDI), a measure of charter prices in international freight traffic has dramatically fallen during recent days and weeks. The BDI is regarded as a good, even though volatile, indicator of world trade.

The situation is more serious than the economic models suggest that economic institutions and banks use to make their forecasts. They just incompletely reflect the financial market. A credit squeeze is one of the events that does not occur in most of these models, which is why they substantially underestimate the severity of the recession. Without the credit squeeze I would continue to be moderately optimistic for Germany, in particular in view of oil having become very cheap meanwhile and a currency exchange rate that is no longer overrated. This would mean a slight downturn followed by an upturn next year. […]

Interactions and waves

[…] Besides, the constant interaction between real economy and financial markets is the reason why this crisis comes in waves. At the moment, the financial market is held responsible, but responsibility is just being passed back on to the real economy where the credit squeeze results in more shortfalls in payment. The past waves also were a result of interaction: At first, interaction between the US housing market and the subprime segment of the credit market. Mortgages declined altogether which resulted in defaults in payment on the property market rising and home prices dropping. That, in turn, had an indirect influence on other credit market segments. In a first wave, the subprime lenders fell, and only long afterwards did the big mortgage companies, Fannie Mae and Freddie Mac, get into trouble.

The downturn has just started and it will probably continue throughout 2009. Real estate prices in the US and the overheated European countries will continue to fall at least until the end of next year. It would be real luck if the crises ended in 2009. I meanwhile expect it to end in mid-2010.

(Source: Financial Times Deutschland / Wolfgang Münchau on 22 October 2008)

Restrictive trade financing

Banks abandon shipping companies

By Mark C. Schneider and Dirk Heilmann

The global credit squeeze has a negative effect on sea transport and world trade. Asian shipping companies complain about the banks' extreme reservation to grant trade financing. Money for building new ships also was hard to come by. In Germany, the problem was not yet very dramatic yet but there are also difficulties with financing.
"Letters of credit and trade credit lines are currently frozen", says Khalid Hashim, managing director at Precious Shipping, Thailand's second-largest shipping company. "Nothing is being shipped because no dealer is willing to risk loading freight onto a ship and then see that no-one can pay for it".
At Pacific Basin Shipping, Hong Kong's largest bulk freight shipping company, they also are sceptical about the prospects. A lack of letters of credit which are used by banks to guarantee payments in trade could become a "major problem" for world trade", says deputy CEO Klaus Nyborg. The more restrictive bank lending also was a reason why the Baltic Dry Index, an indicator of international freight costs, has slumped by 85 per cent this year. About 90 per cent of world trade is transacted by sea transport.
The Israeli shipping company Zodiac Maritime Agencies was considering to put out of service twenty of its largest vessels, two hedge fund managers said yesterday who have information about the plans. The British Lonrho group has announced the liquidation of the SA Independent Liners shipping subsidiary. Economic crisis and credit squeeze were not the suitable environment to invest into that business, explained Lonrho.
The banks' reluctance to grant loans cause double trouble to the shipping companies. Not only do customers need less transportation capacity, but financing new ships also becomes more difficult. For example, Precious Shipping had taken fifteen months to complete the financing of eighteen ships ordered, says Hashim.

According to calculations done by Nordea Bank Finland, the industry will need about 300 billion USD in the next three to four years to pay for ships already ordered. The Hong Kong based leasing company Seaspan estimates that at least one quarter of the ships in the shipyards' order books are not yet financed.
In a poll of 104 bankers carried out by Marine Money Asia, two thirds said they could not obtain money at or near the Libor (London interbank offered rate). About 80 per cent assume that the ship financers will not be able to raise sufficient capital in 2008 and 2009 to offer their customers financing.
German banks asked about 200 base points on top of Libor for loans, that is double the normal markup, said Tobias König, managing partner of König & Cie. issuing house in Hamburg. Shipping companies were in general unable to take up capital.
[…]

(Source: Handelsblatt.com on 16 October 2008)

Steel industry complains about credit squeeze

By Elisabeth Atzler (Frankfurt) and Sven Clausen (Hamburg)

Steel companies accuse their house banks of blocking KfW loans. Despite the indemnity guaranteed by the state bank, the banks shied away from the risk of lending, Ulrich Galladé, the chairman of Wirtschaftsverband Stahl- und Metallverarbeitung, told FTD.

"The banks' credit assessment is too strict." Wirtschaftsverband Stahl- und Metallverarbeitung (WSM) is already the second trade association, in addition to Zentralverband des Deutschen Handwerks, that openly accuses the banks of having a policy of restrictive lending.

According to Galladé's association, many companies fought for access to the KfW special schemes. With two credit schemes, the state bank is to counteract financial bottlenecks. WSM represents 5,000 companies with 450,000 employees and a total turnover of 83 billion EUR that consume 40 per cent of the steel made in Germany, including many automotive suppliers.

The criticism raises doubt about the German banks' assertions that they do not know of a credit squeeze. It is mainly politicians who accuse the banks of granting hardly any loans to the companies or to excessively tighten the conditions for loans despite relief programmes worth billions and low prime rates. However, official data prove the banks right. According to a survey carried out by the Markit market research institute, credit terms were unchanged in January or even less strict than before.

Nevertheless, Galladé's criticism raises doubt as to whether the financing of medium-sized businesses is secured. The difficulties of the WSM members also put a different complexion on the low demand for the KfW credit scheme for medium-sized companies. As at the beginning of last week, the state bank had received applications for just 900 million EUR for the scheme of 15 billion EUR, which had been taken as an indication of the good financing situation of medium-sized businesses. To relieve banks, the state bank takes over up to 90 per cent of the liability per loan. This means that the banks need to deposit less equity capital. The KfW did not comment on the criticism and merely referred to the good co-operation with the house banks.

In contrast to this, the financing crisis of large German enterprises seems to be indisputable. As regards the second credit scheme for large-scale enterprises with a volume of 25 billion EUR that has been started one week ago, KfW is expecting a rush. The scheme is part of the 100 billion EUR "Wirtschaftsfonds Deutschland" economic fund. Apart from the KfW loans it comprises 75 billion EUR sureties provided by the government and the federal states for especially high loans. The decisive factor in granting the KfW loans are the house banks. A company applies for the KfW funds to its bank that recovers the money from the KfW. State and house bank share the risk.

However, at the moment, the awarding process via the house banks was a threat to medium-sized business financing, criticises WSM. "The government must check that sufficient funds are actually provided to the companies", Galladé demands. He suggests to link the KfW loans to the surety scheme.

The house bank decides

However, as matters stand at the moment, the success of the credit and surety schemes depends on the house banks' readiness to grant loans. Government circles say that the granting procedure will not be changed. Direct lending by the government to companies and official instructions to banks to extend loans were seen only as a theoretical option. The government did not intend to influence the entrepreneurial decisions neither of medium-sized businesses nor of the already semi-nationalised Commerzbank, Berlin sources say.

WSM also attacked the credit insurers. They had shirked their responsibility by reducing insurances for goods deliveries "on a massive scale using the lawn mower method" or even by completely refusing cover. Especially automotive suppliers can get under pressure quickly if they cannot insure against non-payment by customers. According to WSM, this may even aggravate the situation in the industry. Suppliers regard companies that offer their goods without insurance as shaky candidates and demand advance payment. However, the credit insurers are themselves in a squeeze because in the financial crisis they can no longer easily pass risks on to reinsurers (mostly 50 per cent).

(Source: Financial Times Deutschland o 16 March 2009*)*

Credit crisis leads to slowdown in world trade

Rainer Sommer, 5 November 2008

Since banks world-wide have been refusing trade financing, freighters pile up at the ports and the warehouses of industrial firms in threshold countries empty.

According to the WTO, 90% of the 13.6 trillion USD worth of goods traded annually world-wide are secured by letters of credit (L/C) or other payment bonds. The procedure is that a bank either guarantees an exporter that his delivery will be paid for, which payment will then be effected against presentation of certain documents, or delivery is guaranteed if an advance payment has been made. Last but not least, L/Cs received by the exporter are usually presented to the house bank and the house bank routinely provides financing to the recipient on the basis of the payment promise, for example for the goods to which the L/C relates.

However, the global financial crisis has apparently also led to a collapse of trade financing because in these transactions one bank enters into an obligation to pay to another bank which, as we know, is a problem at the moment. After all, a customer would have had hardly any problem some months ago to get financing from its local bank for an L/C issued by Citibank or Lehman but this has meanwhile become rather difficult and apparently to a large degree independent of its own or the guaranteeing bank's creditworthiness.

For instance, the Grand Junction Daily Sentinel (1) reported two weeks ago that even oil giant Chevron could not start building a road because the multinational did not succeed in procuring the agreed 25-million USD letter of credit. Originally, the L/C should have been provided by Wachovia which, however, had run into trouble itself and got out at short notice. And even though Chevron had reported a profit of 18.7 billion USD for the previous year, it could not find a replacement for days. Although Chevron was able to present the L/C shortly afterwards and there is quite a number of other industrial firms that still have so much cash that they can order against cash collateral a bank that "suits" its correspondent bank, other, by all means wealthy, enterprises were brusquely refused trade financing that was expected to be certain — let alone food importers in threshold countries. But even those that still get credit must brace themselves for higher expenses. Traders report that the charges for an L/C, following the collapse of Lehman, have risen from up to 1.25 per cent of the purchase price to 3 to 4 per cent recently.

And reports that the collateral securities to be provided by importers for a letter of credit have been raised from 25 to 50 per cent come even from dollar trillionaire China which, according to official information, is almost not affected by the international liquidity crisis.

Other countries have directly switched to bartering. According to the "Truth about trade" information portal (2), Thailand, for example, announced last week that it will barter rice for oil with Iran. [...]

Collapse of international trade

[...] A clearly visible result of this hopefully temporary collapse of international trade is the decline of cargo rates. An important measure for the prices paid in global sea freight transport is the Baltic Dry Index (3) for bulk goods such as coal, ores, steel, bauxite or cement that is fixed by the London-based Baltic Exchange. Since ships cost a lot, the capacity of freighters offered is very inflexible and reacts just very slowly to increases in demand. The faster do cargo rates react to fluctuations in economic activity. They soar up promptly if international export economy is doing well. Last May, therefore, the BDI recorded an all-time high at 11,793 points, while until this Monday it has collapsed to a mere 851. That crash was even more extreme than any crash of even the worst-performing share index in the same period. [...]

[...] So, while goods pile up at the ports, the share prices of sea carriers experience a massive slump. [...]

[...] At the moment, however, news still indicate rather a deterioration of the situation as regards trade financing. What is certain is that at the moment primarily stocks are being reduced.

However, should trade financing be revived upon the massive bank support measures taking effect, then long overdue deals will probably be transacted first. This might trigger a small boom which should mean a jump in the prices of industrial goods and raw materials. Some threshold countries might then prove to be considerably more crisis-resistant than it looks at the moment. If you wish to still be optimistic in these hard times, you might additionally hope that the menacing explosion of the prices of agricultural commodities seen over the last two years will nevertheless be initially curbed to some degree.

(Source: Telepolis / Rainer Sommer on 5 November 2008)

From the BLB Treasury FOREX REPORT dated 24 March 2009, Volker Hellmeyer:

It is no question that banks are indispensable as regards their function in national economies. As a consequence, nations are forced to preserve these structures and make them as operative as possible, but do yesterday's owners with their hunger for profit and the managers with their self-service mentality have to be protected even the least bit?

If the state as a mutually supportive society of the people stands in, then the state must also receive the relevant stabilisation dividends, and not the former owners that in the end share responsibility for the crisis.

The argument that state managers would be or are incompetent becomes void against the background that it was precisely the privately organised banking aristocracy that have brought us this global disaster disregarding the necessary loyalty to the national economies.

Cutting the international banking aristocracy down to a size that is compatible, on the one hand, with the fulfilment of tasks in national economies in a reliable manner and, on the other, with the total of amount of assets for which a national economy is liable is consistently not the subject of discussion. Obviously, the present elites of politicians do not conduct an investigation based on facts into the first causes of the most serious crisis since 1929!

Torsten Westphal

Haren (Ems), 25 March 2009

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