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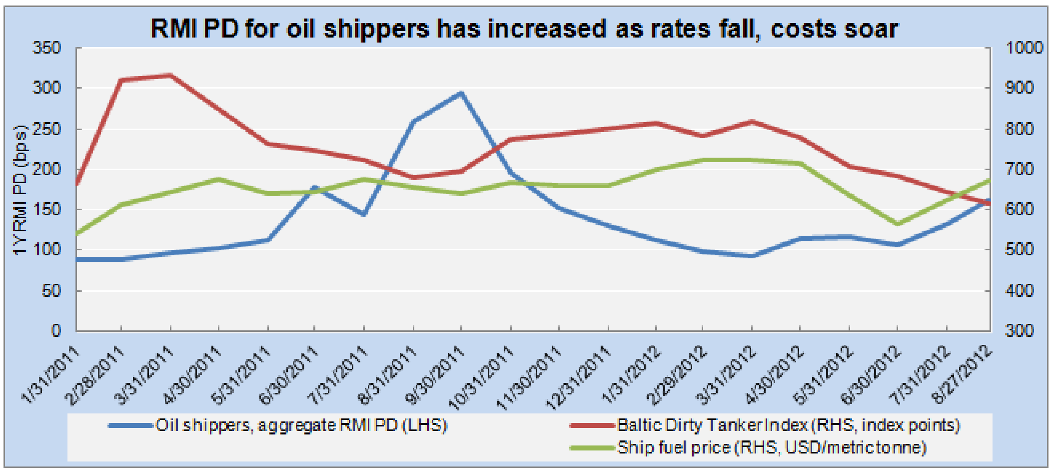
Weekly Credit Brief

Aug 21 - Aug 27 2012

Story of the Week

Overseas Shipholding Group highlights macro-level risks of global oil tanker industry

The aggregate 1-year RMI probability of default (RMI PD) for the global oil tanker industry on August 20 reached levels not seen since late-2011, when a number of oil shippers experienced high levels of corporate distress, and two eventually defaulted. The sector has once again come under pressure this month, as declining operating cash flows weigh on the industry's overall solvency. Shipping rates have dropped below late-2011 lows as a glut of new tankers became operational, and global demand for oil declines in line with slowing global growth. Sanctions on Iran have placed upward pressure on the price of ship fuel, while increased tensions in the Persian Gulf may disrupt tanker traffic, increasing costs for shippers. US-based Overseas Shipholding Group illustrates the risks facing the industry, with these effects amplifying liquidity difficulties and credit deterioration after the company reported 13 consecutive quarters of net losses.



Overcapacity of tankers pressures rates: A glut of tankers ordered before the global financial crisis, that only became operational in the past year has pushed tanker rates down globally. The Baltic Dirty Tanker Index, a compilation of prices on 12 global tanker routes, reached a three-year low of 604 on August 14, recovering slightly to 618 during the past week. Rates on the key Persian Gulf to Far East route have fallen by 97% since April, to USD 1,609 per day on August 23. Data from Clarkson, the world's largest shipbroker, suggests that rates will likely remain low going forward, as the global tanker fleet is expected to grow by 6.2% this year, while demand for seaboard oil transportation is forecasted to increase just 3.9%.

The International Energy Agency (IEA) reduced its oil demand forecast on August 10, and predicted slower growth in demand through 2013. The IEA trimmed its 2012 and 2013 demand forecasts by 300-400 thousand barrels per day, taking into account a weaker global economic prognosis. In addition, oil stockpiles in the US are approaching a 22-year high, reducing demand in the world's largest oil importer.

Higher ship fuel prices: Despite slowing demand for crude, the cost of ship fuel reached the highest level since May 16 on August 27, increasing to USD 670 per metric tonne. Increased sanctions on Iran, including an EU oil embargo which has blocked the availability of insurance for tankers carrying Iranian oil, has reduced the supply of a vital blending component required to produce ship fuel. Slowing Singaporean imports of this high density distillate have pushed prices up in recent weeks. This has amplified the effect of current low shipping rates, with tanker companies losing USD 7,850 per day on journeys from the Persian Gulf to Japan last week.

Tensions in the Persian Gulf: Sanctions on Iran have only had a minor effect on the overall supply of crude oil as OPEC producers, including Saudi Arabia and Iraq, have increased production to offset a reduction in supply from Iran. However, both countries' petroleum export facilities lie on the key Straits of Hormuz, which Iran has threatened to close since the beginning of the year. Moreover, tensions in the Persian Gulf have heightened in the last month, with Israel becoming increasingly hawkish about Iran's nuclear program. Traffic on Middle Eastern routes has already slowed following increased sanctions; the possibility of conflict in the Persian Gulf increases the risk of shipping delays that may weigh on the global tanker industry.

Overseas Shipholding Group: In addition to the aforementioned problems, US-based Overseas Shipholding Group (OSG) faces problems closer to home. The largest US tanker company sources a large part of its revenues from Atlantic Basin routes, where rates have remained insipid since 2008, and reached three-year lows last week. This has dramatically affected the company's solvency, which was already weak following 13 consecutive quarters of net losses. OSG said it faces a USD 100mn shortfall on USD 1.5bn of loans due in February 2013, even after taking into account the USD 900mn forward-start credit line commencing in February 2013.

Efforts to improve liquidity by mortgaging two vessels came to a standstill in February 2012, after the US Department of Transportation indicated a federal loan guarantee would be rejected following reports that OSG's ships had visited Iranian ports in breach of US sanctions. Market participants believe OSG benefits from a large number of unencumbered vessels it can post as collateral for financing, but the company will continue to burn USD 110mn per year while business conditions remain difficult.

RMI users with global access can access the RMI PD for Overseas Shipholding Group at rmicri.org

Sources:
Oil-tanker losses persist on declining Middle East crude exports (Bloomberg)
Tanker trackers turn bearish as IEA trims oil forecast (Bloomberg)
Overseas Shipholding Needs New Loan Agreement (Bloomberg)

In the News

MMFs test Geithner, Bernanke as Schapiro loses
Aug 24. The SEC abandoned a four-year campaign to increase regulation of money market funds (MMFs), after three of five SEC commissioners said they would not support Chairman Mary Schapiro's regulatory proposals. The SEC had proposed two options to reform the MMF industry. The first would have required MMFs to float their net asset values (NAV), or a MMF's value per share, from the traditional target of USD 1. The second option would have seen MMFs continue to target a stable NAV of USD 1, but would require each MMF to adopt a capital buffer of 1% of fund assets to absorb day-to-day share price changes, and hold back 3% of investor funds for 30 days following a redemption request. However, MMFs could still face increased oversight from either the Federal Reserve or the US Treasury, both of which have said that MMFs are systemically important to the US financial system. (San Francisco Chronicle)

India considers USD 35bn debt revamp after blackout
Aug 22. India plans to boost the ability of domestic utilities to supply electricity and avert outages by restructuring about USD 35bn of loans, by transferring their short term borrowings to the books of regional governments. The rest will be rescheduled by banks, with a moratorium on principal payments up to three years. Cash losses at utilities widened 15 times over three years to INR 288bn (USD 5.2bn) in the year ended March 2010. The difference between the average cost of supplying electricity and the average tariff has almost doubled in the 11 years to March 2010 leading banks to refuse loans to state owned utilities. States including Tamil Nadu, Andhra Pradesh, Punjab and Karnataka have increased tariffs since April to reduce the gap between costs and sales. A majority of the tariff increases will be borne by industrial users, which could affect their profitability. (Bloomberg)

Creditors dig in for battle of Belize
Aug 24. Creditors of Belize's USD 544mn superbond maturing in 2029 could see their investment's NPV decline by almost 80% if the proposed restructuring is implemented. The Central American nation missed a USD 23mn coupon payment on August 20, and is unlikely to make the payment before the grace period ends on September 19. The government is seeking a debt restructuring with creditors of the superbond, and is looking to roll their claims into a wider debt restructuring. The latter includes additional liabilities of USD 300mn due to shareholders of nationalized electricity and telecommunications companies. A default may allow the nation to pursue a debt restructuring on more favorable terms. Three options have been outlined by Belize to replace the superbond, which range from a new bond issue with a 15-year grace period to a step-up coupon bond with a 5-year grace period. (Reuters)

Credit risks at insurers increase as fixed income yields fall
Aug 24. US property-casualty insurers are accumulating lower-rated bonds as near record-low interest rates

limit investment income from higher-rated securities, as the Federal Reserve commits to the current low interest rate environment till at least late-2014. The portion of corporate bonds in insurers' portfolios that are rated A or higher fell to 54% as of December 31, from 60% at the end of 2005. The firms held about USD 1.5tn in assets at the end of 2011, with USD 927bn in fixed income. AIG posted USD 1.15bn in Q2 investment income at its Chartis property-casualty insurer, up 1% from a year earlier. AIG altered its portfolio by redeploying excess cash and short-term investments away from non-taxable municipal bonds and into higher yielding corporate and structured securities, as the yield on the 10-year treasury fell to 1.65% on June 30, from 3.16% a year earlier. (Bloomberg)

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