

DBRS: German Shipping Banks - Hopes of Bottoming Out



Insight beyond the rating

In DBRS' view a global and synchronised macro recovery coupled with reduced numbers of newly delivered vessels, should keep the deleveraging window open for German shipping banks in 2018.

However, potential headwinds for the shipping industry in 2018 could come from a significant appreciation in USD as well as from the imposition of trade barriers in steel and aluminum, as recently introduced by the US government.

The downturn in global trade after the global financial crisis led to significant challenges in the shipping markets such as the collapse of freight rates, reducing vessel valuations and the drying up of traditional bank financing. The depressed state in the shipping markets which extended into early-2017, presented German shipping banks with significant challenges, namely the introduction of higher regulatory capital hurdles and stricter definitions for regulatory non-performing loans with a tighter view on loan forbearance. This triggered the need for most German shipping banks to re-evaluate their lending policies towards shipping clients and cut exposures in the wake of the global financial crisis.

Global and synchronised macro recovery will likely keep deleveraging window open for German shipping banks in 2018

DBRS views that the environment for German shipping banks improved in late-2017, evidenced by increasing, but still volatile, charter rates (e.g. Baltic Dry Bulk Index, see Exhibit 1), declining lay-ups, which reached a year-low in Q3 2017, and sharply declining numbers of forecasted new vessel deliveries for 2018-2020 (see Exhibit 2). In addition, global growth forecasts for 2018 and 2019 have recently been revised up by the IMF, so if the traditional high correlation of demand for transportation tonnage with global trade volumes and global GDP growth remains, this should also benefit the industry.

DBRS's views these demand side conditions as an opportunity for German shipping banks to accelerate their deleveraging efforts. In our view the potential easing of the pressure on the banks, witnessed in late 2017, helped to facilitate the sale process of HSH Nordbank, enabled Commerzbank to reduce its shipping assets ahead of schedule, and also facilitated NORD/LB's comprehensive restructuring and downsizing programme. DBRS expects the momentum to remain through 2018.

Summary:

- German shipping financiers suffered significant losses and were forced to cut exposures in the wake of the global financial crisis.
- A global and synchronised macro recovery and benign adjustments on the supply side could, in DBRS' view, keep the deleveraging windows open for German shipping banks in 2018.
- Potential shipping headwinds in 2018 could come from a USD appreciation and a set-back in free trade.

Exhibit 1

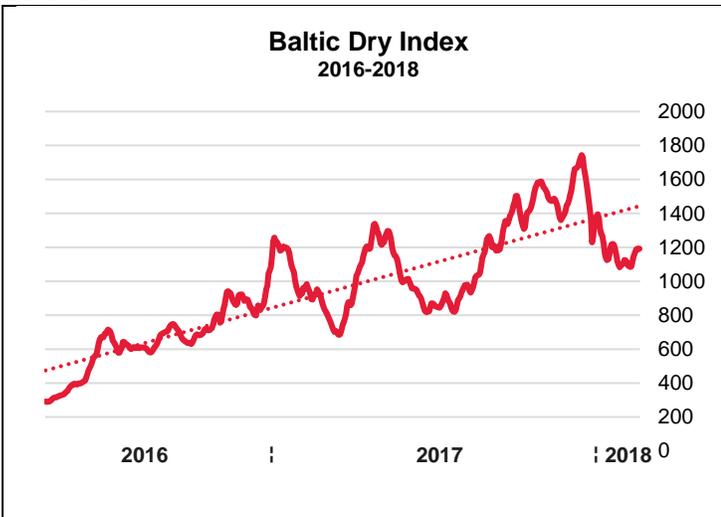
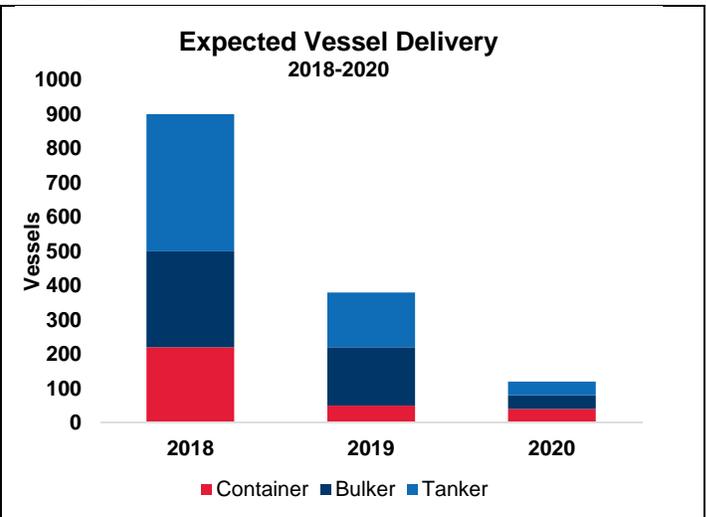


Exhibit 2



Sources: DBRS, Bloomberg, NORD/LB Research, Clarkson

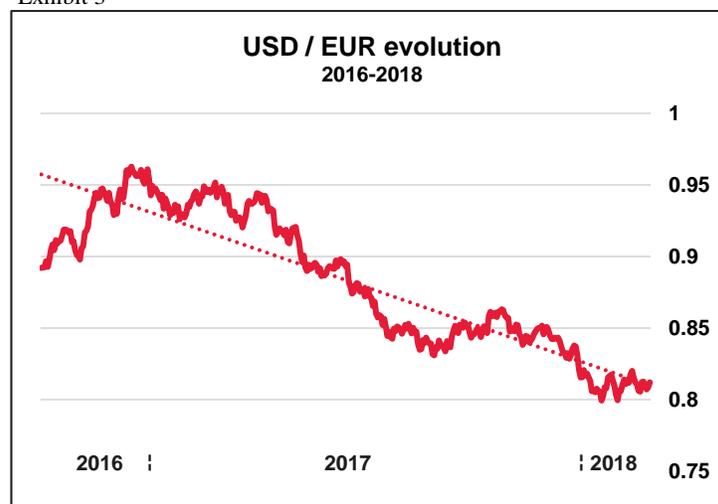
The supply side plays a critical role in the shipping sector. Reduced shipping supply, reflecting a more disciplined approach to the ordering of new vessels during recent years (with the current orderbook-to-fleet ratio of 14% reaching a 15-year-low), the Chinese government's recent initiative of shipyard white-listing¹ and an assumption of stable annual global fleet scrapping volumes, all help to reduce excess supply for transportation capacity in the market.

DBRS recognises that these supply side effects will materialise only gradually over the next few years. It is our view, however, that the continuing positive momentum in transportation demand is likely to benefit shipping corporates and shipping banks alike in 2018.

Potential challenges could come from USD appreciation and risks from a set-back in free trade.

As shipping and lending to shipping corporates is a global business which is conducted predominately in USD, the USD/EUR exchange rate is a key risk in 2018 for shipping lenders, in DBRS' view. We note that the weakening of the USD against the EUR during part of 2017 (Exhibit 3), has supported the deleveraging efforts of German shipping lenders by serving to reduce risk weighted assets. A weakening USD helps shipping lenders to deflate USD denominated assets on their balance sheets, helping to improve regulatory capitalisation ratios. A potential strengthening USD might in contrast exert headwinds for capital ratios and offset to some degree the benign effects from a strengthening of transportation demand.

Exhibit 3



Sources: DBRS, Bloomberg

DBRS further notes the potential risks to shipping from inward-looking policies such as the recent U.S. government measures on aluminium and steel. The US government introduced tariffs of 25% on steel and 10% on aluminium, taking effect on March 23rd, 2018. The tariffs would apply to some USD 46 billion of trade, roughly 2% of America's goods imports. EU steel manufacturers however expect that related exports to the US could drop severely, which might specifically impact the very important dry bulk shipping segment and counterbalance the earlier outlined benefits for the shipping industry in 2018.

¹ A set of criteria set by the Chinese government for domestic shipyards, introduced in late 2016, under which builders are required e.g. to maintain production, keeping a sound order book, keep up with timely vessel deliveries and maintain financial solvency.

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