March 2022 #2

Perfect storm version 2.0

Dear valued customer,

As communicated in our separate advisories zooming in on the effect of the tragic armed conflict between Russia and Ukraine, any hope of supply chain stability remains completely off the table short and mid-term.

COVID-19 lockdowns in China adding fuel to the fire

On top of the ripple effects from the Russia and Ukraine conflict, China is experiencing a surge in COVID-19 cases leading to authorities enforcing a more a less full close-down of the city of Shenzhen. Shenzhen is also known as "the factory of the world," and this will undoubtedly have a significant impact on port and airport operations, leading to delays and disruption to normal schedules. Some analysts speculate that the ongoing lockdowns have a potential effect that can be compared to the Suez canal incident last year. Other major cities in China are seeing the same trend with local restrictions in Shanghai as an example, resulting in a number of airlines diverting flights away from Pudong airport in Shanghai.

The situation in China has its root cause in Hong Kong, where a rapid increase in COVID-19 related cases and ultimately COVID-19 related deaths has triggered many residents to travel to mainland China. With Shenzhen located near Hong Kong, it was only a matter of time before the impact was felt in Shenzhen as well. For the same reason, it is a logical assessment that we will see a similar trend across mainland China in the coming days/weeks, despite rapid measures being taken by Chinese Authorities.

US West Coast standoff heating up

Turning the focus across the Pacific, talk of the town is the brewing US West Coast conflict between ILWU dockworkers and US West Coast port terminals. The current agreement expires by July 1, 2022, and as we speak, the two sides remain deadlocked in the negotiations. This potential threat comes on the back of the US West Coast, having been exposed to the worst port congestion in modern history. Already now, shippers are looking into alternatives on US East Coast and in the Gulf region, attempting to mitigate the worst consequences from a potential strike.

Russia and Ukraine conflict will prolong supply chain chaos

All eyes remain focused on the Russia and Ukraine conflict triggered by the Russian invasion of Ukraine. Especially airfreight is heavily impacted due to the closure of EU and Russian airspaces. Our current guesstimate is that up to 20-25 % of the total capacity from Asia to Europe is affected. This effect is a combination of revised flight schedules, longer flight times, Russian cargo freighter companies unable to operate, and a fair share of capacity dedicated to aid and relief cargo.

Our booking stop for shipments to/from Russia and Belarus remains in place until further notice, with the exception of select product groups such as medicine, aid, humanitarian cargo, and food supplies.

Oil price explosion

As the current situation looks, there will be short and mid-term cost increases, especially on airfreight rates. Oil prices have sky-rocketed, and many airlines have reacted immediately to this, implementing bunker oil surcharges overnight. Similarly, this has also been done on the landside with all trucking companies implementing same with immediate effect.

Ocean freight continues the bumpy voyage

From a general demand and capacity perspective, the latest weeks saw a re-introduction of an old "friend" called blank sailings. A number of carriers introduced this on the Far East Westbound trade signalling the first apparent slump in demand. The decrease in nominal volumes has long been expected by analysts considering the record-high inflation levels across the Western world economies.

However, as also expected, ocean carriers reacted swiftly and pulled out the blank sailing instrument to protect and sustain the record-high freight rate levels. At this point, it is too early to conclude how deep the actual slump in general consumer spending is and thus the potential impact on freight volumes. It is even more difficult to assess the potential impact on supply and demand, considering that the normal supply equation is heavily skewed by the many external factors that continue to impact the industry as a whole.

Keep your seatbelts fastened

All the ingredients for a perfect storm version 2.0 are mixed together. However, it is important to underline that it is early days in terms of some of these impacts, and accordingly, it is premature to conclude that chaos will settle for a longer period.

We can, though, re-emphasize our statement from our last market advisory that the *old normal* as we knew it is gone for good. What the *new normal* looks like is not clear yet, apart from change and volatility being the only constants.

We strive and live to *uncomplicate the world of logistics,* and never has this been more important than it is currently. We encourage a constant pro-active dialogue allowing us to provide a plan A, B, C, and more as needed, observing the chaotic nature of the current marketplace. Constant communication and solution agility will be key to ensuring on-time delivery of your shipments.

We will do our utmost to minimize potential additional costs, recognizing that this comes on top of already elevated freight rates. However, we do wish to proactively communicate that additional costs will occur, especially within airfreight and on landside trucking as a result of the current situation.

All information is given to the best of our knowledge and is subject to change.

Enjoy the reading!

On behalf of

Scan Global Logistics

Mads Drejer
Global COO & CCO

AIRFREIGHT

Post Chinese New Year, and with many countries lifting corona restrictions, primarily in the EU, it was expected that the general capacity situation would ease. Specifically, belly-hold capacity was expected to increase considering the correlation with passenger flight activity level, but this has changed due to the Russia and Ukraine conflict.

Historic sanctions imposed by the EU and other Western countries have thrown the airfreight industry into chaos as a direct result of the closure of respective airspaces. Russian airspace plays a vital role on flights from/to Asia and Europe. The closure impacts Western-based airlines, which have had an instant effect on flight schedules and, ultimately, capacity levels. Additionally, pure freighter capacity has been significantly impacted amongst others due to Russian companies Airbridge Cargo Airlines and Volga having the majority of aircrafts grounded.

Severe capacity constraints

As highlighted, it is the trunk trade from Asia to Europe that has been impacted the most. As before mentioned, we assess a drop in actual capacity of 20-25 % on this trade leading to instant rate increases across all airlines. Short-term, we expect this situation to continue with shippers scrambling to find solutions for priority shipments.

The primary driving factor are the required re-routings after Russian airspace closure for all EU, UK, and US-based carriers. This, in turn, requires different routings adding several hours to normal flight times. Additional fuel is then required, which leads to reduced payloads.

Another side-effect is that a high share of the volumes traditionally moved by rail freight through Russia and Belarus are shifted to airfreight, putting additional pressure on freight capacity.

Inasmuch as capacity is less impacted on other trades (Intra-Asia, Trans-Pacific, Trans-Atlantic), rates are also climbing North here. Once again, it shows how interconnected the respective trades are.

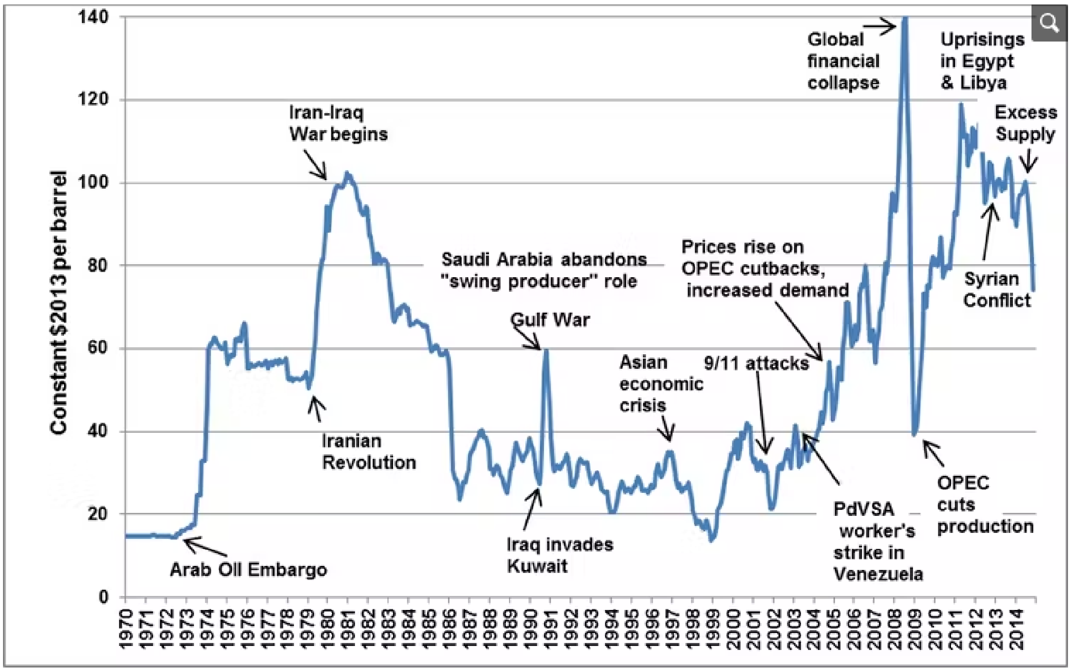
There has been a net increase in capacity on the Trans-Atlantic trade driven by an uptake in passenger travel. Additional routes were added and bigger aircrafts as well, adding positively to the capacity situation.

Ground handling issues remain ever-present due to a shortage of labour, and the same is the case on the trucking side. These challenges are now considered structural and less so only COVID-19 related. We assess that ground handling issues will continue to plague the cargo airfreight industry throughout 2022.

Oil price increase impact

Oil price increases have a global impact by nature. What do these impacts mean for the coming months and the remainder of the year? History may offer some relief considering that especially war and political conflicts have always been an inherent part of the oil price development. As can be seen from the below chart, it is also clear that the market traditionally normalized within a relatively short period.

Source for graph: https://theconversation.com/oil-price-shocks-have-a-long-history-but-todays-situation-may-be-the-most-complex-ever-178861



Summed up, the big-ticket question remains how long the situation with Russia and Ukraine will last?

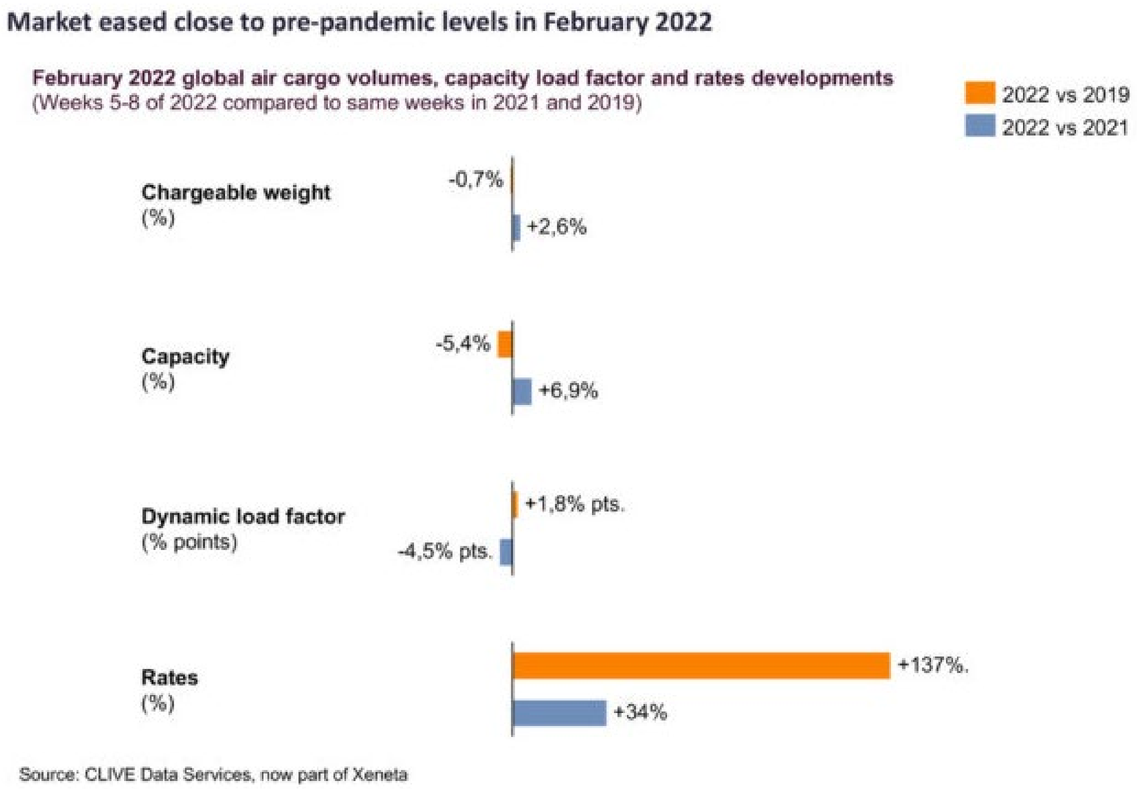
In case of a prolonged conflict, sanctions will remain in place, and the airfreight industry will need to identify stable measures to ensure sufficient capacity availability. With COVID-19 restrictions having eased somewhat in most countries, it is still expected that belly-hold capacity will increase throughout 2022. Still, for now, this increase has been swallowed by the impacts already mentioned.

The second big-ticket question is the macro-economical impact. Both related to the surging inflation levels and now also related to the general global uncertainty from the ongoing conflict and sanctions. All indicators would point to a significant decrease in consumer spending. Subsequently, products moved by airfreight would be first in line in terms of a negative impact considering the high-value nature of airfreight volumes.

Rate and capacity development

From a data perspective below chart from Clive illustrates the situation quite clearly, albeit it is not adjusted for the latest development pertaining to the Russia and Ukraine conflict.

Rates remain elevated vs. pre-pandemic, and 2022 rates are up vs. 2021 despite a 6,9 % increase in capacity vs. 2021.



Graph source: https://www.aircargoweek.com/market-eased-close-to-pre-pandemic-levels-in-february-but-what-now-for-global-air-cargo/?mc_cid=09ccf82ac6&mc_eid=98557a320e

Code **RED** would be a fair description of the situation for the airfreight market as a result of a dramatic drop in capacity over the last few weeks and the surge in oil prices. On top comes the potential third negative impact in China as a result of major COVID-19 lockdowns.

OCEAN FREIGHT

All things considered, the impact from the Russia and Ukraine conflict has been less impactful on the ocean freight side in comparison with airfreight.

As communicated in our separate Russia and Ukraine advisories, all carriers have implemented a near full booking stop for shipments to/from Russia. Re-routing of in-transit containers has commenced, with the majority of containers being discharged at ports in the Black Sea and North Europe.

Blank sailings are back

The impacts from the ongoing conflict aside, then most noteworthy has been the re-introduction of blank sailings on the Far East westbound trade in a carrier response to softening demand. This softening was expected on the back of record-high inflation levels in many cases exceeding the 5 % mark in many Western world countries.

The Ningbo Containerized Freight Index (NCFI) reported that weekly available export capacity now exceeds demand on this particular trade, noting that carriers had been more active in discounting prices on specific vessel departures.

As expected, the 2M alliance comprised of Maersk and MSC reacted swiftly by blanking the AE6/Lion loop sailings for the coming two weeks. Maersk commented this decision was made to cater for "*a high degree of uncertainty and significant delays on the network*." At the same time, MSC labelled the move as rooted in an "*ongoing challenging market situation*."

On the Eastbound trade from Europe to Asia, it remains relatively stable waters both from a capacity and rate perspective.

Rate development

Since the end of January, most indices, including SCFI and NCFI, have experienced a moderate rate level erosion on Far East Westbound. This has also been the case for Freightos and Xeneta indices confirming the overall trend. Both indices reported a rate level of approx. USD 13.500/40´ down from almost USD 15.000 a few months back.

According to the latest reports from Alphaliner, the actual capacity on this trade is up by approx. 9 % vs. the same period last year and combined with the decrease in consumer spending the overall development is not surprising. It remains to be seen to which extent blank sailings will be deployed by carriers as a countermeasure, but we do unfortunately foresee that the concept of blank sailings is here to stay.

The picture on the Trans-Pacific is somewhat more blurry. Despite a massive increase in nominal capacity throughout 2021, freight rates remain inflated at + USD 16.000 levels with no immediate sign of subsiding materially. In fact, moderate and further rate increases have been noted during some weeks. Especially East Coast ports are in higher demand generally with West Coast congestion issues cited as a reason for this.

Oil bunker prices are expected to increase in the coming period as a result of the major increase in oil bunker prices.

Today, fresh of the press, MSC has, as the first carrier, announced a bi-weekly review of BAF levels for all spot and quarterly contracts across all Asia trades effective April 15. We expect other carriers to follow in an effort to mitigate increased bunker costs.

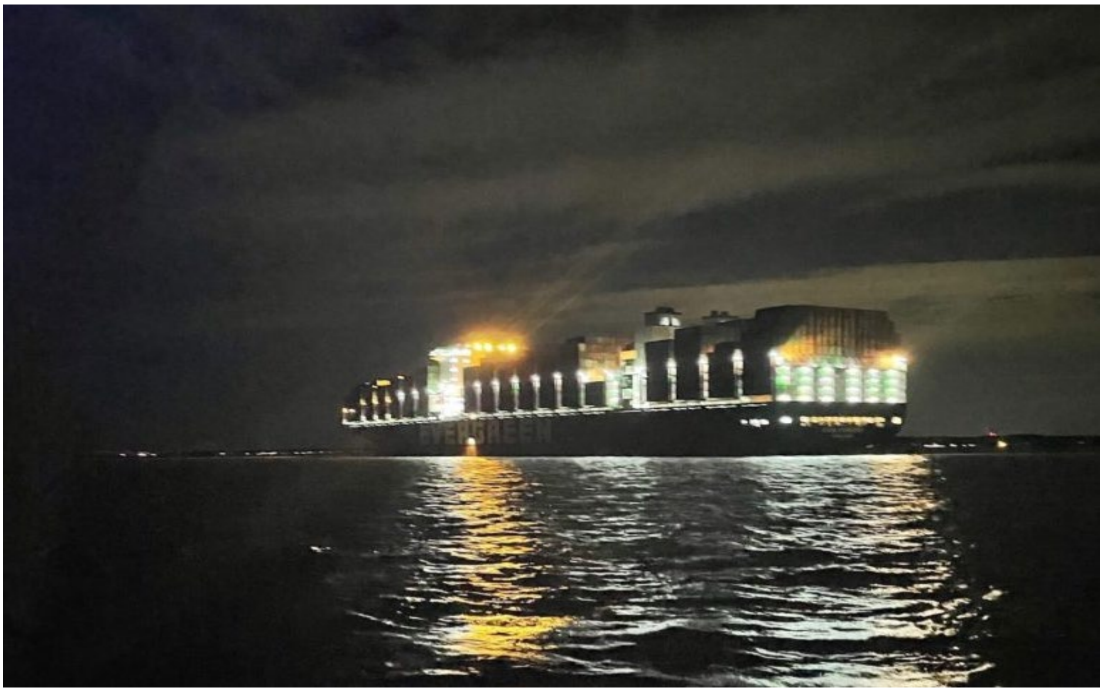
Code orange

Overall, we assess a lesser impact on the ocean freight industry from the conflict between Russia and Ukraine. COVID-19 lockdown measures in major China ports will, though short-term, pose a challenge adding further pressure on all Asia trades.

Mid-term, we expect a soft moderation of freight rate levels during 2022 as a consequence of softening demand. However, with the extreme market volatility now also caused by outside industry factors, it is very hard to predict the long-term impact(s), and a high degree of uncertainty will still be on the menu for some time.

Having declared code red on airfreight, we declare code **ORANGE** on ocean freight, and a high degree of volatility is ever-present.

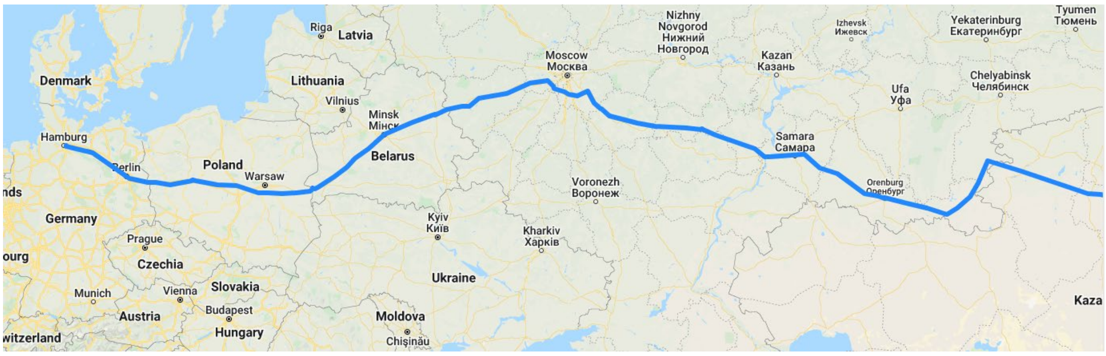
Should anyone be in doubt of this fact, then Evergreen again made sure to remind us all with news breaking that the 334-meter container vessel M/V Ever Forward (symbolic name) had run aground in Chesapeake bay close to the port of Baltimore.



Unlike the Suez Canal blockage last year, this incident has a broader minimal impact, and refloating efforts are ongoing as we speak. According to a US Coast Guard spokesperson, no injuries or pollution have been reported.

RAIL FREIGHT

Rail freight is operational, despite passage through Russia and Belarus. It is, however, heavily impacted by the general uncertainty related to Russia and Belarus sanctions despite transit cargo not formally being a part of the sanctions catalogue.



Due to the fear of potential additional sanctions hitting Russia and Belarus, which could result in cargo idling in Russia or Belarus, majority of customers have opted to turn to airfreight or ocean freight as an alternative.

We assess that rail freight will remain impacted for as long as the conflict is ongoing, however as mentioned, more so related to the general uncertainty on passage via Russia and Belarus and less so due to specific transportation hindrances.

ADVISORY: MARKET OUTLOOK

AIR | OCEAN | RAIL

OCEAN FREIGHT

TRADE UPDATES	SPACE (CAPACITY)	EQUIPMENT	SCHEDULE RELIABILITY	PRICE DEVELOPMENT
Asia-Europe (Westbound)	🟢	🟢	🟡	⇩
Europe-Asia (Eastbound)	🟢	🟢	🟡	⇨
Europe-US	🔴	🟢	🔴	⇧
US-Europe	🟢	🟡	🟡	⇨
Asia-US	🟢	🟡	🔴	⇨
US-Asia	🟢	🟡	🟡	⇨
Intra-Asia (incl. AU)	🟡	🟢	🔴	⇨

COLOR CODES	SPACE (CAPACITY)	EQUIPMENT	SCHEDULE RELIABILITY	PRICE DEVELOPMENT
🟢	70%-100% of normal capacity	No challenges	No challenges	⇧ Up
🟡	30%-69% of normal capacity	Medium challenges	Medium challenges	⇨ Stable
🔴	Less than 29% of normal capacity	Major challenges	Major challenges	⇩ Down

AIRFREIGHT

TRADE UPDATES	SPACE (CAPACITY)	SCHEDULE RELIABILITY	PRICE DEVELOPMENT
Asia-Europe (Westbound)	Yellow	Red	Up
Europe-Asia (Eastbound)	Yellow	Yellow	Up
Europe-US	Red	Yellow	Up
US-Europe	Red	Yellow	Up
Asia-US	Red	Yellow	Up
US-Asia	Yellow	Yellow	Up
Intra-Asia (incl. AU)	Red	Yellow	Up

COLOR CODES	SPACE (CAPACITY)	SCHEDULE RELIABILITY	PRICE DEVELOPMENT
Green	70%-100% of normal capacity	No challenges	Up
Yellow	30%-69% of normal capacity	Medium challenges	Stable
Red	Less than 29% of normal capacity	Major challenges	Down

Fuel Surcharge will drive all-in aspect of rates up globally

RAIL FREIGHT

TRADE UPDATES	SPACE (CAPACITY)	EQUIPMENT	SCHEDULE RELIABILITY	PRICE DEVELOPMENT
Asia-Europe (Westbound)	🟢	🟢	🟡	⇨
Europe-Asia (Eastbound)	🟢	🟢	🟢	⇨

COLOR CODES	SPACE (CAPACITY)	EQUIPMENT	SCHEDULE RELIABILITY	PRICE DEVELOPMENT
🟢	70%-100% of normal capacity	No challenges	No challenges	⇧ Up
🟡	30%-69% of normal capacity	Medium challenges	Medium challenges	⇨ Stable
🔴	Less than 29% of normal capacity	Major challenges	Major challenges	⇩ Down