August 2022 #4

The Macro-Economic Lottery

Dear valued customer,

It is increasingly difficult to find new words to describe the situation the world is facing, including the state of the transportation and logistics ecosystem.

On the one hand, a dampening of consumer spending - described by some as the "***cost of living crisis***" - will provide some relief to congested supply chains and, more so, to an overloaded logistics infrastructure. On the other hand, sky-rocketing inflation numbers not seen since the 70s, fueled not least by an explosion in energy prices, are causing an unprecedented stressed financial environment where uncertainty is the only constant.

Needless to say, the humanitarian disaster in Ukraine sits above all this, and the side-effect of the economic crisis is causing other forms of humanitarian disasters as well, especially in low-income countries that are dependent on Russia and Ukraine for basic food staples.

A recipe for red alert

The list of misery continues if we add the shortage of labor, which officially has changed from being COVID-19 related to being a mid to long-term infrastructural issue. On top, there is an ever-constant threat of labor strikes, which lately has dominated the headlines in the UK and Germany.

Adding to the recipe of a full-blown red alert situation is a continued zero-tolerance COVID-19 policy in China, political tension surrounding Taiwan, and a summer heatwave in Europe drying up major logistics routes, such as the Rhine River.

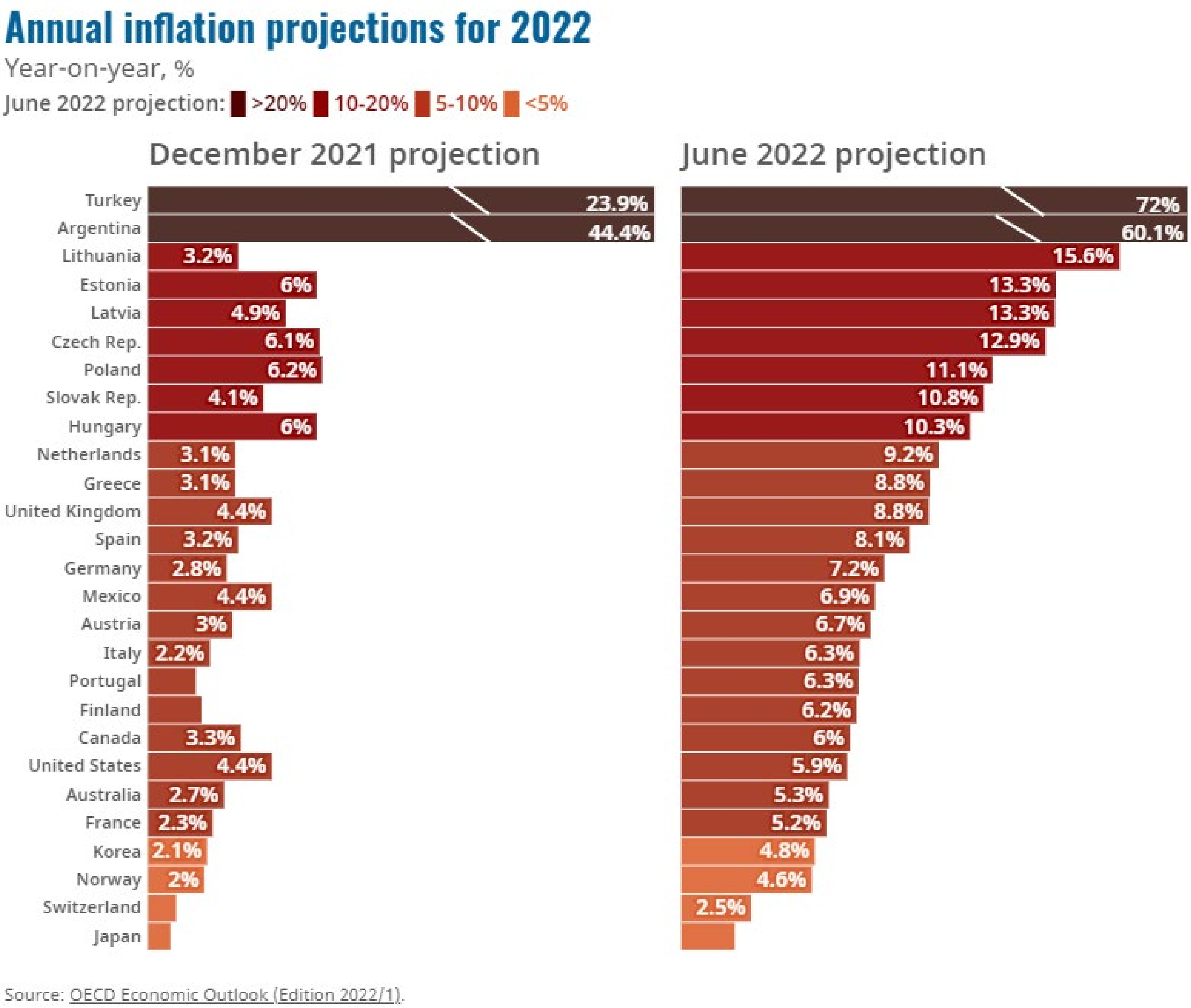
The drop in consumer demand has triggered a significant decline in freight rates across trades. Though, it is worth noting that on some of the blockbuster trades from Asia to Europe and Asia to North America, we are still well above freight rate levels compared to pre-COVID-19.

Record inflation levels reaching up to a 40-year high

The war in Ukraine effectively quashed any hope for a quick end to the rising inflation caused by COVID-19 supply chain bottlenecks that have wreaked havoc on global trade during the last two years.

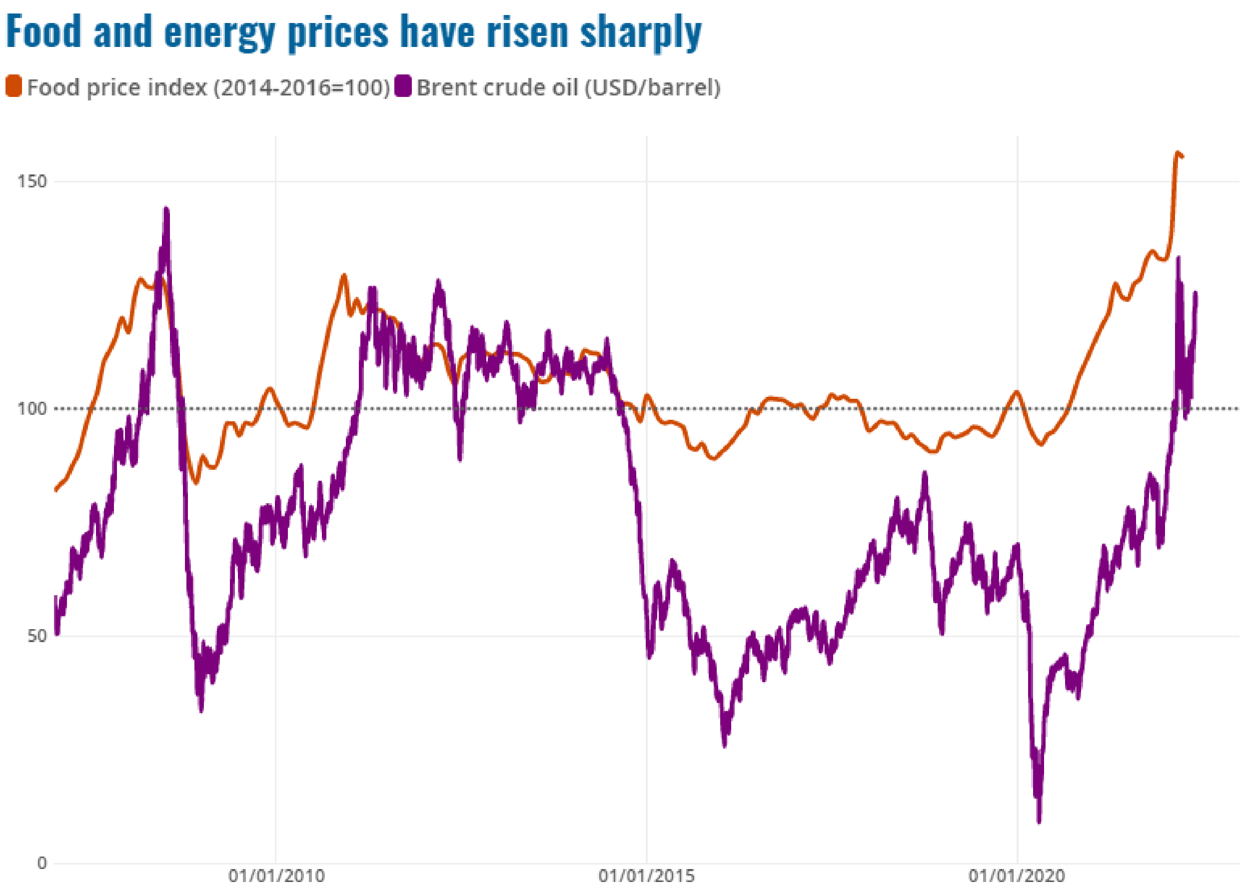
The latest projections from the OECD show the immense impact the war has on inflation levels, reaching a 40-year high in countries such as Germany, the UK, and the United States. There is a glimmer of hope that the reduction of supply chain costs and the impact of increasing interest rates will gain traction during 2023. This should stop further inflation. However, the assessment remains that sky-high inflation levels will remain for the rest of 2022.

The below chart shows the dramatic change in inflation projections, and bearing in mind that OECD has only updated development up until June 2022, it is expected that Q3 numbers will show further increases.



Source: https://www.oecd.org/economic-outlook/

The obvious and immediate consequences for the cost of living can be seen below.



Source: https://www.oecd.org/economic-outlook/

This time around, governments are struggling with identifying remedies to mitigate the current issues. Even consecutive interest rate record increases of 0.75% by the Federal Reserve (FED) in the USA, latest 27 July, have not been enough to fight inflation prices. The moves by the FED in June and July represent the most stringent consecutive action since the FED began to use the overnight funds rate as the primary monetary policy tool in the early 1990s.

Without concluding whether the current development officially marks a full-blown financial crisis similar to what we saw back in 2008-2010, then what we are seeing is surely a scenario that has a massive impact on global trade as we know it.

There is more to freight rate development than just supply and demand

By now, we have also learned (the hard way) that the simple equation of supply and demand, and these being the only two factors that impact the development of freight rates, does not stand proof as it once did.

Recent comments from Hapag Lloyd CEO, Rolf Habben Jansen, framed this in a very simple manner by commenting that the over-shadowing and the largest issue is on the landside, not on the water: "*No amount of new vessels can resolve landside issues, as these would simply have to line up in the queue outside major ports, and there is still some way to go before this is resolved.*"

The last years have also shown that asset players have learned from the past. They are utilizing instruments such as "blankings" as a systemic measure to ensure that freight rates do not tumble.

Unfortunately, therefor instability and also schedule reliability will continue to be a challenge. While freight rates are moderating, it is still crucially needed that all parties in global trade once again can plan basis ***Just In Time*** and not ***Just In Case***.

Data from Global Liner performance shows an improvement in schedule reliability to 40% during the last month. While any improvement is welcomed, a performance of 40% remains dismal and a threat to global trade.

For more in-depth analysis, please fasten your seatbelt as we walk you through some of the specific impacts and developments within air, ocean, and rail freight.

Enjoy the reading!

On behalf of

Scan Global Logistics

Mads Drejer
Global COO & CCO

AIRFREIGHT

During the past two years, we have grown accustomed to the fact that the airfreight market has been in turmoil across more or less all major trades. Summed up, the reduction in passenger flights has caused a lack of bellyhold capacity, which in turn has fueled rate increases. On the landside, ever-growing and persistent congestion constraints have become an increasingly significant issue.

Being the most expensive transport mode, airfreight is, by default, an expedited and premium product. Therefore, the level of instability we have seen has a comparably bigger negative effect vs. ocean freight as there is no buffer nor margin for error.

Passenger travel is seemingly enjoying a moderated yet constant rebound. Does that mean we are in for a return to a pre-COVID-19 normal? **Not just yet** would be the immediate answer when we look at the short and mid-term outlook.

The war in Ukraine continues to impact flight schedules, fuel prices have been on a record upwards trajectory, and labor shortages persist on the landside, be it on cargo handling or related to lack of truck drivers. Adding to this is increasing speculation about the potential effects of the recession-like state we are facing and whether this will translate into a significant decline in general air passenger travel.

Trade development

On the Trans-Atlantic, summer-schedule additions have contributed positively to the overall capacity situation, resulting in a softening of rate levels. This is primarily the case for bellyhold capacity, with pure freighter capacity is withstanding rate level pressure more firmly. Freighter capacity is still reduced due to the war in Ukraine and the sanctions imposed on Russia that, as an example, have led AirBridgeCargo to suspend majority of flights. It is expected, though, that with the start of the winter schedule, we will see a decrease in overall capacity, which in turn could trigger rate increases.

Routes to and from Asia, which would include main trades to North America and Europe, are overall benefitting less from the increase in passenger travel. This is a result of Asian countries, notably China, applying a significantly more rigid and restrictive COVID-19 policy. And we see no immediate signs of this changing.

During the summer months, demand has softened and thus provided some form of congestion relief. However, we still assess that the traditional Q4 peak season will kick in, albeit at a more modest level than in previous years.

Intra-Asia markets will eventually benefit from less tight enforcement of COVID-19 policies. Currently, there is only a minor increase in scheduled flights and thus also in bellyhold capacity. Freight rate levels remain somewhat inflated, primarily on account of fuel prices.

Africa is gaining traction

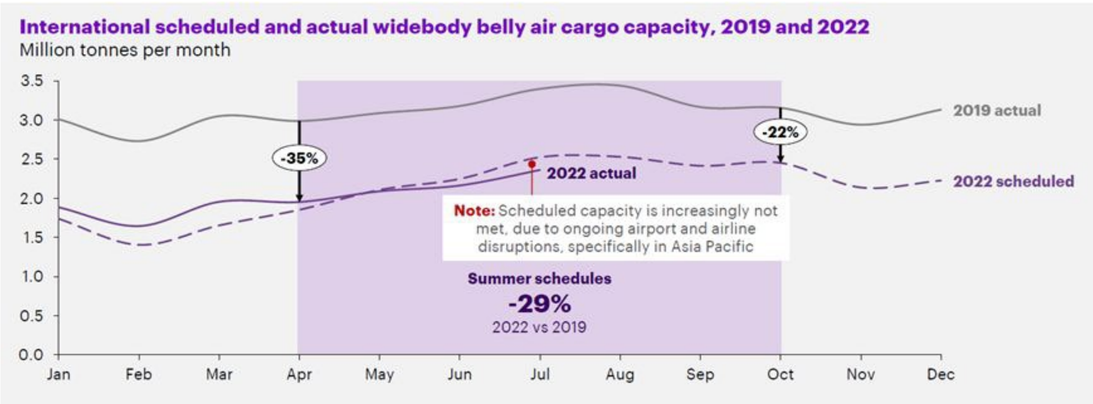
In high demand has been further insight into the development concerning flows to and from Africa. Overall, we assess this trade as being relatively stable in terms of capacity availability and as well rate development. This is partly related to the fact that Africa has been less impacted by COVID-19 restrictions. However, we have seen some decreasing perishable volumes going from Africa to amongst other the EU during the past weeks, with this commodity type being a driving force on this trade.

This is also the mid and long-term outlook. The general expectation is that this is a region and a trade that, growth-wise, will develop positively in the years to come. Meaningful increases in GDP and a growing population are expected to drive this positive development, all while Africa is increasingly gaining traction as an alternative sourcing country to Asian countries.

The landside conundrum

During the summer months, congestion and staff issues at major airports around the world have hit the mainstream media with the news of repeated delays, cancellations of flights, and missing luggage. While the attention has been focused on passenger travel, the root cause(s) for these issues are very much the same when we zoom in on cargo ground handling issues, i.e., a structural issue pertaining to a lack of staff. On top of this, frequent strikes have become the new normal, with workers demanding higher salaries on the back of the rapid increase in the general cost of living.

Seabury (an Accenture company) recently shared the following insight.



Source: https://www.accenture.com/us-en/insights/travel/air-cargo-capacity

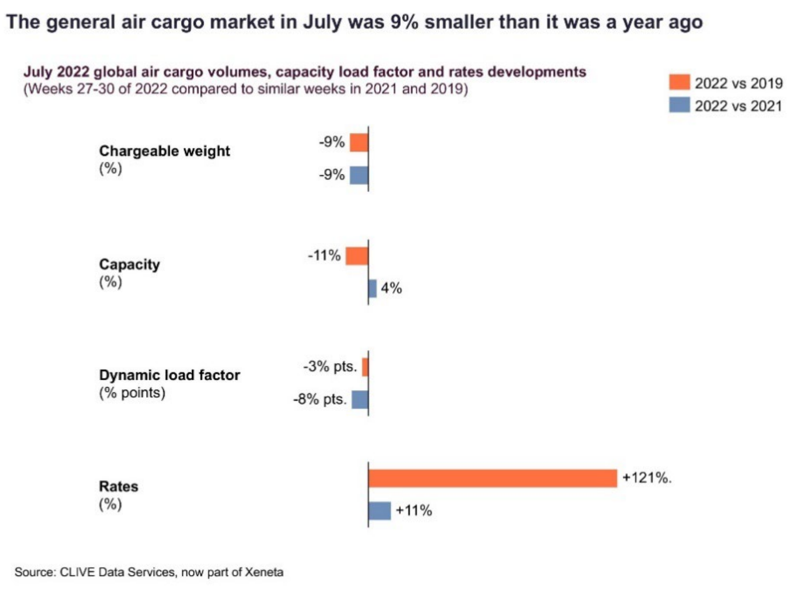
The chart shows that while in theory capacity was available, in practice, it was impossible to convert it into actual capacity due to factors such as staff shortage, lack of trucking capacity, etc. As communicated in our latest advisory, this shows that it is becoming increasingly important to differentiate between gross and net capacity.

It is fair to point out that the worst corner seems to have been turned on the landside. A Lufthansa Cargo spokesperson gave this comment: *"From time to time, we experience disruptions and delays (at Frankfurt) due to ground handling processes, but it is not to the same extent as in July. A lack of loading staff, sickness among crew members, or technical issues have resulted in the cancellation of individual freighter flights this month so far.*

Nevertheless, we remain committed to being a reliable partner for our customers and transporting shipments on time".

He added, *"The longest delays for our drivers this month have been at Amsterdam Schiphol. The cargo handling companies are short of space and short of staff. Forwarders are not collecting import cargo quickly enough, especially over weekends. The breakdown and check-in are taking much longer, freight is not staged at truck docks. The consequence is very long waiting times for truck drivers". It continues, "Staffing levels should recover after the summer holidays, but it's true that historically, congestion has occurred during peak periods."*

In terms of freight rate development, the primary drivers are fuel price increases and the number of pure freighter flights that have replaced a significant portion of the lower-deck capacity from passenger flights. Pure freighter flights have an average operating cost that is higher than bellyhold capacity. These factors are playing their part in sustaining freight rates at a relatively high level, despite the overall demand softening due to the general economic slowdown.



Source: https://www.aircargonews.net/airlines/air-cargo-demand-drops-again-in-july-as-dark-clouds-gather/

Outlook

As mentioned, we expect the traditional peak season to kick in during Q4. However, it will be more modest compared to previous years. Demand is soft, and accordingly, we do assess the general capacity situation to remain positive, albeit with fuel prices playing a part in sustaining freight rate levels despite the drop in demand.

Overall, the normalization trend is continuing with Lufthansa Cargo commenting to *The Loadstar* that the 2022-2023 winter schedule (effective end of October) will see bellyhold capacity on intercontinental routes at approximately 85% of pre-pandemic levels[1]. This statement is a major proof point and an indication that lower deck capacity, which before the pandemic represented roughly 50% of the total capacity, is slowly but surely returning to the market.

[1] https://theloadstar.com/belly-capacity-on-its-way-back-to-pre-covid-levels-says-lufthansa-cargo/

OCEAN FREIGHT

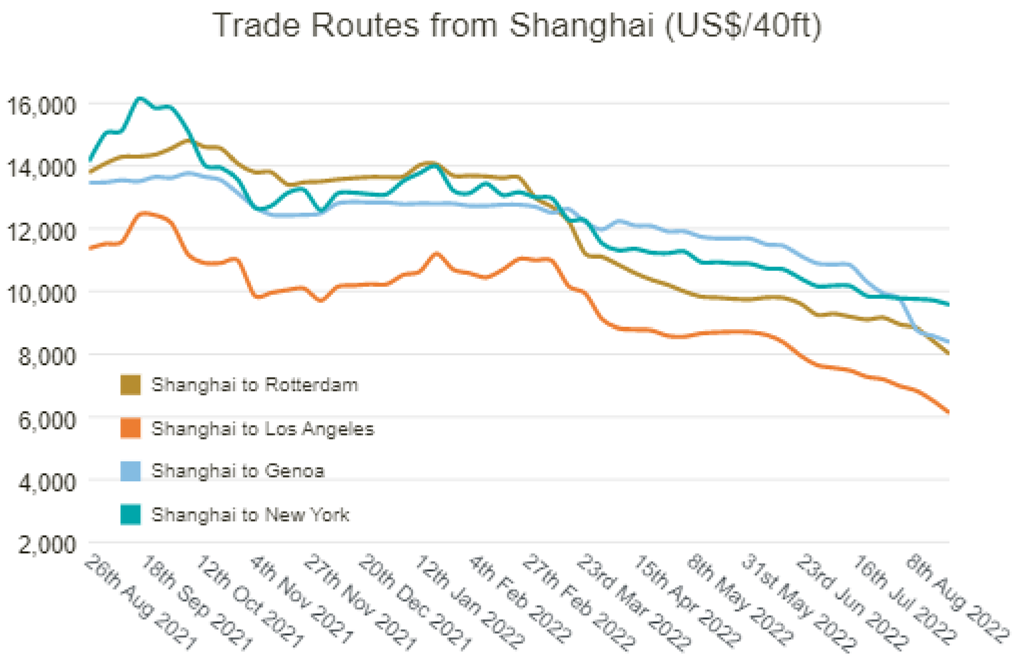
The general headline for ocean freight is the general softening in demand, which is prevailing on all trades and keeps rate levels on a steady downward trajectory. While rate levels have not fallen off the cliff, a significant movement on the short-term (spot rates) is apparent. Last week, the Drewry WCI index on Asia to North America and Asia to Europe dropped 5 and 6 %, respectively, in a period that under normal circumstances would be considered peak season.

Drewry WCI rates from Asia to the US West coast fell to USD 6,127 per 40' feet, and for Asia to North Europe, the corresponding number was 8,010 per 40' feet. Further rate moderations are expected in the coming weeks and months. However, rate levels are still trending at levels that, from a historic perspective, are very high; hence the current development is assessed as being a part of the "*return to somewhat normal*" journey.

So what to expect?

Most analysts assess that this journey holds a landing place that is in between the sky-high record rates seen over the last 12-18 months and pre-COVID-19 levels. There is a general consensus that freight rates will not return to 2019 levels considering that carriers are applying a more disciplined approach, landside bottlenecks are still an infrastructural issue, and also owing to the fact that the cost of operations for carriers has increased significantly. Generally, spot and long-term rates are expected to converge during 2023, with the historic gap between long- and short-term rates diminishing.

All in all, gaps of thousands of dollars between the long and short-term are viewed as unsustainable from both sides of the negotiation table. This development is welcomed, leaving less room for long-term crystal ball bets and allowing the customer to estimate future cost drivers more accurately.

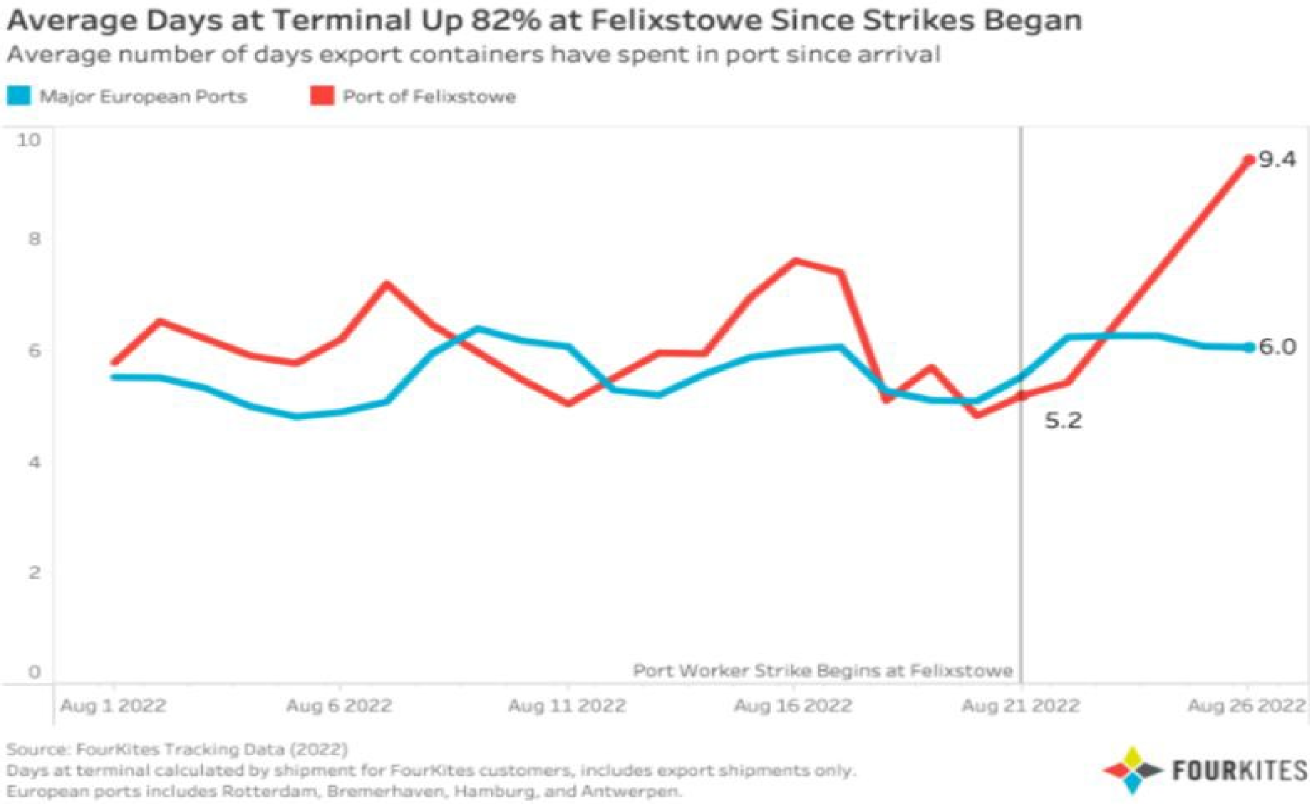


Source: https://www.drewry.co.uk/supply-chain-advisors/supply-chain-expertise/world-container-index-assessed-by-drewry

The landside conundrum 2.0

As it is the case on the airfreight side, labor strikes have been an issue on the ocean side as well. An 8 days strike in Felixstowe effectively ended 29th of August with no agreement, and thus the threat of further strikes is looming in the air. 1900 workers out of 2550 concluded their walk out over a 7% offer issued Sunday, 28th August. Union Unite warned that further strikes will indeed come if no further negotiation would be done from the port owner's side. Not surprisingly, a CK Hutchinson port spokesman labeled the offer as "very fair", leaving discussions stranded for now. However, port workers have resumed work (for now). At the same time, the unions at the Port of Liverpool also voted for a potential strike, although they have not set dates as we speak.

Ripple effects from the strike are already evident, with carriers having had to offload cargo at other ports, including continental ports. It is estimated that it may take up to two months until normal schedules have been reinstated. So far, more than 20 vessel arrivals have been impacted by the strike, and more worryingly, a haulage ketchup effect is expected as customers will wish to get delivery of containers immediately following the strike. This comes on top of a general lack of haulage capacity, with the expectation being massive congestions and further delays. On average, the container dwell time in Felixstowe increased from 5.2 days to 9.4 days during the 8-day strike.



Source: https://www.bloomberg.com/news/newsletters/2022-08-29/supply-chain-latest-felixstowe-port-strike

On a positive note, Germany's unionized port workers and the association representing the seaport operators agreed to terms for a new contract after one of the longest-running labor disputes in Germany for decades. The tentative agreement came just three days before a cooling-off period imposed by the Hamburg Labor Court was due to expire and removes the threat of further strikes, which have been disrupting operations in all the North Sea Ports since June.

Serious drought hitting the Rhine

In Germany and throughout Europe, there are other issues to deal with besides human-made ones. The heatwave and drought that has plagued much of Europe continue to worsen, and the impact on one of the busiest transit routes in Europe has been disastrous.

On Monday, 29 August, the Rhine's water level in the German town of Kaub, the river's bottleneck, fell to around 12 inches deep, according to the Rhine Waterways and Shipping Authority. This is the lowest it's been at this time of year since 1990. The 800-mile-long Rhine connects Germany's industrial heartland, the Ruhr, to major container ports like Rotterdam in the Netherlands. Millions of tons of fuel and cargo pass along the river each year.

Sources: https://www.businessinsider.com/rhine-river-drying-up-causing-problem-european-shipping-companies-2022-8?r=US&IR=T#on-monday-the-rhines-water-level-in-the-german-town-of-kaub-the-rivers-bottleneck-fell-to-around-12-inches-deep-according-to-the-rhine-waterways-and-shipping-authority-which-manages-the-river-this-is-the-lowest-its-been-at-this-time-of-year-since-1990-it-had-risen-to-around-13-inches-by-wednesday-2

The situation on the Rhine has had an immediate effect forcing barge operators to reduce the amount of cargo carried and instead rely on trucks and trains to move deliveries along. With water levels dropping to around 15-18 inches, a large ship/barge that would normally carry 6000 tons can now only load 800 tons.

In the US, the ILWU and PMA have reached a tentative agreement on health benefits but continue the discussion on wages and automation. It is a matter of time when it will be concluded. The general notion is that the worst threats of further strikes on the West Coast have passed.

Blank sailings and "slidings" are back

In order to mitigate schedule delays and the general softening in demand, carriers continue to announce blank sailings and service slidings. While carriers argue that "*slidings*" is a necessity to adjust schedules on account of not least port congestion, and blankings are more of a deliberate choice, the end result is one and the same = further delays and lack of schedule reliability.

As a highlight or rather "downlight", over the next five weeks, there will be a 10% cancelation rate out of the 409 scheduled sailings on the Trans-Pacific Eastbound Trade and a 12% cancelation rate out of the 144 scheduled sailings on the Asia to Europe trade. We assess this picture to continue throughout 2022, having in mind that in recent years, carriers have managed supply and demand in a much more stringent manner than before.

Local challenges but overall stability in Africa

The zoom-in on Africa on the ocean side, to some extent, follows the outlook on airfreight with a market environment that is generally speaking stable, with local challenges. The conflict in the Sahel region (mainly Mali) has spread into the neighboring country Burkina Faso where Government Forces and Militants continue to challenge the Eastern region, resulting in massive obstructions of supply chains and general cargo movement.

Volatility on the Kenyan Railway remains an issue as well. An official memo received indicates that rail operations from Mombasa to Nairobi are to be reversed for transit cargo movement to South Sudan. The Kenyan government now confirms that they have received formal instructions to stop railing all United Nation-related cargo to South Sudan and to retain them at Autoports Mombasa and clear there. All other South Sudan containers are railed to Nairobi and then loaded from there.

These challenges aside, the general outlook for Africa spells growth. We continuously see asset players investing heavily in Africa, latest with the MSC acquisition of Bolloré Africa Logistics at an enterprise value of USD 5.7 billion.

Bunker prices are stabilizing

Oil bunker costs came down slightly in recent weeks. Overall, they have stabilized, albeit at a high level. We do not expect major additional Bunker Surcharges prior to the implementation of IMO 2023, while conversely, we do not expect significant decreases either, considering the general energy crisis.

Outlook

We expect a slow, steady return to a somewhat normalized freight rate environment. However, from a supply chain stability perspective, there is still some way to go. Especially the landside part of the end-2-end equation proves to be a complex component due to infrastructural issues.

The softening in demand is a short-term relief that in itself does not solve the issues that have plagued the logistics ecosystem over the last couple of years. If anything, the last years have shown that transportation and logistics are at the center of a global trade ecosystem where external factors play a significant role in the general development. As highlighted already, the simplistic view of supply and demand ruling the entire development is long gone, and we need to factor in a multitude of components when assessing the mid and long-term outlook.

RAIL FREIGHT

Generally speaking, rail freight East to West and back is enjoying a stable period with sufficient available capacity as a result of the general softening in demand. Rail, as a rule of thumb, follows the development within ocean freight, and thus rate levels have also moderated accordingly.

From a reliability perspective, service disruptions have been at a minimal level in recent weeks and months, and we expect this development to continue short- and mid-term.

AIRFREIGHT

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

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

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
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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
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