JANUARY 2022 #1

NEXT STOP 2022 – ANOTHER BUMPY YEAR AHEAD!

Dear valued customer,

Happy new year!

The end of 2021 marked what is beyond any doubt the most chaotic, challenging, and volatile year in modern logistics history. It is a qualified guess that many professionals within the logistics industry had a new year's resolution that centred around the wish of a more stable working environment in 2022. On the same note, we often tend to believe that the start of a new year also provides a chance to have a fresh start and that certain things will change for the better. While that may be true in many aspects of life, there is no indication that the year 2022 will be more lenient than what 2021 offered.

A comfort amid frustration over all-time high rates and all-time low schedule reliability is that we are forced to re-adjust our mindsets and challenge status quo to find solutions to challenges we never expected to face. Many logistics theory books are overdue for a rewrite, exemplified by the industry joke of the much-praised "*Just In Time*" logistics mantra having been replaced by "*Just in Case*."

So, fasten your seatbelt, turn off your mobile devices and remain seated until you have landed at the end of this advisory.

Back to normal or welcome to a new one?
Kicking off 2022, let us also once and for all kill the notion of COVID-19 impact being the main culprit. Yes, the pandemic triggered a lot of dramatic short-term effects, but more so, it unearthed an industry plagued by infrastructural and demographic challenges that far exceed any impact from COVID-19. An industry where asset owners, forwarders, and customers have opposing views on what the right way out of the evil spiral is, leaving us with the question of what to expect in the coming year and beyond.

One of the best reports read to date recently issued by a world-leading investment bank summed it up perfectly:

"*You've seen the petrol queues, you've read about ships anchored off ports, and you've heard about the container squeeze, the truck driver deficit, and the animal cull. But with governments and corporates making soothing noises about resilience and bounce-back, there's nothing to worry about, right…? Right?*

Here's the thing; we can't find a single data point that suggests "back to normal" next year. And while our faith in human ingenuity is strong, our love of data is stronger. So, we've dug into every aspect of the supply chain crisis and brought together 10 of our top-ranked teams for sector views. Most importantly, we've built scenarios to see how much disruption will impact 2022 and when and where it will hit hardest. Sadly, it's not a pretty picture."

In other words, the much-awaited "back to normal" is overdue for a revision. We are witnessing a new normal, and it is about time we all mentally adjust our thinking accordingly.

A well-renowned author stated that "*hope is not a strategy,*" and at Scan Global Logistics, we wholeheartedly subscribe to this statement. Accordingly, we will base our customer solutions and advice based on our accumulated experiences over the last years, rooted in the new normal that we have been facing for some time now. Less so, our views on the market will be based on hopeful thinking of a return to the old normal as we knew it a few years back.

Adding the financial macro-component to the equation is not making it anymore simple to grasp what will happen. Record-high inflation levels across all major economies are now apparent, coupled with a highly uncertain geo-political environment, notably due to political unrest in Taiwan and Ukraine.

Inflation is up, but inventory remains low

Inflation levels theoretically should trigger some form of regression in 2022 and reduce consumer spending, and while this is also widely expected, then inventory levels remain record low as well. On top, capacity constraints and specifically the net capacity reduction both on ocean and airfreight is double-digit. More capacity on the ocean freight side might have been added, but it is being eaten up by massive congestion at all major ports, i.e., the needed capacity is as much idling outside ports as it is on the water.

With that festive fly-in, we hope you will spend a bit of your time reading through our January advisory, providing our view on the logistics industry's short-, mid- and long-term.

Same procedure as last year

Capacity will overall remain scarce, congestion will lead to transit time-uncertainties, and labour shortages will impact landside operations. These challenges impact all modes of transport. Even though we see different levels of severity, especially depending on whether we look at head or back-haul trades, the conclusion across the board equals all-time low schedule reliability and historically inflated rate levels.

With Chinese New Year around the corner in early February, we are also in the middle of the traditional peak season in Asia, especially on the ocean freight side, whereas airfreight volumes peaked ahead of Christmas. This would normally indicate an added pressure on rates and capacity. However, with the old normal officially revoked from our vocabulary, the situation very much resembles what we have seen throughout 2021.

For the same reason, short-term ocean freight rate levels have remained quite stable over the last weeks, and this is expected to continue short-term. We expect a moderate softening of ocean freight levels during March and April. However, no drastic decreases are expected.

As expected, airfreight rates spiked during December due to the traditional surge in volumes ahead of Christmas, but similarly as expected, rate levels have taken a downwards trajectory during January.

The US market and subsequently the major US trades of Trans-Pacific and Trans-Atlantic remain relatively hot, and all indicators point to this continuing short and mid-term.

All in all, as the headline reads, so far, it is the same procedure as last year.

Please take note, as always, this market update is based on information currently available to us, and therefore is subject to change – especially in the current logistics environment.

Enjoy the reading!

On behalf of

Scan Global Logistics

Mads Drejer
Global COO & CCO

AIR FREIGHT

The vast majority of airlines are currently in limbo mode, having initially planned to add flights on most major routes in the coming period. However, with passenger travel taking a serious hit during the last month on account of the Omicron outbreak, these plans have been parked for the time being. Accordingly, a major capacity increase will be delayed and will be more moderate than expected.

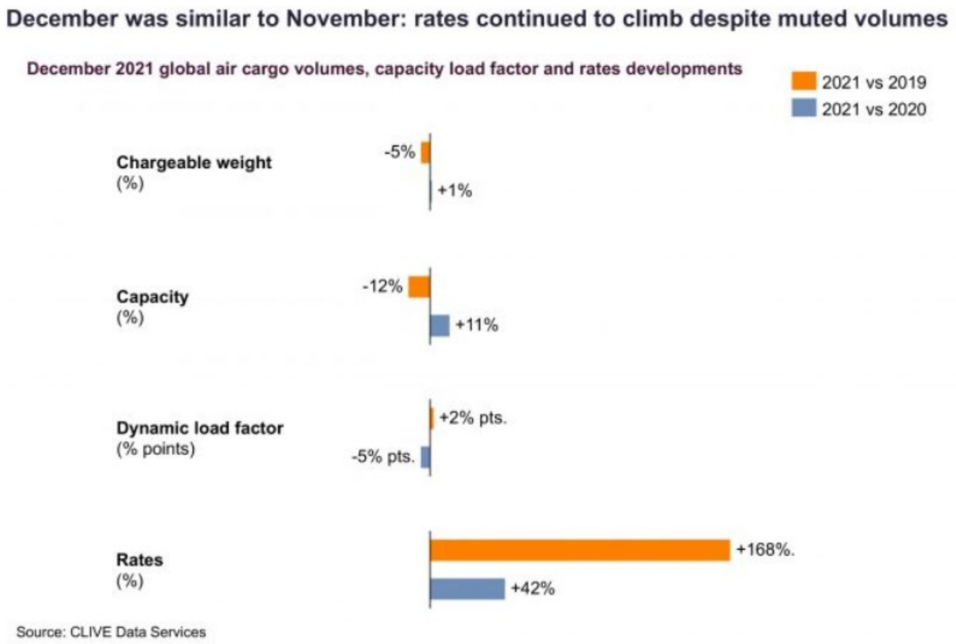
We see schedule plans with an increasing number of flights. However as mentioned, we also register schedules being changed to adapt to local and regional COVID-19 outbreaks. Freighter capacity is already 100% utilized on all routes where possible. This means that any capacity increase will come in the form of belly-hold capacity, following the expected gradual increase in passenger flights.

Ground handling remains a challenge

There is a sustained high concern that ground handling congestion triggered by lack of available labour will persist being a major challenge. This is also the case with haulage capacity, though our analysis shows that ground handling congestion challenges are having the most impact on delays. This will continue to stress the markets, impact transit times and the overall operational stability. We expect rates will remain elevated despite slight moderation during January. On top of that, an increase in ground handling charges and haulage rates is expected, with these two components functioning as counterweights from a price perspective. We also expect oil prices to go up during 2022, resulting in rate levels being sustained at a high level.

Zooming in on the markets

It was without a doubt a pressured Q4 in 2021. The peak season kicked in as expected in November and December, causing a significant impact on an already challenging operating environment. The spike in volumes was by no means record high, far from it. However, coupled with reduced capacity, the pressure came from the cocktail of reduced capacity and ground handling issues rather than a surge in actual volumes. Figures show reduced tonnages during November versus October. The load-factors remained high, as the Clive-Data-chart below shows:



Graph source: https://theloadstar.com/december-air-cargo-demand-dampened-by-supply-chain-issues-and-omicron-concerns/

Other analyses show that load factors in their own right are not maxed out, having been in the mid-to-high 50% range during 2021. This, however, does not reflect reality considering that aircrafts tend to max out space before maxing out on weight, with weight being the metric IATA uses to calculate load factor statistics.

It is expected that especially China on this side of the Winter Olympics will apply a rigid approach to any form of an increase in COVID-19 numbers, with the potential consequence being further cancelled flights.

E-commerce continue to drive airfreight volumes

On the Trans-Atlantic routes, we have seen airlines planning for flight increases as part of the summer scheduling (starting as of April). As we speak, this is hanging in the balance as a direct consequence of the surge in Omicron cases. This, in t,urn, means that we do not expect any significant ratel level changes in the coming period once again speaking to our headline of "same procedure as last year."

Other key trade markets will remain at the 2021 level, with capacity levels not expected to change substantially. Neither on the South-Atlantic, nor Intra Asia, or to and from Africa.

With ocean freight rates at an all-time high, airfreight is widely expected to continue to benefit from this situation as the relative price difference is less than it has been for many years. On top commercial drivers on the consumer side, specifically, e-commerce growth, is pushing volumes towards airfreight to ensure consumer demand is met.

All in all, a busy and challenging year is on the horizon within the airfreight industry. It is, however, important to emphasize that relatively speaking, we consider airfreight to be further ahead than ocean freight in terms of market stabilization. This is, among others, due to the fact, that the airfreight industry is not suffering to the same degree of infrastructural challenges as within ocean freight.

OCEAN FREIGHT

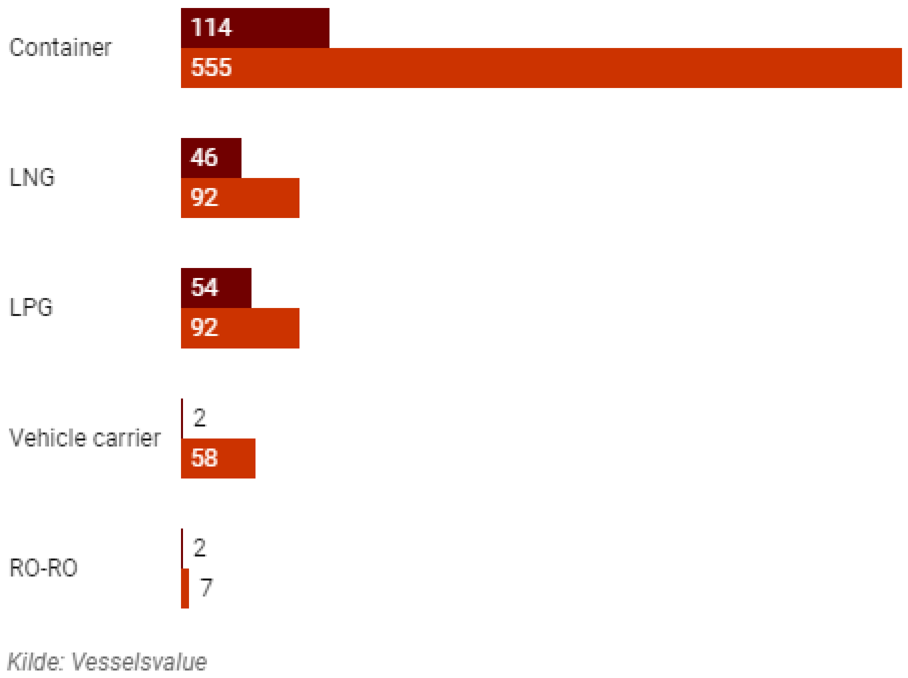
All major ports around the world continue to struggle with heavy congestion. The diagnosis on the landside remains the same under the label of a full-blown systemic issue causing havoc to supply chains around the world.

Delays and low schedule reliability have become a standard, spiced up with rate levels that no one would ever have dreamed of a few years back. Ocean freight carriers across the board have posted record financial results. Maersk, as an example, on 4th January announced (unaudited), a 2021 EBITDA earnings of USD 24 billion, with this being up from previously expected USD 22-23 billion[1].

Interestingly enough, Maersk also informed of a 4% decrease in volumes in Q4 2021 vs. the same period in 2020, highlighting that the current chaotic situation is as much caused by net capacity being impacted rather than a surge in volumes driving rates upwards.

New vessels on order

Looking a few years ahead, there is an expectation that actual capacity will increase significantly. During 2021 a record number of new vessels have been ordered by container carriers, as a consequence of the booming market. In total, 555 new vessels have gone into the order books, which is four times higher compared to 2020, according to an analysis from VesselsValue.



[1] https://investor.maersk.com/news-releases/news-release-details/trading-update-q4-and-full-year-2021

Source:
https://shippingwatch.dk/Rederier/article13650943.ece?utm_campaign=ShippingWatch%20Morgen&utm_content=2022-01-20&utm_medium=email&utm_source=shippingwatch_dk

The majority, of these deliveries are scheduled for 2023 and 2024, and for this reason, it is also too early to speculate on the potential consequence of the added capacity. Logically this could imply a scenario with over-capacity. However, bearing in mind the end-to-end infrastructural challenges, this does not automatically equal a collapse in ocean freight rates. The carrier concentration is significantly different compared to just a few years back, and the instrument of blank sailings is another dimension to be aware of.

Rates seem to stabilize

The 2022 contract season ended, as expected, with long-term rates increasing significantly based on the simple logic that many of these contracts were negotiated at the start of 2021. The statement "s*pace is king and rate is queen*" well describes the assessment made by many customers having emphasis and priority on securing space, and less so on negotiating the last hundred dollars on the rate. We increasingly see a trend in the appetite for long-term rates and in some cases with 2-3 years contracts as the result, in order to safeguard supply chain reliability. Spot rates will continue to serve their purpose. However, the overall conclusion is clearly that both short- and long-term rates have stabilized.

The Shanghai Freight index for Europe-based ports showed a TEU price of USD 7.797 on 14th January, and looking back to early November, the same metric on 5th November was a TEU price of USD 7.637. Considering that this period is considered a traditional peak season, this rate development can be considered marginal at best.

Congestion is not limited to the US

Port congestion will remain a challenge, and unlike most media reports that have a high focus on US ports, we see extended dwell times at all major European ports. In some cases, causing over a week's delay. Especially UK ports are badly hit with some UK destined cargo being offloaded on the continent as terminals in the UK simply cannot cope with the pressure.

Feeder services to the Nordics and Baltics face the same issues with the major trades causing ripple effects on the smaller trades connecting main and out ports.

In Asia, the port of Ningbo has fully re-opened after the latest close due to the COVID-19 outbreak, but severe disruption is still seen due to, among others, labour issues and haulage backlogs that need to be cleared. We expect further potential disruption across China ports, especially on this side of the Winter Olympics, because of the zero COVID-19 tolerance policy.

If a ship is not moving, it is not providing any capacity

To understand the situation on the ocean freight side, the key data point to consider is effective available capacity. It may be the case that actual vessel capacity increased in 2021 vs. 2020 by approx. 6%, but as the circumstances are far from normal, then this is irrelevant. Container vessels during 2021 have likely been the most expensive storage facility one could imagine. Vessels are designed for navigating the world's oceans, not being at anchor outside ports and this is the key point when looking back at 2021, as well as looking ahead at 2022.

Until port congestion is dramatically improved, then effective available capacity will be reduced vs. actual capacity disappearing into a black hole of congestion. It is expected that the anticipated slow-down in consumer spending will provide some relief. However, we do not assess that it will materially impact the supply and demand situation in 2022.

Finishing off where we started this advisory, then hope is indeed not a strategy. On the ocean freight side, no data points indicate that 2022 will be much different than 2021. A black swan event always has the potential to impact the situation, but apart from this, it is same procedure as last year.

RAIL FREIGHT

All things considered, the by far largest rail trade from Asia to Europe have scraped through the peak season period relatively well from a capacity perspective.

Challenges have more been related to a lack of available haulage capacity due to local COVID-19 lockdowns causing a lack of available drivers, and specific restrictions where certain cities simply could not be entered. Xi'an and Zhengzhou are home to two of the largest rail terminals in China and have been impacted by local COVID-19 restrictions. Usage of domestic rail services in China has helped to overcome this. However, delays have occurred and accordingly these issues also lead to an increase in local charges in China.

Actual rates have remained relatively stable. We expect this to continue in the coming period, though local charges and namely pre-carriage levels should decrease again after Chinese New Year.

Political turmoil should not affect rail freight

Despite increasing speculation on the turmoil in Kazakhstan and how this may affect rail transportation, both Chinese rail operators and Kazakhstan railway officials reassure that this critical rail corridor will not be affected by the political turmoil.

As always, we recommend considering rail freight as a standard alternative to ocean and airfreight.

OCEAN FREIGHT

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

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

AIRFREIGHT

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

COLOR CODES	SPACE (CAPACITY)	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
🟢	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