February 2023 #1

2023 – No Breaking News to report...

Dear valued customer,

In an industry that has been plagued by a steady stream of unwelcome news during the last 3 years, the phrase 'no breaking news to report' has been a long time coming.

Rather than crystal balling on which way the supply and demand equation will unfold in 2023, the focus is rather on the long-term outlook. The simple reason for this is the fact that the current market mechanisms across all modes of transport seem to be cut in stone for the foreseeable future.

If there is any form of breaking news, it is the public 2M divorce between MSC and Maersk, but even that was expected and predicted by many analysts, and we will deep-dive into this later.

On the macroeconomic side, there is a glimmer of hope that we are moving towards more positive winds, with inflation levels having peaked and taking a downward trajectory across all larger economies. With this said, consumer confidence remains low especially over-shadowed by energy prices remaining elevated. This, coupled with overstocked DCs and warehouses, means that demand is modest and subdued.

Supply and Demand rules

During the first weeks of 2023, global freight markets broadly remained on the downward trajectory they have been on since the end of summer, reinforcing the current trends. On the supply side, it is now clear that carriers have been unable to effectively manage capacity supply relative to the sudden drop in demand during the second half of 2022.

The decline in demand on the Asia-Europe westbound trade hovered between -20% and -25% during September, October and November (compared to the same months last year). The reduction of the Trans-Pacific Eastbound trade was between -25 and -30%. Considering these numbers represent a decline significantly higher than any drop in GDP, it appears to be a Covid-induced change in consumer spending fueled negatively by sky-high inflation levels and, on top overstocked inventories prompting companies across industries to slash new orders.

Amidst weak demand, there was no real pre-CNY cargo rush. Accordingly, container carriers accelerated blank sailing programs to create a sense of scarcity during the Transpacific contract season to justify contract rates. The scarcity created by blank sailings did not have a material impact on spot freight rates, so the liner industry is heading into its low season from what is already a low start-of-the-year baseline. Spot freight rates on several key trades have fallen to and then stabilized around their pre-pandemic levels. Medium-term and annual contract rates are also falling rapidly, albeit with some delay.

This year, Drewry anticipates a minor uplift of 0.8% in global port throughput. Assumptions include a cooling down in inflation, a weaker US dollar and some inventory replenishment. Economists seem to be slightly more optimistic than they did at the end of last year. Gas prices are down, inflation in most parts of the advanced world is coming down – with the exception of the UK - and stock markets have had a roaring start to the year. Oxford Economics has bucked the trend and maintained the same 1.5% real GDP growth outlook for 2023 in its most recently updated forecast, saying that a short global recession is still likely, but that downside risks are balancing out.[1]

The softening demand for ocean freight also leads to rapid improvements in the congestion situation in especially US and Europe. The resulting expected improvements in ocean service reliability reduce the attractiveness of the more expensive modes of air and rail freight, causing weaker volumes there as well, again proving the interconnectivity across transport modes.

For shippers, all of this is overall good news. As the industry moves back to a comfortable level of overcapacity, with liner services reverting to their intended schedules and port productivity normalized, the container distribution system is able to clear the remaining backlogs and regain its resilience while prices normalize.

Please note that all information is given to the best of our knowledge and is prone to change.

Enjoy the onward reading!

On behalf of

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[1] https://www.oxfordeconomics.com/world-economic-prospects/

OCEAN FREIGHT

It is now clear that carriers have lost control of the container market, failing to proactively manage capacity, limiting capacity only when forced to do so by heavy losses.

When the market first started showing signs of weakness in March 2022, the deep-seated instinct to lower the price to secure short-term bookings rather than to control capacity kicked in. This is not to say that carriers have done nothing, but despite of various service suspensions and a raft of blank sailings, nothing has worked.

This is a good reminder that while the supply and demand equation may have changed somewhat by consisting of new components such as slidings and blankings, at the end of the day, it is supply and demand that rules. It also squashes any form of regulatory intervention, which during the pandemic was a heavily debated topic.

Only minor fluctuations across key trades

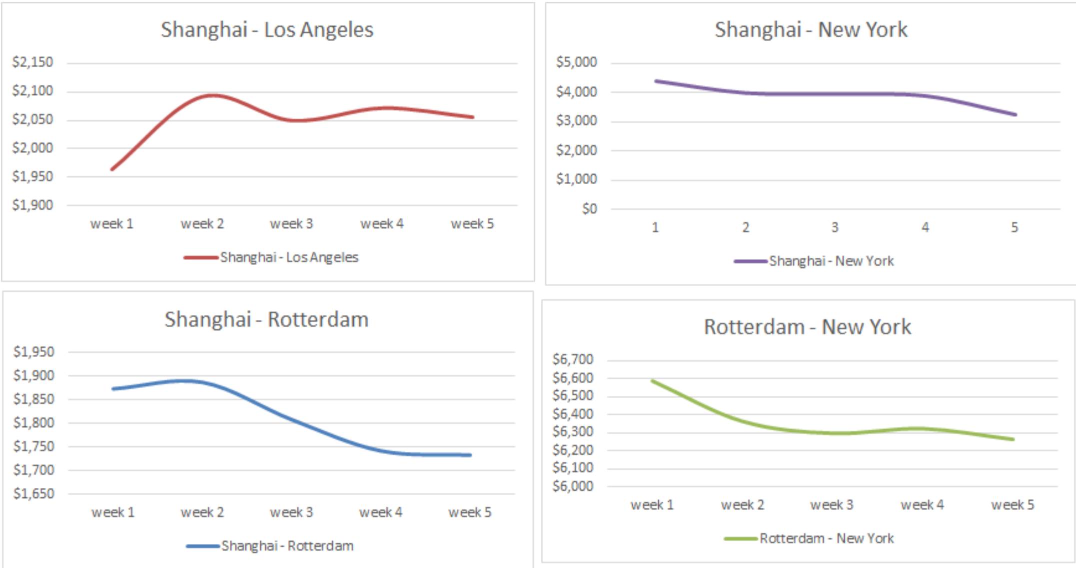
Drewry's first World Container Index (WCI) for 2 February showed a continued softening of East-West freight markets since the start of the year. The Composite Index is now approximately 5% lower, making it the worst 'start of the year' for freight rates since the inception of WCI in 2011, except for 2016. 2016 was a particular infamous year of record-low freight rates, which ultimately triggered amongst other Hanjin bankruptcy.

Rates have softened the most on Asia to US East Coast trade, as the easing of port congestion in the US knocked the seat from under them. Freight rates became 14.7% cheaper in 4 weeks. Also, on the Asia-North Europe trade, rates fell by 7.6%, and on the Asia-Mediterranean trade by 6.8%.

Spot rates are now about $100 below their five-year-pre-pandemic average (2015-2019) on Asia to USEC and the Asia-North Europe trade. With little support expected from the demand side before the third quarter, carriers appear to be in a spot of bother for the next few months, as the rates with longer validities will follow the same trend.

The one head-haul trade where rates are now higher than at the start of the year is Asia to US West Coast trade, supported by what would appear to be a small pre-CNY rush, in combination with a peak in blank sailings in week 4. WCI for Shanghai to Los Angeles increased by $128 during the second week of the year.

Figure 1: Weekly spot freight rates on East-West headhaul trades (US$ per 40ft)



Source: World Container Index assessed by Drewry

As can be seen from above, the so far ‘insulated’ Trans-Atlantic trade is softening as well in the wake of additional capacity having been transferred to this trade from other surplus capacity trades. It is yet too early to say whether this development will mirror the other high-profile trades or whether a plateau stage will set in at an earlier stage.

Significant schedule reliability improvements are still to materialize, despite most expecting that reliability would improve considering the lower pressure on the demand side. The performance continues to hover around the 40-50 % mark, with this being a far cry from pre-pandemic levels.

So, what is next?

Attention now turns to the post-Chinese New Year (CNY) period, with factories gradually ramping up again and a question mark on whether the somewhat brighter economic outlook will have a short-term impact.

Blankings remain a part of the carrier arsenal. However, as highlighted, it is not expected to have a material impact on overall supply and demand. Over the next 5 weeks on the Asia-Europe trade, 146 scheduled sailings are blanked, equal to 15 % of all sailings. The magic number on the Trans-Pacific trade from Asia-US is also 15 %, with 365 scheduled sailings cancelled.

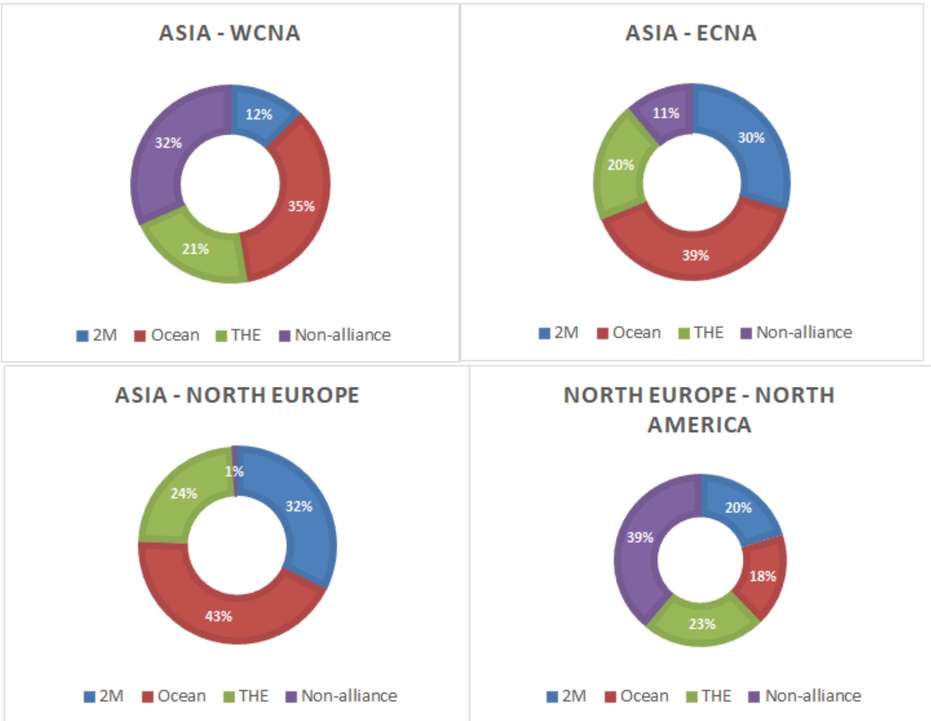
New capacity in the form of new vessels being added is slowly picking up. However, the full force on the new buildings is only expected to kick in during the end of 2023 and into 2024.

Summing up, 2023 will be a year of transition within ocean freight, and until demand picks up, no significant change is expected,

Deep dive: Mega-Alliances in liner shipping

MSC and Maersk stated on January 25 that they would terminate their 2M alliance agreement, bringing the alliances into the spotlight once more as it started the countdown timer on the largest of the three current mega-alliances. It thereby heralded, potentially, the beginning of the end of the current mega-alliances, which are currently deploying more than 80% of the total deployed capacity on East-West trades.

Figure 5: Alliance shares of deployed capacity on East-West trades



Source: Drewry Maritime Research

The operational collaboration that the mega-alliances engage in is, in itself, an innocuous, common-sense approach as the lines share capacity, thereby enabling each partnering line to offer a wider portfolio of port pairs to their respective customers than they could alone.

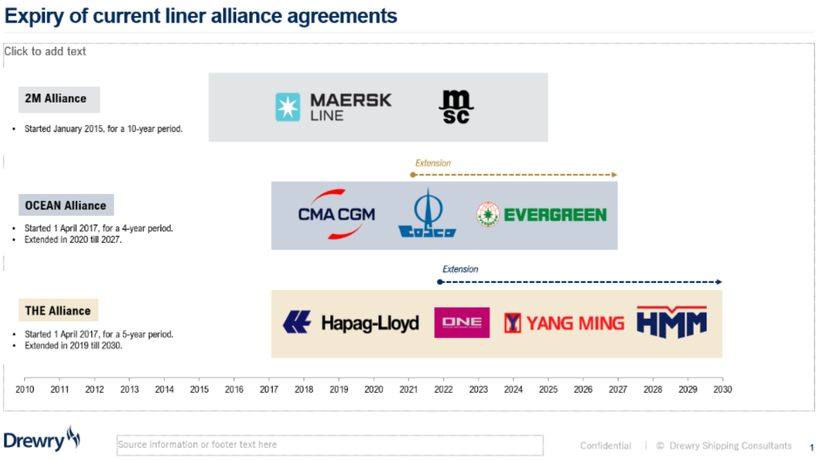
The capacity-sharing practice is usually called a Vessel Sharing Agreement (VSA). It is quite flexible in its arrangements – slots are swapped either for slots on another service, cash, or a combination of both. What sets the mega-alliances apart is the longevity of the agreements and the amount of strategic alignment this enabled for the carrier partners in terms of capacity deployment and strategic trade development.

As a consequence, the legislation that underpins these alliances, the Consortia Block Exemption Regulation (BER), has been a thorn in the eye of many carrier customers and their associations because the alliance constellations regularly failed to deliver the expected value in terms of price or service levels.

The origin of mega-alliances and their members

Larger vessels that minimize slot costs had been the carriers' strategy to beat low profitability. After a phase of rapid vessel upscaling, in January 2015, the 2M Alliance became the first of the mega-alliances to launch. This came after the P3 initiative, which would have seen the three leading European carriers (2M + CMA CGM) collaborate, was blocked by notably the Chinese regulators after it had been approved by EU and US authorities.

2M was agreed for a 10-year period, and the vessel upscaling potential that it unlocked for its members, in combination with the bankruptcy of Hanjin in August 2016, rapidly forced other shipping lines to react. They established THE Alliance and OCEAN Alliance in January 2017. THE alliance was initially established for 5 years (until 2023), but on June 1, 2019, HMM joined, and the agreement was extended until 2030. OCEAN Alliance was initially established for 4 years but extended its agreement until 31 March 2027.



The future of mega-alliances

The decoupling of the 2M alliance agreement in 2025 appears to leave Maersk in a tight spot, albeit there is a growing consensus amongst industry insiders that it was, in fact, Maersk that pulled the plug on the 2M alliance and not MSC as many have speculated.

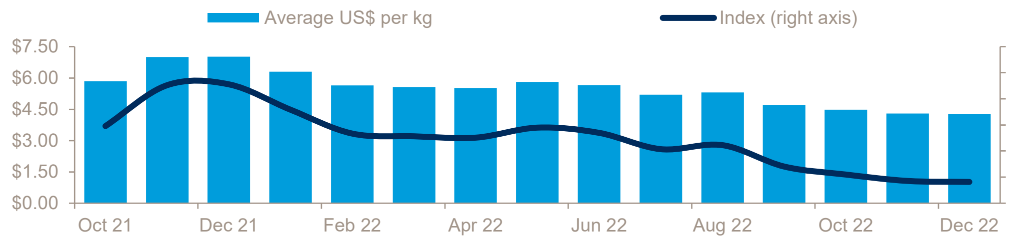
While MSC has been on a vessel-buying spree during the pandemic years and is considered large enough to stand on its own, the Danish mega-carrier appears, at first sight, to be too big to join an existing alliance and too small to go at it alone. Maersk has stated it will not try to lure a new partner out of an existing alliance. Instead, having the advantage of full control over its vessels is considered by Maersk to outweigh the obvious cost disadvantages – only history will answer whether MSC or Maersk has drawn the longest straw.

AIRFREIGHT

Airfreight limped into 2023 with weak expectations. Like the traditional Christmas peak season surge, a spike in Chinese exports before the Lunar New Year break proved elusive.

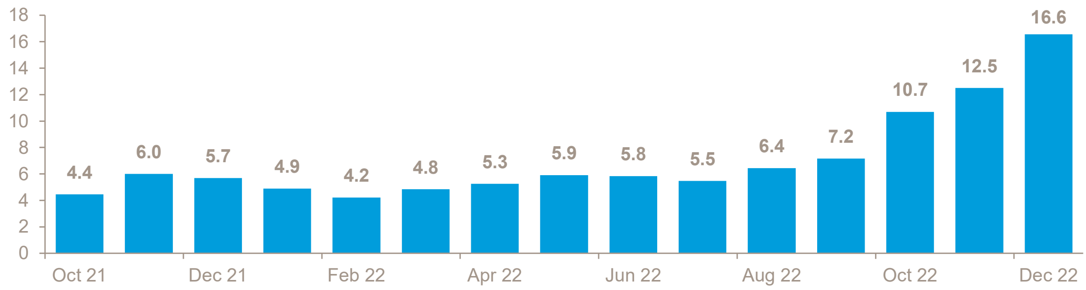
Airfreight rates have, as expected, softened in recent months. The Drewry East-West Airfreight Price Multiplier increased further to 16.6, indicating just how large the cost advantage of ocean freight has become in recent months, hence relatively speaking, airfreight rates have had a softer landing than seen on the ocean freight side.

Figure 2: Drewry East-West Airfreight Price Index (May 2012 = 100)



Note: This index is a weighted average of all-in airfreight "buy rates" paid by forwarders to airlines for standard deferred airport-to-airport airfreight services for cargoes of 1,000 kg+ on 28 major East-West routes. Rates are expressed in US$/kg and include 3 components: the base rate, the fuel surcharge and the security surcharge. They exclude door delivery costs.
Source: Drewry Maritime Research

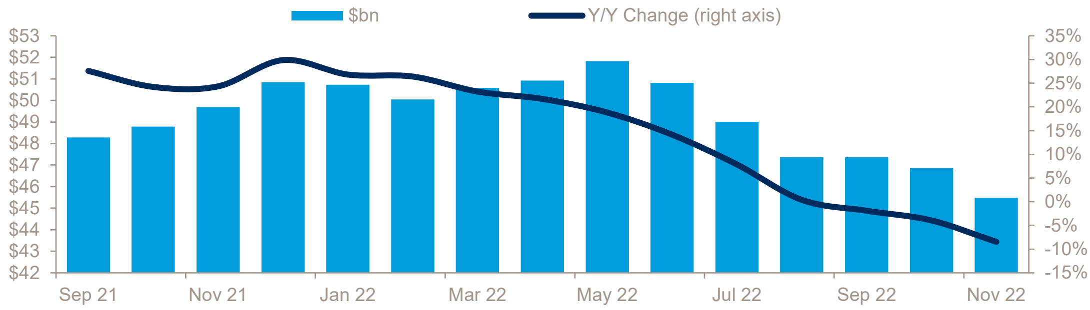
Figure 3: Drewry East-West Airfreight Price Multiplier



Note: Comparison of East-West Air Freight Price Index and Drewry's East/West Container Freight Rate Index (converted in to cost per kg: basis 4,500 kg per teu).
Source: Drewry Maritime Research

Global semiconductor sales growth, a major barometer for airfreight demand, came in at $45.5 bn in November, making it the third month of decline in a row. Compared to the year before, demand for semiconductors had shrunk by 8.5%, illustrating the dire situation of airfreight demand. Near-term improvement is not expected.

Figure 4: Worldwide Semiconductor Sales, 3-month rolling average, % change y-o-y



Source: Semiconductor Industry Association

With the overall market trend consistent across all major trades, one has to look to at specific events to spot any form of significant development in volume. So, on a peculiar note, it actually turned out that Valentine's day represented one of the most significant developments, with flowers from Africa and Latin America northbound impacting volumes positively. Obviously, this is a mere bleep on the radar in the big picture. In that light, it is noteworthy that rate levels do remain above pre-pandemic levels. The overall tonnage- and rate levels year-on-year remain significantly below 2022. At the same time, it is important to highlight that market rates remain above pre-Covid levels.

The post-pandemic capacity increase continues, with especially the re-opening of China mainland driving this. While it may be the case that this, on paper, looks to increase the imbalance between supply and demand, projections are also that a corresponding increase in trade with China will occur, with these two parameters expected to even out each other.

On the Trans-Atlantic trade from Europe to the US, rates continue to remain fairly stable, albeit with ocean freight rate decreases likely acting as a catalyst for the same on the airfreight side. In turn, we see market rates trending downward in most Asian destinations. But as well here, some destinations remain more stable, namely Korea and the majority of South East Asia countries.

For Africa, only minor fluctuations are noticeable, and the market will remain stable, and same goes for exports to Latin America.

Outlook

A traditional key aspect to observe is the change from winter to summer schedule by end of March. Typically, the summer schedule triggers a gradual increase in capacity towards the mid-summer months, especially from Europe to the US, and this is coming on top of a soft demand. However, some counterbalancing factors continue to exist in the form of uncertainty on full freighter capacity will develop, elevated fuel prices and landside staff shortages.

We maintain a view that supply will exceed demand for the foreseeable future, which also leads an increasing number of customers to gauge the possibility of locking in rates for 3 to 6 months as opposed to ad hoc procurement, which has become the norm over the last 3 years.

One factor to look out for is the potential threat of labour strikes, with this being a realistic scenario in countries such as Germany, France and the US. This comes as a reaction to unions fighting for a larger salary increase on the back of sky-high inflation levels during the last year. Latest, Lufthansa announced that it will be forced to cancel over 30.000 summer flights due to a shortage of staff, so it is not all smooth flying despite slow demand.

RAIL FREIGHT

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.

Westbound

Overall, the rail freight market development has a large correlation to the ocean freight market, and there is also an apparent softening of rail volumes.

In terms of freight rate levels, there is a notable difference, with rate levels not having dropped near to the same extent as seen on ocean freight, but there is nonetheless also a downward direction on the rate side, which is expected to continue in the coming period.

In response to this development, the main rail transport coordination entity, China Railways, has issued notice to reduce train ‘slots’/departures similar to the introduction of blankings on ocean freight.

Eastbound

Rail transport from Europe to China remains stable with a relatively constant rate level and stable transit time performance.

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)	Green	Green	Stable
Europe-Asia (Eastbound)	Green	Green	Down
Europe-US	Green	Green	Down
US-Europe	Green	Green	Stable
Asia-US	Green	Yellow	Stable
US-Asia	Green	Yellow	Stable
Intra-Asia (incl. AU)	Green	Green	Down
To Africa	Green	Yellow	Stable

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

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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
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