‘The Freight Party is Over’

After two years of elevated rates and record profits, ocean carriers face changing tides, including a pricing power shift, capacity conundrum and innovation vacuum.

By Dan Zeiger

The trend that could usher permanent changes as to how the global shipping industry operates was reflected by two words and a number in the list of commodities down in price in Institute for Supply Management®’s Manufacturing ISM® *Report On Business®* for April:

Ocean Freight (8).

That entry, indicating that prices declined for an eighth consecutive month, typifies the direction of container spot rates since the heady times ocean carriers had for much of 2021, when they could almost name their price. However, that entry doesn’t reflect the drama of the situation — to visualize that, pick any ocean freight index in graph form. Starting in the second quarter of 2022, you’ll see the angle of downward slopes that took many in the industry by surprise.

“No one expected the backside to be this steep,” says Jason Haith, the Louisville, Kentucky branch manager at OEC Group, a freight transportation and logistics information services provider. “The drop-off has been precipitous since Lunar New Year 2022. That seems to be the inflection point, where the downward trend indicated some kind of great change, and it’s been consistent.”


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The trend is expected to continue in the near term, as carriers compete for business amid lowering demand, inauspiciously timed with an increase in capacity due to a surge in bigger vessels set to come online. A possible economic recession, continuing geopolitical tensions, ports labor strife, heightened regulations (particularly in the sustainability space) and companies' reshoring or nearshoring of manufacturing operations are also dynamics that could potentially create more rough seas.

The coronavirus pandemic's "stuff economy" — when demand for goods soared — has left ocean carriers sitting on hundreds of millions of dollars in profits to help them figure out a response, while procurement organizations and freight forwarders salivate at the current buyers' market. But in an industry long defined by booms and busts, the most recent downturn could be a return trip to pre-COVID-19 business levels, or to a new normal.

"From a supply chain point of view, it's clear that the freight party is over," says Chris Jones, executive vice president, industry and services at Descartes Systems Group, a Canadian technology company focused on supply chain and logistics software and services. "For the freight industry, 2023 is looking more like 2019 in terms of volumes, so you could say it's back to the future. But in many ways, it's not the same."

He elaborates: "(In 2019), there was a lot more stability and predictability in consumer demand. We didn't have the Russia-Ukraine war. COVID-19 is still a factor. And the geopolitical situation has made companies think about where they're going to buy or make their products. If you look at the view from a thousand feet above, there's a lot of uncertainty."

Indexes Show How Low Prices Can Go

The annual contract season for ocean freight is in March and April, and the power shift between this year and last could not have been more pronounced. In early 2022, one report indicated companies should brace for "astronomical" increases. This year, it's "how low can you go?" says Tyler Higgins, managing director at AArete, a Chicago-based management and technology consulting firm.

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>
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> OEC Group

A look at some of the major global freight indexes and reports indicate the degree of rate and volume descent:

- The Drewry World Container Index registered US$1,708.63 per 40-foot equivalent unit (FEU) on April 13, down 82 percent compared to February 2022 ($9,477.46) and 84 percent from a peak of $10,377.19 in September 2021. Rates from Shanghai to Los Angeles averaged $1,674 in April, an 85-percent drop from February 2022.
- The Freightos Global Container Index reading of $1,406 per FEU on April 10 was a decrease of 86 percent compared to February 2022 ($9,789) and 87 percent lower than in September 2021 ($11,109).
- The Xeneta Shipping Index for April 13 revealed year-over-year decreases of 87 percent for both Far-East-U.S. West Coast freight (to $1,150 per FEU) and Far East-Northern Europe cargo ($1,414), as well as a 62-percent drop for shipments from Northern Europe to the U.S. East Coast ($3,213).
- Descartes' Global Shipping Report for March revealed U.S. container import volume of 1,853,705 20-foot equivalent units (TEUs), a 6.9-percent increase compared to February. But that figure was down significantly from the same month in 2022 (2,558,021 TEUs) and in line with March 2019 (1,778,409).

"When the pandemic was raging, capacity was swallowed up," Higgins says. "But the economic climate has changed and consumer spending has been reined in, so capacity has returned, ports aren't congested and everything favors buyers. And I think it's going to take a while for demand to catch up."

The ocean freight indexes — the Drewry and Freightos readings for April were in line with 2019 levels — are based on spot rates, one-time fees paid by shippers or forwarders that are based on current market pricing. The previous two years were boom times for carriers because (1) higher spot rates helped lead to more favorable contracts and (2) rising demand made more companies reliant on the spot market.

"It was a perfect storm," Jones says. "Those who didn't have the contracts in place or smaller companies with little clout were the ones that were hurt." While there were reports of spot rates of $20,000 or more for a container, that was not a big part of the market, he says: "But it is important: Even shippers with contracts saw consumer demand totally outpace their expectations and possibly go beyond the capacity in their contracts. So, sometimes they had to go to the spot market."

Such dilemmas for shippers figure to be non-existent in 2023. The highest-profile facet of the Ocean Shipping Reform Act (OSRA), which became law last year, was a crackdown on carriers' excessive pricing, including demurrage (levied on importers) and detention (on truckers) fees on slow-moving containers at clogged ports.

In an industry once overpopulated with carriers, the market has consolidated greatly in the last two decades, with the nine largest companies forming three alliances, designed to share resources, coordinate schedules and enhance negotiation power with shippers and ports. During the pandemic, critics accused the alliance carriers (which control about 80 percent of ocean capacity) of operating like cartels.

Today, elements of the OSRA targeting alleged price gouging already appear obsolete, or at least tabled. As this issue of *Inside Supply Management*® went to press, freight indexes had stabilized somewhat. However, with industry chatter of a price war — for the lowest — between carriers, perhaps there was still room above the floor.

"It's somewhat of a race to the bottom on rates," Higgins says. "Our advice to companies negotiating contracts with carriers is to balance speed and cost, because the ultimate goal is to get from the manufacturer to the sales floor in the shortest time and lowest cost."

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Booming (and Blanking) Vessel Capacity

Last year, most ocean freight balance sheets and quarterly reports never looked better. Carriers combined for 2022 profits of between $223 billion and $270 billion, depending on the forecaster. Either way, it was a record amount.

Mediterranean Shipping Company (MSC), based in Geneva and the world's largest carrier, is typically tight-lipped about its finances. The No. 2 carrier, A.P. Moeller-Maersk of Denmark, reported a $30.9 billion profit in 2022, though it expects to make less than a sixth of that this year. "There just won't be enough market share for everyone to be as profitable as they've been in the last two years," Haith says.

Seemingly for as long as ocean freight has existed, carriers have responded to large profits by ordering more ships. In 1894, J. C. Gould, Angier & Co., a firm of English shipbrokers, described this mindset as "philanthropy." The firm's annual report stated, "The amount of new tonnage under construction and on order guarantees a long continuance of present low freights and an effectual check against increased costs of overseas carriage."

Carriers have combined for a record 7.1 million TEUs of vessels on order, including a single-year record of 2.5 million TEUs of deliveries in 2023, according to Alphaliner, a French ocean shipping database. In March, a Chinese shipbuilder delivered the world's biggest container vessel to MSC — a 1,312 foot-long, 24,166-TEU behemoth that can carry more than 240,000 tons of cargo, part of the company's reported $1.2 billion in spending on new ships. Maersk has 19 vessels on order, all at least 17,000 TEUs.

Even if demand rebounds quickly, "it won't have much effect on prices," says Alan Amling, Ph.D., distinguished fellow at the Haslam College of Business at the University of Tennessee in Knoxville, Tennessee. "Prices will be depressed for a while, especially as new capacity comes online, and the overall economic situation isn't likely to improve quickly."

And with volumes falling and port congestion easing, carriers are struggling to fill their current fleets. That leaves them with one tourniquet to slow the rate bleeding: artificially reducing capacity through blanked (or cancelled) sailings. According to Drewry, 149 sailings — 21 percent of those scheduled — were cancelled between January 9 and February 12, most between the Far East and U.S. West Coast due to Lunar New Year and Chinese factories still not fully online after Beijing relaxed zero-COVID restrictions.

Morten Juul, Asia Pacific regional head of ocean management at Maersk, wrote in a February advisory, "As markets remain volatile, we're ready to adjust to sudden shifts in inbound and outbound business. We will continue to make capacity adjustments on services to North America, Europe and the Mediterranean over the next several weeks due to reduced demand actuations as a result of the Lunar New Year holidays."

There were 52 blanked sailings (8 percent of routes) scheduled between April 17 and May 21, Drewry found. The Port of Los Angeles recorded 18 cancelled sailings in March, down from 30 the previous month, port executive director Gene Seroka said at a press briefing. However, such declines are likely due in part to carriers simply scheduling fewer sailings.

"Removing capacity from the market is the one tactic carriers have used that is actually working to prop up ocean freight rates," Haith says. "I would venture that they will continue to do that over the next 12 months to try and keep prices from falling."

Hostility Hinders Collaboration and Innovation

In recent years, especially during the pandemic, relationships between shippers and carriers could be classified as contentious. Shippers grumbled when rates were sky high and demurrage and detention charges frequent, and the market turnaround has left carriers feeling the sting. While carriers and shippers should be working to repair damaged business relationships, Higgins says, current conditions will need some time to thaw.

For years, procurement organizations have strived to build strong supplier relationships to foster innovation and ensure product availability. Such relationships have been invaluable in the COVID-19 era. While some companies enjoy "preferred shipper" status from carriers, such collaborative relationships are less prevalent in ocean freight, Higgins says.

"There was a feeling that carriers were taking advantage of businesses, but that has flipped," he says. "In the middle is the supply chain team, which is only concerned with getting its containers delivered on time. There's a hostility that needs to subside, but I think the pandemic put a focus on having a true supplier management approach, where it's a partnership. It needs to happen."

There's room for innovation in ocean freight in such areas as contracting, shipment visibility and sustainability. However, Higgins says, "I can't think of a single real innovation in this sector in the last 20 or 30 years. There are signs of change on climate, but contracting and many logistics processes are pretty much the same — even the containers haven't changed."

Amling suggests that carriers and shippers will have to work together to improve efficiencies, because COVID-19 has permanently changed customer habits and expectations. As an example, he cites the last mile space, where retailers responded to the e-commerce boom by boosting inventory levels to ship from stores and expanding delivery partnerships.

While this transformation has been slower to develop in ocean freight, Amling says, it won't stay that way for long. "The bar has been reset, and it's not going back to where it was. The pre-2020 supply chain is never going to return," he says.

New Conditions After 'Fat and Happy'

The ample cash reserves carriers have built over the last two years provides them some piece of mind, Haith says. However, he adds, "We could be looking at a difficult stretch for global shipping. The next 12 to 18 months may be some of the most challenging in a while."

Sluggish consumer demand and rising vessel capacity amid elevated fuel costs is typically not a recipe for success, but they are not the only dynamics factoring into the long-term health of ocean shipping:

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Regulations. While the OSRA's pricing regulations seem dormant, follow-up legislation designed to strip carriers of a U.S. antitrust exemption and require them to ship more exports has been introduced in Congress. Also, environmental rules and fuel standards from the International Maritime Organization (a United Nations agency that regulates shipping) and European Union are expected to impact freight costs and processes.

X-shoring. As companies continue to explore moving manufacturing and sourcing operations from China to be closer to their customer bases, a map and math dictate they will have less demand for ocean shipping. "(Regionalization) has grown, albeit slowly. We'll need to keep tracking it," Jones says. "But companies are taking a hard look — or at least should be — at how far away their products are coming from and how long it takes to get there."

Structure. In January, MSC and Maersk announced that the 2M Alliance between the carriers will end in 2025, with the two giants planning to operate independently. A reshuffling and more consolidating between the other two alliance members could result.

Ocean shipping is no stranger to slowdowns: A 2018 *Inside Supply Management*® article on the industry — then still regrouping from the demise of Hanjin Shipping two years before and dealing with cooling demand, stagnant rates and increased costs — was titled "Turbulent Waters." In many ways, carriers are already bracing for the next slump.

"Since the 2010s, it seems like the industry has been up for two years, down for two years, then repeat," Higgins says. "But I think this valley could be a little longer because of capacity and other conditions that probably won't allow for a quick slingshot back up."

He adds, "I don't think a wave of shipping companies will go bankrupt. But they got fat and happy for a while, and now it's time for something more normal." ISM

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