SCMR Exclusive: State of Ocean Cargo 2012 and Beyond

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By Patrick Burnson, Executive Editor

August 03, 2012


David Jacoby, President of Boston Strategies International.

While "collaboration" was the watchword for supply chain managers reliant on ocean carriage, it appears that in 2012 it is going to be "accountability." Many carriers, for example, have built in schedule integrity metrics for shipper contracts, promising a new level of on-time service. What then, becomes of "slow steaming" and other energy-saving trends?

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SCMR's executive editor, Patrick Burnson, moderates the discussion with David Jacoby, President of Boston Strategies International.

Supply Chain Management Review:
From your perspective, what represents the biggest change in ocean cargo market forces this year?

David Jacoby: The rate increases have stuck. Carriers have implemented four major general rate increases (GRIs) this year and have pulled enough capacity out of the market to make them stick. Although many carriers are still losing money, the succession of rate increases has brought some Asia-Europe routes back to profitability, which would have been unheard of six months ago. Overall the situation for carriers has improved much quicker than expected (at the expense of shippers).

SCMR: Ocean carrier capacity still seems to be outstripping demand. When will this trend be reversed?

Jacoby: We are close to a turning point, but we are not there yet. Carriers have redeployed about half of the idled fleet, but since there was so much idle capacity that still leaves a lot of overhang. Furthermore, as the year wears on and economic growth slows down, carriers may have to sideline still more capacity to keep rates at today's levels. While newbuild rates are low enough to make some carriers consider ordering again, most will wait until they are reporting a profit to investors.

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SCMR: Will the Asia-EU peak season be weakened by the ongoing "Eurozone crisis," or will we see volumes remain stable through August?

Jacoby: Although the Eurozone crisis is mostly being felt in the banking sector, Spain needs a bailout and Greece may drop out of the euro. The effect of these developments will be felt in the broader economy, so yes, I believe that the Eurozone crisis will depress volumes, but the effect may be felt in September rather than August. Waterborne imports to Europe look like they will rise by 2.3% in 2012, which is substantially weaker than in 2011, due to the Euro crisis. It will take time for the effect to reach other economic sectors, and August is a vacation month throughout most of Europe.

SCMR: What is your forecast for the Transpacific peak season? Should carriers be concerned about another slump in the fourth quarter?

Jacoby: U.S. growth has been coming in slower increments, and the annual increase in trade is going to be smaller than last year as the US economy experiences uncertainty leading up to the presidential election in November. That means that the second half of the year is likely to be sluggish.

SCMR: Carriers are initiating their own "schedule integrity" metrics of late. How are shippers responding? Should we expect to see this reflected in future service contract negotiations?

Jacoby: Shippers will inevitably attempt to work the metrics into their contracts, as some of them have worked rate indexing in. Carriers and forwarders are very pleased to see these metrics. I think they have been surprisingly widely accepted in a very short time, compared to other changes that the ocean shipping industry has tried to make. It doesn't hurt that Maersk, the largest player on the block, is focusing intensely on the customer and has its APM network of terminals to influence the metrics in a positive direction. This is all good news for shippers.

SCMR: Shippers are also placing increasing pressure on "green" practices. Will carriers have the financial resources to respond without passing on a great deal of the cost?

Jacoby: Carriers will not be able to absorb even half of these costs. The new regulations and frameworks are individually and collectively very expensive to implement, and somebody has to pay the bill. Major green regulatory frameworks implemented by agencies such as Environmental Protection Agency or the California Air Resources Board that will add cost related to limits on the use of anti-fouling paint, use of biofuels, regulations on the disposal of ballast water (Coastal Zone Act Reauthorization Amendments (CZARA) Section 6217), Transport Equipment Cleaning (EPA SIC 4491, Marine Cargo Handling), mandated reduction of air pollution (Clean Air Act), ship recycling, energy efficiency, and carbon reduction, notably the EPA lowering bunker fuel sulfur percentages from 3 percent to 1 percent. There are other stringent regulations such as the International Convention for the Prevention of Pollution from Ships (MARPOL) by international bodies like International Maritime Organization. They might not get as much attention as they otherwise would have, though, since GRIs and fuel surcharges have been so steep as a percent of the base rates that shippers are used to absorbing costs at this point. Some of these regulations or acts have existed for a few years, but there is increased focus on compliance today.

SCMR: With new trade agreements, and a federal policy to increase U.S. exports, should we expect to see a greater balance of trade in the next 12 months?

Jacoby: If anything, at current growth rates the trade deficit will increase. Imports are growing slightly faster than exports, at 7 percent compared to 6 percent according to the US Census Bureau. April's trade deficit was $50b (according to the Department of Commerce), which will grow to $57.5b by December at growth rates consistent with the first four months of the year. At this rate, the full-year trade deficit for 2012 will be $623b, or 4.1 percent of GDP, up from 3.7 percent of GDP in 2011.

SCMR: May we expect to see more investment in port infrastructure both in the States, and in the markets U.S. shippers serve?

Jacoby: Some US port infrastructure investments are moving forward. US public spending on port infrastructure will rise to a cumulative 18.3b from 2012 through 2016, according to the AAPA – double the rate of the previous five-year period. The AAPA's latest survey also indicates that private capital expenditures will total a whopping $27.6 billion from 2012 through 2016, for a cumulative public and private investment of $46 billion over the period. The Long Beach Board of Harbor Commissioners recently approved a $942 million budget for fiscal year 2013, a 12 percent increase over the past year, to invest in its facilities and infrastructure modernization. The 2013 budget includes $104 million in environmental infrastructure projects.The Governor of Florida signed two bills on June 14 approving investments to improve Florida's 14 deepwater sea ports, so the port can benefit from the anticipated international trade expected Panama Canal expansion. The Strategic Port Investment Initiative within the Florida Department of Transportation will provide a minimum of $35 million per year from the State Transportation Trust Fund. The Intermodal Logistics Center Infrastructure Support Program will provide will provide $5 million per year for roads, rail, or other methods used to move goods through a seaport.

In contrast, there continues to be huge investment in ports in the Middle East and emerging economies where volume has increased dramatically – about 20 percent annual growth compared to the 12 percent growth rate at the U.S. Port of Long Beach, so congestion at US ports may become an issue again within the next five years as the traffic that originates at those foreign ports needs to be handled on U.S. shores.

There are around 35 ports in the Arabian Gulf region, many of which are currently undergoing expansion to meet increasing trade demand.
India will invest over $94 billion in new port infrastructure over the next 10 years.

Investment in Port infrastructure in Southeast Asia will exceed $78 billion with the aim of increasing capacity in Indonesia, Malaysia, and Vietnam.

SCMR: With the Panama Canal expansion on schedule, are shippers telling NVOs, forwarders, and carriers how future deployments should be configured?

Jacoby: The Panama Canal expansion is NOT driving freight patterns at this point, although many shippers plan to revisit this issue within a year. It's too early. The expansion will allow more volume through the Panama Canal in the same amount of time, which should help stabilize freight rates. However, the impact is uncertain so most shippers will review the issue in about a year when freight rates and volumes are clearer. Only two ports on the east coast have the necessary depth for the new, larger vessels anyway, and the Savannah dredging operation is not synched up with the Panama Canal expansion, so it could be some time before more shippers view the expansion as a major issue.

SCMR: Finally, will you share your thoughts and/or concerns about issues that we have yet to address?

Jacoby: Piracy continues to be a major problem that has propagated and extended far beyond East Africa, where it made so many headlines a few years ago. This is causing a structural increase in security costs for carriers.

The discussion continues with Brian Conrad, Executive Administrator, Transpacific Stabilization Agreement and Peter Friedmann, Executive Director, Agriculture Transportation Coalition

About the Author

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Patrick Burnson is executive editor for *Logistics Management* and *Supply Chain Management Review* magazines and web sites. Patrick is a widely-published writer and editor who has spent most of his career covering international trade, global logistics, and supply chain management. He lives and works in San Francisco, providing readers with a Pacific Rim perspective on industry trends and forecasts. You can reach him directly at pburnson@ehpub.com .

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