

The Bullwhip Effect in Global Trade - This is One Wild Bull

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The more you look, the more bad economic news you find. The financial sector is worse condition than it was in the 1930s. Nine percent of US bank loans are likely to fail - more than failed in the Great Depression, and this will take two or three years to rectify and result in a 7.5% loss of total asset value. Through the mortgage crisis and credit card debt, this has driven retail sales volume down by about the same amount, which has driven industrial production down by 15% and torpedoed trade that was growing at 15% per year. Shipping, at the end of the bull's whip, is reacting the most profoundly - rates have fallen by 50% on major trade lanes and even more in some trades. The remedy that most policymakers are applying - easy credit - will quite possibly create inflation when the economy rebounds. For some economists, the biggest concern is about a deflationary spiral, but this won't happen with shipping rates since carriers have already adjusted capacity to account for the slowdown in demand.

The banks and hedge funds that caused the problem are still devastatingly sick. While everybody is eager to see the first signs of a financial spring, the facts are much more sobering. Loan default rates will peak in 2011 (banks will lose \$4 trillion in bad loans during the debacle) and then float down to 2003 levels throughout 2012-2015, according to the IMF.¹ By the time they recover, the top 19 banks will have lost 7-8% of their total assets.²

While the US government tried valiantly to prevent the banks' failure, its budget deficit has grown from 3.2% of GDP in 2007 to over 13% of GDP in 2009. Public debt will rise from 39% to 78% of GDP by 2012, according to Economist Intelligence Unit estimates.³ The IMF figures that the average government debt of the G20 countries will have jumped from 40% in

1980 to over 100% in 2014, according to The Economist.⁴ This recession more closely resembles a Kondratiev "long wave" than a normal business cycle, and as Jay Forrester of MIT points out, there are 45-70 years between "long waves" compared to 3-10 years for a normal business cycle, so it could take several years or more to stabilize.

Consumers are in bad shape and the depth of their problems has just become apparent. Over nine percent of US commercial banks' loans are going sour, compared to 8.9% in 1935 during the Great Depression and less than 3% during the intervening 78 years. Twenty-three percent of the bad debt is coming from mortgages and an equal amount from bad credit card debt, according to US government regulators.⁵

Since consumers are buying fewer goods, manufacturers are forced to transform themselves or die. GM officially went bankrupt on June 1. Chrysler will sell its assets to the Fiat group. US auto sales fell by 37-51% in April. For as dramatic as these results are, Boston Strategies International is seeing similar results in some of the 50 industries that we track on a quarterly basis.

To try to avoid total collapse, governments are jointly making credit easier than ever. While the US is shoveling some hundreds of billions of dollars into its economy, China loaned \$750b to Chinese banks in Q1.⁶ Unfortunately, easy credit is exactly the same prescription that drove real interest rates negative in 2003 and 2004, which subsequently spurred the excessive wave of investment and spending that got us in this mess in the first place.

Shipping, at the end of the bullwhip, has suffered even more dramatic decreases in volumes and rates. Trade growth, which has consistently accelerated for three generations, screeched from a 15% annual



growth rate to a near-complete halt. Air freight volume is down almost 25%, according to the International Air Transport Association (IATA), which doesn't expect a return to normal growth until 2011. Ocean, port, and rail volume is down 20-30% at major carriers and facilities. Container shipping lines could lose a collective \$10 billion this year, Lloyd's List said, citing Mitsui O.S.K. Lines Ltd. President Akimitsu Ashida.⁷

This has led rates on a downward spiral until recently. Transpacific rates have fallen by over 50%, according to data compiled by Drewry and published in The Journal of Commerce. We won't even talk about the Asia-Europe container trade or dry and liquid bulk. Eleven percent of the world's container fleet is laid up now, and some expect that number to rise to 20% as 910 previously ordered new vessels are delivered.⁸

What does this all mean for supply chain managers? The recession will be prolonged, and carriers that are financially secure will withstand a prolonged recession while those that are debt-laden may not. To avoid making costly mistakes, shippers should conduct due diligence while choosing carriers and service providers, and both shippers and carriers should get volume, cost and pricing intelligence before setting or revising rates. ■

Source:

¹ IMF Global Stability Report April 2009

² The Supervisory Capital Assessment Program: Overview of Results, May 7, 2009

³ "World economy: Ratings concerns," May 25 2009.

⁴ "Rebuilding the Banks," The Economist, May 14 2009, cited in Free Republic.

⁵ The Supervisory Capital Assessment Program: Overview of Results, May 7, 2009

⁶ "China could face banking crisis," Time Magazine, May 21, 2009.

⁷ "Shipping Lines May Double Number of Laid-Up Container Vessels," Hellenic Shipping News, May 28, 2009

⁸ "Shipping Lines May Double Number of Laid-Up Container Vessels," Hellenic Shipping News, May 28, 2009.

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