

Importers Could Benefit From Ocean Carrier Overcapacity

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LAUNCH SLIDESHOW 1 image



The locks of the Panama Canal are being expanded to accommodate ships twice the size of those currently able to pass through. Photo By Mary Knox Merrill/The Christian Science Monitor/Getty Images

Ocean freight carriers will spend years trying to cope with a substantial overcapacity problem, giving brands and retailers the advantage of market-driven limits on freight rates for imported goods.

In addition, importers' reliance on West Coast ports as the primary entry point for Asian-manufactured goods may wane by mid-decade because of the expansion of the locks in the Panama Canal. The project, slated to be completed in 2014, could make an all-water route to the East Coast more viable to importers and spur growth of port facilities there.

Ocean carriers such as Maersk, APL Lines, Evergreen Line and Hanjin Shipping were hit hard by the dip in trade volume that accompanied the economic downturn. That blow was compounded by their pre-recession investments to order new and larger ships. As economic conditions worsened, carriers sought to lessen the pain by slowing down ships to save on fuel costs, altering schedules and routes and eventually idling more than 10 percent of the world's container fleet — all while new ships kept being delivered. The end result was staggering losses for 2009.

"For the near term, I think there's still a significant amount of uncertainty and concern about what the economics of the industry look like," said Christopher Koch, president and chief executive officer of the World Shipping Council. "There's a large amount of capacity being delivered this year and only in a very optimistic set of predictions would demand be as much as that capacity." It remains to be seen exactly how long it will take for the imbalance to be sorted out.

Koch hammered home just how dire 2009 was for ocean carriers in a speech he made earlier this year at the Harris County International Trade & Transportation Conference in Houston

"[Last year] was a financial disaster for liner shipping," he said. "Estimates are that the industry losses for 2009 might be as high as \$20 billion."

Over the last 30 years, Koch said container volumes expanded about 10 percent annually, or more than three times the average growth rate for global gross domestic product. Ocean carriers placed orders for new ships based on these

average growth rate for global gross domestic product. Ocean carriers placed orders for new ships based on these growth rates. Given the long lead times required to build the vessels, many of the ships started hitting the water in 2008.

"Since the second half of 2008, however, we have seen a 10 percent global volume decline and an industry order book for more than 30 percent additional capacity, a debilitating combination," Koch said.

Although trade volume has started to rise, it will take years for the level of imports to catch up with overcapacity. According to AXS-Alphaliner, a service that tracks the container shipping industry, the amount of idled capacity still hovers around 10 percent, or more than one million 20-foot containers, also known as a TEU. Alphaliner anticipates the number of TEU will reach 16.8 million by 2013, up from 13.1 million TEU in 2009 and representing an average growth rate of 8.3 percent.

"The shipping industry continues to face the most difficult times since containerization was invented," Koch said. "It's not out of the woods. It is in duress. And while 2010 may not look as bleak as 2009, the industry does not have a speedy escape from its problems. While there are encouraging signs of economic recovery, the supply and demand imbalance in liner shipping will take several years to be addressed."

Paul Bingham, managing director of world trade and transportation markets for IHS Global Insight's global commerce and transport group, believes ocean carriers could return to capacity equilibrium between 2014 and 2015 if there is sustained global economic recovery and growth in developing countries. Until then, Bingham said it will be difficult for carriers to get higher freight rates.

Importers have started the latest round of rate negotiations with The Transpacific Stabilization Agreement, or TSA, a collective of 15 major container shipping lines that negotiates rates from Asian ports. The talks traditionally conclude by May. Rates are likely to increase from the lows of last year, but aren't expected to exceed the highs reached before the recession.

Koch told WWD that most industry watchers acknowledge that 2010 will show improvement over 2009 and that freight rates will rebound somewhat, but "a number of major lines have projected 2010 still won't be profitable."

"I don't think there's a scenario where the collective will of the industry is such that they'll be able to push rates up substantially higher even as demand comes back with the recovery of the economy because there still is so much capacity overhang," Bingham said. "The pressure on the carriers still stays there and, in fact, even if they do nothing capacity still increases because you get these new ships out of the shipyards."

Maintaining rates will depend almost entirely on the carriers.

"The baseline scenario would be that the rates don't collapse, that the industry maintains enough discipline so that they don't rush to deploy this idled capacity, thereby flooding the market with capacity and pushing rates back down [to the lows]," Bingham said. "They're desperate not to get back into the situation they were in last year financially. And it's just a question of has the industry psychology been changed enough so that they don't suffer by having somebody try to jump out of greed in the short run to try to grab some market share or grab some margin over somebody else, which would contribute to the collapse."

The process of bringing capacity back is already underway. Neptune Orient Lines, which owns APL Lines, said on March 29 that container shipping volume was up 37 percent in February because of increases in Transpacific and Intra-Asia trade. For the first two months of the year, container shipping volumes rose 52 percent. A week before that announcement, Ron Widdows, chief executive officer of Neptune Orient, said APL would charter as many as 10 more ships this year and bring its last 10 idled ships back into service by June.

Bingham also noted environmental efforts to reduce packaging from major retailers such as Wal-Mart Stores Inc. could actually have a measurable impact on container utilization.

"Does that actually take out some of that capacity demand, even though maybe it's the same number of sku's and maybe the same value of sales?" he said. "Does it actually result in a lower cube demand for the industry?"

As the decade progresses, importers will also find more to West Coast ports. Los Angeles and Long Beach, which together make up the largest port system in the nation and have been the key gateway for goods from Asia, have faced growing challenges from ports in Canada and Mexico and are likely to face another from East Coast ports in the latter half of the decade. The Panama Canal renovations will double the size of ships that are able to pass, to those with a capacity of 12,000 TEU, compared with the current maximum of 5,000 TEU.

"This will encourage an increase in all-water volumes to U.S. East and Gulf Coast ports from Asia," Koch said. "How much volume diversion from U.S. West Coast ports to U.S. East and Gulf ports is hard to predict. Planning for the Panama Canal expansion has led U.S. East and Gulf Coast ports to expand capacity and has caused U.S. West Coast ports to be mindful of the more competitive Panama Canal transits that will be available after 2014."

Editor's Note: This is the second part in a series examining global sourcing in the next decade.

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