

LOGISTICS

Falling cost, low demand: why the shipping industry can't recreate its pandemic-era success

By Kunal Pawaskar Jun 19, 2023, 04:45 AM IST



Jawaharlal Nehru Port Trust (JNPT) Gateway Terminal One in Mumbai, India.

Synopsis

During the pandemic years, in 2021, Indian exporters could not find empty containers to send their goods abroad to the US due to excessive demand. However, as the global economy faces forces that impact financial markets and the real world of goods, the trend has reversed. What does this mean for businesses?

The initial years of the pandemic saw a boom in goods consumption than services. This led to a shipping cost rollercoaster for which one of the reasons was stimulus driven by the government and central bank policies in the West. The trend has reversed now.

During the pandemic, the swing was towards online shopping. Supplier countries in Asia were caught in a frenzy to satisfy the American demand. This led to a shipping demand in certain routes, thereby shooting shipping rates.

In July 2021, the WPI Composite **Container Freight Benchmark**, which tracks

shipping rates, touched a high of USD10,000. It is now down to USD2,000 in May 2023. Even the number of times "shipping and cargo" mentioned in the earnings call of investor presentation for Nifty 500 companies peaked in CY21 and subsequently fell.

If you look carefully, channels that drive imports and exports are a relatively unglamorous business. A drive down to the JNPT Port near Mumbai, for example, takes you through clouds of dust. You can see a pile of containers stacked in yards until you reach the port itself. These containers are the visible symbol of global trade for most of us because we do not see their subsequent ocean journey.

But there was a time in 2021 when Indian exporters could not even find empty containers to send their goods abroad to the US. What happened here?

The global economy faced novel forces that pushed and pulled at the financial markets and the real world of goods. In this article, we will be looking at them, and also at the outlook for businesses that got affected by this problem.

A rollercoaster ride

John Henry Holland, a famous expert in complex systems, had this to say about non-linear systems (read, our world too, where things are very different from a controlled setting), "Non-linear interactions almost always make the behaviour of the aggregate more complicated than would be predicted by summing or averaging."

Multiple factors came together to create the shipping cost rollercoaster:

1) **Unprecedented central bank action** and fiscal stimulus packages by governments in the West and less so in the less-rich countries in Asia that serve as the goods factories to the West. The large quantitative easing programmes of the US Federal Reserve are well understood by now. They greatly increased the relative purchasing power of the US consumer vis-à-vis the rest of the world.

2) Restrictions that swung buying towards relatively **more goods and less services**.

If you could not take a flight or go to the pub or a cinema chain due to the Covid-19-related lockdowns, maybe splurging a bit on curtains for your home seemed like an option to some at least? *More goods. Less services*

"I want to spend a moment discussing inventory. As a backdrop, the shifts that we've seen in consumer behaviour through the pandemic, shifting from in-store to online, along with big swings in the purchase of goods versus services, and then the reversion back to pre-pandemic norms have been sharp and difficult to predict," said John David Rainey, CFO, Walmart, in June 2022 earnings call.

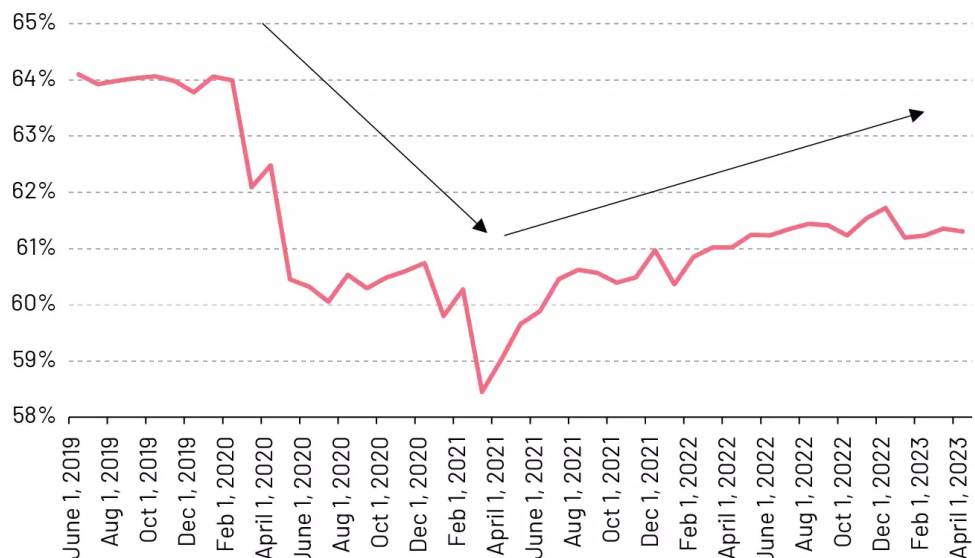
We analysed the US's data to understand this goods vs. services ride.

Goods vs. services swing

US real personal consumption expenditure on goods



US real personal consumption expenditure on services



Data as percentage of goods + services

Source: St. Louis Fed

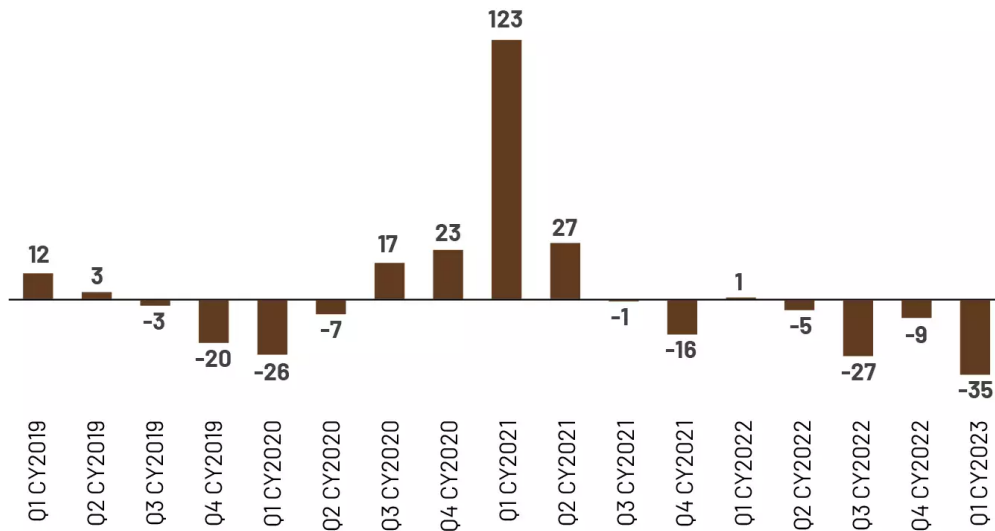
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Goods consumption spiked hard and peaked around Q1 CY21. This rise set off a chain of events including order backlogs; developed country importers' worrying about not receiving goods on time and over-ordering; suppliers in Asia scrambling to satisfy demand while enduring their own countries' lockdowns; restrictions on workers; and extra Covid-19 testing and illnesses. It could be likened to a frenzy almost.

3) **Imbalances in customer demand** led to a greater demand on certain shipping routes. Shipping lines diverted ships and containers to where it was most lucrative.

The port of Los Angeles was the poster child for the global media to understand how bad or good things were at the US end. See the move up in the first quarter of CY21. In a way for some advocates of more sound money, this was also a good example of how our economic systems have prioritised capital over labour (or the financial over the real world). You can “print” as much as you want, but it has to work within the confines of the physical world’s ability to produce and deliver goods and services.

Inbound containers at Port of Los Angeles



Note: Y-o-Y growth in percent

Source: Bloomberg

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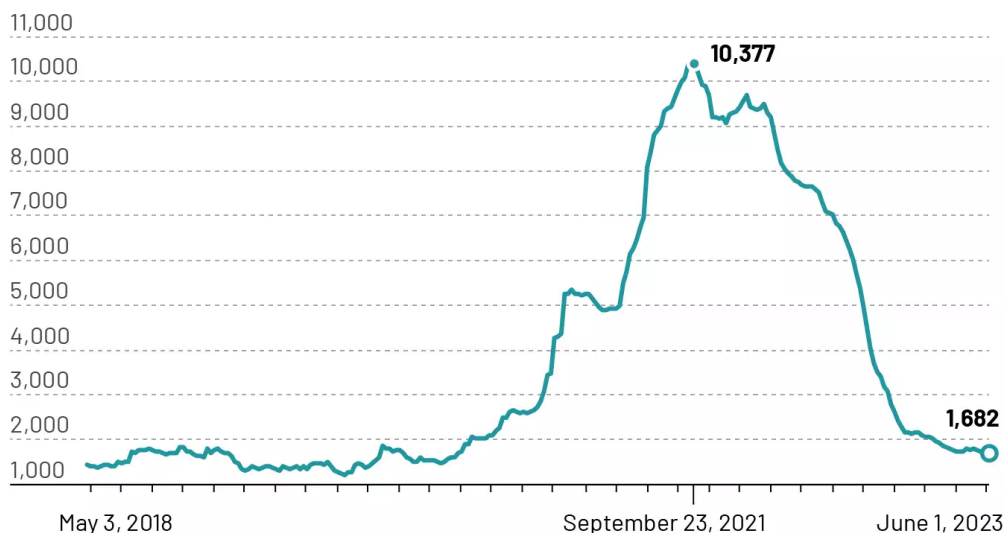
4) Shipping rates responded and **touched highs**

The WCI Composite Container **Freight Benchmark** is an average measure of rates over multiple key global shipping routes (for example Shanghai to Los Angeles or Rotterdam to New York).

The shipping lines made record profits that must have surely been beyond their imagination in the pre-Covid-19 days.

The good times had to end at some point, and they did. Now the cycle has played its down leg. Rates are down, profits for the shipping lines will go down too.

WCI Composite Container Freight Benchmark



Figures in USD. Rates per 40-foot box

Source: Bloomberg

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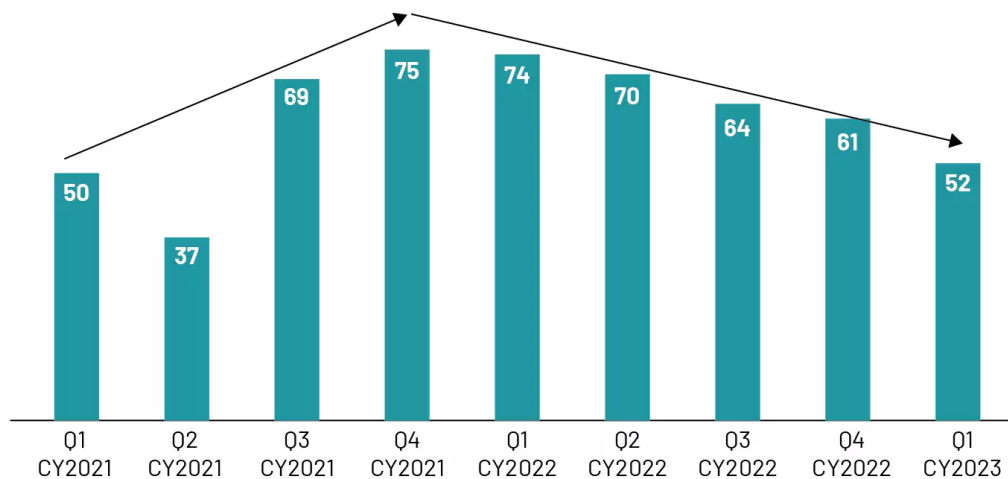
What lies ahead?

Supernormal profits for the shipping lines meant that businesses that consumed shipping services suffered on this account. We have seen Indian businesses reporting freight and forwarding costs in FY22 that were substantially higher than FY21 figures, as per company filings with stock exchanges.

The past couple of years were high-stress periods for many business owners and managers. Freight costs going up 4x-5x is not normal. Take a moment to imagine the plight of a supply-chain area professional who must manage this cost pressure for his organisation.

It is useful to see aggregate data in addition to anecdotal data. For this, we turned to earnings call and investor presentation filings from the universe of Nifty 500 companies. The following chart shows the number of times a certain phrase was mentioned every quarter in the documents analysed.

Mentions of 'shipping/cargo' in earning calls and investor presentations



Source: Bloomberg

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Both these phrases “Material Costs” and “Supply Chain Disruptions” indicate that things are healing. The worst appears to be behind for businesses in India from the perspective of these variables.

Like in a roller-coaster ride, where some patrons enjoy it and are raring to go one more time while there are some who swear to never go again, there are two sets of businesses that will have seen the last two years very differently.

There are the ones that owned logistics-assets businesses, which saw an upcycle that has ended.

There is another set of businesses that endured tough times over the last two years on the dimensions of shipping costs and raw material inflation (this has a similar story that we urge the reader to explore). Ceteris paribus, their operating margin pressure is expected to recede in the coming year as healing continues.

For those of us in the investment management area, it is a good time in my view, to look at the second set. For the rest of us, it is a reminder that the real world is messy and non-linear – there is rarely just one cause for an effect.

If you happen to drive near a port next time, I am sure you will have renewed appreciation for these critical parts of the global economy.

(The author is principal officer and head – PMS at Tata Asset Management. Views expressed are personal and for information purposes only.)

(Graphics by Mohammad Arshad)

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