NOVEMBER 22 2021 #8

2022 CONTRACT SEASON KICKS OFF – MARKET UPDATE

Dear Valued Customer,

While unnormal seems to have become the new normal for everyone involved in the transportation and logistics industry, there is full steam on the quest to find the elusive answer to what 2022 and beyond will bring.

No signs of pre-COVID 19 rates in the foreseeable future

Airfreight continues to act somewhat in accordance with historic development. Q4 is marking the traditional peak season, and it has triggered rate increases throughout the quarter. It is our opinion that these increases are primarily owed to peak volumes and less related to other factors such as COVID-19 impact. However, ground handling congestion is a serious concern causing significant delays, which can largely be contributed to a lack of labor due to COVID-19.

Ocean freight remains the big-ticket item and talk of the town. On the back of eye-watering financial results, all carriers remain adamant that a return to a market situation resembling pre-COVID-19 is not on the cards, neither short/mid-term nor long term. In any case, hoping for more merciful rate levels would hinge on the ever-present option of further blank sailings not being introduced at a large scale.

The macro-economic, port congestion, and peak season cocktail

Looking at the macro-economic indicators, the growth in global GDP has remained strong throughout the last months. We are, however, seeing the first signs of a slow-down as a natural result of record-high inflation levels, as well as the year-long consumer spending spree aided by governmental stimulus packages slowly coming to an end.

With continued global port congestion triggered by lack of labor in most ports in the western world, and additional vessel capacity not being added until 2023, there are though only little signs that this will trigger a dramatic shift in the supply and demand situation. In plain terms, whatever economic slow-down comes in the short-mid-term, it will be leveled out by many other factors that continue to plague the shipping industry.

Development in short-term rates on the Far East to Europe and Far East to the US has shown a moderate decrease during the last weeks. We assess that this reflects the traditional slack season on Asia exports. The overall consensus from analysts is that the rate peak has been reached, which, in turn, triggers immediate speculation on where the "new normal plateau" is.

Christmas sales under threat

The chaos across trades incl. record-low schedule reliability has severe consequences for supply chains around the world and is officially a full-blown "supply and delivery" crisis. Global retailers, most recently IKEA, have informed that not all products will be available for the foreseeable future. Many other retailers are in the same situation, not being able to promise that all products will be on the shelves for the Christmas season. In the Automotive industry, the shortage of micro-chips has already halted production at many factory sites. While this as much is owed to a manufacturing crisis, it again shows the delicacy of the supply chain ecosystem.

2022 contract negotiations will show the direction

Short-term rate development aside, there is though one usual strong indicator for what we can expect in the coming year(s) regarding the 2022 contract negotiations for long-term rates. Writing this update, 2022 contract negotiations have slowly but surely kicked off, and we will offer our best take on what to expect in this market advisory.

As always, we wish to emphasize that we remain confident in finding solutions to the challenges we jointly face. There is no one-size-fits-all solution, and the market overall remains very volatile. However, the pro-active and constructive dialogue we experience every day with you makes a true difference in finding the optimal solutions.

To get an overview of the important changes in the specific lanes, please see the traffic light update included in this advisory

Note that all information is given to the best of our knowledge and is prone to change.

Enjoy the crystal ball reading!

OCEAN FREIGHT

All major ports around the world continue to struggle with heavy congestion as peak season cargo keeps pouring in. Landside infrastructure is by now a full-blown systemic issue causing havoc to supply chains around the world.

Re-routings to avoid further delays

Many carriers are now choosing to omit the worst-hit ports to stabilize vessel schedules and rotations. From Asia to Europe, the average delay is up to 18 days, and in the US, the average berthing waiting time in the Port of Los Angeles is between 18-24 days.

In the US, the situation has reached a point where US President Joe Biden has attempted to intervene, encouraging all port authorities to look into any measure that can improve the situation. So far, with little effect.

The trans-Atlantic trade from Europe to the US continues to suffer from a lack of capacity, which is a logical consequence of the heavy port congestion. Overall, the US is a serious cause of concern as the situation is, on average, somewhat more critical compared to some of the other major markets.

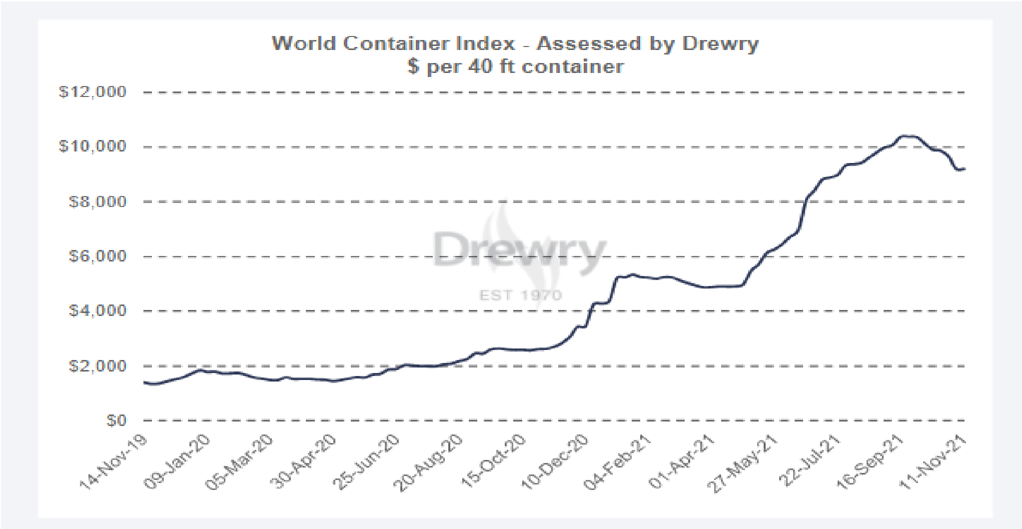
Subsequently, it is no surprise that vessel schedule reliability is at an all-time low and, as stated by Sea-Intelligence,[1] the lowest level since monitoring of this started.

The situation impacts all major trades, and for the same reason, short-term rates have also been sustained at record high levels. SCFI has dropped moderately for 4 consecutive weeks during October and the first part of November, only to increase again during the last week.

Rate level outlook

Drewry, a leading maritime consulting company, announced on 11 November 2021 that their World Container Index remained steady at USD 9.192,50 per 40 ft container. This index comprises the average of short-term rates across 8 major trades, and the current level marks a 250 % increase vs. the same period last year, cementing the inflated rate levels, as indicated on the next page:

[1] https://www.maritime-executive.com/article/sea-intelligence-two-of-every-three-containership-is-behind-schedule



Graph from: https://www.drewry.co.uk/supply-chain-advisors/supply-chain-expertise/world-container-index-assessed-by-drewry

The new normal

As for long-term rates, we are now seeing the first indications for 2022, including an increased appetite from both carriers and customers to discuss 3-year agreements. This development should be seen in the light of carriers expecting 2022, very much similar to 2021. It also shows that some level of normalization is expected to kick in during 2023, with more capacity coming in. In turn, certainty and reliability today rank higher than ever before on the customer side. For this reason, being able to secure capacity for the long term is increasingly considered a strategic move.

The indications are currently that 2- and 3-year rates are locked at lower levels than 12 months rates. It is, however, worth noting that these rate levels are at a high level compared to historic and pre COVID-19 levels. In many cases, these types of agreements come with rigid structures in terms of forecasting and potential penalties on both sides in case commitments are not met.

The development right now points to a mid-term where rates will settle at a middle ground, i.e., below current short-term rate levels and conversely above 2019 levels. It is not expected that we, in the coming years, will return to anything that resembles 2019 levels. In short, we are looking at a new normal rather than a return to the normal as we knew it.

A few major impacts can alter this picture. At the top of the list sits a so-called “black swan” event, i.e., a major unexpected event with severity to push the underlying fundamentals in a new direction. An example of this could be a financial market collapse similar to the 2008 financial crisis.

The impact of IMO 2023

IMO 2023 is another major change to take note of, potentially adding to further concerns on how the coming years will unfold. On 1 January 2023, new carbon reduction targets will be implemented, with carriers scrambling to find ways to meet the new targets. It is in this context very likely that not all carriers, if any, will be fully ready for this, leaving the only option of further slow steaming to meet the targets. This will cut into already scarce capacity as it could be required to add further vessels to each rotation. In a worst-case scenario, this may level out any additional capacity coming in. Long story short, the much-awaited extra capacity may disappear into a black hole.

Conclusion

Summing up, our assessment is a moderate downwards change in 2022 vs. current rate levels, with the mid/long term signaling a rate middle-ground plateauing at somewhere below current levels but well above historic levels.

AIRFREIGHT

In our latest update, we highlighted the problematic situation of flight restrictions at major airports across Asia following outbreaks of COVID-19. Back then, the only uncertainty was how long this situation would last and how the situation would evolve. In the meantime, we have seen this situation around COVID-19 cases ease, but we are still facing backlogs and rates- and capacity impacts from an increase in volumes overall.

The market is, as expected, in a peak-season mode that is adding further pressure on the capacity situation and, in turn, driving up rate levels. Singles day, Black Friday, and Cyber Monday product launches, and not least the traditional Christmas rush, are causing constraints on most of the major trades. Major trade lanes like Asia to the US and Asia to Europe are, as usual, the most impacted ones, having experienced significantly increasing rate levels. Other trade lanes, i.e., Europe-Asia, Europe-US, and Latin America, remain under strong pressure too, however with a lower degree of rate increase impact.

During the past weeks and months, the importance of the airport Ground Handling Agents (GHA) has become painfully apparent. COVID-19 cases in GHA teams across most airports have significantly impacted the industry, causing backlogs and bottlenecks to which there is no quick-fix solution. The cocktail of labor and equipment shortage, warehouse congestion, and increasing pick-up/delivery waiting times will continue to cause delays for the foreseeable future.

Zooming in on the markets

The highest focus is as often before on the Asia export markets. Increasing cargo output and capacity constraints continue to put high pressure on rates and transit times. Passenger flights are only resuming at a very slow pace, and we do not expect a significant effect from this in the short term. In fact, some signs of an increased level of restrictions could cause the suspension of certain flights again.

On top of this, and even if countries may announce a reopening on particular routes, airlines will not be able to add flights with immediate effect. Schedule changes and aircraft availability will limit short term-effects, and it may take weeks, if not months, until airlines can adjust schedules.

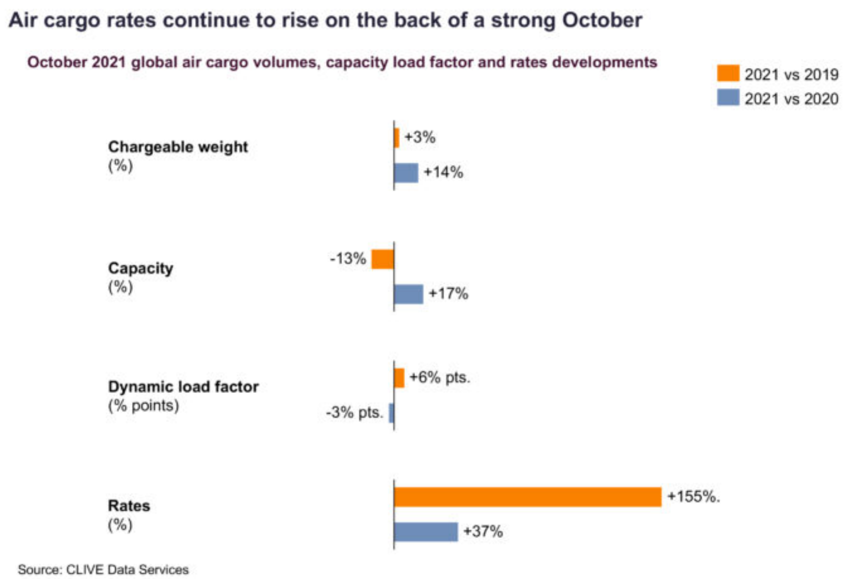
The rates we currently see in the market to and from Asia will remain elevated; however, we assess that the peak has been reached for now.

On the Trans-Atlantic trade, we continuously see pressure on capacity as well. Even with travel restrictions lifted to the US, no ketchup effect is in the making. Several airlines have announced an increasing number of flights over the coming weeks and months, but it is expected that it will take time for this to ramp up. Also, worth noting that an increase in passenger travel could have a short-term negative effect, leaving less room for cargo payloads from a total weight perspective.

Future outlook

We expect most trades will only experience a moderate development until the end of the year, implying that rates will remain elevated. Looking into next year, we do not assess that the capacity and rate situation will change drastically in 2022. Additional passenger flights will positively impact the capacity side, but as mentioned, the decrease in payload versus pure cargo flights will, as mentioned, negatively balance this effect. However, frequencies and the number of served port-pairs will undergo a positive trend.

The current market situation is clearly explained in "Clive Data's" most recent market update: With a 13% reduced capacity vs. 2019, but a 3% increase in volumes, the global load factor remains high. Especially on the largest trade lanes, we see an even higher impact between supply (available capacity) and demand (transported volumes).



CLIVE: Air cargo rates up again in October - AIR CARGO WEEK.

Lastly, a very strong indicator that airfreight rates will continue at an elevated level is the rate differential for ocean freight. AirCargo News on 1 November commented, "On a per kilo basis, the differential between air and ocean rates has imploded from around 13:1 in September 2019 to less than 4:1." [2]

[2] https://www.aircargonews.net/monthly-exclusive/putzger-perspective-air-cargo-price-increases-a-drop-in-the-ocean/

With such a slim price differential vs. ocean freight, it is our clear assessment that the demand for airfreight will remain red hot, overall sustaining the current market situation.

Increasingly we experience customers that are looking into full charters in order to evacuate products from Asia. This is a viable option, albeit also a costly one due to limited aircraft availability.

RAIL FREIGHT

The rail freight market continues to follow suit with the ocean freight developments, and capacity remains scarce. Rate indications suggest a continued strong market on this mode of transport; it is though worth noting that we have seen a moderate rate decrease over the last weeks.

Congestion is also easing up slightly with improvement in transit times as a natural result. There is, as we speak, sufficient equipment to meet the demand, and we expect this also the case throughout December; however, it is to be expected that January leading up to Chinese New Year will cause a tightening of the market.

Cost and lead-timewise, rail freight remains a strong alternative to both ocean and airfreight.

In a continuous effort to respond to the increased demand for rail freight from China to Europe, critical infrastructure is constantly being developed. New border crossing stations connecting China with Kazakhstan and other border points are being built and are undergoing pilots ahead of implementation to increase overall capacity on this route.

On behalf of

Scan Global Logistics

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OCEAN FREIGHT

TRADE UPDATES	SPACE (CAPACITY)	EQUIPMENT	SCHEDULE RELIABILITY	PRICE DEVELOPMENT
Asia-Europe (Westbound)	🟡	🟡	🔴	⇩
Europe-Asia (Eastbound)	🟡	🟢	🔴	⇩
Europe-US	🔴	🟢	🔴	⇨
US-Europe	🟢	🟡	🟡	⇨
Asia-US	🔴	🟡	🔴	⇩
US-Asia	🟢	🟡	🟡	⇨
Intra-Asia (incl. AU)	🟡	🟡	🔴	⇧

COLOR CODES	SPACE (CAPACITY)	EQUIPMENT	SCHEDULE RELIABILITY	PRICE DEVELOPMENT
🟢	70%-100% of normal capacity	No challenges	No challenges	⇧ Up
🟡	30%-69% of normal capacity	Medium challenges	Medium challenges	⇨ Stable
🔴	Less than 29% of normal capacity	Major challenges	Major challenges	⇩ Down

AIRFREIGHT

TRADE UPDATES	SPACE (CAPACITY)	SCHEDULE RELIABILITY	PRICE DEVELOPMENT
Asia-Europe (Westbound)	Red	Yellow	Up
Europe-Asia (Eastbound)	Yellow	Yellow	Stable
Europe-US	Red	Yellow	Up
US-Europe	Yellow	Yellow	Stable
Asia-US	Red	Red	Up
US-Asia	Red	Red	Stable
Intra-Asia (incl. AU)	Red	Yellow	Stable

COLOR CODES	SPACE (CAPACITY)	SCHEDULE RELIABILITY	PRICE DEVELOPMENT
Green	70%-100% of normal capacity	No challenges	Up
Yellow	30%-69% of normal capacity	Medium challenges	Stable
Red	Less than 29% of normal capacity	Major challenges	Down

RAIL FREIGHT

TRADE UPDATES	SPACE (CAPACITY)	EQUIPMENT	SCHEDULE RELIABILITY	PRICE DEVELOPMENT
Asia-Europe (Westbound)	🟡	🟡	🟡	⇩
Europe-Asia (Eastbound)	🟢	🟢	🟡	⇨

COLOR CODES	SPACE (CAPACITY)	EQUIPMENT	SCHEDULE RELIABILITY	PRICE DEVELOPMENT
🟢	70%-100% of normal capacity	No challenges	No challenges	⇧ Up
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