

# 2011 Container and Intermodal Freight Rate Outlook for Trades to and from North America

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The economy grew slowly in 2010, and world GDP growth will further slow down - decreasing from 2.7% in 2010 to 2.2% 2011 in advanced economies and 4.7% to 4.2% in developing economies - as the effects of economic stimulus wear off and the labor, real estate, and banking sectors remain vexed.



Although West coast container imports were up 5-10% for 2010 and export trade was up 10-15%, US trade will grow at only 4.4% in 2011, according to economists at the EIU (Economist Intelligence Unit). After rates fall a bit further, carriers will seek rate increases and manage vessel capacity in order to at least hold rates, on average, at current levels for most of the year.

Although ocean freight rates will not change much, rising fuel surcharges (the price of fuel looks like it will rise by 4-5%) and intermodal rates (also 4-5%) will force shippers to increase their total ocean and intermodal budgets by 4-5% compared to last year.

## Ocean Freight Rates

After surging in the first half of 2010, the demand for ocean freight waned as stimulus effects wore off - a classic bullwhip effect that I predicted in my article in this magazine titled "The Bullwhip Effect in World Trade" (July 2009).

Asia-US West Coast container rates peaked in August (transpacific rates leapt 50% year over year) and declined for most of the rest of the year. For example, Expeditors International's ocean freight revenue was up 65% in August, and its volume rose 26% on rate and volume increases. Pacer's ocean revenue was up 81% in November.\* But most indicators dropped off in Q3 and Q4, depending on the trade.

Thanks to the severe drop in late 2010, US trade should rebound faster than GDP in 2011 (4.4% versus trade growth on 2.6% economic growth for North America). However, several factors could disrupt 2011 trade growth. One risk factor is the value of the dollar, which could sink further in world markets if it seems that the US does not have a long-term solution to its fiscal and budgetary woes. US exports would pick up if the dollar declines, but there would be a lag.

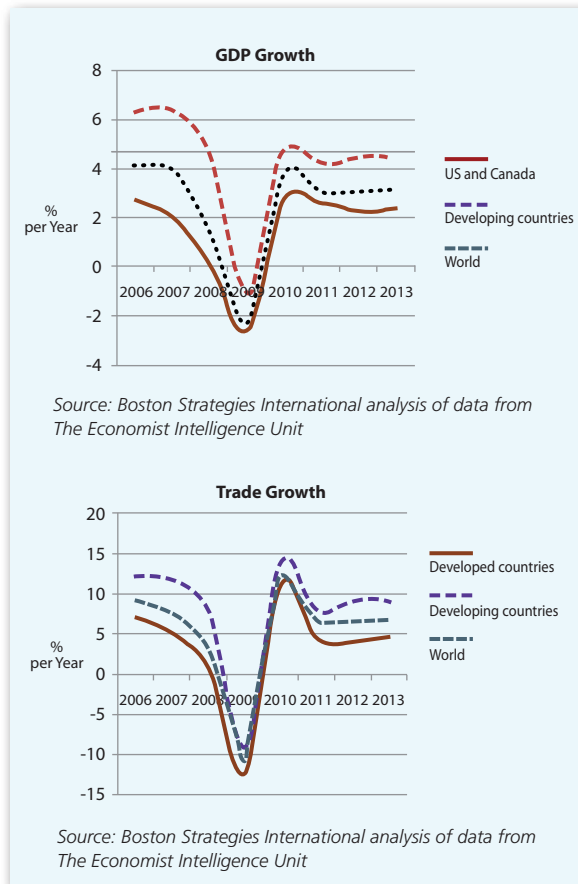
The other factor that could disrupt the rebound is the value of the Chinese yuan. If the Chinese bow to US pressure and revalue the yuan, or if the yuan begins to substitute for the dollar as the world currency, new demand for the currency would make Chinese goods more expensive in the West, which would slow the rate of growth.

Ocean capacity will expand at about twice the rate of demand this year (8.8% incremental vessel capacity to be delivered in 2011, vs. 4.4% trade growth in the developed world), which would normally translate to downward rate pressure, but carriers have developed a clever bag of tricks to deal with the capacity overhang.

They will "slow steam," slot-share, redeploy vessels to intra-Asian routes, add and remove vessel strings in response to the demand of peak season, and lay up capacity (about 7% of the fleet is currently laid up, compared to the 10% that prevailed during the global rate depression in 2009).

On balance, rates will fall some more before the upcoming seasonal negotiations, but carriers will be able to restore them to current levels during through a general rate increase, and these contracts will stabilize base rates at this level for most of the year (with monthly variation and volatility, of

course). That being said, bunker fuel prices, which have been rising for the last two months, will rise by 5% more during this calendar year as rebounding demand in Asia exceeds new oil production capacity. So the total cost of ocean freight to shippers will rise by about 5% this year, mostly due to the rising cost of fuel.



### Intermodal Freight Rates

Intermodal demand was strong and more consistent than ocean freight, and will continue that way as North America continues a long trend toward converting truck freight to rail. Norfolk Southern, Union Pacific, and CSX reported record years, thanks in significant part to their intermodal businesses. Norfolk Southern reported its fifth consecutive quarter of intermodal revenue growth.

Union Pacific aims to convert 11 million truckloads to intermodal traffic over the next five years (truck conversion will be helped by continuously rising costs of fuel). Kansas City Southern (KCS) is benefiting from a near-sourcing trend, and JB Hunt had

record intermodal volumes in Q3.


The supply of equipment is also tight, which has allowed carriers to raise rates: the Hub Group and JB Hunt raised their intermodal rates in Q3 by 3% and 2% (year on year), respectively.\* In the end, the total revenue per intermodal FTE increased by almost 10% in 2010. Rates will rise (even without fuel costs) by 4-5% more in 2011 as capacity tightness and truck conversion trends continue to increase core demand.

### NEGOTIATING IMPLICATIONS

The economic rebound is so fragile that brokers are currently only quoting ocean freight rates with a one-week validity. If consumer demand surges in America and Europe in the first half of 2011, rates could rise more aggressively. On the other hand, if consumer demand dips, the rates could decline.

The relationships between GDP and trade, and between vessel utilization and rates, have been quite direct over the last two years, so even small changes in economic growth will affect rates, either upward or downward.

My advice for the upcoming rate negotiating season? If you are a shipper, stress vessel overcapacity and discount the prospect of a resurgence in demand as wishful thinking. Strong shipper pushback could prevent a rate increase. If you are a carrier, push for rate increases on trade lanes where there is current growth or there is the earliest, most concrete potential for growth, and negotiate based on your ability to guarantee capacity.

For shippers and carriers, the upcoming negotiations will be about economic theory and forecasts more than facts. If you want some economic analysis to support your case, call me. Good luck! 

\* Company data based on equity research from Stephens

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