

Why is everybody so surprised by the falloff in ocean freight rates and port charges? Ocean carriers way over-invested in capacity, and what goes up must come down. Carriers are mitigating the decline as much as possible by removing capacity from the market, and it is working in some container trades. However, shippers will be in the driver's seat for several years to come due to the massive overinvestment.

was not enough to prevent a huge drop in US imports and exports, which dropped by 25% and 20% respectively in the second half of 2008.

As a result, traffic volume is off 8-10% or more in the last 12 months on the transpacific trades and Asia-Europe traffic has been annihilated. Eastbound transpacific volumes fell by 8% in 2008 after 15 years of 8% annual growth, hit by a total shutdown

Rates have fallen below the rates of the early 1990s on the Asia to US West Coast trade. By mid-November, the Baltic Dry bulk Index fell by 93% from its peak, popping the rate bubble that continuously inflated since 2002. To make matters worse, buyers of bulk ocean freight are not able to take advantage of the low freight rates since credit is so tight that they cannot secure letters of credit. Asia-Europe spot market rates are below \$300 per TEU.

The global economic crisis is not the only cause of the collapse in ocean freight rates, however. Carriers ordered too much new capacity, starting in 2007. Today, the market is awaiting the delivery of 175 10,000+TEU ships, which will be delivered in 2009, 2010, and mostly in 2011. These will add 10-12% more capacity to the market at a time when over 5% of the world's container capacity is already idle.

Hence, the outlook is for rates to stay low and to fall in trades that have not been impacted much yet. Boston Strategies International projects a further decline in transpacific volumes of 13-22%, depending on the trade and the port. Asia to Europe traffic won't decline much farther from its current low. Ocean carriers will remove capacity by laying up more vessels (they have already laid up hundreds of ships).

Shippers can definitely gloat about the low prices, but they should keep a long-term perspective since the most sustainable cost savings comes from long-term partnerships with highly competent supply chain providers that are tuned into corporate business objectives. Shippers can definitely save money, but if it is accomplished by forcing carriers to increase transit times, discontinue value-added services, and optimize their own service rather than the end-to-end cost, they will have let short-term opportunism unravel years of effort building lean supply chains. **D**

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## The Ocean Market: Overcapacity Until 2012



Demand fell off a cliff in a storm of economic bad news that brewed for several years until the US recession dealt its fatal blow. The US dollar lost 48% vs. the Euro since 2001, lowering consumer purchasing power. Chinese labor costs doubled since 2004 and China's consumer price index (CPI) rose by 6% in 2008, effectively turning off the low-cost sourcing spigot. A 29% revaluation of the US dollar versus the Euro

in US homebuilding. Traffic at Chinese ports declined to 10% per year growth, compared to a historical level of 30% per year. And at the largest ports, imports to the US West Coast fell by nearly 10% even before the year closed. Carriers on the Asia to Europe trade are trying to make ends meet by steaming around the Cape of Good Hope since it costs less to pay for fuel than Suez Canal tolls.