DRIP/c

MAY 2021

Global Shipping Crisis

The detrimental impact of the rising tide of freight costs on SMBs

KEY POINTS

- Drewry **WCI has skyrocketed by over 300% to US$ 6727** since the onset of the COVID-19 pandemic.
- The shipping crisis is a result of the **uneven post COVID-19 economic recoveries** of the world's largest importing and exporting countries.
- Exporters and Importers are **paying the shipping lines premium rates** over and above the freight costs to get hold of a container.
- There is an **overall container capacity of over 34 million TEU worldwide**, but all these containers have been piling up in the wrong place over the months.

TIMELINE

Dec 19 - Feb 20

GLOBAL TRADE CAPSIZES

China's **exports fall by 17%** in the first 2 months of 2020. Production comes to a standstill.

Mar 20 - May 20

BARRICADES AGAINST TIDE

Lockdown restrictions lead to slowdown at ports. Thus, **empty containers were not getting picked up fast enough** to send back to China.

Jun 20 - Jul 20

DEMAND WAVES

Imports from China rise due to WFH. Container shortage leads to a **245% increase in empty containers sent back** from the US to China.

Aug 20 - Oct 20

GLOBAL TRADE RESURFACES

Demand for shipping containers surges as many economies resume activity. Freight rates rise, and the **WCI jumped by almost 27%.**

Nov 20 - Feb 20

UNCHARTERED WATERS

For every 100 containers imported in the US, only **40 were exported while 60 were sitting empty** at the ports. Drewry WCI doubles.

Mar 21 - Now

SHIP OF STATE

Suez Canal clog leads to **300+ ships being jammed.** Alongside, a logjam develops at LA port with over **30 ships anchored at sea,** radically above the usual 0-1 ships.

A rundown

WHAT IS HAPPENING

The shipping industry is the backbone of international trade and the largest enabler of globalization. According to the United Nations Conference on Trade and Development (UNCTAD), around 80% of global trade by volume and over 70% of international trade by value happens by sea. As per Drip Capital's internal analysis, SMBs worldwide contribute over 25% of the US$ 18 trillion maritime trade. The Suez Canal blockage in March 2021 highlighted various issues faced by the shipping and logistics industry. However, Drip Capital observed that this sector has been going through a more profound and widespread crisis since the onset of the COVID-19 pandemic and the resulting economic contraction.

"The entire global supply chain has been disrupted. It has become challenging to cater to the buyer's demand because of the shortage of shipping containers."

While every exporter and importer felt some degree of the brunt from the economic contraction, the most heavily affected were the SMB traders of the world. Mr. Jignesh Mehta from Rise and Shine Overseas, a small agri-products exporter from India, shares the panic around the shipping crisis. He said, "The entire global supply chain has been disrupted. It has become challenging to cater to the buyer's demand because of the shortage of shipping containers.

Even after getting a container, we pay astronomical ocean freight costs that we have never seen before. The agri-commodity industry operates on low-profit margins, and this spike in freight rate has been deeply cutting into our margins, and survival at times has become tough".

SMBs worldwide contribute over 25% of the US$ 18 trillion maritime trade.

Many other shippers around the world share this SMB exporter's plight. The shortage of shipping containers has led to freight costs skyrocketing over the last year and settling on all-time highs. As of June 10th, 2021, Drewry's composite World Container Index (WCI) -- a global index for container spot market freight rates on all the major routes, peaked at US$ 6727, up by more than 300% since the emergence of the coronavirus in December 2019.

The shipping crisis is a consequence of the uneven post-COVID-19 economic recoveries of the world's largest importing and exporting countries. The novel coronavirus has hit the world with multiple waves and new variants. But, the difference in the degree and level of its impact on each country meant everyone around the globe experienced lockdowns and the subsequent easing of restrictions at different points in time.

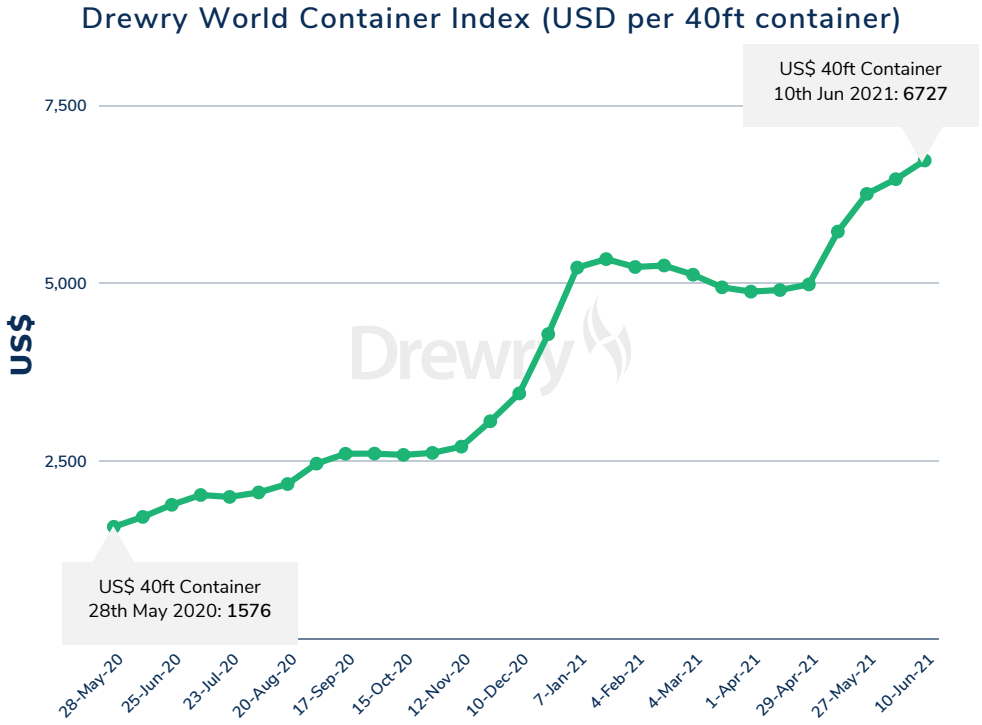


Figure 1: Rising freight costs

300%
spike

> ***"Even after getting a container, we pay astronomical ocean freight costs that we have never seen before."***

How it started

GLOBAL TRADE CAPSIZES

China is the largest exporter in the world, with 16.1% of global exports. When COVID-19 hit this global trade powerhouse, many unfortunate events started unfolding for the shipping industry. Manufacturing came to a standstill due to strict lockdowns leading to Chinese companies walking away from purchase contracts which led to a considerable fall in import of raw materials. Containers that were coming in were stuck at the ports as signaled by the Drewry port throughput indices. This was due to a shortage of workers to unload, handle and transport them to the factories. Due to the unavailability of power supply plug-in points, multiple reefer containers were diverted from major ports like Shanghai and Xingang. Shippers incurred huge congestion surcharges as these containers had to be rearranged and discharged to alternative ports.

Simultaneously, manufactured and finished goods were lying at the various ports in China but were not being shipped and transported worldwide.

Exports from China plummeted by 17% in the first two months of 2020 when COVID-19 was still an epidemic and isolated.

> ***In 2019, 16.1% of overall global exports were done by China.***

Something interesting happened at this point, consequences of which are only being understood now when it is too late, and we are knee-deep into the crisis. According to reports, due to barely any freight movement in and out of China in January and February, multiple shipping liners worldwide started seeing a decline in their monthly revenues. They predicted a further plunge for the months that followed. There was just not enough demand for ocean freight in a time when supply was plenty. Shipping liners announced blank sailings to shield themselves from further potential top-line losses. According to DHL Glossary, blank sailings are scheduled sailings that have been canceled by a carrier or shipping line, so a vessel skips specific ports or even the entire route.

What followed

BARRICADES AGAINST TIDE

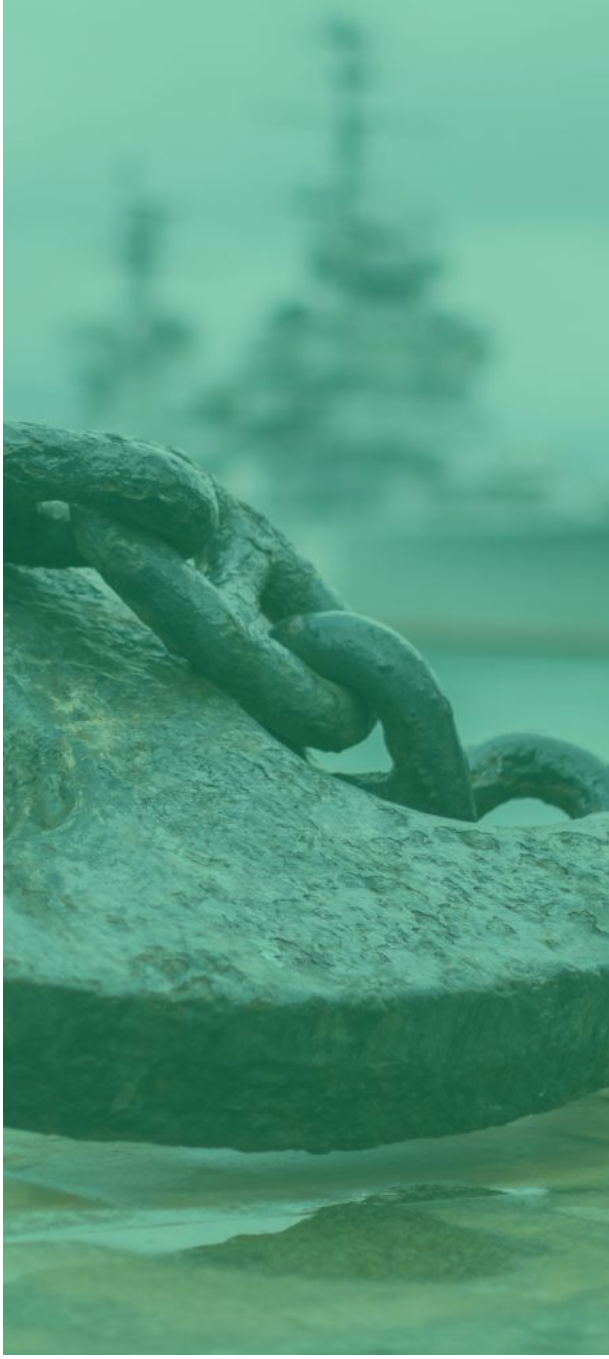
Concurrently, by the start of March, the virus had started to spread to multiple countries worldwide. Governments started imposing restrictions to curb the spread of the virus, and this heavily reduced economic activity and thus global trade. Since nobody knew what this new virus was and could do, many ships and their crew were quarantined at sea before entering the ports. This was one of the initial measures that commenced the entire loop of delays in ocean trade.

As a result of the dampened trade activity, the entire global supply chain was disturbed. Shipping liners were forced to cancel their sailings and idle their vessels. Thus, empty containers were not getting picked up, especially those lying in North American ports, and were much more needed in Asia. According to The Geography of Transport Systems, empty containers are usually repositioned to mitigate trans-oceanic trade imbalances from a surplus (export-oriented) to deficit (import-oriented) areas using ports as gateways. Also, most of China's imports are raw materials that come in bulk vessels and are not containerized. In contrast, most of China's exports are finished goods that are usually containerized- this adds to the need for repositioning.

While the rest of the world was still facing an economic slowdown, China started recovering quickly as its COVID-19 cases fell significantly. China resumed its exports in March and recorded a 3.5% year-on-year (Y-o-Y) growth in exports in April 2020. It first shipped stalled-filled containers sitting at its ports. But once these containers reached North America and Europe, social distancing and coronavirus clusters amongst dockworkers meant slower shipment processing times. As a result, there was a backlog of claimed cargo at the Europe and North America ports. This further aggravated the container shortage issue.

Alongside this, China also kickstarted its manufacturing plants, and much of the labor force was back to work. It resumed steel production before other countries, leading to considerable differences in steel prices between China and the Americas. This resulted in bulk exports of steel from China to the US. Due to the non-availability of containers usually used to ship steel products, this shipment was loaded on vessels used for bulk exports which takes more time to load.

Empty containers are usually repositioned to mitigate trans-oceanic trade imbalances from export- oriented to import-oriented regions.



Sailing upstream

DEMAND WAVES

In North America and Europe, working from home and studying from the dorm meant people wanted to purchase new desks, chairs, and gym equipment. Since most of these products are usually imported by retailers, e-commerce companies, and consumers in these regions, demand started rising. Consumer sentiments around the uncertainty of the pandemic led to a rise in bulk purchases and hoarding of grocery items which meant large stores needed to replenish their stockpiles. The US is the largest importer in the world, and as of 2019, according to ITC Trade Map data, 16.8% of China's exports were to the US --its largest trading partner.

With barely any empty containers in China to cater to this demand, freight costs started increasing. And once these containers were in the US, where economic activity was still slow, no exports from there meant these containers did not come back quickly enough. The global container capacity is roughly 34 million TEU, but these containers are piling up in the wrong places over the last few months.

Due to all the issues highlighted above, the trans-oceanic trade imbalances had grown out of control. Acknowledging this worsening situation, China started ramping up its global empty container repositioning program. In June, the total volume of empty twenty-foot equivalent unit (TEU) containers shipped from the US to China went up by 188% Y-o-Y, and in July, it increased by 245% Y-o-Y, according to S&P data.

At a glance

17%

China's Exports to USA

34 Mn

TEU Global Container Capacity

245%

Rise in empty container export

A convalescence

GLOBAL TRADE RESURFACES

At this point, on one side, there was more cargo coming into the US, while on the other hand, the goods movement system had slowed down due to a lack of workforce. This simply led to more ships waiting in the sea to unload containers. There was a 17.3% Y-o-Y rise in October 2020 in the volume of imports, according to S&P. August to October marked the start of the astronomical increase in freight costs. As many other economies gradually started coming out of their respective lockdowns and restarted their manufacturing activities, their requirements for shipping containers returned. This surge in demand, coupled with the fact that empty containers were at the wrong place at the wrong time, saw Drewry's composite WCI jump by almost 27%, from US$ 2059 at the start of August to US$ 2615 at the end of October. The Baltic Dry index revealed that hauling dry bulk goods costs were up by 50% too.

October is the onset of the holiday season in the US, and it is usually when demand for certain manufactured goods like electronics and garments rises. This factor also fed into the rising prices of containers.

During the same month, China unofficially banned its coal imports from Australia, its largest trading partner for this commodity. In the past, the country imported more than 50% of its coal from Australia. However, this disruption of a major trade relationship altered many things for the shipping industry. With multiple Capesize dry-bulk carriers full of coal stranded mid-ocean, there were fewer ships in operation. Additionally, due to this trade spat, smaller quantities of coal started traveling to far-away locations. Australia began exporting coal to countries like India, while China, on the other hand, imported coal from Colombia and South Africa. This resulted in smaller Panamax ships being used to move this coal across the world, further worsening the container shortage problem.

China produces more than 80% of the world's containers, and Drewry's composite WCI expects a 6.5% growth in shipping container production.

China increased imports of iron ore by 19% to US$ 119 billion in 2020. Also, imports of iron and steel metal products increased by 58% to almost US$ 37 billion. In 2020, trade with India in these commodities particularly rose multi-folds with 81% more iron ore and 336% more iron and steel metal product imports as compared to 2019. Perhaps, as India is closer by, it is easier to import from the country. But, why did China ramp up its iron and allied goods imports by such a large amount? Is it possible that China is building more ships and maybe more shipping containers? China produces more than 80% of the world's containers, and Drewry's composite WCI expects a 6.5% growth in shipping containers, so this could be one of the explanations for the rising imports.

trouble begins

UNCHARTERED WATERS

To the shock of the shipping industry, the worst was yet to come. Desperate companies fighting to export their products abroad meant their willingness to pay to acquire containers was relatively high, and they ended up paying premium rates. This led to shipping costs skyrocketing, and Drewry's composite WCI rallied from US$ 2628 at the start of November 2020 to a whopping US$ 5340 in January 2021. Simultaneously, freight rates for the US went up too, though not that substantially. It became harder for US exporters to get containers because of China's aggressive tactics to bring back empty containers. This competitive environment affected many but especially all the SMB exporters who were burdened by these high costs.

Drewry's composite WCI rallied from US$ 2628 at the start of November 2020 to a whopping US$ 5340 in January 2021.

At times, shippers were forced to decide between paying a significant premium versus pushing back deliveries and disappointing their customers. Mr. Vivek Pandit, CEO of Indian Foods and Spices -- an SMB wholesale importer from the US of Indian food items said, "We are planning our shipments well in advance than we used to a year ago. Still, container availability has been an issue. When the goods are sitting ready for two to three weeks, we don't get an empty container to have the goods shipped to us from India. This has been affecting our sales and delaying our collections." Importers are also avoiding accumulating slow-moving goods and only focusing on fast-moving consumer goods to ensure that they can be sold quickly in these uncertain times.

Pandit also added that "The constantly rising freight rates have been cutting into our margins. While certain small-end buyers are willing to carry forward some of these increased costs to their customers, most large retailers are unwilling to take on the price increase and at times even ask for discounts. But over time, if the freight costs do not go down, everyone will have to adjust to increased prices gradually".

At this point, North America was facing a 40% imbalance. This meant that for every 100 containers that were coming in, only 40 were being exported out. 60 out of 100 containers were still sitting empty at the ports of North America. The pressure to get the containers back to Asia had started rising tremendously. Shipping liners did not want to bother waiting for the containers to get filled up at the US ports before sending them back to Asia. The same is true for the Europe-China trade route. Why? Because of the considerable pricing arbitrage involved. Alphaliner reports that carriers can get 66 cents (per 40ft container per nautical mile) on the Shanghai to LA route against less than 10 cents on the return. Carriers want to be able to take advantage of these margins.

Figure 2: Price per nautical mile (40ft container)

xChange

CONTAINER AVAILABILITY INDEX

The container availability index (CAx), a measure ranging between 0 and 1 created by xChange, reveals the number of containers that leave and enter a port in the same week. Low CAx values indicate a deficit of containers, and high values indicate a surplus of containers. The situation of container shortage got quite out of hand in November 2020, such that the CAx for Forty Foot Equivalent Units reached 0.9 as containers were piling up at the port of Los Angeles (LA). At the same time, the growing unavailability of containers in China led to the CAx reaching close to 0 during the first week of December.

0.9
Los Angeles port

0.02
Shanghai port

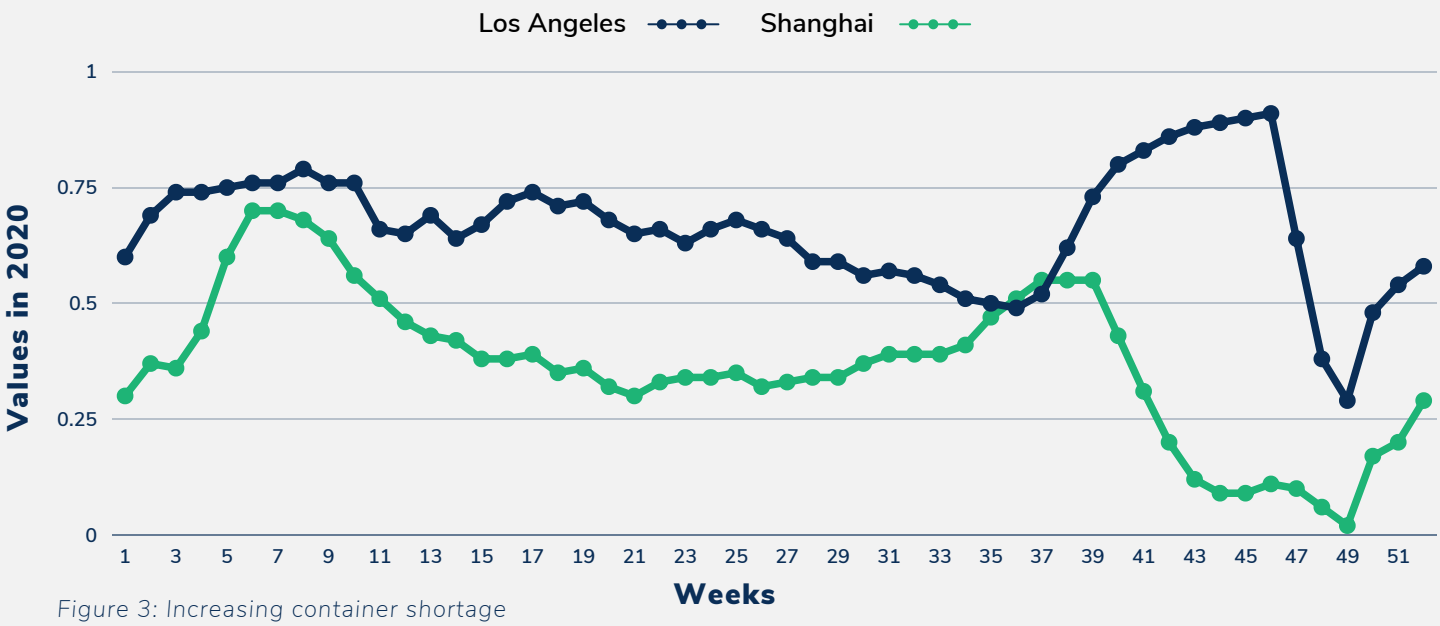
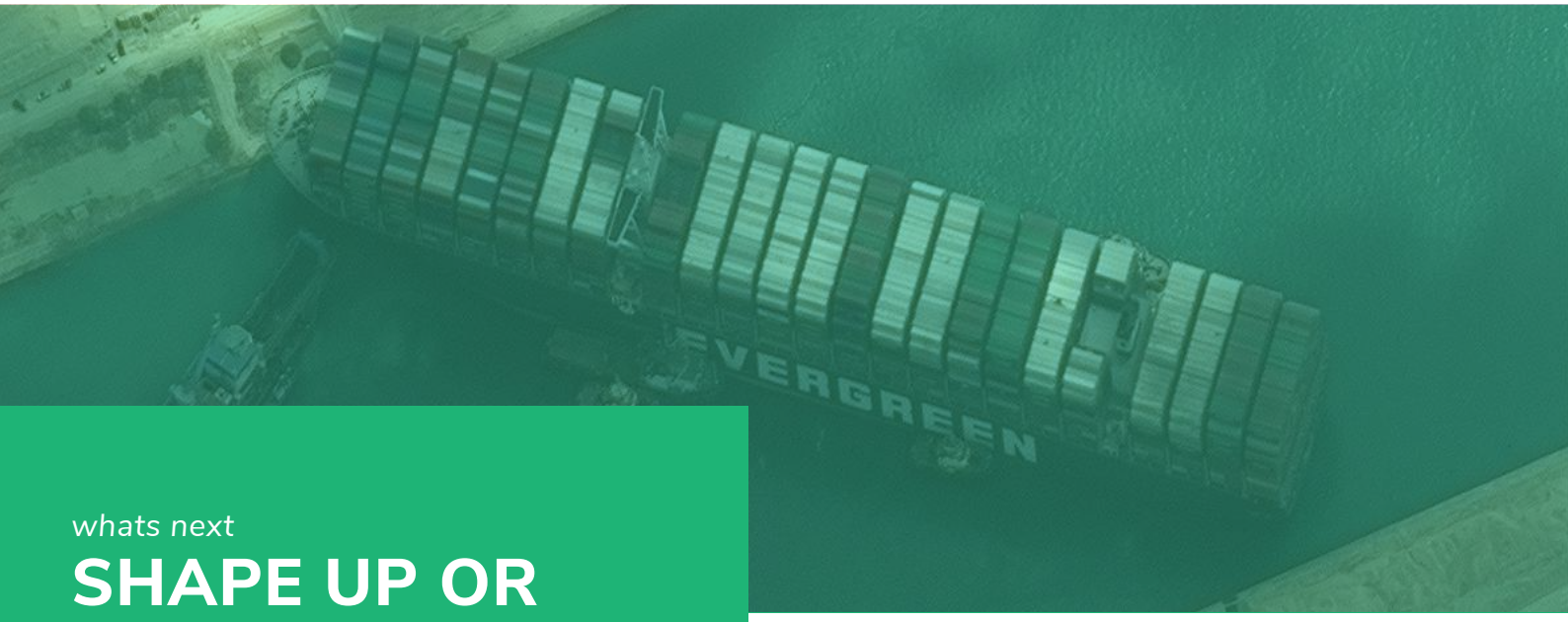


Figure 3: Increasing container shortage

Many export-reliant Latin American countries also struggled with sending out their shipments as shipping liners placed low priorities on them and at times skipped the South American ports altogether. At times, buyers in the US who imported from African and East Asian countries were also facing issues due to multiple bottlenecks being created at various major sources, transshipment, and destination ports. Mr. Hendra Taruli from Opal Coffee, a coffee trader, based in the US, commented, "The supply chain is crumbling, and goods are spending more time on the sea. This is a problem for us. A larger chunk of our money gets tied up in transit, leading to disruptions in our financial planning.

Going ahead if the container crisis were to persist, we have to be very smart with the way we manage our capital and inventory to continue doing well in the market".

Due to these pricing and priority differences, the industry is suffering from a rapid deterioration of reliability and visibility. Ships are skipping ports- a practice called blank sailing, and their number in some trade increased as much as 30%. Commodities information provider S&P Global Platts said that the sailing schedule reliability was at a 10-year low. According to SeaIntelligence, a maritime consultancy, just 50% of container vessels arrived on time in November, the lowest share since the firm began tracking the measure in 2011.



whats next

SHAPE UP OR SHIP OUT

These events culminated in Drewry's composite WCI witnessing its highest points ever this year and settling over the US$ 5000 mark. With the substantial trade volumes moving around, this seems to be the reality for the shipping industry for months to come.

On 23rd March 2021, the Suez Canal got blocked by the grounding of the Ever Given shipping vessel. This blockage added to the entire supply chain disruption as it caused major traffic jams and delays, blocking over 300 ships. Many shipping liners started re-routing their vessels around the Cape of Good Hope, the southern tip of Africa, anticipating long delays in movement and wanting to get their freight delivered as soon as possible to the destination. While the Ever Given vessel was jammed due to high winds, this event also shed light on how desperate the industry has become to move things quickly.

According to Marine Exchange of Southern California's data, in early April 2021, there were about 30 container ships anchored on the Port of LA. This was leaps and bounds above the usual number of anchored vessels, which is around 0 to 1. Constant demand rise in the US combined with the shortage of containers has led to this bottleneck. Also, as ships are getting bigger, it takes much more effort to park them on the port and unload them. While ships are much more efficient when at sea, they become a problem onshore, adding to the bottlenecks and delays.

Figure 4: Ships anchored at port of L.A

Mr. Richard Lam from First Choice Seafood, a major importer and distributor of seafood in the US, highlights that shippers are forced to pay demurrage and storage fees to shipping lines over and above the mammoth freight costs. “It has become difficult to manage inventory due to this crisis which is beyond our control. We will be carefully planning our business strategies this year, given that the market is uncertain. Staying stable and afloat will be our main aim”, he shared.

Facing similar problems is Mr. Sandip Patel from SLT Foods, an importer of food products in the US, who said, “Our main business is in the west coast where the logjam is causing a long delay of three/four weeks. Hence we are trying to divert our shipments to the east coast. Moreover, the repeated opening and closing of the country’s borders has made inventory uncertain. To be on the safer side, we are trying to keep at hand more inventory than we would normally do. Our profits have been affected, and we don’t foresee this problem going away anytime soon.”

According to the World Shipping Council, desperate shipping firms have also started pressing rail-cargo containers into maritime service due to container scarcity. Reduced air-freight capacity has made the market situation worse. Cargo that might typically have been transported by air must now fight for space on container ships. This pressure to speed up deliveries has at times been leading to the risk of safety errors. Sometimes, standard protocols like mandatory underwater repairs and machinery overhauls had to be waived off due to a workforce shortage in the repair docks. Estimates by Bloomberg revealed that containers lost at sea by falling overboard rose to a seven-year high in 2020.

Containers lost at sea by falling overboard rose to a seven-year high in 2020.

Some SMB’s like Rise and Shine Overseas have had to make changes to their business plans for the new financial year. The CEO, Mr. Jignesh Mehta, said, “I trade with products that have a low shelf life. Delays in shipments mean the products would barely have a few months on the shelf of the buyers, who now run the risk of not selling the products.

New orders will not be placed if the buyer suffers a loss. As a result, my strategy for the coming year until the container shortage issue persists is to only export on shorter and close-by trade routes. To avoid spoiling my trade relations, for the rest of 2021, I will not be servicing long-distance clients.”.

To summarize, the crisis has primarily arisen for four reasons - a significant fall in the availability of containers, reduced workforce, fewer shipping vessels operating, and erratic movements in demand for various commodities. But, there is another factor tugging at this problem and adding to it.

This is from the container production perspective. During the first half of 2020, many countries canceled their new container orders due to the economy’s standstill. There was also a lag in the supply of lumber and steel needed to build the containers. In addition, AFP reported, many containers in service were withdrawn from the market for refitting to meet the carbon reduction standards. Also, in 2020, the number of containers scrapped was higher than the number of containers produced, indicating a shrinking container fleet. For container producers, all of these demand and supply-side factors ended up allowing them to charge as much as US$ 2500 per container, up from US$ 1600 last year.

what's next

SHIP OF STATE

However, all is not bleak. Mr. Sachin Malani from Shree Metal Products, an industrial metal goods exporter from India, commented, “The buyers are understanding the gravity of the issue and are willing to share the ocean freight costs with us. They are also willing to renegotiate the product rates. There is cooperation by everyone in the shipping industry in these pressing times”.

But the big question is until when will there be cooperation? Expressing his concern, Malani added that, “If the transport cost keeps increasing, there might come a time when our local distributors in the US start doing a cost-benefit analysis. They might evaluate whether they should keep importing from us or source locally from the US. Competing with US manufacturers could be a problem for Indian SMBs.” This seems to be a worry shared by many more Indian small and medium exporters who do not see this crisis normalizing soon.

While prices increased for commodities like steel in 2020 due to the massive freight rates, food product importers had to absorb a substantial amount of these costs as they found it difficult to pass it on to the stores that shelf their products. But, this has pressed the margins of SMB importers quite a lot and affected their ability to stay afloat if they continue to shoulder these costs. There is no other solution other than passing it on to retailers and, ultimately, the end consumers. This upward pressure on prices of products, usually part of an average consumer's basket of goods, could indicate rising imported inflation for the US, which is already witnessing the highest consumer prices since 2009. For example, data on wholesale prices of different Asian shrimp varieties reveals that these prices have been rising gradually since February 2021 Y-o-Y compared to the average price for the last three years (2018-2020). It almost jumped by 10% in May. If this trend continues, which is seemingly the current market sentiment, these prices will soon start feeding into the system.

Upward pressure on prices could indicate rising imported inflation for the US, which is already witnessing the highest consumer prices since 2009.

As countries continue to roll out massive vaccination drives and pandemic restrictions are lifted globally, consumers are more likely to spend on recreational activities like travel, entertainment, and hospitality. This would bring some relief to merchandise exporters. However, until then, the container crisis will continue to wreck the shipping industry. It's time to look at the container shipping industry holistically and as a key enabler of globalization and not just a means of transportation of goods.

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About Drip Capital

Drip Capital is a digital trade finance company based in Palo Alto, California. The company offers working capital solutions to small and medium-sized companies engaged in cross-border trade in India, Mexico, and the United States using technology and data analytics. Visit us at dripcapital.com for more details.

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