

2010 MID-YEAR RATE OUTLOOK:

Paying a Premium

BY JOHN PAUL QUINN, CONTRIBUTING EDITOR

While the extent of the recovery remains uncertain, shippers will continue to be hit with rate increases across all modes.

In the earlier stages of the downward economic trend of the past two years, analysts were initially reluctant to use the dreaded “R-word.” But now it seems as if they’re equally wary about using another “R-word,” but this time it’s “recovery.”

“We seem to be enjoying a burst of growth, but the fundamentals aren’t there,” says David Jacoby, president of supply chain consulting firm Boston Strategies International. “The job growth is largely in temp work and there has even been a slowing of this as we approached the middle of the year.”

Jacoby adds that corporate investment is also lagging as companies are conservatively hedging their bets since many don’t see this as a sustainable growth situation—at least not yet. “This is not necessarily a dangerous scenario, but it’s a disappointing one,” he says.

Forecasts of GDP growth are hesitant and cautionary as well, according to Paul Bingham, managing director of trade and transportation at IHS Global Insight. According to Bingham, real growth is forecast to be up 3.4 percent this year in contrast to the negative 2.4 percent of 2009, but the pace is expected to slow back to 2.8 percent in 2011.

And there’s another critical factor missing this time around, says Bingham: “In the past, there was a good deal of debt-financed consumption on the part

of households and small business that enabled economic expansion to proceed faster, but that won’t be repeated because people can’t get that kind of credit anymore.”

In addition, there is the perennial volatility of fuel pricing to consider, exacerbated by the undetermined long-term impact of the Gulf oil spill that could cause fuel prices to rise more precipitously than usual.

And as shippers move through these perilous next few months they’ll continue to be hit with rate increases while the extent of the projected recovery of their businesses remains uncertain. To help get a better handle on just how high your rates will be heading over the next six months, here’s a breakdown of where they stand at midyear.

ON THE WATER, IN THE AIR

Drewry Shipping in London reported some fairly stark figures in mid-June, noting that the rate of \$2,607 per 40-foot equivalent container unit for shipments from Hong Kong to Los Angeles was 183 percent higher than the rate of \$929 posted for the second week in June a year ago.

Factors contributing to this situation include the fact that space on vessels remains tight, there’s a shortage of containers, and peak season surcharges are already being implemented by a number of carriers.

"Rates are going up as ocean carriers are trying to make up for the money they lost in 2009," says Jacoby. "While a lot of supply-demand disciplinary adjustments have been made in ocean transport, shippers should expect rates to return to pre-crash 2008 levels. But the wild card, as in all modes, will be the threat of increasingly escalating fuel pricing."

Global Insight's Bingham believes that if the economic recovery remains sluggish, then ocean capacity will exceed demand to a certain extent, and shippers may be able to rate-bargain with carriers. If this occurs, shippers who have made it through the first half shouldn't have as difficult a time during the second.

"Air cargo rates will also be on the rise," states Chuck Clowdis, IHS Global's managing director for North America. "As shippers see economic recovery they will start flying things again like high-end designer goods from Asia which they've been content to ship by water during the slowdown. But so far consumer spending spurts seem to be on an as-needed basis in a sporadic pattern."

Drewry Shipping has reported that first quarter 2010 traffic for Asia-Pacific air carriers surged 33.8 percent year-over-year, and that in some cases air freight rates out of Asia to the U.S. West Coast jumped 18 percent from March to April of this year.

PARCEL PROBLEMS

There are a few significant developments in the parcel sector that have been developing simultaneously, and none of them bode well for shippers.

FedEx and UPS continue to consolidate their virtual duopoly in parcel transportation that began with the exit of DHL from the field a year ago last January, observes Jerry Hempstead, president of Hempstead Consulting.

"The rhetoric out of both FedEx and UPS is shot through with phrases like 'yield improvement,' 'rational pricing,' and 'discounting integrity,' all of which

mean higher rates," says Hempstead. "Both companies are delighted that the U.S. Postal Service is losing billions of dollars and is applying for a January 2011 rate increase of perhaps 25 percent for parcels under a pound. If that happens, then it's probably more economical for shippers to see if they can negotiate a discount rate with FedEx or UPS."

In addition, fuel surcharges have mounted as well. A year ago, the surcharge at both companies for an air package was 0 percent. It's now 10 percent. For a ground package it was 2.25 percent. It's now 6 percent.

Finally, both carriers have made moves to exclude shippers' third-party consultants from contract renewal negotiations. "The plan is for them not to bid if a third party is called in," Hempstead notes. "This is like going to court without a lawyer, or a tax audit without your accountant."

Altogether, says Hempstead, the carriers know that some growth is occurring, so their capacity will be filled by organic growth and they don't have to compete rate-wise on the street to attract business. "There is just no pretty news for parcel shippers right now," he adds.

BY TRUCK AND RAIL

By comparison with the other modes, trucking and rail seem relatively stable as far as rates are concerned.

"Over the first half of 2010, truckload has recovered about a third to half of the volume lost over the past three to four years," observes John Larkin, managing director of the transportation and logistics group at analyst firm

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Stifel, Nicolaus & Co., Inc. "So there's much more of a balanced supply-demand situation, although there have been a few examples of \$2 to \$3 per mile spot rates above contract rates. I don't think there are widespread across-the-board rate increases coming," adds Larkin.

In the less-than-truckload sector, the remarkable financial survival of YRC, which has about 20 percent of LTL market share, has led to more than adequate capacity, leaving carriers little room to impose rate hikes.

However, Larkin continues to encourage shippers to look at intermodal seriously and consider using it in long-haul, high-density lanes where savings can be quite considerable.

On the rails, Brooks Bentz, Boston-based partner in Accenture's supply chain management practice, believes that rates shouldn't vary much and conventional wisdom is that there may be 3 percent to 5 percent price hikes coming down the line. However, according to Bentz, rail shippers should have no capacity constraints when moving freight by intermodal or carload.

By the end of August, as seasonal traffic is flowing in from Asia, shippers will get some indication of what the peak picture is going to be like this year—and how the traffic patterns will develop in whatever modes they employ.

"I've been watching the logistics industry for 30 years," says Clowdis, "but I've never seen anything like a slow economic period that has lasted this long and with this much uncertainty. I have to say it's kind of scary." M

—John Paul Quinn is a Contributing Editor for Logistics Management