

BE ON THE LOOKOUT



While the economic recovery will be slow, shippers should keep their eyes open for early signs of rate hike activity in the first half of the year.

BY JOHN PAUL QUINN, CONTRIBUTING EDITOR

Nobody is predicting any dramatic post-recession bounce as the national economy slowly emerges from its fitful and uneasy hibernation. On the freight transportation front, carriers in most sectors are still plagued with overcapacity, hoping that consumers will shake off their credit concerns and begin to register the kind of demands for goods that translate into shipping volume growth.

But most observers agree that while the economy may have bottomed out in mid-2009, it will be running along the bottom for some time—and there will be no “hockey stick upturn” in demand for goods and services. Forecasts are that the second half of 2009 saw a GDP advance of 3 percent, but that will probably settle at closer to 2 percent for the entire year.

And although by all accounts a recognizable rebound will be slow in coming, shippers should nevertheless be on the lookout for the first indications of rate hike activity in the first half of 2010. This will reflect a subtle increase in demand, but nothing substantial enough to tip the rate scale in the carrier’s favor.

“Shipping volume will pick up slowly through this year, but there will not be the big boom that usually occurs at the beginning of an economic recovery,” observes Jim Haughey, director of economics for RBI-US, *Logistics Management’s* parent company. “Keep in mind that although there is still a credit shortage, it is not apparent because there is little borrowing going on. But as the economy improves, many small carriers and shippers won’t be able to obtain financing readily.”

According to Haughey, shippers should expect small rate increases that will probably happen slowly and could be progressive. “Although this upward pressure on rates will not be excessive,” he says, “the direction of rates has begun to turn. Depending on the transportation mode, this would generally be a good time to lock into prices.” With that subtle warning in mind, here is how the various sectors are shaping up as we move into 2010.

TL/LTL: CONTINUED TOUGH TIMES

Any way you slice it, times continue to be tough for truckload (TL) and less-than-truckload (LTL) truckers; and all indications are that this will continue through 2010 with no real rate activity being good news for shippers.

“The second half of 2009 remained a buyer’s market in the trucking sector,” reports Paul Svindland, director and co-lead of the transportation group at AlixPartners. “There was a little tightening of capacity during the pre-holiday peak season in September and October largely involving imports from Asia, so there were some temporary spot rate increases in trucking,” he adds. “But this died down by mid-November instead of the peak holiday volumes continuing on into early December. Truckers were hoping that the spike would continue, but it didn’t and demand dropped off.”

And as the year began, the conditions as well as the quantity of the parked equipment continued to worry carriers. “Nobody is buying trucks and this is expected to continue,” says Chuck Clowdis, managing director for North America at IHS Global Insight. “Equipment is being used longer and there is an abundance of used trucks on the market.”

Clowdis also notes that while there have been some bankruptcies, there might have been more. If the diesel price spike in the last half of 2009 was not short-lived and had not quickly returned to reasonable levels, some of the carriers who have survived would not have been able to adjust fuel charges in time to stay solvent.

“Given the overcapacity in the industry and the slackness of the economy, there’s no way truckers

ILLUSTRATION BY CHRIS GALL

can find a reason or a way to raise rates," says Clowdis.

Svindland agrees, adding that since there is still significant capacity, and assuming that fuel prices remain reasonable, rates for truckload, intermodal, and LTL will stay flat in the first half of the year, with perhaps a slight increase in the second half of the year.

"The only lingering caveat has to do with the financial situation of YRC Worldwide, which has almost 20 percent of the LTL market share nationally," Svindland cautions. "If they were to be removed from the scene, then the other LTL carriers would have significantly more pricing power."

RAIL: STILL ON BRAKE

The railroad sector has probably been busier keeping its eyes on the recently released STB reauthorization legislation than it has been shipping freight this past year.

Some major carriers did manage to introduce minor rate increases of 2 percent to 4 percent, but they also downsized personnel and rolling stock and cut back on some local service. However, recently there have been reports of some renewed activity in the yards.

"Several of the rail carriers have called back operational people who were on furlough, which hasn't happened for a while," notes Brooks Bentz, Boston-based partner in Accenture's supply chain management practice. "Also, some locomotives have been returned to service. There is a sense that there is a slight uptick in rail volume developing, but not enough to say it's a definite trend."

Bentz expects carload haulage to stay flat initially, but probably pick up toward the end of the first quarter, and this is expected to result in modest rate increases.

In the view of Svindland at AlixPartners, intermodal continues to have an even worse time than the trucking sector. For a long haul move two or three years ago, there would be as much as a 30 percent price differential in favor of intermodal; but that has dropped radically to as low as 5 percent to 10 percent, and in some lanes trucking rates can even be at parity with intermodal because carriers are so desperate for freight revenue.

OCEAN: ACTIVITY PICKS UP

The ocean sector is the only quarter of the transportation industry that has seen a recognizable pickup in activity and a resultant increase in rates—at least along one sea lane, and even there with qualifications.

Transpacific traffic from Asia to the U.S. has noticeably increased and reportedly saw the strongest freight movement of any mode toward the end of 2009.

"There was a major reversal of freight rate trends on the Asia to U.S. route during the last half of last year," states Philip Damas, research director at Drewry Shipping in London. "Rates went up as much as 40 percent in some cases, but of course these increases

have to be seen in the context of how low they had fallen in these lanes during the recession."

Paul Bingham, managing director of trade and transportation at IHS Global Insight, expects that there will be a modest recovery in ocean rates generally over the next six months; but still lower than before the downturn, and in some cases not much above what shippers were able to negotiate in the depths of the recession.

"There will be continued rate pressure on the carriers, but they will have limited ability to act because of the industry's capacity situation," Bingham says. "Whatever increases they've been able to achieve have been due to their collective discipline to keep 10 percent

of their fleets in layup."

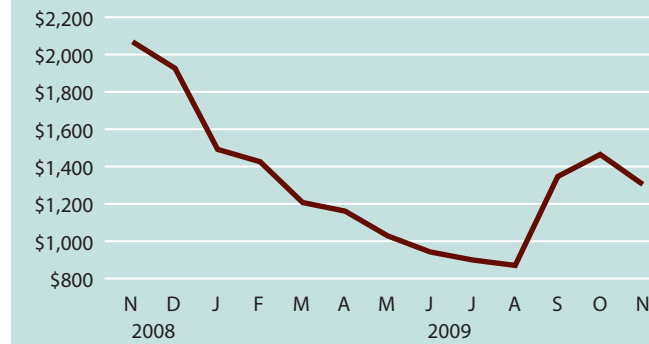
According to Bingham, this layup figure goes up each week since the ships that the carriers ordered three years ago are still coming out of shipyards despite their attempts to cancel or delay. "The huge order book for container ships still overhangs the ocean carrier industry," he adds, "and no economic recovery will be strong enough in volume to make up for this excess capacity. This will play out for at least two years and is the bottom line for the ocean rate picture."

David Jacoby, president of Boston Strategies International, has this assessment of the capacity overextension of the ocean transport industry: "They built for a bubble and they still have ships undelivered. While their losses have decreased, they're still not profitable. In fact, one major line lost \$800 million in the third quarter of 2008, and 'only' \$150 million in that period in 2009—more ships are due to be delivered this year."

Jacoby says that carriers will probably push through increases of 1 percent to 2 percent through this year. "However, toward the end of 2010, consumer spending may well taper off and then the overcapacity situation will become even more evident," adds Jacoby. "Keeping this in mind, shippers

Drewry Hong Kong-Los Angeles container rate benchmark (U.S. imports)

In US\$ per full 40ft container load, excluding terminal handling charge at origin port.



Source: Drewry Shipping Consultants, derived from Hong Kong non-vessel-operating common carriers.

"There may have been some slight flurry of air traffic toward the end of last year, but that was seasonal activity related to products like electronic gadgetry and high fashion," states Clowdis of IHS Global Insight. "While there will always be goods like pharmaceuticals that have to be flown, that won't fill up the overcapacity. There are out-of-service planes parked on tarmacs and in deserts throughout the world."

Bentz at Accenture estimates that air rates will probably increase 3 percent to 5 percent over the next six months, but if fuel moves up again that would drive them up more accordingly (*Logistics Management* takes a deeper

this will begin to change in 2010.

"There are a number of factors at work here," observes Jerry Hempstead, president of Hempstead Consulting. "Last November was the first anniversary of the DHL withdrawal from the market. When DHL exited there was a rush of shippers to UPS and FedEx. And to get that business from each other, these two carriers most likely did some heavy discounting," he says. "With the anniversary, the two have probably deemed these discounts inappropriate in the current environment and will move to increase rates as contracts expire."

As an indicator of what can be expected, Hempstead cites the statement made last October by UPS CFO Kurt Keuhn who stated flatly: "Our intention is to drive yield improvements from existing customers that did not provide a fully adequate return."

Given the anticipated slowness of the economic recovery, there will be no sudden surge of business for the carriers, meaning that they will seek increased revenues from their existing customer bases.

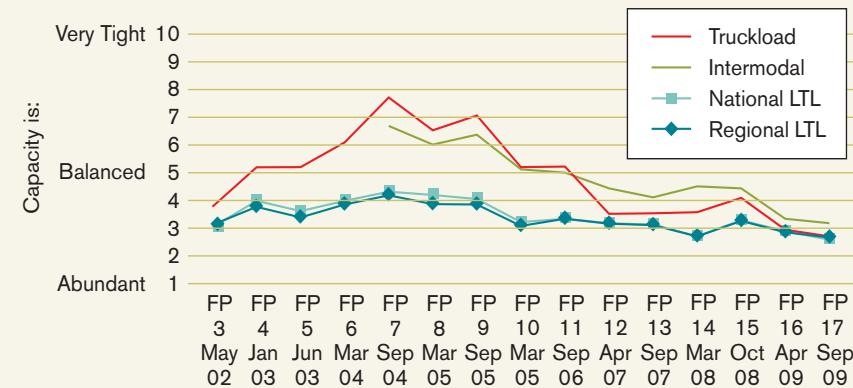
The United States Postal Service (USPS) announcement that they would not raise prices in 2010 was a bright spot for shippers, but Hempstead believes that by 2011, the USPS will eliminate Saturday delivery to trim costs. Shippers switching to UPS or FedEx for that service will likely have to pay a premium.

"The parcel pricing environment will change this year," Hempstead says. "Since new incremental business will probably be modest if at all, increased carrier revenues will come from lower discounts and higher base prices. Shippers should reassess their situation, renegotiate for the best terms they can, and lock in for as long as possible. The clock is ticking" (See the 2010 Parcel Roundtable on page 26).

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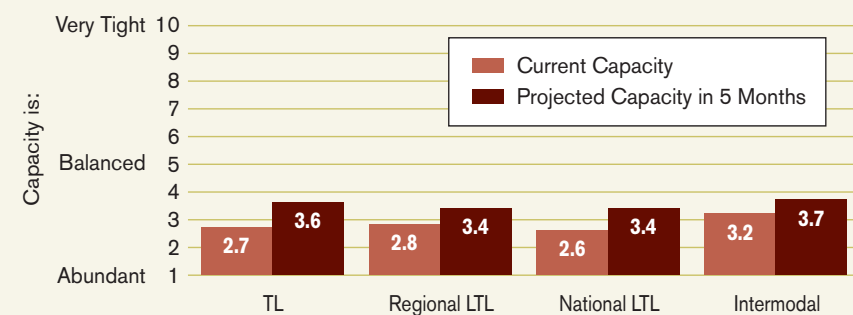
Truck capacity abundant; shippers see only modest tightening

Trucking shipper responses to: "How would you currently characterize the availability of equipment?"



Capacity rankings remain near all-time lows (abundant)

Current vs. Projected Capacity by Mode



Shippers do not expect a sudden tightening of capacity

Source: Morgan Stanley Freight Pulse Surveys

"There will be continued rate pressure on the ocean carriers but they will have limited ability to act because of the industry's capacity situation."

—Paul Bingham, IHS Global Insight

should be careful about locking into contracts longer than a year."

AIR: FOGGED IN

Air carriers remain fogged in, and the only shippers who will continue to be affected by excessive and fuel-boosted air freight rates are those who simply have no other option.

look inside the air market this month on page 43S).

PARCEL: SHIPPERS GET SQUEEZED?

As in other sectors, excess capacity has been driving rates lower over the past year or more in the parcel express market, but there are indications that