JOC.com

Published on *JOC.com* (https://www.joc.com)

Lars Jensen, CEO & Partner, Vespucci Maritime, and JOC Analyst | Aug 15, 2022 10:39AM EDT

The current pace of decline in spot rates signals that the market will not arrive at normality until mid-2023. Photo credit: Shutterstock.com.

The container shipping market is in the process of reverting back to normality. Depending on how the data are viewed, this process may have begun as early as September 2021 but is likely to not reach its endpoint until mid-2023.

Along the journey, there will be quite a few bumps in the road, some of which are not only fully predictable but are already beginning to manifest themselves.

Using the phrase “downturn” might appear at odds with a reality in which ocean carriers continue to set new records for profitability in the second quarter of 2022, but it is important to examine the broader context of those profits.

Spot freight rates in general reached their peak in September 2021, although some trades followed a different pattern, such as the trans-Atlantic, which peaked in May 2022. But the extreme increases in spot rates last year were not matched in the contract market. Even though some shippers found themselves unable to load the volumes they wanted under existing contracts, a significant amount of cargo did indeed move on the contract market, leading to an extreme spread between spot and contract rates.

As spot rates began to come down in the fourth quarter of 2021, carriers started to adjust contract rates upward, a trend that continued into the second quarter of 2022. The substantial demand growth seen in 2020–21 has also waned, replaced with much lower growth rates but maintained for now at levels that far exceed those prior to the COVID-19 pandemic.

As a result, the two parts of the market appear to be “out of sync,” with spot pricing indicating that the extreme tightness of capacity is disappearing while contract rates also signal that the market is clearly not yet back to normal.

Operational bottlenecks are keeping the brakes on this downturn back to reality. As of mid-August, 9.3 percent of global container ship capacity remains unavailable due to schedule delays. This is an improvement from 14 percent in January 2022 but still a far cry from normality.

As the market continues to normalize, schedule reliability will improve, which will release more capacity into the system and, in turn, continue to push rates downwards.

Still, the current pace of decline across the wider spot rate indices since the absolute apex in September implies that the market will not arrive at normality until approximately mid-2023.

During this gradual downturn, spot rates will fall materially below contract pricing levels. For some, this is already the case. For the rest of the market, pressure will mount, and some adjustment is inevitable. There will also be a greater separation in the market between traditional service contracts and newer contracts that include two-way penalties to ensure adherence.

The next trigger point is likely to be the lead up to Chinese Golden Week in early October. If volumes and spot rates don’t get a temporary bump during this period, the downturn will likely accelerate in the fourth quarter. And presently, that appears to be the most probable outcome.

The new, smaller carriers operating charter tonnage at a high cost will lead the charge on lowering spot rates in an effort to keep those vessels full — particularly in the trans-Pacific trade — and this will result in a freight rate war that will play out in mid-2023 as the market gets back to normal.

The improvement of supply chain bottlenecks will release large amounts of empty containers into import markets, especially North America. We are already seeing parts of this, but the impact is poised to become two to four times larger than what is currently seen, amplifying the problems related to returning empties to depots and terminals. In addition, the market will enter a phase of severe overcapacity globally in terms of the containers themselves.

The industry will also likely see further political action aimed at “penalizing” carriers on the back of two years of extremely high profits and severe operational disruptions. The tonnage tax and vessel-sharing alliance regimes will come under even more pressure, and the political outcome of this pressure will have a profound effect on the industry in the coming decade.

But even when the market eventually normalizes, it will not necessarily return to pre-pandemic normality. Contract frameworks are gradually shifting toward mutual commitments, head-haul freight rates are likely to remain above their pre-pandemic averages, and shippers for the next two to three years will continue to focus less on just-in-time logistics and more on building buffer stock. Should the supply chain prove stable in those two to three years, those buffers will be removed, gradually setting the scene for a similar operational crisis sometime in the 2030s.

Contact Lars Jensen at lars.jensen@vespucci-maritime.com.

Maritime News › Container Lines