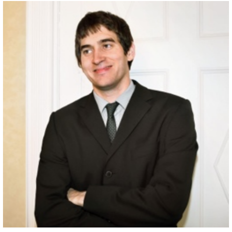
Key logistics market update and prospects for the future

In this article, Ti's analysts provide a snapshot of how 7 key logistics markets have performed in 2017 and some of the key trends which will affect their development.

The sectors covered are:

- International Freight Forwarding
- Contract Logistics
- European Road Freight
- US Trucking
- Express parcels
- Air Cargo
- Container Shipping

More details on all these markets are included in Ti's latest report 'Total Logistics 2018' as well, of course in the Global Supply Chain Intelligence portal.



1. International Freight Forwarding, by David Buckby, Economist, Ti

The international freight forwarding sector is facing a challenging time not least because the global economic environment has remained volatile and difficult to anticipate.

After a sustained period of weakness, the industry enjoyed a buoyant year in 2017, with the air cargo sector in particular performing well. However increasing freight rates due to tightening capacity in both air and sea freight markets will inevitably impact on freight forwarders' profitability.

Some freight forwarders have gone so far as to accuse carriers of cancelling services to control prices. This has resulted in some delays as the markets move from buyers' to sellers' and, especially in air freight, higher rates/lower capacity could become the 'new normal'.

The forwarding sector has always dealt with uncertainty and volatility well – that is the nature of the job. However, it also faces longer term structural challenges which will prove more difficult to deal with.

Political upheaval throughout the world has cast doubt on the sustainability of globalization. Remote manufacturing which has characterized trade over the past few decades (and international freight forwarding) is under threat from protectionist forces.

This is likely to have an important impact on cross-border trade. The growing prominence of regional trade blocs, such as a TTIP alliance shorn of the USA, will tend to favour road based transport and, particularly in Asia, low value, low margin shipping. That combined with near-sourcing, driven by increasing labour costs in Asia, will mean that products manufactured in a region will increasingly stay within that region.

In addition, there is the looming threat of disruption from a range of players including the giant e-Commerce retailers, such as Amazon and Alibaba, as well as a host of tech start ups.

In 2018 customers will increasingly demand real-time information, quotes and visibility and those that cannot or do not invest in the necessary technology will rapidly lose their place in the market. New forwarders (such as Flexport), unburdened with legacy systems, are rapidly gaining ground, building their entire customer offering around the latest technologies.

Political, economic and technological pressure will continue to shape the industry in the coming year. One thing is certain, whether large or small, freight forwarders will need to remain agile if they are to flourish in an uncertain and complex world.

2. Contract Logistics by Professor John Manners-Bell, CEO, Ti

Globalisation of supply chains, the growth of e-commerce and technological innovations have changed the structure of the contract logistics market, with logistics providers trying to retain their competitive edge by expanding their service portfolios either organically or via acquisition.

An analysis of the contract logistics capabilities and strategies of the most prominent logistics providers indicates that they continue to grow in size whilst shrinking in number, maintaining the trend of consolidation from previous years.

While 2017 has seen contract logistics providers pursuing different growth avenues, expanding in high-margin markets was a common growth strategy, with the healthcare and pharmaceutical sector being identified as a particularly lucrative market.

Logistics providers are increasingly forming deeper collaborative partnerships with shippers and taking on greater control of their supply chains.

Faster economic growth and higher standards of living in emerging markets will push contract logistics providers to expand in these markets.

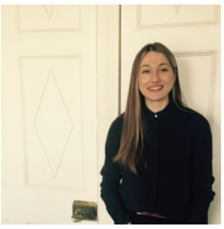
The role of Amazon and Alibaba in the logistics sector is still yet to be fully understood. Amazon is a partner, customer and – crucially – a competitor to many contract logistics providers. The impact which Amazon is having on the retail sector is unquestionable, with traditional 'bricks and mortar' retailers either going out of business or having to change their supply chain models. This has led to rumours of further vertical integration in the sector – for instance, Home Depot buying XPO Logistics in order to gain some sort of competitive advantage over Amazon.

Following a wave of acquisitions in the industry, key players are focusing on post-acquisition integration. Recognising that leveraging a common structure across the globe can be difficult, key players have put acquisitions on hold, instead focusing on integrating their acquisitions and driving organic growth.

Such decisions emphasise that while contract logistics companies typically integrate well due to their asset-light nature, they still need to work on integrating the IT systems of the acquired company.

Blockchain holds great potential, and is still developing, but it is unlikely to be a silver bullet for supply chain visibility.

2018 will be characterised by greater complexity and more extensive collaboration between logistics providers and their customers.



3. European Road Freight by Violeta Keckarovska, Analyst, Ti

The European road freight market remains a fragmented and competitive space where providers face a tough battle to increase volumes and market share.

The operating environment is by no means easy for the market leaders, with operating margins stubbornly low for the likes of DB Schenker, DHL Freight and Kuehne + Nagel, as DSV continues to lead the pack in terms of profitability.

In domestic markets, which make up over 70% of the total, private consumption and domestic demand are key factors driving road freight growth.

Input cost pressures were negative overall and these pushed down the top line figures of major providers. DB Schenker, one of the biggest operators, stated that, "continuing fierce competition and much lower diesel prices… meant that the increased volume was only partially reflected by revenue growth." The price weakness to which it refers to was seen in both domestic and international markets.

Tightening capacity due to demand growth mean that driver shortages will be an issue in 2018. EU proposals affecting minimum wage and cabotage rules threaten upheaval, while technological innovations pose a number of questions.

Disagreements over the EC's Mobility Package of road freight reforms appear to reflect a West-East clash, with the proposals attempting to reach compromises. For example, the proposed rules on posted workers protect Western European companies more than the status quo, whereas the proposed changes to cabotage rules imply the opposite.

Road freight providers can't rely on overall market volume growth to keep their businesses strong. Increases remain in the low single digits and are set to do so for the foreseeable future. The strategies of the market leaders will focus on service diversification, enhancing sector-specific offerings, developing their networks and investing in new technology. Above all, what remains clear is that there are no easy routes to success in European road freight.

4. US Trucking

The US trucking sector had a very strong year in 2017 and is set to see further strong growth in 2018. However, this has meant that the sector is facing an acute shortage of supply according to industry associations and the US government.

A report by Department of Agriculture has concluded that the market is very tight. Of the 26 regions in the survey 13 were reporting a 'shortage' on the spot market with only six reporting an 'adequate' availability. None reported an over-supply.

Weather conditions are partly responsible. The US has suffered from a series of weather-related disruptions for most of the past six months and these have undeniably disrupted both road and rail services.

The underlying picture in terms of demand suggests that this tightness may well continue. The US economy is growing rapidly fuelled in part by retail demand, leading to a record level of imports and a highest-ever trade deficit. This is reflected in volumes handled at container ports, with the National Retail Federation/Hackett Associates Global Tracker Index estimating a 6.4% rise in container import volumes for 2017.

With the economic numbers suggesting that consumer spending may well continue over the short-term, underlying demand conditions are unlikely to ease.

The consequences for most areas of the US logistics economy are clear. Many sectors are facing medium-term constraints on supply-side growth, such as the shortage of drivers. Fixed assets such as rail services and ports are achieving sustained higher levels of utilisation, giving them a strong-hand in terms of pricing.

Concern has been expressed that continued loose monetary policy in the US, combined with tax cuts in the face of what is clearly a strong economy, may lead to higher inflation. If so, the logistics economy may be an early indicator.

Extra layers of regulation are adding to truckers' woes. From December 2017 companies will be obliged to use electronic monitoring devices to measure the working hours of truck drivers. All vehicles over 4.5 tons must install 'electronic logging devices', that monitor the length of time the truck has been driven as well as other information such as speed.

What has not attracted so much attention is the impact such new technology will have on the relative competitiveness of different business models. It may be that greater levels of control may negatively affect smaller truck companies and owner-drivers that account for so much of road freight capacity.

5. Express Parcels by Joel Ray, Head of Consultancy, Ti

Growth in the global express markets in 2017 has been driven by strong domestic e-commerce sales. In the major markets of Asia Pacific and North America, the domestic market is growing by more than twice as fast as the international segment but in Europe difference is far smaller. Due to the interconnectedness of the European market, the barriers to international trade are substantially less.

Domestic markets have proved capable of seizing on the opportunities that e-commerce brings. A number of issues remain for international market: there is a higher cost and delivery time connected with international parcels. Trust of international retailers is also a problem for many.

There is still enormous potential for cross-border e-commerce. It is expected to grow at nearly twice the rate of domestic e-commerce from 2015-2020.

The B2B market is slower growing then the B2C segment. Numerous reports into B2B parcel volume growth in developed markets have suggested that there is approximately a one-to-one relationship between B2B parcel volume growth and real GDP growth. However, the boom in B2C e-commerce related parcel deliveries far exceeds this figure.

The market in 2018 will continue to be driven by:

- The continued growth of e-commerce volumes and cross-border business in particular.
- A generally stronger global economy and international trade.
- Buoyant air cargo market and tight capacity amongst bellyhold carriers, leading to more shippers sending goods through the integrators' systems.
- Investment by the market leaders in new infrastructure leading to greater efficiencies and opportunities.

The market will face challenges of:

- Increased protectionism and the potential re-negotiation of NAFTA.
- Threat of a slowing global economy
- Longer term fears of e-commerce maturity (although not yet)
- Labour shortage issues for drivers and warehouse staff.

6. Air Cargo

The air cargo industry in 2017 enjoyed a record year. IATA estimated a 9.3% growth in world cargo volumes during the year and air freight rates continued to be very strong throughout the peak season. The strength of the market seems set to continue into 2018.

Economic activity is by far the biggest influence on the growth of the air cargo sector. According to the IMF economic activity is strengthening, with global growth forecast to rise to 3.6% in 2017 and 3.7% in 2018. Growth was better than expected in the Eurozone, China, Japan as well as in emerging markets such as Brazil. Demand in the US continued to drive international trade, despite fears that it might weaken.

The World Trade Organisation raised its projections for the year, estimating that global trade volume would rise by 3.6% compared with 1.6% in 2016 due to:

- Resurgence of Asian trade flows as intra-regional shipments recovered
- Chinese demand (industry grew 6.4%)
- Import demand in North America recovering after stalling in 2016.

However, the WTO warned that the pace of trade growth in 2017 is unlikely to be sustained at this rate in 2018.

- Trade growth in 2018 will have more difficult comparisons with 2017
- Monetary policy is expected to tighten in developed countries with interest rate rises and the reining back of quantitative easing.
- Access to credit in China will be reduced to prevent the economy from overheating.

Despite this, underlying demand should still remain strong throughout the year. Air cargo carriers have more power in the market and by controlling capacity should ensure that rates remain much higher than they have been over the past decade. Although some air cargo buyers may see higher rates as a bad thing, many carriers believe that this is just an overdue correction of the market.

The strength of the economy and consumer spend caught many retailers by surprise in 2017. This had an impact on inventory levels which ran down faster than many supply chain managers thought. As a result, in order to avoid loss of business through stock outs, faster forms of transport were employed to re-position inventory, leading to an increase in air cargo. Even goods such as toys have been flown in order to meet demand whilst keeping inventory levels lean.

A surge in demand for perishable products around the world has had a beneficial impact on the air cargo sector. An example of this is export of cherries from the US to Japan, China which benefited many of the US airlines. Volumes were up on these lanes by 50%.

7. Container shipping by Thomas Cullen, Analyst, Ti

The container shipping industry has been through a highly traumatic few years with huge losses incurred by many of the market leaders. The underlying problems for the industry have come about fundamentally due to overcapacity in the market and weak global economic growth. At the time of its results in 2017, Maersk commented that market capacity had been expanding by 7-8% at a time when demand was significantly less than that.

This imbalance in supply and demand had serious consequences for the sector resulting in the bankruptcy of a top ten carrier, Hanjin Shipping. Smaller market players have been acquired by competitors and others forced to go to governments for emergency loans (for instance, Taiwanese carriers Evergreen and Yang Ming).

Rates and volumes now seem to have revived and Maersk, Hapag-Lloyd and CMA CGM have all suggested that full year 2017 results will be much better than those in 2016. In 2017 estimates suggest that shipping demand grew by 5% compared with capacity growth of just 3.9%.

Despite this, parts of the market still struggle and it is likely that there will be further consolidation in the market in the years to come. There are also fears that over-supply may depress rates once more in 2018. Fitch Ratings believes that capacity will increase by 5.5% compared with demand growth of just 4.5% in the year.

One major concern is that there will be a new-build 'arms race' as the major carriers vie for market share – CMA CGM has already placed an order for 9 mega-ships in September 2017. Shipbuilders are reportedly offering very attractive deals and cheap finance is widely available.

It is likely in the future that the Chinese carrier COSCO will increasingly challenge European competitors for market leadership, supported by the Chinese government. Following its acquisition of OOIL it is now the third largest carrier behind Maersk and MSC.

Despite the hopes for continuing global economic growth, there are demand-side worries too. Some economists believe that China will re-orientate itself around domestic investment rather than exports and its government will suppress the flow of easy credit. At the same time as this, many people believe that the Trump administration will toughen its stance on major exporters such as China, Mexico and even Germany, leading to potential trade wars which could have a serious impact on the shipping industry.

About Ti Insight

For further information about this article please contact John Manners-Bell at jmannersbell@ti-insight.com or visit the Ti website at www.ti-insight.com.

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- Micro-economic analysis of key logistics segments: express, freight forwarding, road freight, contract logistics, warehousing, air cargo, shipping and e-commerce logistics.
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