What happens now

by Mike Garratt, *Managing Director,*
and Antonella Teodoro, *Senior Transport Consultant, MDS Transmodal*

Someone falling into a deep coma four years ago in December 2019 and re-awakening today might be forgiven for believing that little had changed in the world of deep-sea containers. Container Trade Statistics reported a 4.7% growth in global loaded TEU. The Shanghai Containerized Freight Index was marginally higher. Maersk's Q3 EBITDA was still around 14% of turnover. Mean ship size was up by 11%. How misleading those initial observations would have been!

Over those intervening four years, which incorporated a global pandemic, an initial fall off in traffic had been followed by demand exceeding supply to such an extent that the mean freight revenues had nearly trebled by Q3 2022. Consequently, the lines made enormous profits that were (in part) used to extend vertical integration into port terminals and increasingly into door-to-door logistics.

However, having won their case four years before, the lines had just lost the argument to retain the anti-trust legislation provided by the Consortium Block Exemption Regulation (CEBR). The UK Competition and Markets Authority has similarly decided that the country will not establish its own CEBR. And there's the signed & sealed inclusion of much of the shipping industry in the European Union Emissions Trading System (EU ETS), effectively raising energy costs to the lines by 40% for ships sailing between EU ports (but not if sailing between other ports – an invitation to develop ingenious routing if ever there was!).

The age-old supply-demand (different tune) dance

In so far as demand is concerned, the trade statistics which feed our **World Cargo Database** suggest that while the European market has been depressed in 2023, the global pattern of 3% per annum growth is re-establishing itself; exports from the Far East are now growing, including to Europe. We estimate that at its peak, the very high freight rates that drove as much as 7% of cargo normally containerised to alternative maritime, air, or overland modes – but this level of diversion has now been halved.

Figure 1 indexes the changes in scheduled deployed capacity, fleet capacity, demand, and mean revenue per TEU over the last few years (with Q1 2019 as the baseline). A supply shortage in late 2020 accelerated rates that peaked over a year later when fleet capacity was already creating a capacity surplus. Demand fell back, and only now is returning to the levels of three years ago.

The impact of the coronavirus pandemic and the management of fleet capacity led to the curious feature of utilisation levels (demand/supply) falling as the number of ports the lines called at relative to 'scheduled expectations' also fell, a significant slump in service quality that is only recovering in the second half of 2023. Our forecasts for all deep-sea containerised trades over the next five years reflect the gradual pick-up in demand being experienced as 2023 comes to an end (most marked on the Pacific).

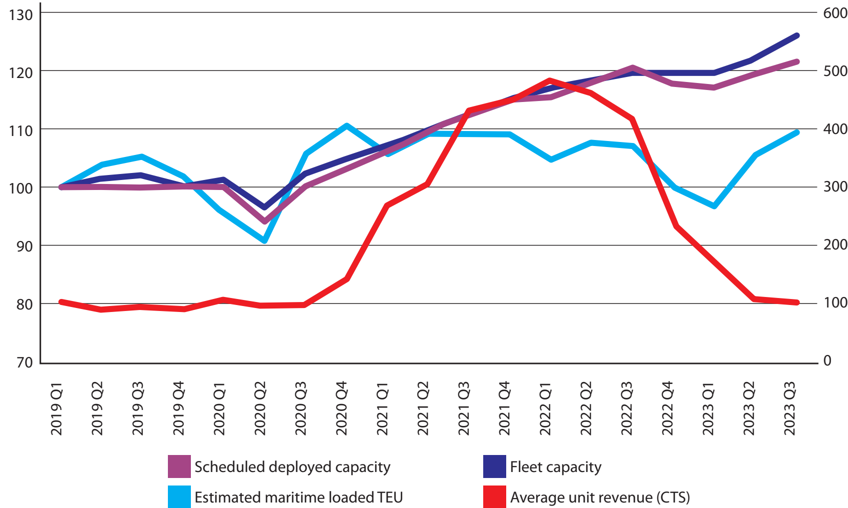
However, this level of growth appears unlikely to match the additional capacity that has recently and is currently being built. The lines offered less deployed capacity during COVID-19, which drove rates up. Ironically, as ship queues and capacity challenges in the ports have been resolved, the lines have more ships on order than demand may justify over the next three years.

Table 1 describes our current estimates for fleet supply (including newbuilds and scrappage) and the capacity required to address a yearly 3% growth in demand (assuming ships continue to operate at current speeds in existing strings). If the way vessels are deployed remains the same, then we estimate excess fleet capacity to be around 4.5% in 2026 (1.4m/30.8m TEU of fleet capacity) compared with today.

In practice, the lines will be able to absorb some surplus fleet capacity through further speed reductions to re-optimise given the impact of the EU ETS, increasing the proportion of the fleet deployed on 'multi-regional' services (e.g., Europe-Gulf-Far East), more lines operating services independently, and through adding ports to rotations to reduce feeder costs (and potentially game-play the EU ETS to minimise nautical miles between ports in the European Economic Area). Scrappage may also accelerate.

An important question is the overall impact that the end of CEBR will have. MDS Transmodal's role in this debate was to provide the European Commission

Fig. 1. Scheduled deployed capacity, fleet capacity, estimated maritime loaded TEU & unit revenue for deep-sea routes



Source for all figs. and Tab. 1: MDS Transmodal

Fig. 2. Utilisation vs port calls – global

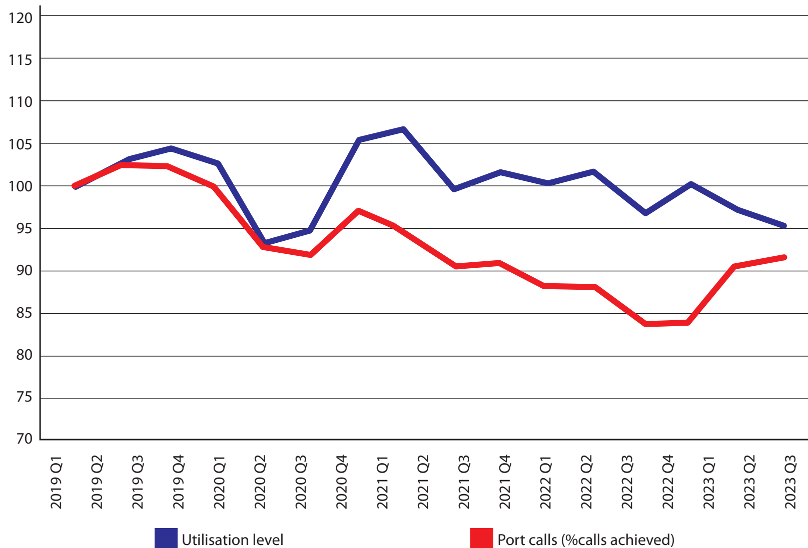
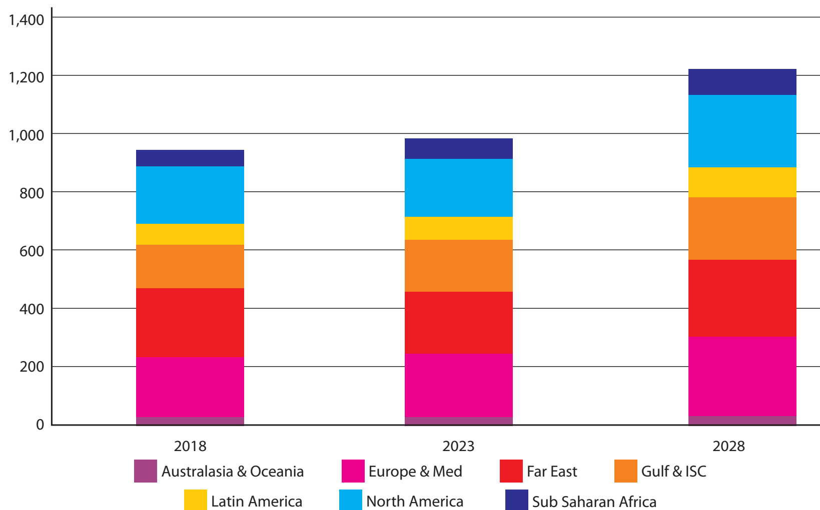


Fig. 3. Deep-sea containerised trade in 2018, 2023, and 2028 (million unit-tonnes)



(COM) with statistical analyses on fleet deployment and market shares.

Crackdown?

The lines lost the argument to retain CEBR because COM decided that providing the liner business with anti-trust privileges that exceeded those available to other sectors **did not pass the five tests (of effectiveness, efficiency, relevance, coherence, and EU-added value) it set** and, crucially, did not protect shippers (i.e., consumers) when a crisis occurred.

While a number of European trade associations collaborated to also argue against CBER because of the high levels of vertical integration taking place, the most dramatic statement against the lines probably came from another jurisdiction. President Biden's March 2022 State of the Union speech included this passage: "See what's happening with ocean carriers moving goods in and out of America. During the pandemic, about half a dozen or less foreign-owned companies raised prices by as much as 1,000 % and made record profits. Tonight, I'm announcing a crackdown on those companies overcharging American businesses and consumers." So, will this legal change make a difference?

The degree to which the World Shipping Council campaigned to retain CEBR suggests that it will make a difference. Then again, it may be that the major lines were already adapting to a decision they had anticipated. The 2M Alliance will complete its break-up in 2025. The very largest carriers are likely to operate their global networks on a stand-alone basis or with support from the smaller players; there may even be a further consolidation because the nine leading lines cannot each sustain global networks alone. While for smaller markets, lines may be able to make a case that market shares above 20% are in the wider interest, this will not be the instance for the larger markets.

The impact may extend beyond the lines themselves. Page 32 of the COM staff working paper discussed the relationship between CEBR and the container terminals that the leading lines also control, implying that CEBR also protected the relationship between lines and these terminals, and its end could raise questions about the rights of equal-term access. Such uncertainties may be compounded where different regulators (on a trade route) have differing rules; some (e.g., Singapore) allow up to a 50% market share for a given consortium.

To raise awareness and to question

Rather than make a firm prediction, we put forward three potential outcomes.

Photo: Canva

Tab. 1. Fleet capacity, newbuilds, and assumed scrappage in TEU (fully cellular) in 2018, 2023-2026

Year	Scrappage (=> 25 years)	Newbuilds	Capacity - scrappage + newbuilds	3% growth in demand	Capacity difference
2018			21,900,616		
2023[1]			26,938,222		
2024	1,077,367	3,012,345	28,873,200	27,746,369	1,126,831
2025	341,417	1,597,740	30,129,523	28,578,760	1,550,763
2026	469,690	1,150,446	30,810,279	29,436,123	1,374,156

[1] *Existing fleet as of Q4 2023 and outstanding newbuilds due for delivery in 2023*

Firstly, one that does not favour the lines and to which an excess supply weakens their position. The uncertainty that may apply to the relationship between terminals and lines post-ending of CEBR may play to the advantage of the non-liner major stevedores, who did not have the leverage to make super profits during COVID. These stevedores seek to develop a closer relationship with shippers, which will improve their ability to provide value-added services and onward transport services (directly or by sub-contract). This is already happening; stevedores own companies feedering containers (DP World – Unifeeder, Peel Ports – BG Freight Line, Abu Dhabi ports – Safeen Feeders, etc.), and ports contract for space with railroad operators. At the same time, port-centric distribution hubs secure cargo to an individual port. The lines themselves come under increasing pressure to offer the most cost-efficient services, leading to further consolidation of liner services. Non-vessel operating common carriers expand their port-centric distribution centres and, likewise, their capacity purchasing from the lines.

Quite clearly, this may not be attractive to some of the shipping lines. The ability to make profits by charging an economic rent to pass through a port will pass to the ports themselves. The step taken at Jebel Ali is worth noting, where DP World announced that cargo owners, not the lines, will pay terminal handling charges.

The second scenario favours the lines. If market shares do not exceed 20%, an individual shipping line will continue to vertically integrate (including with terminals, inland transport services, and door-to-door logistics). In an environment where scale economies are crucial, any share less than 20% could, therefore, be uncompetitive, and a very small number of look-alike global vertically integrated operators emerge. Ports whose terminals are not included in such networks may find it challenging to remain in the market. Individual lines (and two of the existing ones already reach this scale) are supported by a range of sub-contractors (feeders, third-party logistics, etc.) who are effectively rate takers; the advantage will lie with the lines. The relatively broad definitions of markets may be such that within these, sub-markets remain oligopolistic.

Outcomes may not be so extreme, and much may depend upon the legal interpretation of the new regulatory environment. The World Shipping Council may have a point that change will generate legal uncertainty (but that's in the nature of change).

Thirdly, a possible course of events in which nation-states and regulators take a more proactive approach. Given the problems shippers faced during the pandemic, the decision to terminate CEBR despite the position that the lines have taken, and the vast challenges faced to decarbonise the industry, global bodies may choose to examine whether the current industry structure serves the public interest to promote trade. Such an examination may consider that regular and reliable liner shipping services should be seen as a global trading utility, providing a minimum level of connectivity, frequency and reliability (including to emerging economies). In these circumstances, it could be that lines will find themselves being obliged to offer minimum levels of service to individual nation-states to be authorised to operate at ports in their countries.

We do not suggest which, if any, of these 'travel directions' might be followed. However, one of the effects of the industry's reaction to the pandemic has been to raise awareness of the vulnerability of world trade to investment and operational decision-making by a relatively small number of companies and to question the level of resilience the industry offers.

MDS Transmodal is a transport economics consultancy. Founded in 1983, we have a simple mission: to provide impartial and independent advice on a range of transport issues. We strive to de-mystify the transport sector with objective analysis brought to real-world issues. Our work is informed by the development and maintenance of detailed data sets, coupled with econometric modelling and statistical analysis. Visit **mdst.co.uk** to learn more.