SHAPIRO FREIGHT

# REPORT

## *Trans-Pacific Ocean U.S. Imports*

JUNE 2019

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## *TRANS-PACIFIC OCEAN U.S. IMPORTS*

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### OCEAN CARRIER UTILIZATION STATS

For late May to early June sailings, ocean carriers reported stabilized utilization ratios across the board. In regard to fill factors, the USWC is sitting between 95-100%, while the USEC and Pacific Northwest are both estimated to be around 95%. The relative equilibrium of utilization ratios implies that carriers are continuing to effectively utilize blank sailings, cancellations and new service strings to combat the current lull in demand. And while early-June blank sailings have helped prevent further rate erosion, at current demand-levels there remains a net 5-10% overcapacity as we approach the beginning of the traditional peak season.

## JUNE 2019: THE BIGGER PICTURE AND CURRENT RATE ENVIRONMENT

### SOURCING SORCERY

As the Head Conjurer waved his magic wand on May 10th and imposed an additional 15% in duties on $200B worth of List 3 Chinese goods (representing roughly 4M TEUs in cargo annually), the rest of us Harry Potters must reach into our bag of magic and divine the perfect spell to construct and maintain efficient, reliable, and flexible supply chain solutions. For many would-be sorcerers, the first problem is where to apply our witchery beyond China. Here's a quick list of the less magical aspects of alternate sourcing today:

- Infrastructure Woes in Developing Economies like Vietnam
  - ✓ Longer Lead Times
  - ✓ Higher Transportation Costs
  - ✓ Planning Uncertainty
- Production Limitations beyond China
  - ✓ High Investment Costs for Proper Tooling
  - ✓ Untrained and Limited Labor Force
  - ✓ Quality Control Concerns
- Unprecedented National Security Justification for Trade Restrictions with China and Mexico
  - ✓ Reluctance to Make Capital Investments with So Much Uncertainty
  - ✓ World Trade Organization Retaliations?
  - ✓ Ramifications for NAFTA/USMCA?

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- Threat of Tariffs with Mexico, Once the Most Promising Sourcing Alternative
    - ✓ Is Mexico Capable of Holding Up Their End of the Current Agreement?
    - ✓ Will the Head Conjurer Find New Reasons for Tariffs with Mexico?

With dark clouds circling, the specter of the remaining 6M plus TEUs of Chinese goods being afflicted with a "tariff blight" of 10-25% is far from a fictional fancy. In fact, despite the obstacles to alternative sourcing listed above, U.S. trade for List 3 commodities has already shifted markedly from China to Vietnam, Taiwan, and Mexico (marking a $30B dip from China to U.S. in 2019 YTD). While this might look like a victory for the warlocks in Washington, there is likely some true supply chain sorcery in play as well.

The trade in List 3 commodities between China and America's new best friends in trade (Vietnam, Taiwan, and Mexico) has also sky-rocketed. The same is true for the raw material inputs that go into the manufacture of List 3 products. Is this a conjured coincidence? Are we witnessing a purchasing presto?

Sadly, the speed with which alternate sourcing has materialized for List 3 strongly hints at non-conformity necromancy of the highest order. Voila, welcome to the world of "roundabout exports" and specious country of origin claims. Abracadabra, welcome to the worlds of rules of origin, substantial transformation, and essential character.

At the end of the day, we Potters need to know where to point our wands, and that is not at all clear in June, 2019. Washington is motivated to make the Chinese tariffs a powerful weapon with China, and that could spell less than magical mischief for companies attempting to circumvent product classification laws and for countries fostering "roundabout" trade that masks true product origin.

## DON'T EXCLUDE PLANNING FOR JUNE 30TH EXCLUSION REQUESTS

Ten days after the Tokyo G-20 summit, the Office of the U.S. Trade Representative (USTR) expects to open the window for List 3 tariff exclusion claims. While most people are skeptical that breakthroughs are possible in Tokyo, it is a slightly promising sign that the USTR is providing a clear pathway to file exclusion requests.

Importers should begin compiling their data and substantiation now. In basic terms, the following information is required:

~Product Description/Details
~Other Sources for Product
~Value/Quantity Imported 2017-2019
~Degree of Financial Harm from Tariffs
~History of Previous Claims

## June 2019, Rate Environment

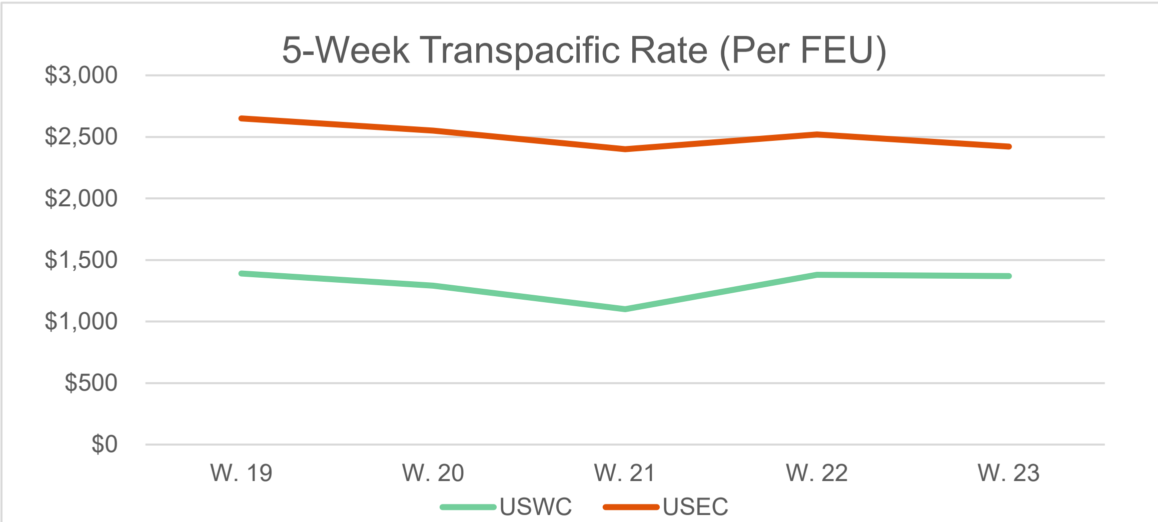
## What Did We Learn from Contract Season 2019?

The ocean carriers walked away with an average victory of 20% vs. one year ago today for long-term contracts. While the industry continues to bite its fingernails over the future and costs of low sulfur fuel, let's look at why the carriers got their pay hike:

1. The carriers have earned shipper respect with capacity discipline through service cancellations, blank sailings, and more efficient service strings.
2. Consolidation in the industry and alliances have made the ocean carriers more determined and effective commercially.
3. Recent planning/budget nightmares for shippers during the Hanjin bankruptcy and tariff front-loading have pushed negotiations to a focus on allocations (not just price).
4. Port inefficiencies in the era of mega vessels allow carriers to skip ports in rotation (without direct blame) which creates pent-up demand for capacity.
5. As retailers continue to do battle with each other and e-commerce alternatives, a "just-in-time" mentality makes shippers much more dependent on carrier service and transit reliability (which comes at a cost).

## June 2019, Rate Trends

Please have a look at the rate picture for the recent past here:




We have also estimated future rates here: