A Riveting Story

MUCH CONVENTIONAL WISDOM about the cause of the 1912 sinking of the Titanic has been challenged since the 1985 discovery of the vessel’s wreckage. In 1996, an expedition found not a large gash from an iceberg but six narrow slits, which experts suspect caused bow plates to part from failed rivets. Many now believe the ambition by Harland and Wolff to simultaneously construct the world’s three largest vessels (Titanic, Olympic and Britannic) overwhelmed caution and that the firm used low-quality rivets while discontinuing quality control inspections.

Today, the simultaneous construction of many of the world’s largest container ships has some invoking the Titanic’s memory. The liner shipping market is experiencing serious disequilibrium. Consumer confidence has evaporated, and with it the demand for the shipping of retail goods. Yet vessel supply has increased significantly because of the arrival of record amounts of new capacity. Projections on the return of supply and demand balance range from later this year to 2012.

Ship operators are doing whatever they can to reduce capacity. They are combining strings, slowing rotations and even taking vessels out of service. Estimates of the “parked” vessel capacity worldwide ranges from 10 to 15 percent, and that is expected to increase as new ships enter service.

The painful effect of overcapacity doesn’t fall solely on the ocean carriers, because they can return chartered vessels. German shipowners are implementing a pain-sharing mechanism, while one of their leaders, Claus-Peter Offen, says shipyards must delay container vessel deliveries or risk the future of their own companies. According to Offen, 750 ships in excess of 3,000 TEUs are on order, and 150 have no employment commitments, some 90 percent of them German-owned.

Many believe this represents traditional industry cycles: Strong peaks inevitably follow terrible troughs. But, maybe not. Trade generally has grown at three to four times gross domestic product, but some economists question the future of this trend. There are growing questions about how much more production can be moved offshore, and the threat of protectionism hangs over the global economy.

Many view today’s downturn as similar, or at least proportional, to the 2000-2001 recession. But the liner shipping market has changed significantly in less than a decade since then. Many of the capacity leaders have changed, either through mergers and acquisitions or through significant organic growth, so the past cannot be considered prologue.

Some of today’s largest carriers have never gone through the simultaneous challenge of managing a perilous business cycle while trying to expand market share with expensive new capacity. Although all lines have vessels of comparable size, the ships do not carry comparable costs. Many of these vessels were ordered at the peak of the market, with a price tag perhaps two or three times higher than competitors may have paid for identical capacity. The vessels eventually will be deployed, but opportunistic investors may acquire them at distressed prices.

In an asset-based world, this will only put more pressure on the rest of the market as owners of “cheap” vessels use their cost advantage to drive down rates and to take share from owners of “traditionally priced” assets.

Senator Lines is gone, and several other carriers are under “death watch.” What will shipping lines do to survive? The Transpacific Stabilization Agreement’s (now withdrawn) request to discuss “capacity” upset shipper groups around the world. TSA officials rightfully point out they had merely requested a dialogue, but the resulting stir made clear that stress is more prevalent than trust in the market.

As The Journal of Commerce’s Trans-Pacific Maritime Conference begins, many lines are nervous. The annual prediction of overcapacity — there is always at least one speaker to make that forecast — and declining rates causes market disruption. This can range from unreasonable customer expectations to panicked pricing by lines, a self-fulfilling prophecy that drags down the overall market.

The market feeding frenzy has begun. Unproven rumors claim Asia-Europe rates are down to nothing, with only fuel and terminal costs charged. There is a long-standing joke about rates being so low that ocean carriers pay the customers to ship with them.

I wonder if this is the year when that tale goes from the apocalyptic to the apocryphal. Joc

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