

21 February 2022

Big Picture

Global Supply Chain issues to slowly ease up in summer

- We expect that the worst supply chain issues will start to ease during the summer but the problems will stay elevated well into the second half of the year
- A full normalisation will take many months, but will most likely be faster than normally due to the extraordinary nature of the current problems
- For a normalisation to take place we need to see both lower goods demand and a pick-up in productivity and return of labour in ports
- A rapid opening up from restrictions will boost service consumption and shift away consumption from goods
- The dramatic drop in real wages following historically high inflation will put a lid on consumption in the coming quarters.
- The broader supply bottleneck problems have hit US inflation significantly more than euro area inflation, hence also the reversal of supply chain and supply demand mismatch issues will have a bigger disinflationary impact on US inflation

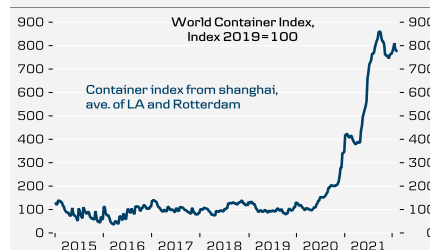
Supply chain woes still large

Although freight rates started to level off in late September last year and have since then dropped slightly, the average freight rates from Shanghai to Rotterdam and Los Angeles are still eight times the level before the COVID-19 crisis began (see figure on the right). Furthermore, waiting lines outside many, mainly North American, ports remain long. According to the freight forwarder Kuehne+Nagel's Seaexplorer disruption indicator, there is a persistently high level of disruption in the container business currently, more than ten times higher than normal levels expressed in waiting days¹. According to this indicator, roughly 80% of the congestion is in North America, but it affects the whole global supply chain since so many container vessels are tied up in these congestions. Also, both Maersk and Sea Intelligence have stated that around 11-12% of total container liner capacity is tied up in bottlenecks currently.

The Port of LA has just started to publish a daily operations report where they track the number of vessels at port as well as vessels that run at slow steaming waiting to come to port. The number of vessels was 72 at Feb 16. This is down from around 100 vessels a couple of months ago. This could be influenced by the Chinese new year but is none the less a promising sign.

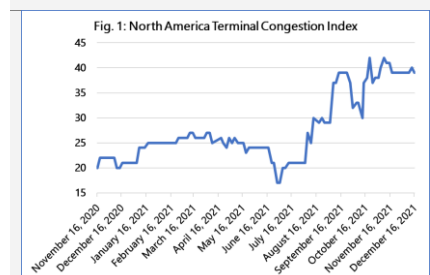
¹ kuehne-nage.com

Freights rates have levelled off but at a high level



Source: Macrobond Financial, Bloomberg

Congestion levels are still at very high levels



Source: Sea Intelligence

Slight reduction in delivery times



Source: Macrobond Financial

Global Head of Research

Heidi Schauman
+358 503 281 229
heidi.schauman@danskebank.com

Chief Analyst and Head of Global Macro Research

Jakob Ekholdt Christensen
+45 45 12 85 30
jakc@danskebank.dk

PMI indicators on delivery times also give cause for cautious optimism. Delivery times have shortened slightly recently but still remain very long in a historical context in both the US and euro area. An interesting decomposition of bottlenecks by the *ECB* suggests that the latest improvement in supplier delivery times has been driven more by receding demand rather than easing supply constraints.

Ports are still struggling with lack of staff, especially truck drivers, but also more generally capacity shortages. This situation will partly ease as the pandemic recedes and people can return to work but longer-term issues, such as lack of vessels, cannot be resolved short-term. A meaningful amount of new vessels can only be expected in traffic in 2023.

There are also downside risks to the cautiously optimistic outlook; Port shutdowns due to the pandemic in China cannot be excluded, and on the other side of the Pacific there is a heightened risk of strikes in ports on the American west coast following stormy ongoing labour negotiations.

Goods demand could fall back rapidly

The outlook for the freight rates and delays in shipment of goods depend to a large degree on two things; 1) the demand for goods shipment and 2) supply obstacles caused by the pandemic. Out of these two conditions the fall back of goods demand is, by far, the more important one. Consumer behaviour, economic policy and inventory stocking will all be important for the development going forward.

Consumers will shift to services demand at the expense of goods. Easing of lockdowns and fading virus fears are beginning to bolster services demand in the US at the expense of goods demand. Goods consumption is gradually falling back towards its pre-covid trend line while services are catching up. The latest retail trade figures also point towards a gradual normalisation. We expect this trend to strengthen even further as the milder Omicron variant is turning the pandemic into an endemic, bolstering demand for travelling and entertainment.

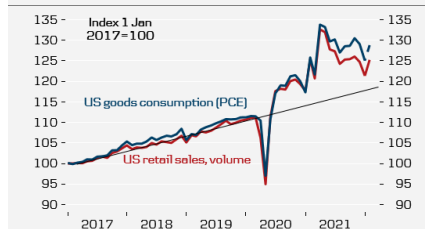
Real wages have plummeted both in the US and in the euro area during the past months following historically high inflation. This erodes purchasing power and should together with the uncertain economic outlook put a lid on consumption during the coming quarters.

Fading tailwind to consumption from stimulus. Goods demand was particularly supported by the huge fiscal easing undertaken in the US, and to some extent also elsewhere, last year. This was further supported by very easy monetary policies spurring sharp rises in both house prices and financial assets creating positive wealth effects on consumption.

With fiscal support programmes ceasing or even reversing (like the VAT cut in Germany) and prospects of tighter monetary policies leading to higher interest rates, goods demand, and demand more generally, is seeing headwinds. In the US, the expiry of the child tax credit in December will give a hit to especially low-income families, which tend to have the highest propensity to consume.

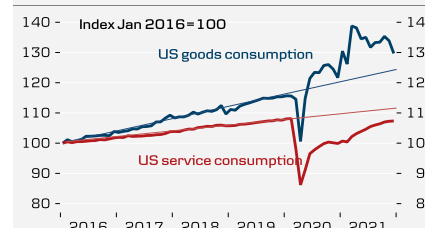
Inventory restocking is showing signs of peaking. The sudden, sharp and persistent rise in delivery times led companies to ramp up inventories to reduce vulnerability to lack of supplies. This probably exaggerated the pressure on supply chains over and above the level of demand. We think that companies will start to bring down inventories going forward as they grow confident that supply chain woes are coming to an end, which should reinforce the normalisation in freight markets.

Retail trade and goods consumption



Source: Macrobond Financial, Danske Bank

Goods demand in the US normalising



Source: Macrobond Financials

Backlog of orders still increasing but at a slower pace



Source: Institute for Supply Management, IHS Markit, Macrobond Financials and Danske Bank

Real wage plummeting amid high inflation



Source: Macrobond Financials

Our analysis points towards that supply chain problems will begin to ease through both the demand and the supply channels already towards the end of the second quarter of this year, but a full normalisation will take much longer. This analysis is in line with communication from companies such as Maersk, signalling they expect normalisation to occur “early in the second half of the year”.²

An additional thing worth factoring in is that too high demand also reduces supply due to the congestion effects. If demand falls enough for the lines of ships outside ports to go away, supply will also increase 10-12 percent (even if you don’t see any isolated increase in port capacity). Hence a decline in demand would also increase supply (more ships actually sailing). That is why we potentially could see a very sharp turnaround in freight rates once demand cools down.

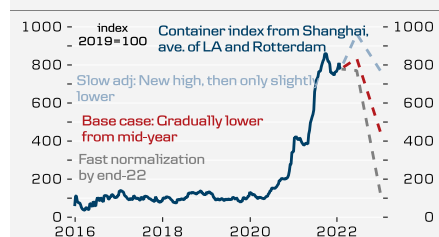
Easing up of bottlenecks will be disinflationary

Taking a slightly broader view on bottlenecks, also including factors related to the supply and demand mismatch that has arisen during the pandemic, it becomes apparent that these problems have a significant effect on core inflation.

Currently we are in a situation where both items relating to reopening and bottlenecks are highly inflationary. The bottlenecks are significantly more inflationary in the US than in the euro area (see graphs on the right). The ECB³ estimates that higher costs associated with supply bottlenecks added about 0.4 pp to the core CPI inflation in annual terms, while they added almost 2pp to the US core inflation.

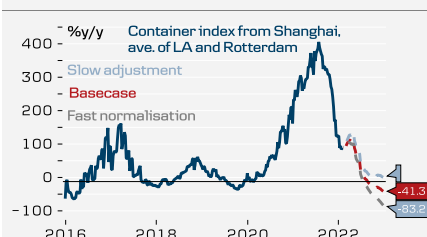
Going forward, what happens to shipping costs and, more generally, bottlenecks will be important for inflation dynamics. It is important to keep in mind that it is the annual change in prices, which is the key for inflation dynamics. Just a stabilisation of freight rates hence has a significant impact on inflation. Given that bottlenecks more generally are more inflationary in the US right now, the deflationary effects will also be larger when bottlenecks are resolved.

Our scenarios for freight rates...



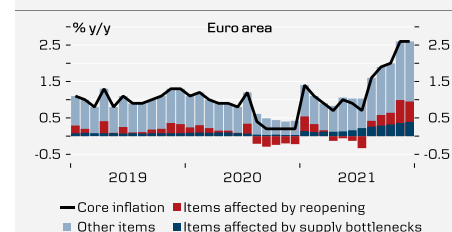
Source: Macrobond Financials and Danske Bank

... will have widely different contribution to inflation outcomes.



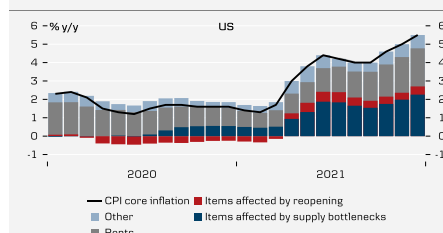
Source: Macrobond Financials and Danske Bank

Supply bottlenecks stoke inflation in euro-area...



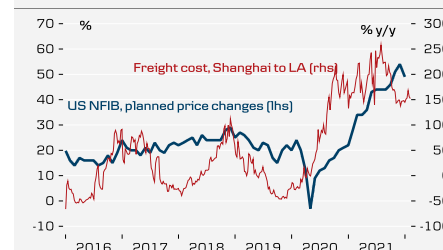
Source: ECB, Macrobond Financials and Danske Bank

...but even more so in the US



Source: ECB, Macrobond Financials and Danske Bank

A 6-9 months lag from higher freight costs to price hikes by US companies but correlation not so good



Source: National Federation of Independent Business,

² Maersk expects supply chain problems to ease this year | Financial Times (ft.com)

³ Bottlenecks and monetary policy (europa.eu)

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This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Heidi Schauman, Global Head of Research and Jakob Christensen, Head of Macro & Emerging Markets Research.

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None

Date of first publication

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