China e-commerce exports, unreliable Red Sea shipping boost air cargo

Capacity crunch looms in fourth quarter as market upcycle maintains momentum

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Monday, April 22, 2024

Airlines connecting China with Europe and North America are picking up a lot of cargo business from e-commerce players, which often bypass forwarders and book direct. (Photo: Jim Allen/FreightWaves)

Resurgent air cargo demand and rising rates, powered by the quasi-blockade of Red Sea shipping and continued growth in bookings by Chinese e-commerce platforms, during a normally slow shipping period is creating high expectations among air carriers for peak season and making logistics providers nervous about securing adequate capacity.

Air cargo demand has grown by double digits for four consecutive months, while rates have risen steadily since late February. The strength of the market rebound after a prolonged downturn that bottomed out last August has surprised industry watchers. But the recovery is not lifting all regions equally and can be partly attributed to a weak 2023 that makes the comparison look better.

Primary factors driving growth in air cargo are poor ocean shipping reliability and Chinese e-commerce players like fast fashion dynamo Shein, and online markets Temu and Alibaba sucking up outbound capacity from China. Ever-growing demand for airlift by those B2C companies has Taiwan-based logistics provider Dimerco Express warning in a market update that capacity commitments for airlines operating from China and Hong Kong to U.S. and European destinations are already sold out this year. That could make it more difficult for freight forwarders to secure consistent space for their shipments.

Airfreight volume increased 11% in March year over year, according to rate benchmarking platform Xeneta. Growth has been remarkably consistent, per Xeneta data, at 11% in January and February too. The International Air Transport Association recently said February demand increased 11.9%, backstopping Xeneta's findings.

The stronger-than-expected start to 2024 is underscored by a 6.2% increase in flight activity for cargo jets during the first quarter, the first positive growth in two years, according to research by BMO Capital Markets. Flight activity for the global air cargo sector increased 6.8% in March from 2023.

With airfreight from new sources exceeding the influx of capacity, the average global airfreight spot rate in March increased 7% from the previous month. A year ago, freight rates sank more than 40% as the pandemic wave lost steam. And the global average spot rate has increased for seven consecutive weeks, up 9% from a month ago and 6% from the same 2023 period. The year-over-year gap in rates has now been nearly erased, with the global shipping price (about $2.55/kg) 40% above pre-COVID levels. A month ago, rates were 15% lower than this time last year.

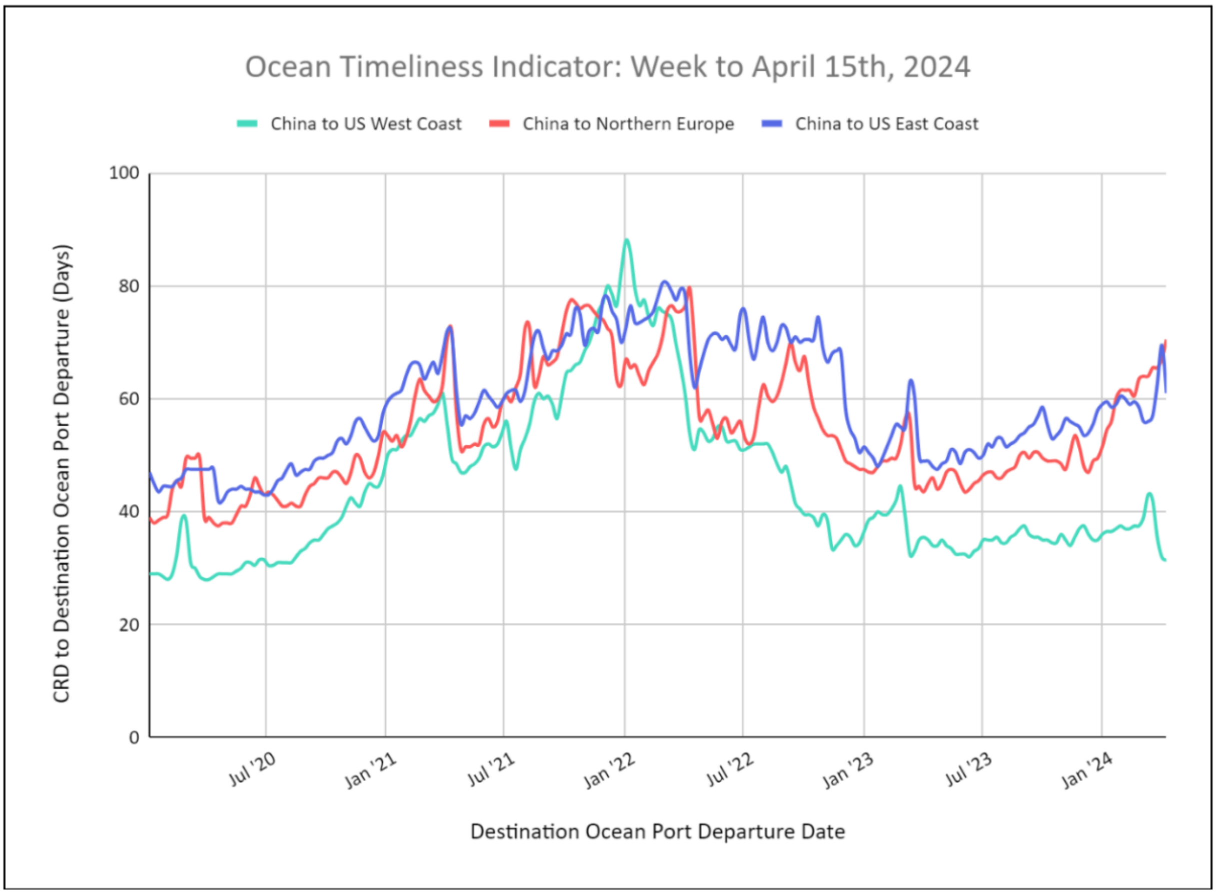
"The level of demand in the first quarter doesn't indicate a market which is running out of steam so far," said Niall van de Wouw, Xeneta's Chief Airfreight Officer, in his monthly report.

The biggest action is happening on trade lanes out of the Middle East and Southeast Asia to Europe, as well as China to Europe and the United States. The strength of those corridors is pumping up the average performance globally. The upturn nearly carried United Airlines back to growth during the first quarter, with revenue only down 1.8% year over year after contracting 31% in 2023.

Red Sea wave

Some businesses that depend on predictable supply chains are putting products on aircraft to avoid Red Sea shipping delays. Houthi rebel missile and drone attacks on commercial shipping have forced vessel operators to bypass the Red Sea, extending transit times by 10 days or more. Vessel schedule reliability on the Asia-to-Northern Europe route hit a low of 34% in February, according to Sea-Intelligence. Logistics provider Flexport last week said research showed the ocean journey for China to Northern Europe, measured from factory to departure from the destination port, increased to 70 days. Apparel companies in Bangladesh, India and Sri Lanka, which do not want to take the risk of missing the spring fashion season in the West, are likely behind the mode shift, said Niall van de Wouw, chief airfreight officer at Xeneta, said on a recent episode of The Loadstar podcast.

Demand, however, is lessening. With catch-up production and distribution following China's Lunar New Year holiday in the rearview mirror there is less urgency for shippers to utilize fast transport. Also, container lines have had time to adjust vessel networks to the new normal of sailing around Africa instead of using the Suez Canal shortcut that is subject to Houthi rebel missile and drone attacks. Ocean schedules are more stable now after carriers moved in spare capacity to sustain longer transit times without gaps, Judah Levine, head of research at data provider and transportation marketplace Freightos, said in his industry outlook last week.



(Source: Flexport)

The latest information from Xeneta is that demand has decelerated to an 8% year-over-year growth rate as of mid-April. A major wild card is the potential for a regional war, after Iran launched an aerial attack on Israel and Iranian forces seized an Israeli-owned container vessel in the mouth of the Persian Gulf, that could cut off shipping lanes from Dubai and other ports, and lead to air diversions.

During the first quarter, demand outpaced capacity growth, putting upward pressure on rates and boosting load factors two points to 61%. But those patterns are beginning to change. Supply in April so far is about 11% higher than a year ago. And a surge of aircraft from passenger airlines for the summer travel season is expected to significantly add to total cargo capacity in the coming weeks – with the caveat that if flights are extremely full with passengers and baggage there could be less space for cargo.

Despite the influx of widebody aircraft, capacity remains tight on the trans-Pacific corridor because Asian carriers haven't fully rebuilt networks since the pandemic and a diplomatic spat between the United States and China. U.S. authorities have been slow to restore permits for Chinese airlines because they have a competitive advantage being able to overfly Russia while U.S. carriers have to bypass Russian airspace. The Department of Transportation in April raised the number of weekly flights from 35 to 50, but that is only a third of the pre-COVID flight activity by Chinese airlines.

Some airlines are introducing more freighters in Asia to take advantage of the strong market. CMA CGM Air Cargo, for example, said last week that it will begin flying a new Boeing 777 cargo jet between Hong Kong, Chicago and Seoul, South Korea, in the second half. A second 777 could enter service late this year to connect China and North America.

Airfreight demand even in hard hit areas like the Indian subcontinent is starting to abate this month as shipping delays and equipment scarcity improve, according to market intelligence firms.

Air tonnage from Dubai to Europe is more than double the level a year ago, but that's down from early March when volumes had tripled, according to researcher WorldACD. The increase reflects a move toward sea-air options that involve ocean transport from Asia and Southwest Asia to Dubai, where the close proximity of the port and airport facilitate transfers to aircraft. Shippers in Vietnam and other parts of Southeast Asia are also moving goods by road to Bangkok, where they are transloaded to aircraft bound for

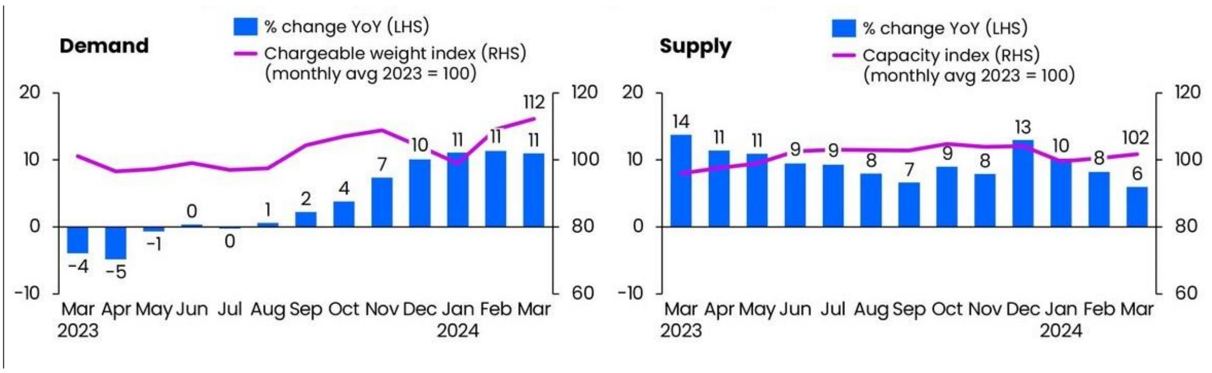
Europe and North America to avoid ocean delays. Bangkok air cargo demand is down 13 points from early March to 33% higher than last year. And air exports out of Sri Lanka contracted slightly this month after being more than 20% higher seven weeks ago than in 2023.

The average spot rate from the Middle East and South Asia to Europe jumped 46% in March from February and 71% year over year to more than $2.80/kg. Prices have continued to surge this month to more than double their level a year ago.

E-commerce shift

Meanwhile, direct-to-consumer shipping from China is having a massive effect on air cargo demand and rates. Until recently, most international goods consumers in Europe and North America purchased online were fulfilled from inventories kept in U.S. warehouses after being shipped by ocean.

Dimerco Express Group estimates that e-commerce accounts for about 50% of air cargo coming out of South China and Hong Kong and 30% of every kilo of airfreight exported from Shanghai Pudong airport, said marketing executive Catherine Chien in an email.



Air cargo demand has outpaced capacity growth so far this year. (Source: Xeneta)

"Global airfreight capacity not growing at same rate [as e-commerce demand], so there will be a fight for capacity between e-commerce and all the other supply chains relying on airfreight," said Thomas Kempf, senior director global airfreight development at logistics provider Flexport, during a company webinar in March. He said e-commerce represents about 35% of airfreight volumes out of the Asia-Pacific region.

Freight forwarder demand for block space agreements – contracts reserving a predetermined amount of cargo space on specific flights – is stronger than usual because e-commerce is occupying such a large share of available capacity outbound from China and other locations in Asia, according to Dimerco and other logistics experts. Forwarders want the space guarantees either to support their own business with e-commerce platforms or to make sure they have capacity to meet shipping needs of other customers, especially during the busy stretch heading into the holiday shopping season.

Chien said airlines this year are setting aside a larger portion of space on outbound China flights for pre-purchased allocations. The result is that there will be less capacity available on the open market during the peak season, which will lead to higher rates unless the number of flights increases.

U.S.-based Atlas Air this month began operating a 777 freighter six times a week between China and the U.S. that carries small parcels for freight forwarder YunExpress. The partnership follows the December launch of a dedicated route from Xiamen, China, to Miami.

Hong Kong to Europe and to North America rates are up about 11% and 8% year over year, while rates on outbound routes from Shanghai, China, to North America are on par with last year, as of mid April, according to the TAC Index. It currently costs about $5.50/kg to ship products from Hong Kong to the United States – a third higher than before the pandemic.

Despite the tighter market, shippers are showing a preference for short-term capacity purchases over long-term contracts in expectation that the Red Sea disruption will ease and more passenger belly capacity pours into the market for the summer, Xeneta said. Fowarders' appetite for multi-month air contracts increased late last year with the rise in spot rates and interest in guaranteeing container slots for clients because of uncertainty ocean shipping, but the pendulum is swinging back to immediate transactions as freight flows around the Red Sea smooth out, explained Manel Galindo, chief revenue officer of Freightos and head of the WebCargo platform.

Rosy outlook

Air cargo providers are generally optimistic that volume growth will be solid for the full year even if today's elevated performance isn't sustained.

Michael Steen, CEO of all-cargo operator Atlas Air, said in a STAT Media Group video interview last month he expects the market to grow about 3.5% to 4.5% for the full year versus 2023 as it comes out of the trough.

Global economic signals remain mixed, but conditions favorable to air cargo are moving in a positive direction.

Global shipments of smartphones, a major product category for airfreight, increased 7.8% in the first quarter from the same period last year, marking the third consecutive quarter of shipment growth that is likely to continue as the year progresses, reported International Data Corp.

The Purchasing Managers Index for U.S. manufacturing moved up 2.5 points from February into growth territory as demand for goods increases factory production, and with it orders for industrial machinery and equipment. Manufacturing, a leading indicator for air cargo growth, is also recovering in China and the United Kingdom. U.S. ocean imports are projected to be 11% higher this year than last, according to the National Retail Federation's Port

Tracker report. In Europe, inflation fell for the third consecutive month to 2.4%, but manufacturing continues to shrink.

Negotiations between East Coast ocean terminals and longshoremen bear watching. If dockworkers go on strike in October after their contract expires that could scare retailers and manufacturers to divert shipments to airlines to avoid delays. Many businesses are already exercising contingency plans by shipping goods sooner or shifting moves to West Coast ports. But if negotiations are stalemated, diversion to air for critical shipments could take place weeks before an official strike.

U.S. imports in the second half could pick up too if companies anticipate a possible election victory by Donald Trump, who has threatened a universal tariff of 10% and to raise tariffs on Chinese goods by 60%, said supply chain consultant Jon Monroe on the March 20 edition of The Freight Buyers' Club podcast.

Traffic in other regions besides Asia is still weak, especially out of Europe.

"We are not yet in a full recovery mode for air freight as the strengths in rates and volumes are mostly driven by specific regions (Asia-outbound) and products (e-commerce)," said Mark Zeck, senior research analyst at investment bank Stifel in a commentary for the Baltic Air Index.