Global Re-balancing

AAPA Port Finance Seminar

Walter Kemmsies, Chief Economist
Moffatt & Nichol

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Major Themes

- The economy is recovering but
  Supply-side recessions are tougher than demand-side recessions. World economy is still struggling with the aftermath of the developed economies’ credit crunch.

- Risk aversion and competitive pressures remain high so
  Customers are still frugal. Importers are not willing or able to rebuild inventories. Risk of stock-out is balanced with risk of over-stock. Freight rates are higher, enough to cover variable and now fixed costs but not enough to fund investment.

- Expect new arrangements
  Supply chain elements need to pool their efforts and resources in order to meet requirements of infrastructure improvements and high return on capital

Low inventory and high ROC requirements are not a new normal… more balanced world trade would be a new normal
Outlook: Global Re-Balancing

Macroeconomic Trends
Globally Synchronized Recession and Recovery

Industrial Production Indexes

Source: Bloomberg, Moffatt & Nichol
US consumers account for 17.5% of World GDP – global economic recovery depends on the US outlook

The greatest threat to the global economy and trade is the Mediterranean debt crisis
Where The Problems Began

- US home prices increases began deviating from trend growth around 2000
- Falling long term interest rates during most of the decade were a significant but not sole cause

Source: MarAd, US Census Bureau, Moffatt & Nichol
The US has never officially accused China of manipulating its exchange rate

The Renminbi may be under-valued by as much as 20% to 40%
China became the largest source of US imports and second largest export destination

China’s holdings of US treasuries increased in line with its trade surplus through Nov 2009

US Treasury bond yields remained unusually low in the last decade
China impacted the World and US economies in several ways

- Excess demand for US treasuries contributed to a real estate boom
- China’s capacity expansion and US real estate booms drove commodity prices up
Fed Funds policy interest rate was kept at a high level for an unusually long period

Inflation was considered a greater risk than real estate finance
The Fed Made A Dramatic Effort As Liquidity Dried Up

- The Fed’s response has been in proportion to the magnitude of the crisis
- Bank loans could double overnight if the Fed doesn’t pull back as the economy recovers
- Need to avoid too much money chasing too few goods

Source: St Louis Federal Reserve, Moffatt & Nichol
Household Debt Default Rates Are Peaking

- The “great recession” is rooted in consumer loan defaults following the real estate bubble
- House prices and sales are showing signs of stabilization and default rates are peaking
- The real estate and finance sectors are beginning to be less of a drag on recovery
Early Signs of Recovery

- Unemployment insurance claims growth is declining
- Better labor markets will support consumer spending and self-sustaining growth

Source: Bureau of Labor Statistics, Moffatt & Nichol
Retail Sales Are Recovering But Inventories lag

- Retail sales troughed in Q2-2009 despite continuing increases in unemployment
- Businesses are rebuilding inventories but not very quickly

**Retail Sales and Inventory-to-Sales Ratio**

Source: Conference Board, Bureau of Economic Analysis, Moffatt & Nichol
US Manufacturing Is Recovering

- US manufacturing capacity utilization fell dramatically between 2008 and 2009
- Low inventories and private sector spending are bringing US capacity back on line
- Capacity utilization and employment are not high enough to push inflation up

Source: Conference Board, Bureau of Economic Analysis, Moffatt & Nichol
Rail, Truck and Port Volumes Are Recovering

- Truck and Intermodal Rail volumes bottomed in 2009-Q2
- Port volumes bottomed in 2009-Q1

Source: Railfax, ASI/Transmatch, ATA, AAPA, Moffatt & Nichol
Port Volumes Sustained Recovery From 2009-H1

- Export volumes have led overall growth and drive empties’ volume lower
- Import volumes are recovering as US businesses rebuild inventories
- Both import and export volumes are expected to deliver double digit growth in 2010

**Source:** Seattle, Tacoma, Oakland, LA, LB, Savannah, Moffatt & Nichol

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**Monthly Int’l Container Volumes (in TEUs) For 6 Of The Largest US Ports**

- **TEUs Per Month**
- **Jan-Mar ’10 vs ’09**
  - +12.6%
  - +15.0%
  - +11.0%
  - +21.2%
  - +4.2%
Emerging Markets have higher population and productivity growth
Near term is weak due to mature economies
Policy withdrawal creates uncertainty - look for “all clear” in 2011-H2
World trade patterns will change due to the changing relative size of emerging and mature economies over the forecast horizon

Source: International Monetary Fund, US Department of Commerce, Moffatt & Nichol
Outlook: Global Re-Balancing

Long Term Trends
Global Trade Has Exceeded GDP Growth

♦ Cyclical Drivers
- Trade has grown faster than GDP
- Macro shocks have not impacted trends

♦ Structural Drivers
- Containerization; lowers freight cost
- Trade Agreements; lowers trade costs
- World Wide Web; allows “globalization”
- Demographics; drives off-shoring/import substitution
Aging industrialized nations’ populations is not news, but the significant rise in their elderly populations over the next 20 years will reinforce the consequences already evident in the structure of their economies.

Without immigration and trade, these economies face an output shortfall.

Average Age in 1990
- US: 35.2 years
- Canada: 35.2 years
- EU: 37.5 years

Average Age in 2030
- US: 40.2 years
- Canada: 43.3 years
- EU: 45.4 years

Percentage of Population Over 55 Years of Age

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Maturing Industrialized Economies Are Increasingly Service Intensive

- Developed economies are becoming more service-intensive and less manufacturing-intensive, as a function of domestic and international demographic change.
Manufacturing Industry Wage Comparisons

- Low wages in emerging markets are partly due to their younger populations
- Outsourcing services maturing markets more cheaply and accesses growing markets
- Low wages in Latin America indicate they are prime locations for manufacturing “near-sourcing”
Autos and housing-related sectors lagged other industries in terms of outsourcing due to strong demand for their products... until recently.

Similar expectations have been expressed by analysts at the US Dept of Labor.
Eventually The US Will Have To Balance Its Trade

- It is unlikely that the service sector will ever offset the goods trade deficit.
- The US will have to reduce dependency on fuel imports and start selling goods, or the dollar will cease to be the world’s reserve currency.

About 55% of the goods deficit is due to oil imports.

Source: US Department of Commerce, Moffatt & Nichol
Manufactured goods and non-agricultural products trade have grown faster than GDP.

Agricultural products trade has lagged GDP and other products.

Gap between manufactured goods and other products trade must narrow.

Bulk commodity trade depends on manufactured goods trade and other structural factors.

Source: World Trade Organization, World Bank, Moffatt & Nichol
Outlook: Global Re-Balancing

Transportation Infrastructure Issues
Some ports will eventually have to increase channel or air draft

Ocean carriers will eventually have to adapt their fleets
Demographic Trends Are Changing The Economy’s Structure

- US population is moving to urban, coastal and Southern locations
- It’s not just baby boomers retiring to the south, but mostly younger people to work in those growing markets
Competitive US Export Candidates

♦ Relative to faster growing Emerging Markets, the US has
  ♦ Lower cost of capital, higher cost of labor
  ♦ More advanced biotechnology
  ♦ More reliable quality control and surveillance of compliance
  ♦ Relative abundance of scarce resources such as water

♦ A partial list of high potential exports fitting these advantages:
  ♦ Low labor-content capital goods
  ♦ Grain and oilseed
  ♦ Meat
  ♦ Wood pellets
America Is The World’s Bread Basket

- Lack of investment in inland waterway infrastructure is a significant bottleneck
- The rail network can handle agriculture exports in place of the inland waterway system
West Coast ports have gained share of agricultural exports aided by containerization.
As incomes rise in emerging markets, the trade intensity of these economies will catch up with those of more developed economies.
Containers Concentrate In Population Centers

- These are the locations where the bulk of consumption takes place
- Containers are increasingly retained near ports

Source: US Census Bureau, Moffatt & Nichol
Rail Capacity in 2035 Without Improvements

Current Level of Service

- **A, B, C**: Below Capacity
- **D**: Near Capacity
- **E**: At Capacity
- **F**: Above Capacity

Source: AAR
At the end of 2007, the US had 4,048,529 miles of public roads

Highways need expansion and repairs – AASHTO estimates $140 billion to repair and modernize the nation's 600,000 bridges
Outlook: Global Re-Balancing

Container Trade Forecasts
Global macroeconomic trends remain supportive of trade growing faster than GDP

China is expected to moderate its currency stance and increase the consumer’s share of GDP

International policy is expected to further remove trade barriers and reduce the environmental impact of economic activity

Source: MarAd, PIERS, Moffatt & Nichol
Takeaways

- The recovery is on the verge of self-sustaining, negative growth risks remain but continue to moderate – policymakers are aware of these risks.

- Global rebalancing is the new normal – outsourcing, not debt-fueled consumer spending will drive imports, US exports have to grow to pay for imports.

- Low inventory and high ROC are not the new normal, but new arrangements are partnerships will be.

- *Transportation is a first-mover advantage industry. The time to make investment decisions is now. The winners are those who acted when others were afraid to look.*

Thank you for your time.