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Are supply chains fixed?

Bottlenecks clearing and freight costs collapsing

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- Firms are saying that delivery times have normalised…
- …and global shipping costs have collapsed, …
- …which may mean good news for durable goods prices

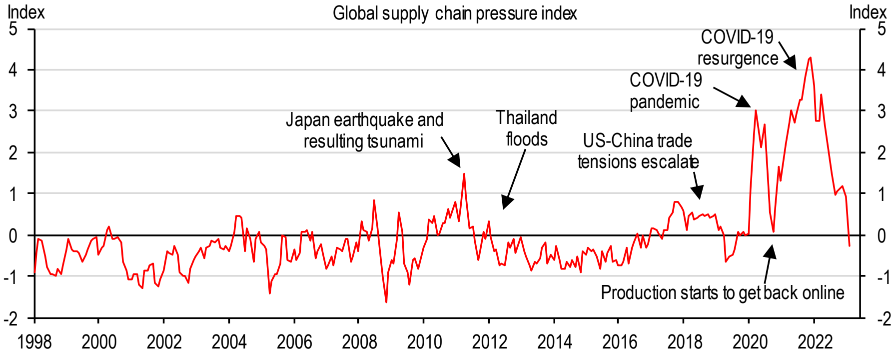
Having caused havoc with global consumer spending and inflation patterns in recent years, it looks like much of the global supply chain challenges are over. That's at least according to the latest reading of the New York Fed's global supply chain pressure index, which fell back below zero in its February reading – suggesting that supply chain pressures are now less intense than normal.

This index includes a range of global transportation cost indices and supply chain-related components from the PMI surveys across the world – and in the early part of 2023, both of these parts of the equation have improved sharply. This process appears to have happened in the US first, but has now spread to Europe and is filtering across a range of sectors at the start of this year.

We previously wrote that easing supply chains could have a dramatic impact on goods prices in the coming months. We've seen that impact in the US already – durable goods prices fell by the fastest rate in history (on a 3m basis) in late 2022 – but elsewhere it may take longer for this new paradigm of available goods and lower transport costs to filter into prices.

But it's worth remembering why this is happening. In part, it's supply side improvements, but it's also a reflection of weak global demand for goods. So while we can cheer the easing up of bottlenecks, it may reflect a challenging time for global trade.

1. On a headline basis, supply chains are back to normal



Source: New York Fed. Note: Index is a z-score from a number of components such as PMI supplier delivery times and shipping costs

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Bottlenecks gone?

- Data show a rapid improvement in global supply chains
- Shipping costs and delivery times have fallen quickly
- This may mean lower goods prices, but reflects weak demand, too

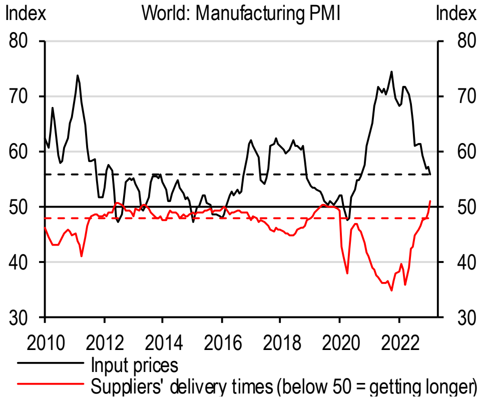
Supply chains easing

The easing up of global supply chains is one of the biggest changes to the macroeconomic landscape to take place in the past year. This time a year ago, supply chains were clogged in most industries – with PMI data suggesting that supplier delivery times were getting longer than they ever had been (chart 2). Additionally, shipping costs had been running at 5-10 times pre-pandemic levels (chart 9) as fierce competition to get some of the limited capacity in shipping containers led to a surge in prices.

Fortunately, these challenges began to unwind. The policy move from the port of LA-Long Beach to start charging firms for leaving empty containers at the port (which accumulated as nobody wanted to send them back to Asia empty while demand there was soft due to lockdowns) started the corkscrew unwinding. Even the most ardent optimist a year ago would have struggled to believe global shipping rates would halve over the course of the next year – when in reality they fell by 95%.

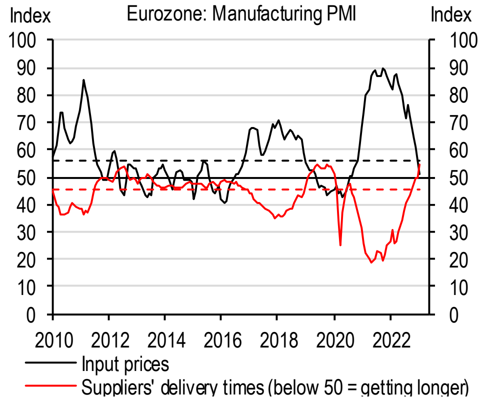
This easing was ongoing through most of 2022, marked by a steady drift lower in shipping rates and upturns in the supplier delivery indices; but, in the past month we've hit some important milestones. The global manufacturing PMI's supplier deliveries index is now above 50 – rare in itself, let alone given what's come before it – and global shipping rates are now lower (at least from Asia to the US or Europe) than pre-pandemic. As a result, the New York Fed's global supply chain pressure index is back below 0. Based on the data, global supply chain challenges are over.

2. On a global basis, supplier delivery times are improving quickly…



Source: S&P Global. Note: Dotted lines show pre-pandemic normal levels for both indices based on historical averages

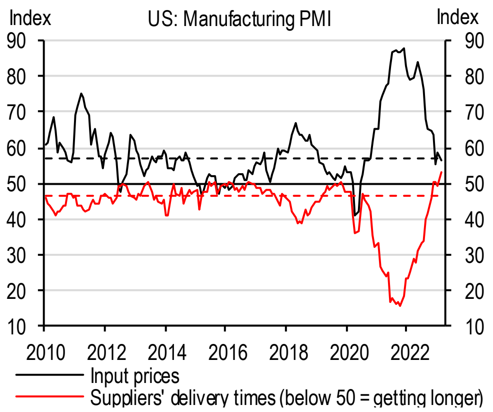
3. …and very clearly in Europe



Source: S&P Global. Note: Dotted lines show pre-pandemic normal levels for both indices based on historical averages

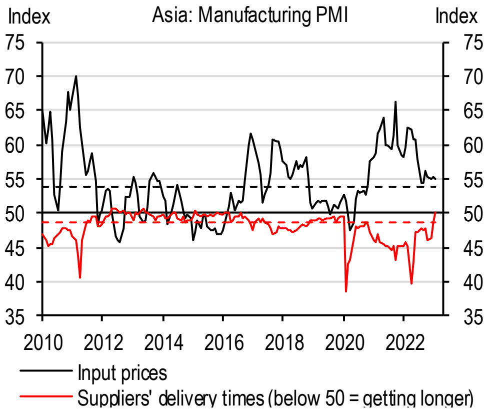
One part of the world where this change has happened very quickly so far in 2023 is Europe. The equivalent data – both on delivery times and shipping costs – have seen sharp improvement so far this year, playing a big role in the improvement on a global basis. In the US (chart 4), this happened sooner – the supplier delivery times index hit pre-pandemic norms in October 2022, and was back above 50 in November; while in Asia, things weren't quite as bad at any point during the pandemic, but still appear to have been given a lift in early 2023 – likely related to the reopening of mainland China.

4. US data improved first…



Source: S&P Global. Note: Dotted lines show pre-pandemic normal levels for both indices based on historical averages

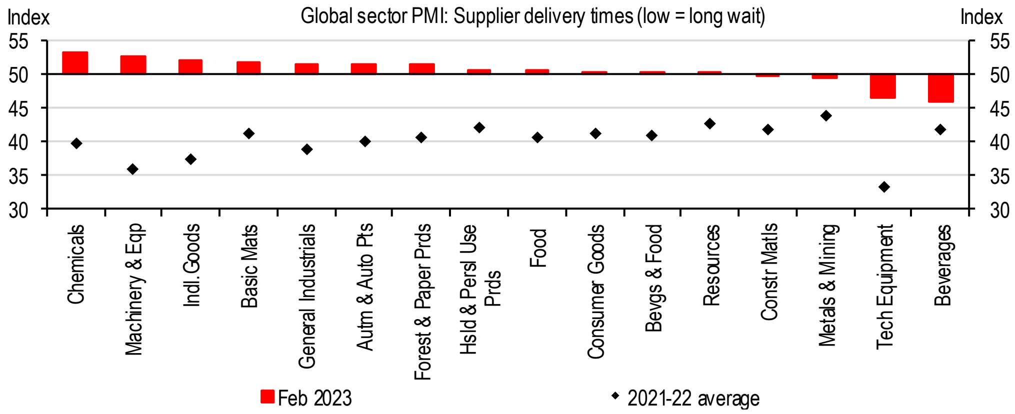
5. …while Asian data were never as bad



Source: S&P Global. Note: Dotted lines show pre-pandemic normal levels for both indices based on historical averages

So on a global basis, things now look much better. But what about on a sectoral basis? Luckily, we get this same PMI data on a global basis by sector. These indices have shown an equally remarkable turnaround during the course of the past six months or so – with only metals, tech, and beverages showing a sub-50 reading in the February data.

6. PMI data show huge improvements across most sectors

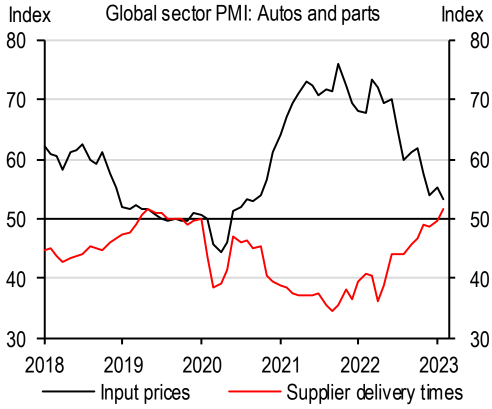


Source: S&P Global

But while supply chains are easing up materially, there are some sectors that are still proving problematic. Autos has been a sector where supply challenges were intense through the pandemic – leading to elevated vehicle prices (and a subsequent correction of sorts) that have played havoc with inflation data.

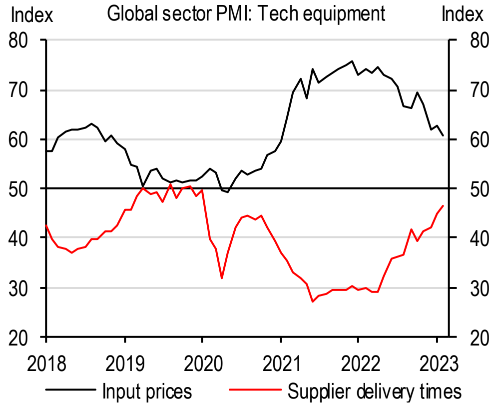
But part of this has been due to the tech cycle – with extremely stretched supply chains through 2021-22 (chart 6) just as demand for products in the space was so strong. This area, too, is starting to show signs of bottlenecks easing – with things improving since early 2022 when pandemic restrictions in most of ASEAN and North Asia (notably Japan and Korea) were relaxed or removed.

7. Autos supply chain issues are clearing up…



Source: S&P Global

8. …at least in part due to improvements within electronics



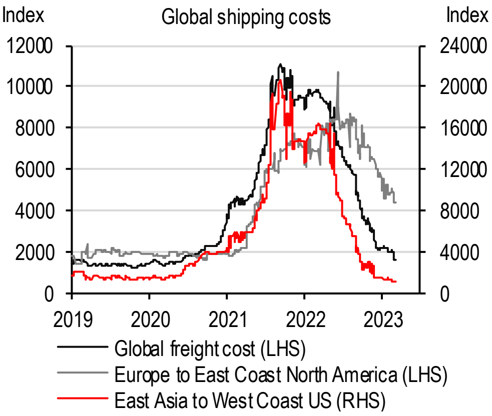
Source: S&P Global

Shipping costs falling quickly

So now that goods can flow more easily, this is being reflected in much lower freight costs for businesses. The cost of shipping by sea, based on the Freightos shipping costs data, has now fallen by 85% y-o-y on a global basis – and roughly 95% y-o-y when looking at costs from Asia to the US – a route where the average cost is now 30% lower than pre-pandemic.

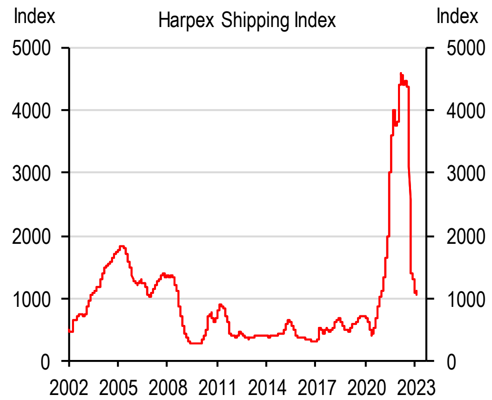
That said, not all rates have seen the same correction. Rates between Europe and the US, for example, are coming down, but lag the moves we saw in 2022 in terms of trade with Asia. As more spare capacity is appearing, with supply of containers and boats coming online just as goods demand stagnates or falls, we will likely see this trend continue until we're back at levels close to pre-pandemic across most routes. The Harpex index, which reflects Charter Rates for 6-12 months fixture periods, is falling very quickly, too.

9. Sea freight rates have collapsed



Source: Refinitiv Datastream

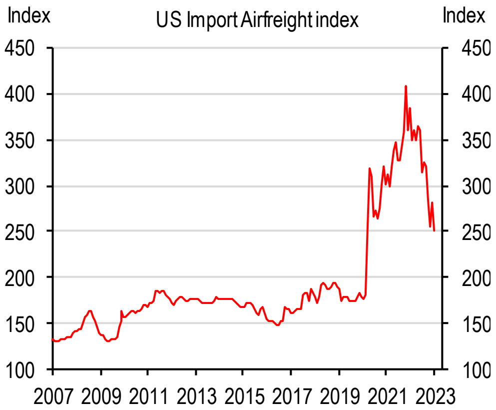
10. The Harpex index suggests shipping rates are falling quickly



Source: Refinitiv Datastream

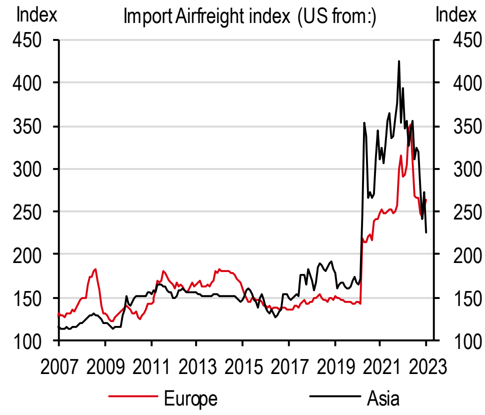
And it's not just sea freight where we've seen this shift. The cost of air freight has fallen, too. It's not been quite as dramatic as freight rates, but the trajectory is clear. As more spare capacity opens up in the global trading system and fuel prices come down, we're seeing sharp drops in transportation costs across the world.

11. Air freight prices are coming down…



Source: BLS

12. …across all regions

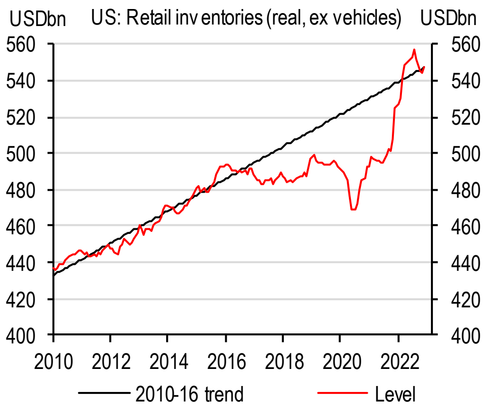


Source: BLS

What does this mean?

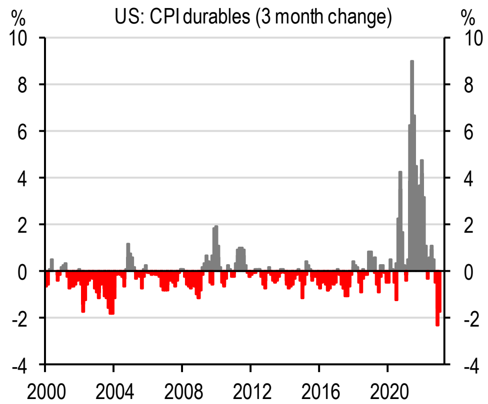
The easing up of global supply chains is almost universally good news. More items can flow easily, shortages should abate, and firms should see their input costs come down. All of this is good news for economic activity and inflation. We've seen the first round effects of this in the US CPI data already, with firms building inventories back quickly in the second half of 2022, leading to discounting of many products. In the final three months of 2022, durable goods prices in the US fell the most ever over a period of that length.

13. Inventories have been rebuilt…



Source: Refinitiv Datastream, HSBC. Note: Calculated based on latest CPI data and historical data adjusted to be in 2023 USD.

14. …weighing on goods prices



Source: Refinitiv Datastream, HSBC.

Elsewhere, we haven't seen quite the same impact, at least not yet. But easing global supply chains will take time to feed through into inventories and pricing strategies. Firstly, the backlogs need to clear, then inventory needs to arrive, and *then* we may start to see more widespread goods price cuts or at least prices stop rising. Through 2023, goods prices (particularly durable goods) will play a key role in determining overall inflation rates and central bank policy. That's not to say all policymakers' problems are solved – services inflation remains stubbornly high.

It's also important to remember why supply chains have been able to ease. Some of this is supply side improvements – with more ships and containers – but also goods demand has slowed. Retail sales volumes are down in annual terms in most developed economies as the cost of living squeeze has hit spending and consumers are rotating towards more services purchases. The trade outlook, at least on the goods side, therefore remains fragile this year.

Whilst there may still be the odd section of the global economy where supply chains aren't quite back to normal, on an aggregate basis, we're there. Some sectors, like electronics, are going through the last phases of healing, while transport costs between some regions have been a little slower to react as spare capacity moves through the global economy. In the coming months it seems sensible to suggest that further normalisation will take place in those regions and sectors that aren't quite back to 'normal'.

This may prove to be good news for central bankers if it feeds into lower goods prices. We've seen the impact in the US, but not yet elsewhere – and so goods prices could be a source of goods news in the coming months. But don't forget that whilst this is by-and-large a positive development, it is at least in part due to weaker consumer demand.

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