Supply chains keep easing

Further improvement as goods trade drops

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- Supply chain indicators have loosened notably…
- …with backlogs clearing and shipping delays disappearing…
- …which may continue to put downward pressure on goods inflation

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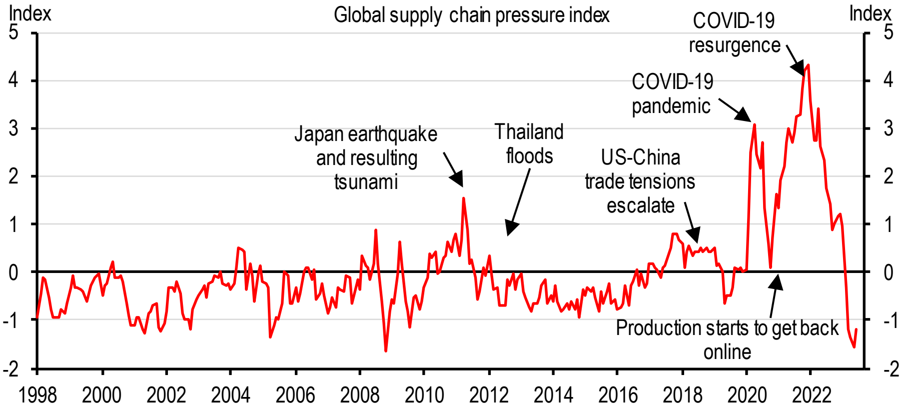
Back in March, we asked the same question – are supply chains fixed? The answer was that we were getting there – with the New York Fed's global supply chain pressure index dropping back into negative territory for the first time since the onset of the pandemic.

In the months since then, the continued improvement has been extraordinary. Having had global supply chains under the *most* pressure in history at the start of 2022, by the middle of 2023 they are now among the *least* pressured in history, at least according to the New York Fed's supply chain pressure index (chart 1).

The improvement is resonating through almost every indicator for global supply chains we can find. PMI data are pointing to collapsing delivery times, port congestion is no different to normal and the shortages are now few and far between, with inventory levels being replenished in much of the world.

Of course, much of this is due to very subdued goods demand – with much softer exports from Asia due to weaker demand from developed economies, but the better news is that this is still to filter through to inflationary pressures in much of the global economy. While services prices may well cause central banks problems for a fair while longer, easing supply pressures should help pull down goods inflation in 2023 across the world.

1. Supply chains now as good as ever



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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Somehow, even better

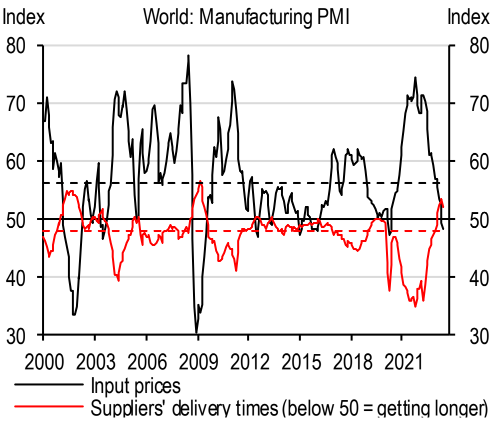
- Bottlenecks in global supply chains have largely disappeared…
- …with a range of indicators suggesting that the 2021-22 shock is past…
- …and costs are coming down quickly as a result

What bottlenecks?

If you'd posited a year ago that today we'd be looking at global supply chains as they are today, you would have been met with a healthy dose of scepticism. Yet, here we are. Over the course of the past year, but in particular in 2023, global supply chains have eased remarkably quickly – removing one of the biggest headaches in terms of activity and inflation.

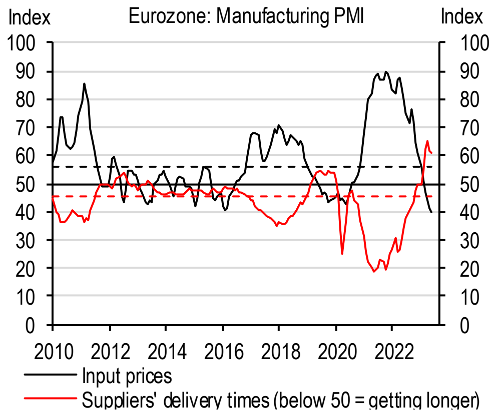
This is clearly seen in the lesser-reported subcomponents of the PMI data, notably the suppliers' delivery times indices that have risen above the 50 watermark for the first time on a global basis since 2009. Zooming in on key regions, the improvement has been most evident in Europe, with firms' ease in finding supplies coinciding with a sharp drop in input costs.

2. Globally, firms are seeing shorter delivery times…



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

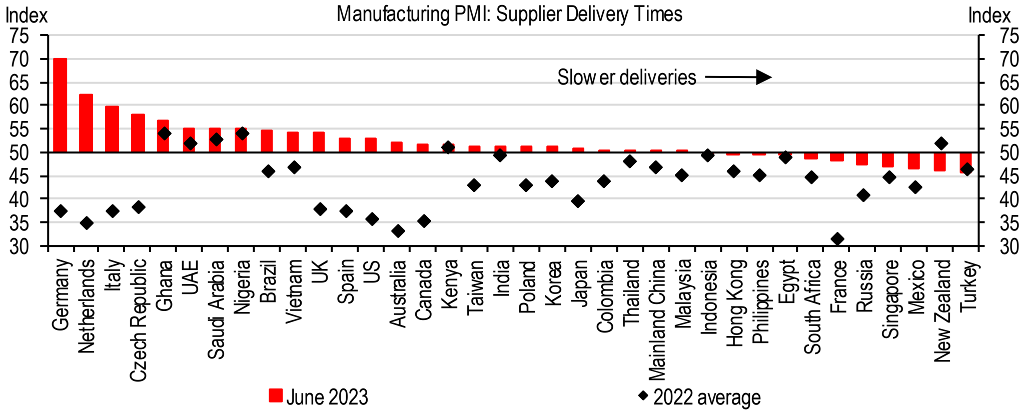
3. …and very clearly in Europe



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

The turnaround has been evident almost everywhere. The standout is Germany – where delivery times are now falling sharply – but the improvement in delivery times across Europe and the exporting parts of Asia (notably Vietnam, Japan, Korea and Taiwan) has been stark. It's worth remembering, however, that these indicators are diffusion indices, and so while supply chain challenges may now be notably easing, some issues may still persist for some firms.

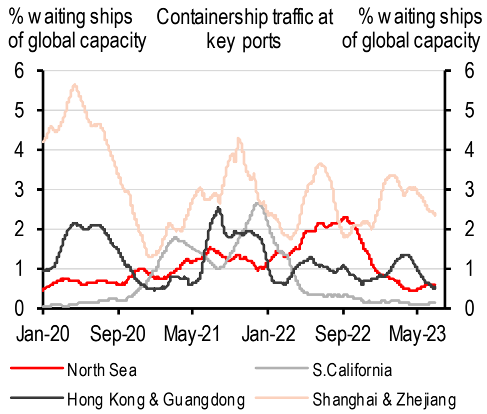
4. Supplier delivery times have eased up a long way



Source: S&P Global

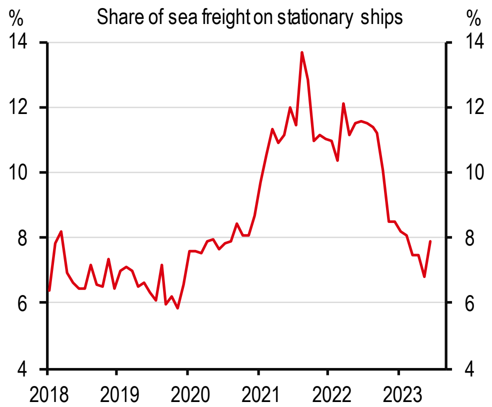
The encouraging thing is that it's not just these PMI data that have started to look a lot better. The level of traffic in much of the world's key ports has returned to normality, as seen in chart 5. The reversal in the North Sea, for example, was really seen only in the back end of 2022, compared to the easing of backlogs in California in early 2022.

5. Port congestion has largely disappeared



Source: Kiel

6. Much less freight is stationary on boats

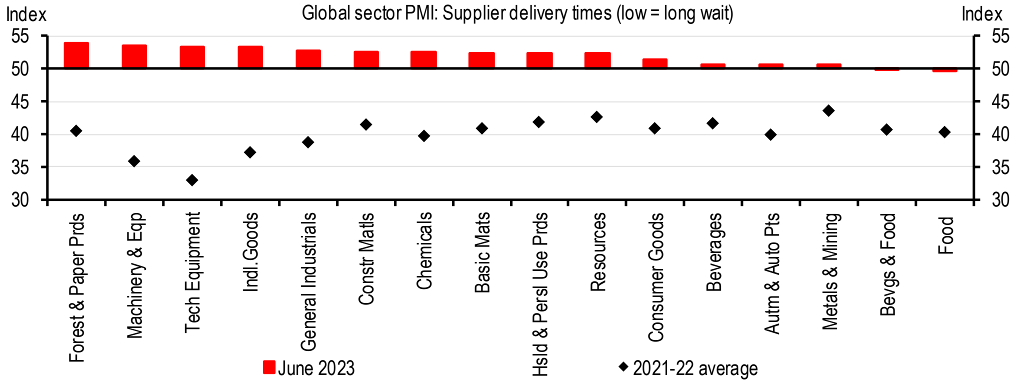


Source: Kiel

A widespread story

While some sectors are still reporting longer delivery times – namely food – the reversal in the degree of backlogs across industries in the PMI data has been quite remarkable. Having seen all major sectors point to huge supply chain issues through 2021 and 2022, as of June 2023, all non-food sectors are seeing delivery times shorten and input costs and output charges have dropped dramatically since 2022. Across the board, both by sector and economy, supply chain issues have alleviated greatly.

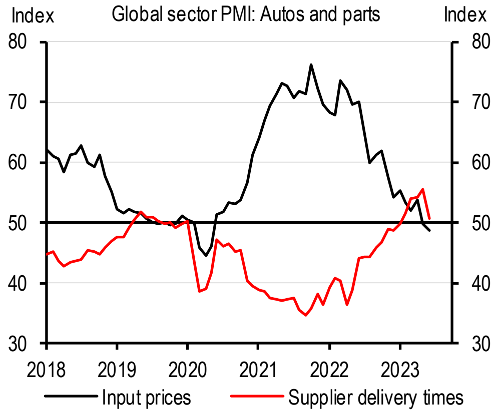
7. Supply chains are easing up across all manufacturing sectors



Source: S&P Global. Note: Supplier delivery times being above 50 indicates a shortening of supply times.

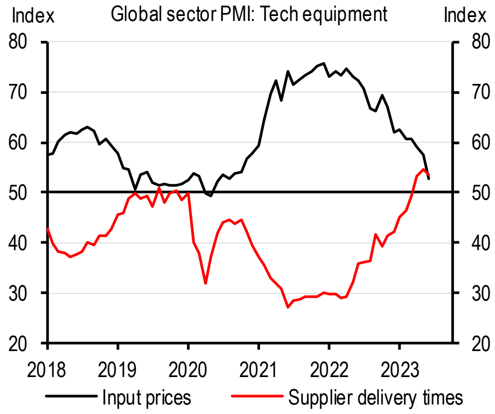
Even the sector often held up as an example of supply chain problems – autos – is now seeing delivery times fall, and input prices are falling. The same is true within electronics – but in both sectors, this clearing out of supply chains, for now, is still satisfying many pre-existing orders (evidenced in the rise in vehicle sales in early 2023), and so may take some time to impact supply and demand in these sectors, and therefore, prices.

8. Even the autos sector has seen supply issues clean up…



Source: Refinitiv Datastream. Note: Supplier delivery times being above 50 indicates a shortening of supply times.

9. …and electronics, too



Source: Refinitiv Datastream. Note: Supplier delivery times being above 50 indicates a shortening of supply times.

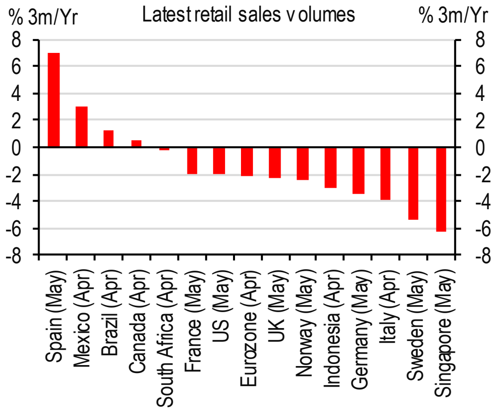
Why is this happening?

There are a couple of key reasons for the easing congestion within supply chains. Firstly, there's a demand story – with global demand for goods dropping sharply over the course of the past year. While goods spending is still elevated in some markets – the pace of growth has collapsed – with levels stagnating.

10. US goods demand is strong but has stopped growing…

Source: Refinitiv Datastream

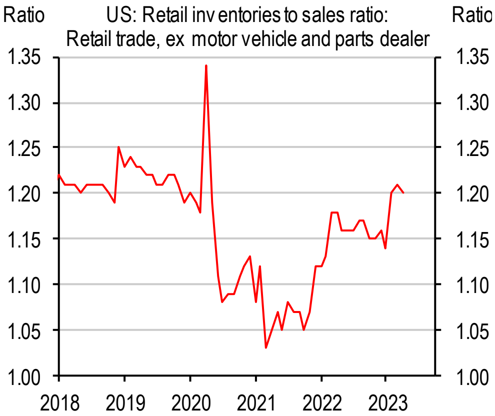
11. …and retail sales volumes are down in many economies



Source: Refinitiv Datastream

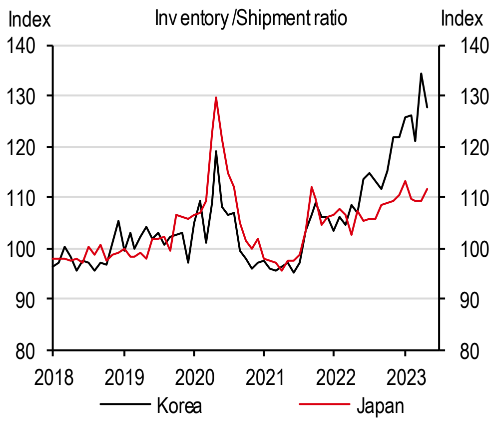
This stalling of demand growth has allowed firms to increase inventory levels. Across the world inventory accumulation has played a major role in supporting headline GDP figures in recent quarters, while inventory levels for firms are up above pre-pandemic levels in Asia (chart 13) and are running at the same rate in the US as back in 2019.

12. Inventories have been built up…



Source: Refinitiv Datastream

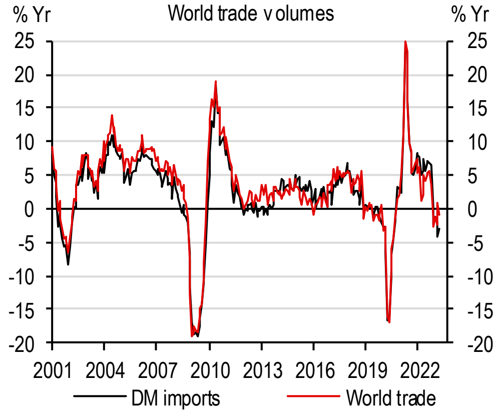
13. …across the world



Source: Refinitiv Datastream. Note: Indexed to 2018/19 average = 100

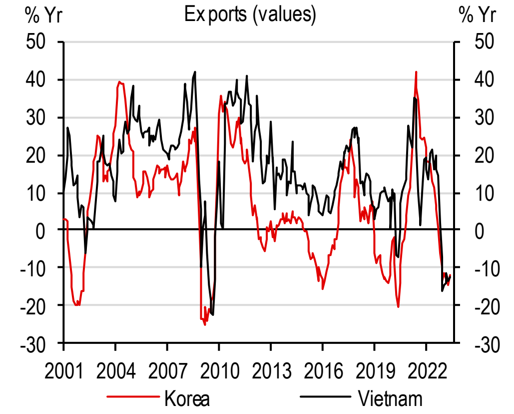
These rebuilt inventories, coupled with a slowdown in end demand, means that firms need to ship less. And that's clearly being seen in global trade data. Global trade volumes stagnated in 2022 and have turned down notably in 2023, with volumes now down roughly 1% so far in 2023 compared to the same period in 2022. The drop is, however, more notable for imports from the developed world, down about 2.5% over the same period – as can be seen in the gap opening up in chart 14. For some economies, the pain is much clearer – with exports down by roughly 15% y-o-y in nominal value terms in Korea and Vietnam.

14. Global trade volumes are down…



Source: Refinitiv Datastream

15. …and some exporters are feeling the pinch



Source: Refinitiv Datastream

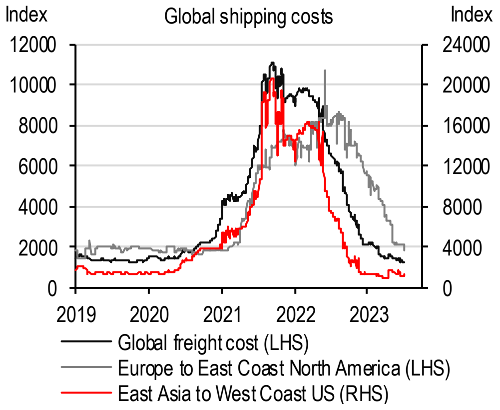
And, so, with demand for shipments having fallen – due to this weaker end and trade demand – this has created some excess capacity in many supply chains, leading to a continued drop in shipping costs for businesses.

Some big cost savings

This weaker demand may be bad news in terms of global demand growth, but it is playing a role in pulling down costs for businesses. We showed in charts 2 and 3 that input costs for manufacturing firms are now steadily falling, and while some of that is due to lower energy prices, the additional impact of lower transportation costs is clear.

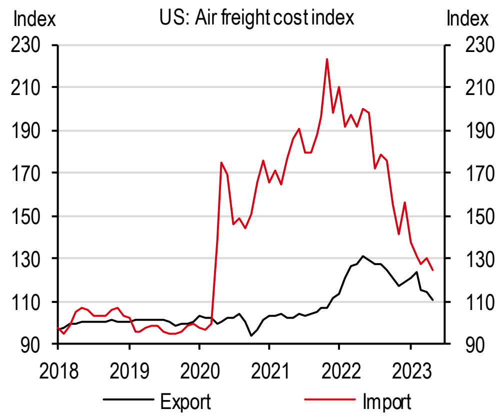
It's worth stressing how big these moves have been. Since their peak, global freight costs are now down 90%, and on routes from Asia to North America, the drop has been closer to 95%. Some moves are still filtering through – freight costs from Europe to North America have fallen by 2/3 this year alone, with global costs down 40% over the same period.

16. Freight costs are down a long way…



Source: Refinitiv Datastream, Freightos

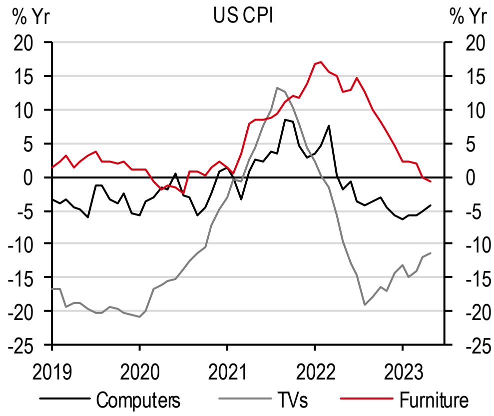
17. …across a range of transport options



Source: BLS. Note: Index where 2018-19 average = 100

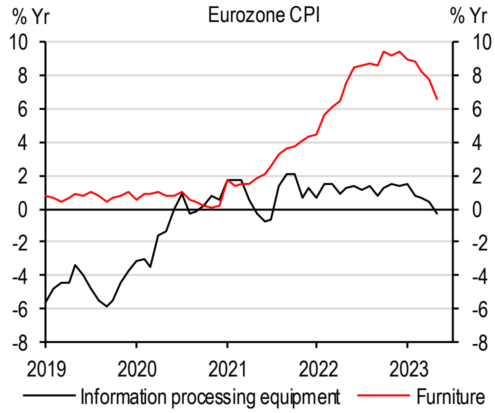
This could well feed into lower goods prices in the months to come. In the US, we've seen the reversal play out already in some key categories – with furniture prices now falling on an annual basis and deep deflation (once again) for many electronics products. In Europe and much of the rest of the world, this same impulse hasn't yet returned, meaning that as goods shortages continue to alleviate, we could see further downward pressure on prices – particularly if firms need to get rid of any excess inventory.

18. Many durable goods prices are falling again in the US…



Source: Refinitiv Datastream

19. …and could well do elsewhere



Source: Refinitiv Datastream

Unfortunately, for central banks, things aren't so simple. Despite the better news in supply chains in 2023, they're yet to see broader inflationary pressures dissipate as much as they would like. A combination of stronger wage pressures, particularly in Europe, is likely to mean services inflation stays stickier and central banks keep tightening. The impact of fewer stresses on the goods side of the economy may be more evident in Asia, where goods make up a larger part of the economy and inflation, and so central banks may be able to ease policy sooner.

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