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A Surge in Ocean-Shipping Rates Could Increase Consumer Prices

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A recent surge in ocean-shipping rates to their highest levels in decades is adding upward pressure on already rising commodity prices that could push up the cost of imported goods in the U.S. and other countries.

With the demand for seafaring vessels far outstripping supply, the cost of shipping iron ore, soybeans, coal and other commodities used in the manufacture of a wide range of goods has nearly tripled this year. The Baltic Dry Index, the key industry indicator for commodity freight rates, has doubled in just the last two months. Industry officials say there are no signs of relief on the horizon in terms of lower prices or additional supplies of vessels.

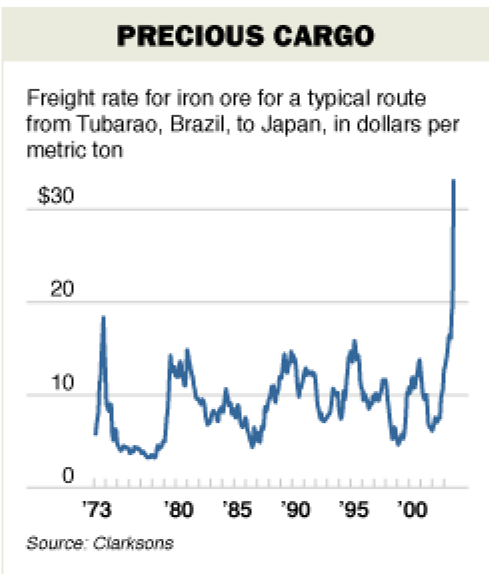
China's surging economy is creating a huge demand for ships to import the basic raw materials the country needs to build infrastructure, supply its massive manufacturing sector and satisfy a growing consumer market. As more ships go to China, fewer are available to ferry goods between other countries, causing a supply shortage that helps to boost prices. Compounding the squeeze, shrinking mining industries in the Americas and Europe have increased those regions' imports of coal, while the summer drought in Europe is boosting grain shipments from the U.S.

"We are at a price spike that has never been seen before, the highest-rate market of all time," said Tom Cutler, a shipping analyst for Clarksons, a big London-based shipbroker. "It has caused a total disruption in the way that ships are being positioned." Clarksons has kept records on shipping rates for about 30 years.

Economists say the high shipping rates could be felt by consumers within months. The impact will come in the form of higher prices on goods made of steel, aluminum and other metals, and on certain food products derived from livestock, such as cattle and pigs, that feed on soybeans, grains and corn.

Robert Dunn, professor of economics at George Washington University in Washington, said the inflationary pressure will be keenest in countries that import more than they export, such as the U.S., China and countries in the European Union. "For products that are heavier and bulkier, like textiles and metals, the effect on prices would be larger," as much as 3% next year, Mr. Dunn said. But for lighter items, such as electronic gadgets, the effect on prices shouldn't be as strong because transportation costs are less of a factor, he said.

Already commodity prices are heading higher. Copper is trading on the London Metal Exchange at six-year highs of about $2,083 a ton. The cost for alumina, the basic ingredient to produce aluminum, has nearly doubled in the last year. Cotton prices have been trading at near five-year highs of about 84 cents a pound, in part because of increased demand from China.



The growing use of the world's sea lanes has followed rising demand from China. This year, China has increased its imports of iron ore, a basic material to make steel, by nearly 40 million tons, or 33%. Meanwhile, coal exported from China, Indonesia and Australia is making its way to Europe in strong numbers, up about 35%, according to industry statistics. As Chinese consumers' incomes grow, Brazil, a major supplier of soybeans, is shipping greater quantities of them to China, where they are used for animal feed and human food products, such as soybean oil.

Higher ocean-going freight rates are mainly hitting bulk-shipping vessels, specialized carriers that transport commodities in their raw form and which account for about a third of all commercial ocean-going trade. More than a third of all bulk ships carry iron ore and coal. The other classes of freight ships are container vessels, which carry semifinished and finished goods, such as electronic devices and appliances, and tanker vessels used for oil.

Although ships come in different sizes and shapes, the current spot cost to rent a typical bulk ship -- the length of between two and three football fields -- to ferry coal or iron ore is about $75,000 a day, say traders and shipbrokers. That compares with $20,000 to $28,000 a day in January. About 40% of goods are transported in ships hired on the spot market. Companies that locked in contracts with ship owners before the recent price run-up are paying about $30,000 a day, but those prices are likely to increase as the contracts come up for renewal.

"It's been outrageous," said Leon Goldenberg, president of Fremak Industries Inc., a world-wide metals trading company based in New York. "You can't continue to absorb costs when the freight rises higher than your profit margin." He said that in some cases his shipping costs have risen $10 a ton at a time when his profit margin is only $9 a ton.

Shippers shouldn't expect newly built vessels to ride in on the waves to deal with the demand anytime soon, analysts say. The shipbuilding business, centered in South Korea, Japan and China, is backed up and the lead times for taking new deliveries are almost twice as long as normal.

Shipbuilders, the vast majority of which are privately held, usually jump at the chance to build more ships when demand is so high. But the world's shipbuilders are busy building new oil tankers to satisfy more stringent safety requirements called for by European regulators. Also, previous orders for new container ships have pushed any new orders for bulk ships to the back of the line. A new ship that used to take 18 months to two years for completion, now requires as much as three years for delivery.

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