December 11, 2019 | 1:33 PM EST

Intermodal Markets

Overview

Year-over-year intermodal volume comps are tougher than before because last December, both railroads and trucking carriers experienced a strong surge in freight. Now, across the Class I rails, intermodal volumes are down more than 11% y/y.

Still, railroads are holding to pricing and have even changed some of the language management uses in investor presentations to indicate more bullishness on price next year. In our view, railroads are likely encouraged by accelerating truckload carrier failures to maintain their current strategy, not attempt to match price, and watch for capacity to bleed out of the continent's transportation network.

With volumes negative by double digits, railroad networks are exceptionally fluid. Intermodal tender rejections are very low and terminal dwell times in most major markets are falling, though there are some exceptions where networks are still being reengineered (Norfolk Southern's Atlanta terminal).

We're waiting to see whether in 2020 the newly optimized (and higher priced) intermodal services offered by the rails will be able to maintain their current levels of service once volumes return. In our view, the ability to smoothly manage intermodal trains in a higher-volume environment will, more than anything, determine the prospects for the sustained growth of intermodal as a business going forward.

Spot rates per mile

Chicago to Linden, NJ	$1.88
Los Angeles to Dallas	$1.53
Linden, NJ to Chicago	$1.16
Los Angeles to Chicago	$1.18
Chicago to Los Angeles	$0.91

53-foot container volume seven-day MA (weekly change)

Los Angeles to Chicago	1129.14 (+22.44%)
Chicago to Los Angeles	823.71 (+42.17%)
Chicago to Elizabeth, NJ	660.00 (+118.11%)
Los Angeles to Dallas	434.86 (+26.71%)
Elizabeth, NJ to Chicago	408.57 (+40.61%)

Outbound intermodal tender rejections

Savannah, GA	0.00%
Joliet, IL	1.02%
Chicago	0.83%
Memphis, TN	0.44%
Los Angeles	0.14%

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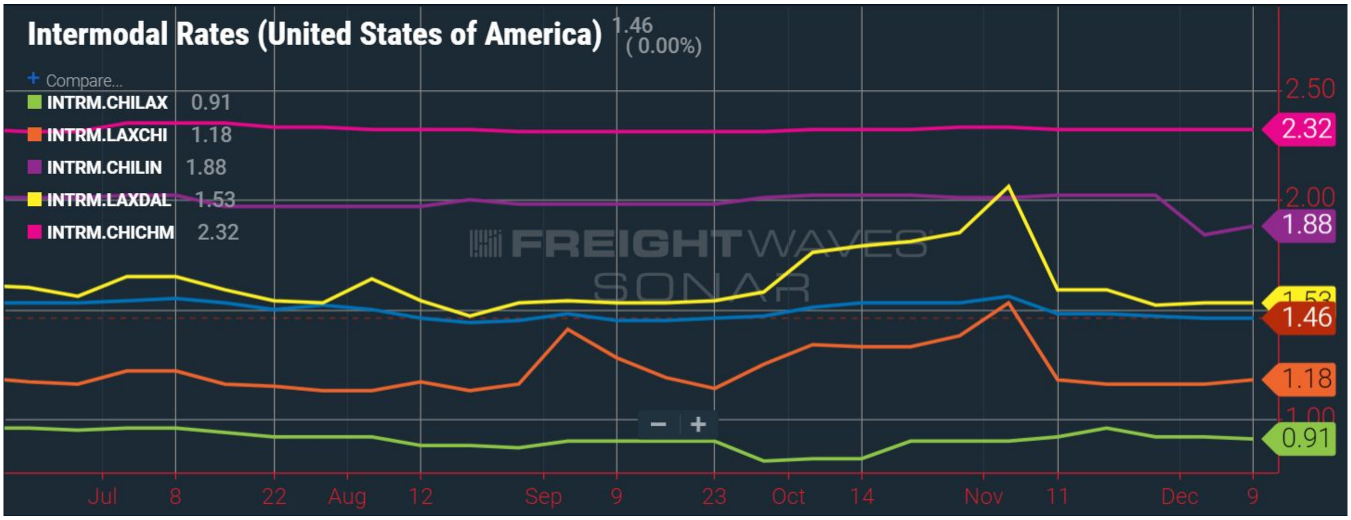
Intermodal spot rates



(Chart: FreightWaves SONAR)

Intermodal rates continue to walk along the x-axis, as expected. Although most lanes remained flat, there was movement in three of the lanes. Chicago to Linden, New Jersey, led the way with the biggest increase (+2.2%), followed by Los Angeles to Chicago (+1.7%). The one lane that saw a decrease in rates was the backhaul Chicago-to-Los Angeles lane, which saw a decrease of 1.1%.

We continue to expect rates to remain steady with a bias toward upward movement. Our thesis going forward is that the gap between intermodal rates and trucking rates will continue to narrow, driven by improvements in rail service and subsequent repricing. With the nationwide dry van truck rate near six-month highs and dry-van outbound tender rejections at the highest levels since late January, we believe that it is likely intermodal rates are near or at the bottom.

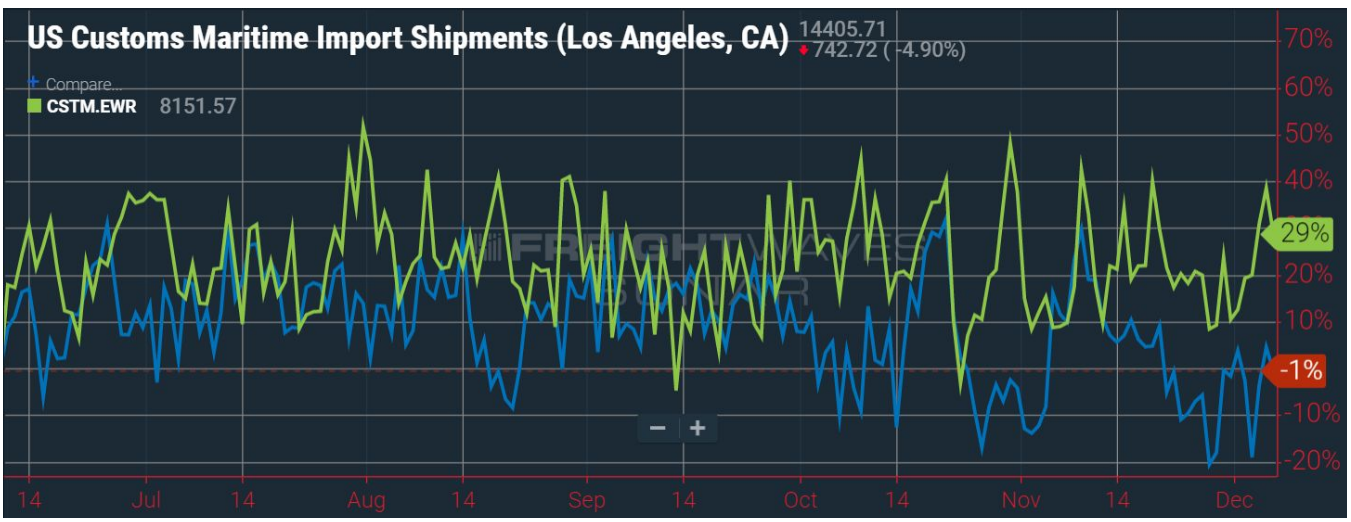
The question is how quickly intermodal rates might recover; the first quarter is typically the softest quarter for the commodity types moved by truck and intermodal. Management commentary last week from Union Pacific indicated higher prices for carloads in 2020, but the read-through to intermodal is less clear.

“Union Pacific appeared even more confident that its price increases will ‘well exceed’ its pace of cost inflation, reinstating the word ‘well’ after a period of using language that was not as strong,” wrote FreightWaves intermodal expert Michael Baudendistel in a customer note Dec. 11. “Therefore, shippers on UP should plan for higher rates in the coming year, particularly on rail carload traffic; meanwhile, the pace of rate increases on intermodal traffic may increase at a slower pace in 2020 than 2019, based on commentary from intermodal providers and competition from the highway.”

Freight demand

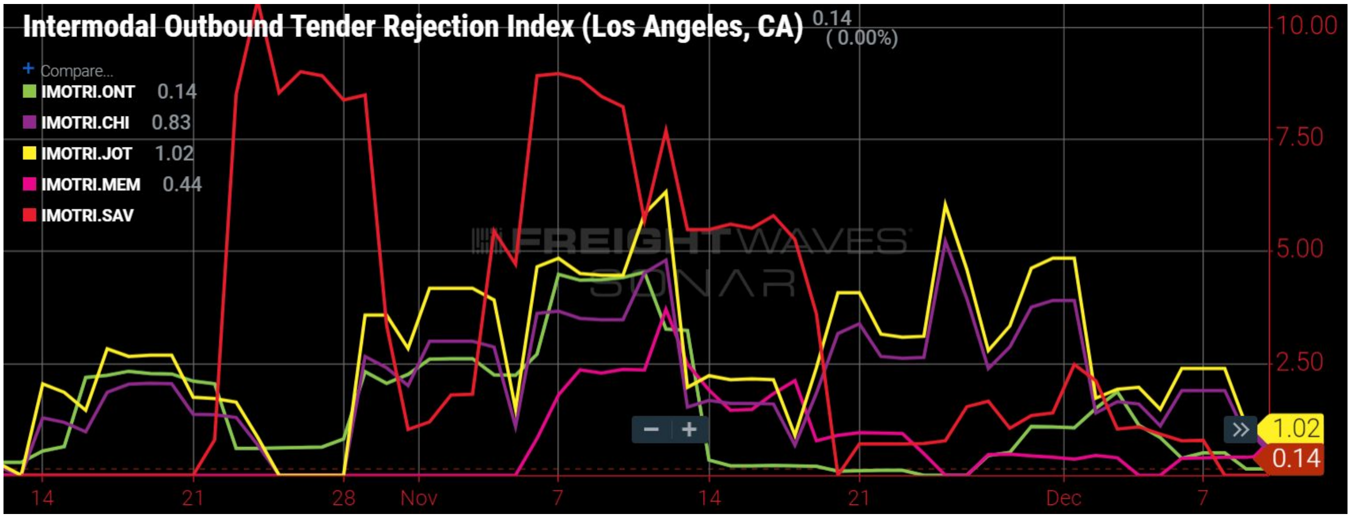
We are continuing to see ugly Y/Y comparisons, with last week's U.S. total intermodal units down 11.30% Y/Y. These are the first numbers since the Thanksgiving break, which isn't encouraging. The tariff effect of last year is likely to continue to make comparables difficult throughout the next few weeks. We have not seen as much of a tariff deadline push in freight this year as last year. It is likely that companies didn't fear the Dec. 15 tariff deadline or are still flooded with inventory from last year.

The railroad that saw the biggest weekly percentage decrease was Union Pacific with a decrease of 20.4% Y/Y. This coincides with continued weak imports into the Los Angeles market. It is unlikely that these volumes will rebound quickly without a resolution to the Chinese-American trade dispute.



We wrote previously about the recent shift in imports from the West to the East Coast. Over the past six months, imports into the Elizabeth, New Jersey, market, a proxy for the Ports of New York and New Jersey, have grown 29%, while imports into the Los Angeles market decreased 1%. A depressed North Asia-U.S. trade and growth in trade relationships with Southern Asia have made the Suez Canal more viable; meanwhile, East Coast investments in dredging and cranes reflect renewed sales efforts on the part of those port authorities.

Intermodal capacity



(Chart: FreightWaves SONAR)

Intermodal capacity remains extremely loose in the weeks following Thanksgiving and the weeks leading into the rest of the holiday season. Intermodal Outbound Tender Rejections (IMOTRI.x) measure contracted loads ejected by IMCs. IMOTRI has stayed stable right around 1%, showing that railroads are not willing to turn away any of the contracted loads. This low rejection rate can be explained by having trucking rates sitting around the operational cost of the truck and the service reliability of a truck. Intermodal shipping typically takes an additional day or two from the time it reaches the port, including inland ports like Memphis, Tennessee, and Chicago, to reach the destination. Unfortunately, this trend will continue as long as trucking rates remain low, but the good news for intermodal is that the trucking rejections have started to climb, meaning that there will be some pressure on trucking rates moving into Q1 2020.

(Chart: FreightWaves SONAR)

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Railroad Terminal Dwell Time (RRTD.x) is a measure of how long a train waits in one of the specified terminals. This information is a measure of service that the railroads are trying to improve with the implementation of precision scheduled railroading (PSR). The lower the terminal dwell times the better for the railroads and their customers. In some of the major intermodal markets, the terminal dwell times have moved in opposite directions since the beginning of the year.

In Chicago, terminal dwell times contracted by more than 11 hours since this time last year, an improvement of almost 46%. Outside of a spike in the middle of February, terminal dwell times in Chicago have been on a steady decline. Atlanta has seen quite the opposite happen, with dwell times expanding by approximately 3.5 hours since mid-May, an increase of 30%. As some of the major railroads stated last week, their primary focus remains optimizing their networks. We're waiting to see to what extent the railroads are optimizing for yield (operating ratio and profitability) versus service (train velocity and terminal dwell time). While service and financial performance have been loosely (or even negatively) correlated in the past, the rhetoric of PSR suggests that the operational turnarounds currently underway are trying to do both.