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Intermodal markets

Overview

It's an open question as to how fast intermodal volumes will grow in 2019; volume growth in the sector has halved in the past five-year period compared to the five years prior to that.

CSX management guided for "GDP-plus" intermodal volume growth this year in its earnings call last week, but U.S. GDP growth is expected to come in around 1.9% in 2020, according to the Chicago Fed. Even with the number of locomotives in storage, that does not seem like enough volume to tighten capacity or drive meaningful price increases.

Intermodal also is driven by the trucking spot market, the tail that wags the entire freight industry dog. Trucking outbound tender rejections have held steady above 7.5% this week, a higher level than most of 2019.

Intermodal capacity tightened in West Coast markets along with trucking rejections, but we believe this is a temporary, pre-Chinese New Year effect and will dissipate in February. Intermodal train velocities and dwell times indicate that networks are fluid, which comes as no surprise given the relatively weak volume environment.

Both GATX and Union Pacific report earnings before the market opens Thursday. Management commentary and analyst Q&A will enrich our view of the coming quarter and year.

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	$1.16
Chicago to Los Angeles	$0.90

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

Los Angeles to Chicago	1008.29 (+1.29%)
Chicago to Los Angeles	794.00 (+5.17%)
Chicago to Elizabeth, NJ	558.00 (-0.86%)
Elizabeth, NJ, to Chicago	378.57 (-4.19%)
Los Angeles to Dallas	372.29 (-4.37%)

Outbound intermodal tender rejections

Savannah, GA	0.00%
Joliet, IL	3.66%
Chicago	2.91%
Memphis, TN	1.07%
Los Angeles	5.03%

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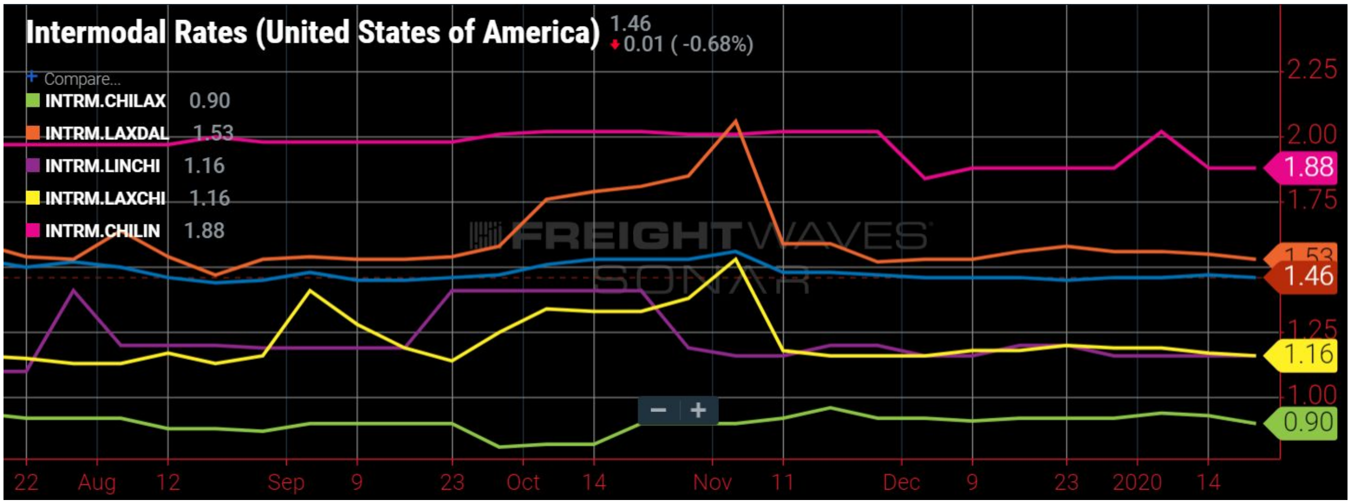
Intermodal spot rates



(Chart: FreightWaves SONAR)

Intermodal spot rates continue to walk along the x-axis, in stark contrast to trucking spot rates. Trucking spot rates have been considerably weaker since the beginning of the year due to seasonality affecting truck volumes. Although intermodal spot rates are slightly lower than where they were at the beginning of the year, railroads have made it clear that they don't plan on drastically reducing rates to increase volumes. This is quite evident in our intermodal spot data.

Over the past week, the national average intermodal rate decreased 0.7%. Major lanes that moved significantly included Chicago-Los Angeles (-3.2%), Los Angeles-Dallas (-1.3%) and Los Angeles-Chicago (-0.9%). Three lanes remained unchanged from the previous week. We expect that rates will remain roughly where there are currently, with an upward bias through the remainder of the year.

CSX reported earnings after markets closed last Thursday and was the first of the Class I railroads to report this season. Intermodal market expert Mike Baudendistel said of the earnings, "Management expects intermodal volume growth this year and expects intermodal to return to 'GDP-plus' growth status after de-marketing lanes in fall 2018, [and] management doesn't have any plans to reduce intermodal rates in an effort to attract more freight."

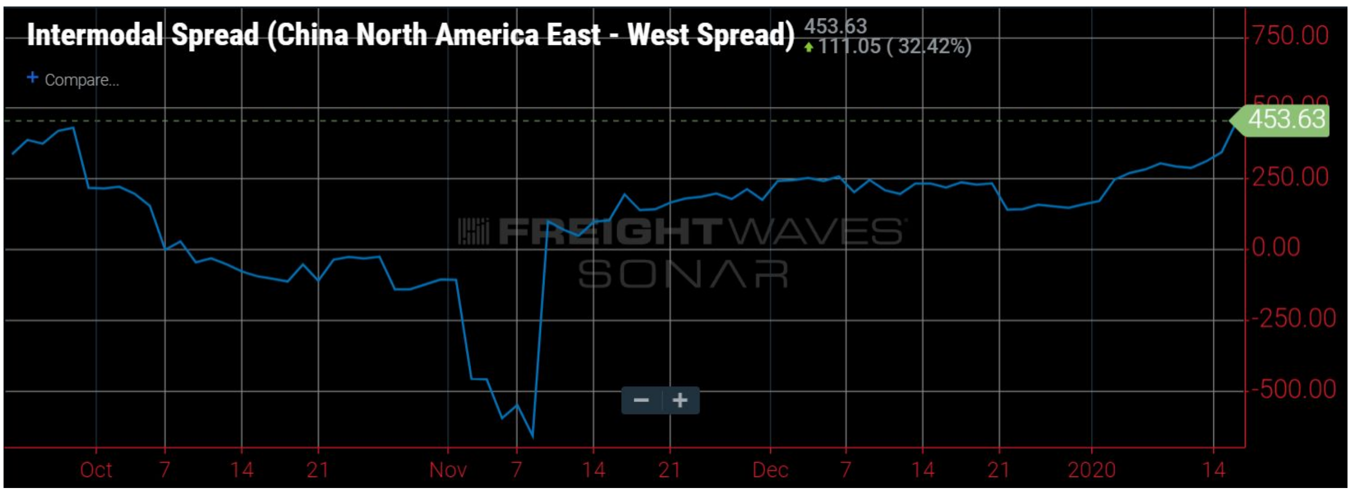
After an initial drop Friday, CSX shares recovered most of their losses by the time trading ended. As of Tuesday's close, shares were trading 2.50% lower, while the S&P 500 was trading 0.11% higher.

Freight demand

U.S. Class I intermodal volumes were down 7.7% y/y in Week 3, an improvement over the past four weeks, during which volumes declined 8.4%. We are still in a tough comps environment, which we expect will continue through at least the end of this month. The Chinese New Year holiday is on Jan. 25 and will last for at least a week. Coastal manufacturing and shipping in China will shut down for approximately two weeks as workers return to their villages for the holiday; after a lag, volumes will dry up in West Coast ports.

Canadian National was the worst performer this week, with intermodal volumes decreasing 16.3% y/y in Week 3. This comes as a surprise as Canadian National had been a relative outperformer in 2019. Union Pacific was not that far behind: UNP volumes dropped 16.1% y/y in Week 3.

Canadian National cited cold weather in the Western region as the reason why intermodal volumes dropped off so sharply. Extreme cold weather forces rails to run their trains shorter lengths and at slower speeds. We note that CN's Western network includes the Ports of Vancouver and Prince Rupert. These are large international ports and if the weather slowed or prohibited ships from entering the ports, this would definitely impact intermodal volumes. CN exclusively serves Prince Rupert, which could explain the underperformance relative to Canadian Pacific.

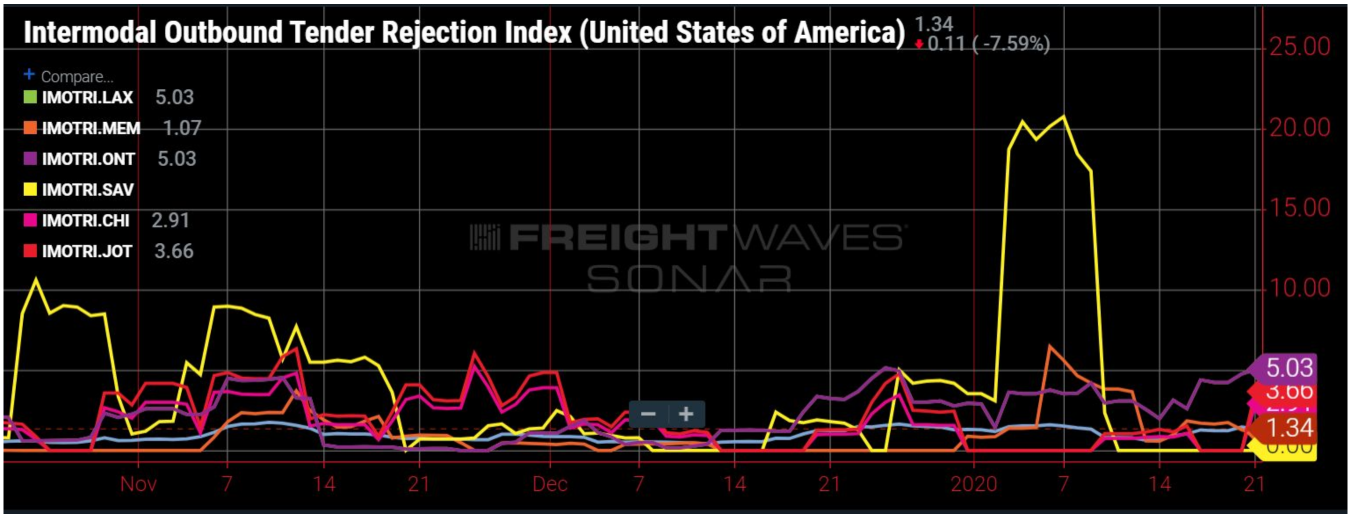


(Chart: FreightWaves SONAR)

The adjusted intermodal spread represents the difference between an all-in transportation cost from China to Chicago (or the U.S. Midwest) going through East Coast and West Coast ports, including container spot rates and intermodal spot rates. A positive value indicates the dollar amount by which the East Coast route is more expensive — today moving a container from China to the Midwest through an East Coast port is $453.63 more expensive than the West Coast.

The widening spread is being driven by the China-West Coast container spot rate (FBXD.CNAW), which fell off faster than the East Coast rate after the last round of rate increases imposed by the container lines. Demand is soft on that lane and steamship lines have pulled capacity in an attempt to stabilize the price environment.

Intermodal capacity



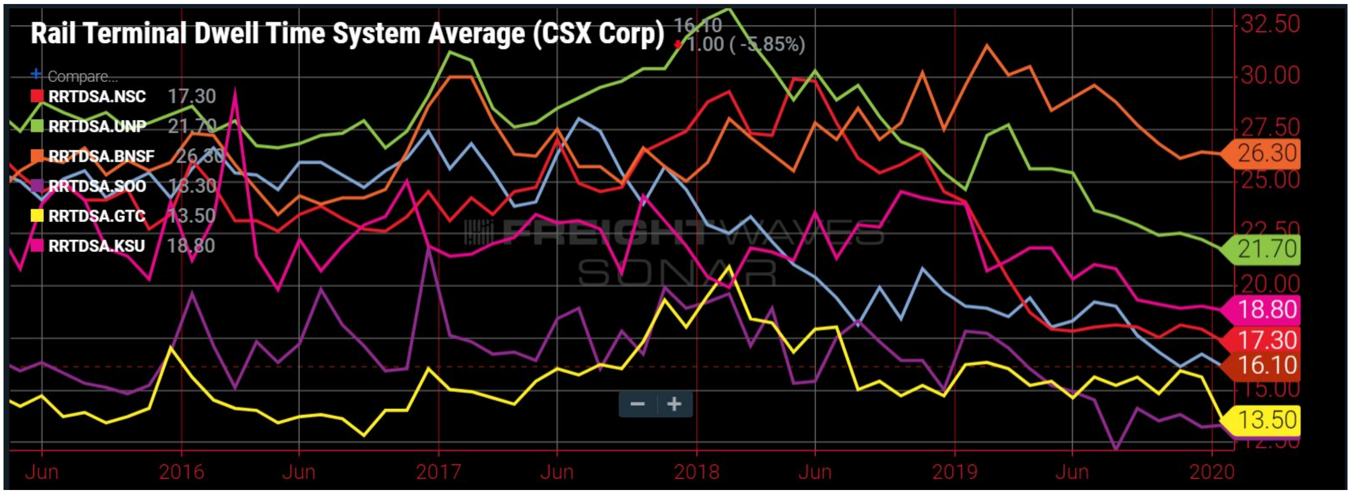
(Chart: FreightWaves SONAR)

Intermodal capacity has started to tighten across the country but still remains very loose overall. Intermodal tender rejections (IMOTRI.x) are a measure of capacity as a percentage of the overall contracted loads that are rejected by IMCs. IMOTRI.USA breached 1% after spending the past week well below 1%. Mounting intermodal rejections can be partly attributed to trucking capacity remaining tighter than anticipated.

Intermodal rejections in Southern California have risen over 155% in the past week and are nearing trucking rejection rates in Los Angeles. As the second-largest intermodal market, the tightening of capacity will lead to rate increases out of Southern California that could ultimately cause volumes to move to trucking and the loosening of intermodal capacity again.

Chicago and Joliet, Illinois, bounced off the bottom at the beginning of this week. After spending most of the past month underperforming other major lanes, rejections rebounded to around 3%.

Class I railroads and IMCs are continuing to transload more 40-foot container freight to 53-foot containers to keep capacity stable and utilize their container assets. We expect capacity to remain loose through the first half of the year as trucking markets continue to rebound.



(Chart: FreightWaves SONAR)

Railroad terminal dwell time is the average number of hours that trains spend sitting in terminals across the Class I networks; shorter dwell times imply better customer service. Overall Class I terminal dwell times have steadily contracted for the past two months.

We note that lower volumes and the removal of assets from the rails have made it easier for railroad networks to achieve fluidity and cut dwell times; it's unclear to us how well these service levels will hold up in a high-volume environment.

All of the Class I rails — with the exception of BNSF — are in the process of implementing their versions of precision scheduled railroading (PSR). BNSF has yet to come out and say that it is implementing PSR, but it has continued to decrease terminal dwell times across its networks.

Canadian National, the first to implement PSR, has regularly had the lowest terminal dwell time over the past five years. CN also has seen the most improvement over the past month, and dwell times have decreased to just 13.5 hours.

Norfolk Southern, which reports earnings next week, begins its implementation of the third phase of TOP21, its version of PSR, this quarter. NS will focus on the intermodal segment of the business. As management makes these operational changes, look for NS' service metrics to improve further, meaning that trains should be longer, move at higher speeds and spend less time sitting in terminals.