VIEWPOINT

COVID-19:

Farewell Globalization. Hello Regionalization.

Implications for Supply Chains

The current global pandemic has severely tested the resiliency aspect of supply chains, with delays and disruptions pervasive. Shutdowns in production across multiple industries and many regions have been a feature of much of the past three months, causing companies to rethink how they will deliver products in a reliable and cost-effective manner. In tandem, globalization continues to be under scrutiny, and trade volumes are down markedly, as reflected in port and railroad data. As all of these phenomena collide, COVID-19 could be the catalyst for a complete rethink of supply chains as we know them.

Supply Chains – A Brief History

For much of the past 30-plus years, globalization has created increasingly complex [and longer] supply chains that now encompass every region of the globe. Asia Pacific, in particular, became (to a large extent) the factory to the world, and as a result much of what the world consumes originates in countries such as China, and then is transported across the globe through a series of shipping lines, railroads, trucking companies, and air freight operators. As a result, for North America, the flow of goods is from west to east [although the recent widening of the Panama Canal has resulted in a notable uptick in East Coast container volumes with Savannah, Georgia now number three in North America].

Supply chains have been designed to support this movement, including the establishment of large warehouse markets such as Inland Empire on the eastern fringe of Los Angeles, to facilitate imports to the rest of the United States. A similar pattern also exists for Canada, where Vancouver serves as an entry point for the majority of containers coming to Canada and then shipped eastward. This model has served well for companies and consumers alike (through lower prices), but even prior to COVID-19 there were a number of forces calling into question the merits of moving goods across long distances, perhaps most notably the large carbon footprints created by such long supply chains. Improved technology was also beginning to raise the question of whether bringing some forms of manufacturing back to North America was now a viable option. But in all the discussions about supply chains, reliability was generally not an issue, until COVID-19.

North America Port Container Traffic

Rank	Port	Total TEU's YTD April 2020	Prior Year Change %
1	Los Angeles/Long Beach	4,691,398	-12.8
2	New York/New Jersey	2,316,907	-3.4
3	Savannah	1,415,758	-6.7
4	Seattle/Tacoma	1,036,556	-17.5
5	Vancouver	1,013,723	-10.6
6	Houston	994,627	5.0
7	Norfolk	861,609	-9.7
8	Oakland	783,583	-5.4
9	Charleston	770,017	-4.1
10	Montreal*	698,966	-2.5

TEU - Twenty Foot Equivalent Unit (containers) | *May | Source: Cresa Research

Supply Chains Going Forward

There is now a complete rethink going on about the interdependence between countries and the resiliency vs. cost trade off. While there has not been a complete breakdown in supply chains, the disruptions seen across myriad industries and regions resulted in heightened calls into whether globalization, and the premise behind global trade flows, needed to be rethought. Even before COVID-19, global trade was already being pressured, most notably with a series of tariffs introduced by the Trump administration, but also by technological advancements, moving some companies to question whether long, and often complex, supply chains needed to be replaced. The arrival of a global pandemic only increased the pressure to revisit global trade patterns.

Any reconfiguration of existing supply chains would have a significant impact on North American industrial real estate markets. While the point-of-origin for many imported goods could shift, for example from Asia to Latin America, or Eastern Europe, or even Africa, an equally seismic shift would be for manufacturing to be done on home soil. Returning manufacturing to North America could yield several benefits, including being closer to the end consumer, less risk in the transport of goods, and greater oversight and safety protocols.

Supply chain patterns would look very different if goods were produced domestically than if imported from another part of the world. It should be noted, however, these changes, if they occur, would be over a period of years, if not decades and would vary considerably by industry. By example, auto production is a very complex and highly specialized process, so it is doubtful that it would be altered in any meaningful way. Apparel, on the other hand, could be more easily shifted to another country or, indeed, produced domestically.

United States, Canada, Mexico Rail Traffic

Country	Carloads - WEEK	YoY %	Intermodal Units - WEEK	YoY %	Carloads - YTD	YoY %	Intermodal Units - YTD	YoY %
United States	433,171	-15.6	240,677	9.6	4,906,251	-15.1	5,427,307	-11.2
Canada	68,464	-18.7	63,886	-8.4	3,192,067*	-7.6	3,192,067*	-7.6
Mexico	18,066	-18.6	14,714	-18.3	770,890*	-9.8	770,890*	-9.8

* Carloads and Intermodal combined | Week ending June 6th 2020 | Source: Association of American Railroads (AAR)

De-risking Supply Chains: Five Takeaways for Warehouse Markets

For the immediate term, the focus for supply chain executives will be to de-risk the delivery of goods, with an emphasis on resiliency through a series of diversification strategies. The impact on warehouse markets will be varied and mixed.

1 Multiple suppliers, more of whom will be North American, could lead to more point-to-point delivery, reducing the need for larger hub-and-spoke distribution centers. This would drive the demand up for warehouse space in secondary markets, and down in some of the larger markets including Inland Empire, Dallas, Chicago, Northern New Jersey and Atlanta

2 Increased transportation of goods moving in a north/south direction, and decreased west/east movement, increasing the need for distribution centers accommodating imports/exports from Canada and Mexico (NAFTA, and the about to be implemented USMCA will be an added tailwind).

3 To offset the almost certain higher manufacturing costs from reshoring, industrial production will become more automated, placing less emphasis on the availability (and price) of labor, and more importance on being located in key distribution hubs, as they relate to intermodal yards and the Interstate Highway System.

4 The reshoring of industrial production will create demand for traditional manufacturing space, a change from the heightened demand for warehouse/distribution and light assembly space seen for the past several decades.

5 Just-in-time inventory systems to be augmented (not replaced) by just-in-case supply chain management, will lead to increased inventories, and possibly more (smaller) regular deliveries (watch inventory-to-sales ratio currently 1.67/April 2020, up from a recent low of 1.34/June 2018).

Closing Thoughts

The now trending discussion on how manufacturing should be brought back to local shores, and the resulting impact on supply chains, will undoubtedly lead to subsequent discussion how industrial markets will also have to adapt to new inventory flows. Not just where manufactured goods will be produced, but what type of buildings are required, the size of building, the role of third party logistics (3PL) companies, and the role of small batch deliveries, will all be up for consideration.

As stated previously, globalization is showing signs of peaking and a move towards more regional trade looks ready to take its place. The transition from importing (from one region/country) and then subsequently distributing, to importing from a limited number of regional trading partners, augmented by domestic production, will present a host of challenges, and opportunities, for industrial markets across North America.

This is the fifth in a series of Cresa Viewpoints covering the COVID-19 crisis.

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