

It's Logistics

The primary line from the United Parcel Service commercial of a few years ago describes the basic function that propels business. The buying and selling of goods almost always requires a third party. That party is the company that transports the good from the seller to the buyer. Logistics indexes are an accurate barometer of business conditions.

It would appear that very little is moving. (<http://www.zerohedge.com/news/2016-01-11/nothing-moving-baltic-dry-crashes-insiders-warn-commerce-has-come-halt>). When I read this article originally I checked www.marinetraffic.com. I have been using this site to monitor traffic between the Black Sea and the Mediterranean through the Turkish Straits. While I saw a lot of what might be called coastal traffic, there apparently is little if any traffic of an intercontinental nature.

I watch three indexes to monitor logistics: The Baltic Dry Index, the Harpex and the Cass Freight Index. The Baltic Dry Index is a measure of the movement of raw material such as coal, ores and bulk foods. The Harpex is an index of container shipping. I use this index as a proxy for the shipment of finished goods. (<http://www.harperpetersen.com/harpex/harpexVP.do>) The Cass Freight Index is a consolidated index covering all modes of transport within the United States. (<http://www.cassinfo.com/Transportation-Expense-Management/Supply-Chain-Analysis/Cass-Freight-Index.aspx>)

I began writing this on January 11. It is now January 12. The Baltic Dry Index has dropped to 402, its all time low. The Harpex is down to 363, its all time low. The Cass freight Index is also down to approximately 1.03, its lowest since 2013. I rechecked www.marinetraffic.com today and found that while there is still significant intra continental shipping, There is apparently little or no inter continental shipping.

There is a maxim in international affairs that says if goods and services don't cross borders, armies do. These indexes indicate that at least goods are not crossing borders and manufacturing is at a very low level. As the level of manufacturing is reduced so is employment in jobs that allow the workers to purchase the products that they make.

One example of the slowdown in economic activity is the current depressed oil prices and the international activities surrounding the price of oil. One of the outgrowths of the current oil price war is the massive shutting down of oil production in the United States and Canada. These operations that use hydraulic fracturing ("fracking") require a certain minimum per barrel price of oil to be profitable. That price varies but it is somewhere in the neighborhood of twice the current price of oil which is about \$32.00 per barrel.

This price "war" is a deliberate attempt to punish Russia for its support of the Assad government. In 2009 King Abdullah of Saudi Arabia went to Damascus to attempt to convince Bashar Assad to allow the construction of a natural gas pipeline from Qatar through Saudi Arabia then Syria to link up with the natural gas pipelines that carry gas to southern Europe. Understand that the head of the House of Saud is not only the ruler of Saudi Arabia but he is also the Custodian of the Two Holy Mosques: the Grand Mosques of Mecca and Medina. It is upon this title given him by ibn Wahhab in the early 1850s

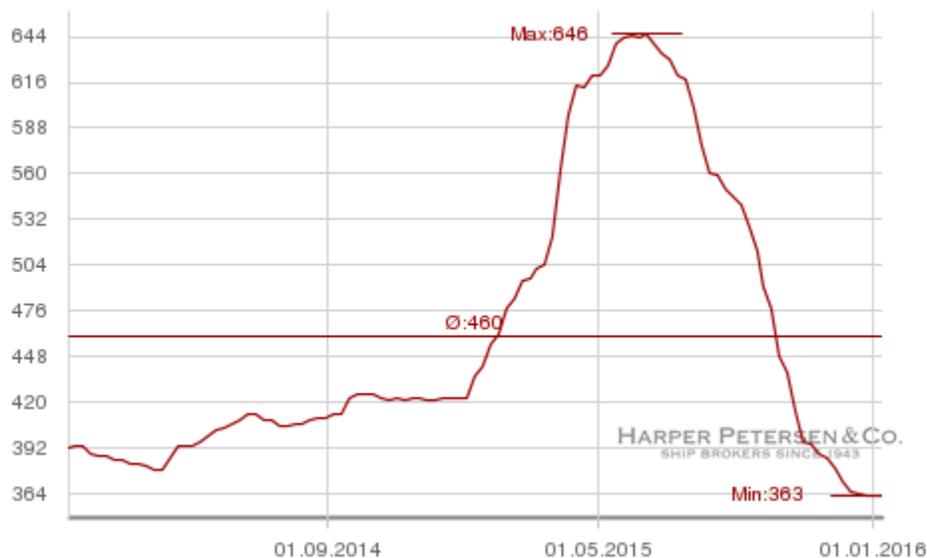
through marriage between the Wahhab family and the House of Saud that constitutes the real power of the House of Saud in the Islamic World. If the Custodian of the Two Holy Mosques comes to see you, you are in serious trouble.

Bashar Assad refused permission for the “Sunni” pipeline. To the House of Saud this was an unacceptable slight and cause for a blood feud. This feud has taken the form of the current Saudi sponsored war in Syria to unseat the Assad family and put a Sunni Muslim in charge. This also reflects the competition between the two main branches of Islam: Sunni and Shi'i.

Russia's support for Assad is not religious in nature. The Assad family and the Russians through the former Soviet Union have had a relationship that has lasted over 50 years. In 1973, the Soviet Union was willing to start World War Three to prevent the Israeli Army from entering Damascus and deposing the Assad family. Putin is no less serious about the survival of the Assad family than the Soviets were. This also blends nicely with Russia's support of Shiite Iran and Iran's desire to cripple the power of Saudi Arabia as the leader of the Islamic World. This is a contest that began at the death of Mohammed and has lasted some 1400 years.

Where does logistics apply here? There is currently a large surplus of oil available. This surplus is large enough that oil tankers are being used as floating storage because of the lack of on land oil storage facilities.

This is analogous to the recent spike in the Harpex as container ships were being used as floating warehouses during the recent West Coast ports slowdown



during the labor negotiations. You can see the spike in the Harpex that occurred during February and March of last year. Once the labor strife was settled, the Harpex fell to its all time low where it sits now. (Harpex chart 13 Jan 16)

Sun Tzu said:

“When provisions are transported for a thousand li (a measure of distance) expenditures at home and in the field, stipends for the entertainment of advisers and visitors, the cost of materials such as glue and lacquer, and of chariots and armor, will amount to one thousand pieces of gold a day. After this money is in hand, one hundred thousand troops may be raised.” (Sun Tzu, The Art of War, Griffith translation, ISBN 978-0-19-501476-1)

War is expensive. Sun Tzu said, "when the army engages in protracted campaigns the resources of the state will not suffice." We have been engaged in almost continuous conflict since Operation Desert Storm in 1991. How are we paying for this? The current logistics indexes indicate that there is insufficient economic activity to finance these conflicts. A popular talk show host, Jerry Doyle, said repeatedly about the pharmaceutical industry that "the money is in the medicine not the cure." An analog to that would be the money is in the conflict not in winning the war.

Boycotts in support of foreign policy also reduce the requirement for logistic support. The United States and Europe have instituted boycotts against Russian goods, services and people. The Russians have likewise instituted boycotts against various countries in retaliation. Whose economy will break first? The Russians have a bit of a trump card though. Russia supplies approximately one third of the natural gas used in Europe. In some cases Russia supplies all of a country's natural gas.

Most of the major gas pipelines serving central and southern Europe from Russia pass through Ukraine. That means that the nations of Europe must support Ukraine's purchase of Russian gas to keep the pipelines open. This was a problem a few years ago when Ukraine could not pay for its gas. Many people downstream in places like Romania froze to death when Russia cut off the gas flowing through Ukraine until the gas was paid for. Ukraine has applied to join the European Union. In retaliation, Russia is boycotting good from Ukraine. So far the gas is flowing but paying for that gas is putting a strain on Ukraine as it can no longer sell its produce to Russia.

Logistics indexes are an indicator of the health of the World economy. They are also a proxy for the level of conflict in the World. If business is bad the chances of major conflict escalate. The People's Republic of China is attempting to take control of most of the South China Sea to protect its trade routes and to exploit the natural resources under the sea bed. The PRC must do this to keep its one and a half billion or so population employed. This is causing conflict with the other countries who also have claims to the islands in the South China Sea notably Vietnam and the Philippines. The United States has again been granted basing rights in the Philippines based upon the threats from the PRC.

These are only a few examples of the uses to which logistics indexes, combined with a knowledge of current events, may be put. While the data is not subject to much interpretation, goods move or they don't and that movement is recorded, the causes and effects are open to interpretation. I believe that the absolute low level of these major indexes shows that the World economy is a disaster. Money must be earned if goods are to be bought. Borrowing will no longer provide enough money to stimulate the economy. Debt must be extinguished before more may be incurred.

We are entering a period where there may be major political upheavals in response to the poor economies. We should all be prepared for such events as we would be for natural disasters. How is your "earthquake preparedness"?