Rock the Boat

Global Shipping Analysis

March 2024

Table of Contents

Published by:
Sucden Financial Limited
Tuesday, 19 March 2024

Author:

Daria Efanova
Head of Research

Research Desk
research@sucfin.com

Press Enquiries
press@sucfin.com

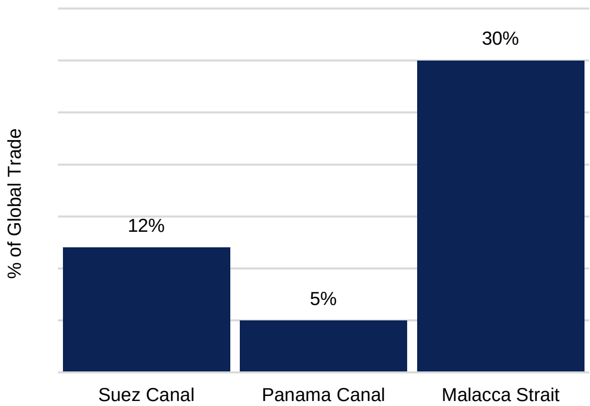
Rock the Boat

The Suez Canal

Tensions in the Middle East, compounded by ongoing security issues in the Red Sea, continue to escalate concerns about their potential adverse effects on Europe's already fragile economy. As the strikes in the Red Sea led major shipping companies to redirect their vessels away from the Suez Canal and take a longer route via the Cape of Good Hope, how could the Red Sea crisis escalate to impact shipping costs and inflation?

Percentage of Global Trade Passing through the Key Strategic Passages

About 17% of global trade passes through the Panama and Suez Canals.

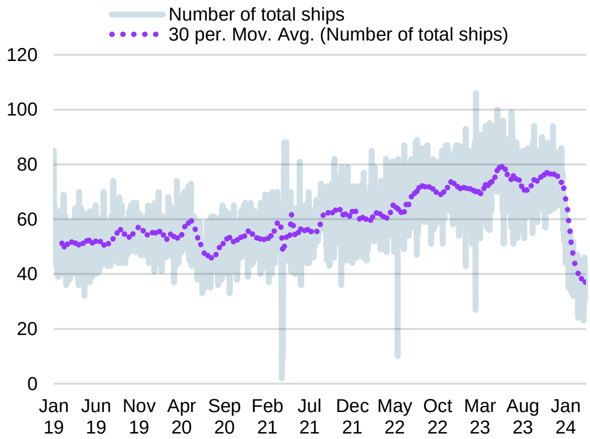


Source: The World Economic Forum

Following the outbreak of the war between Hamas and Israel on October 7th, the Yemeni militia Houthis started attacks on vessels associated with Israel and its allies. The Houthis, who control the western coast of Yemen, emerged as an opposition to the Yemeni establishment after the unification of Northern and Southern Yemen in the 1990s. The Houthis are backed by Iran as part of its longstanding hostility with Saudi Arabia and are supporting Hamas in the war in Gaza. Houthi rebels said they would continue to attack vessels as long as Gaza remained under siege, demanding Israel to agree to a ceasefire. According to Ambrey Analytics data, over 40 ships have so far been attacked in the Red Sea, mostly close to the Bab-el-Mandeb strait – the southern entrance to the sea. In response to the attacks, the US initiated Operation Prosperity Guardian, a naval endeavour supported by several nations. The European Union also launched its own naval mission last month to protect cargo ships in the Red Sea.

Number of Total Ships Transiting through the Suez Canal

Since early December, the number of ships transiting through Suez halved.

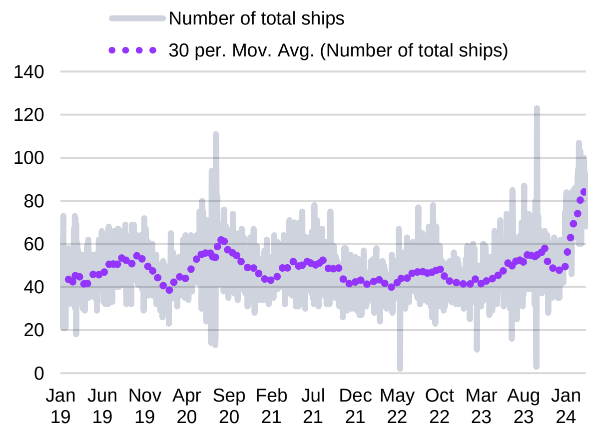


Source: IMF PortWatch

The disruptions in the Red Sea and the blockade of the Suez Canal have impacted the West, as this route is pivotal for the fastest maritime connection between Europe and Asia. In 2023, the Suez Canal, extending 120 miles across Egypt, saw passage from an estimated 21,344 vessels, or about 59 ships daily, accounting for 12% of global trade. Houthi attacks on commercial ships have led shipping companies to divert their routes away from the Red Sea, choosing instead the longer path around South Africa’s Cape of Good Hope. This diversion adds an extra ten days, increasing transit times by 30%, prompting a possible 5% increase in effective capacity this year to account for longer shipping routes.

Number of Total Ships Transiting through the Cape of Good Hope

As a result of the tensions at the Red Sea, most of the ships have been redirected via the Cape of Good Hope.



Source: IMF PortWatch

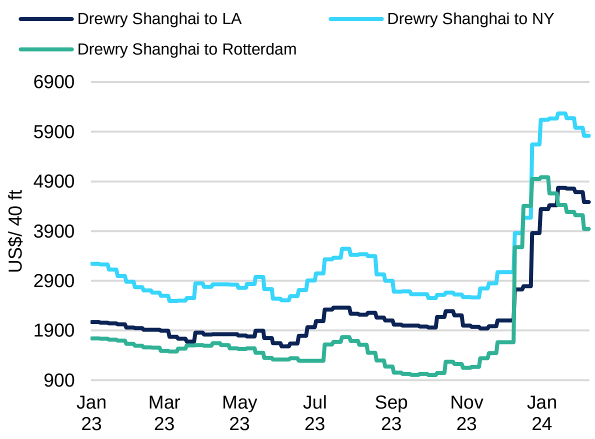
The deployment of Western military forces has not significantly enhanced security in the region. Container ships that normally navigate through the Suez Canal are now frequently taking a detour around the Cape of Good Hope. In March, the daily number of vessels passing through the Suez Canal, based on a 7-day moving average, dropped to almost half of the pre-conflict levels. Meanwhile, the number of daily transits at the Cape of Good Hope has increased to twice the amount seen before the conflict. Additionally, the volume of container cargo moving through the canal has decreased by 82% since early December. Maersk, a leading company in the industry controlling approximately one-sixth of global container shipping, announced in March that it would continue to divert all its vessels via the Cape of Good Hope for the foreseeable future.

To counteract delays, vessels have been increasing their speed by an average of 10%, leading to higher fuel consumption. A 1% increase in speed can result in a 2.2% increase in fuel usage, raising costs for shipping companies. As of March 2024, rerouting via South Africa is costing $1m extra in fuel costs for a round trip. Emissions produced during the trip will also be higher, with an estimated total of 55,000t of CO2 for an average vessel carrying 150,000 mt of cargo. Given that the EU Emissions Trading System costs apply to the entire trip, companies might choose to limit the duration of the trip to save on costs. The EU Emissions Trading System costs are applied to the entire trip, which could cause companies to limit the duration of the trip to save on costs. Currently, the EU ETS price is at EUR 57/mt of CO2, resulting in an additional cost of EUR 0.6-1.5 million per single trip to Europe. In addition to this, the extra fuel costs incurred due to faster travel put a significant burden on vessel buyers, forcing them to reduce the duration of the trip or avoid it altogether. This problem is especially prevalent for smaller vessels that have thinner profit margins from the trip.

Rerouting ships to circumvent the increased war risk premium – which has risen from 0.07% to 1% of a vessel's value since November – does come with its own set of challenges, including a 10-fold increase in insurance costs, potential losses from piracy, schedule disruptions, and port congestions, inflating the operational costs for shipping companies. Consequently, this increase in operational costs has led to higher freight charges, raising concerns that these higher rates might be transferred to European consumers, especially impacting the cost of imported goods. Almost a quarter of Europe's imports from Asia are transported by sea, compared to just 10% of its exports. According to Drewry, freight rates on the route from Shanghai to Rotterdam increased by 148% YoY in February, reaching almost $5,000/40ft container. The surge in freight rates is most pronounced on routes traversing the Suez, but its impact is felt globally, including on trans-Pacific routes to the United States West Coast, where rates have escalated by 130% since early November.

Drewry Shipping Rates from Shanghai to the West

A combination of closures on the Suez and Panama Canals prompted the rates to NY more than double.



Source: Drewry

Although the rerouting of ships around South Africa may have eased some of the supply chain pressures on transportation infrastructure, it has come at a cost. Carriers have imposed additional charges to compensate for the expenses incurred by rerouting vessels around the southern tip of Africa and avoiding potential security risks in the Red Sea. This has introduced a new level of complexity for businesses engaged in international trade, prompting a proactive approach to managing costs. In addition to the standard shipping rates, these surcharges can add more than $2,000 to the base rate and include various fees such as a bunker recovery charge, Emissions Trading System charge, contingency adjustment charge, origin and destination terminal handling charges, carrier security fees, and ship and port security charge. Although the Suez Canal authorities have promised to provide maritime services such as ship repairs, maintenance services, fuel, food, water and first aid, the total bill for companies shipping to Red Sea ports has increased significantly to $6,800 per container compared to $750 before the crisis.

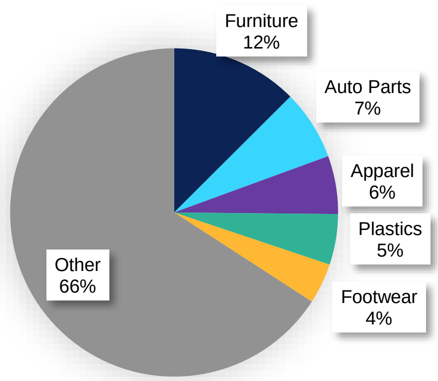
The current state of global supply chains suggests that the Suez Canal conflict will pose limited implications on overall trade. However, if disruptions continue to persist for an extended period of time, the costs for shipping companies might remain elevated relative to last year's levels. The delays could lead to cashflow difficulties and material shortages, according to BCC. Although most retailers have coverage hedges to protect against freight exposure and lock in rates to more normalised levels, there could be a case for upward renegotiations. Contracted shippers are not immune to price increases via surcharges when spot rates unexpectedly climb. Those vessels that need to deviate via the Cape of Good Hope will suffer corresponding surcharges to compensate for the extra vessel costs. This means that carriers may be in a strong position to either increase base rates or at least resist any further decreases in rates despite overcapacity fundamentals.

The Panama Canal

While the problems in the Middle East are being diverted via the Cape of Good Hope, the Panama Canal, which is particularly important for countries on the West Coast of South America, is also under stress. Low rainfall has dwindled water levels, forcing the authorities to limit the size and capacity of loaded vessels. Facing alarmingly low water levels, the Panama Canal Authority has reduced daily transits from an average of 36 to 18 per day. As a result, total transits plummeted by 23% YTD.

Breakdown of Imports to the LA Port in 2023

Around 25% of total LA imports are brought in by the end-user goods.

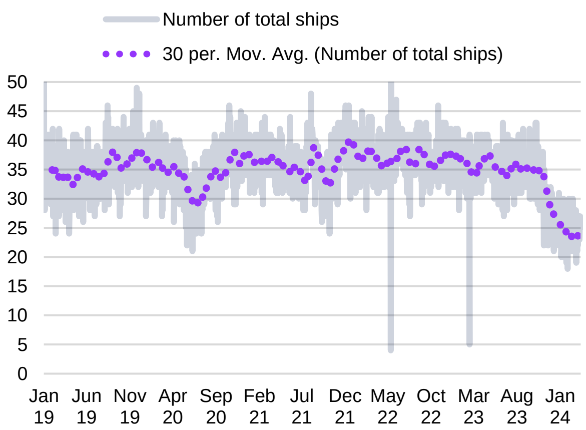


Source: The Port of Los Angeles

As the prolonged drought at the Panama Canal poses risks to imports, ports along the US East and Gulf Coasts are facing uncertain times. This coincides with the impending expiration of a six-year labour contract at the end of September 2024 between the International Longshoremen Association (ILA), which represents 70,000 dock workers at these ports, and the United States Maritime Alliance (USMX), which acts on behalf of employers at 36 coastal ports, including three of the busiest ports in the US. Negotiations between the ILA and USMX, which started in February 2023, have yet to yield an agreement, particularly on issues like salary increments. Consequently, the ILA has declared its intention not to renew the current contract beyond its expiration date, raising the possibility of a strike at East and Gulf Coast ports in October. Importers are wary, given the increased leverage of unionised workers following the COVID-19 pandemic. The labour disputes at West Coast ports last year prompted intervention from the Biden Administration, resulting in a deal that awarded West Coast dockworkers a 32% pay raise over six years. Leading up to the current negotiations, the ILA has secured several local wins. This year, it won litigation that will effectively force the Port of Charleston to employ more unionised dockworkers at a new container-handling terminal. With the contract's expiration six months away, many importers using East Coast ports are expected to advance their supply chains to ensure their cargo is delivered before any potential disruptions. Additionally, shippers might consider expanding their shipping routes and port choices to include more West Coast ports until a new agreement is reached between the ILA and USMX. If there is ongoing tension in the Suez and Panama Canal, a union strike at US ports could make things even more complicated for the global supply chain. This could cause shipping rates to increase or at the very least prevent them from decreasing in the second half of 2024.

Number of Total Ships Transiting through the Panama Canal

The number of ships transiting through the Panama Canal has decreased substantially.

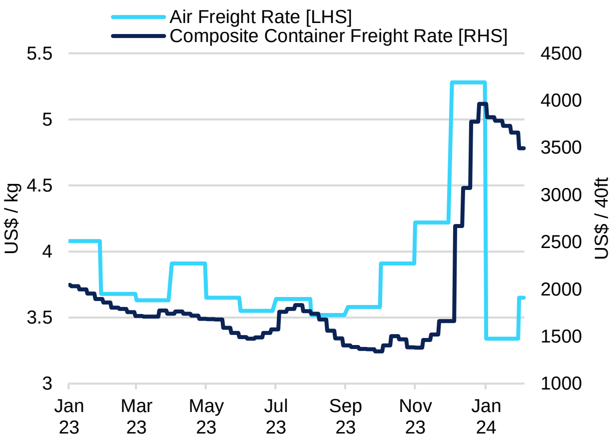


Source: IMF PortWatch

As the result of elevated ocean costs and longer transit routes, the global air freight market has begun the year strong, with demand surging 5% YoY in January, with a corresponding 12% increase in capacity, according to WorldACD. The delayed start of the Chinese New Year in 2024 and the ongoing disruptions at sea underscored the need for air freight solutions to address logistical challenges efficiently. According to Drewry, the average air now costs $3.65/kg. While this is down from January's peak of $5.28/kg, the continuing demand for air freight as a means of leapfrogging some of the bottlenecks should prevent air freight costs from substantial declines for the majority of 2024.

Average Air and Container Freight Rate

The Air freight rate is expected to appreciate slightly, as demand for air cargo increases.

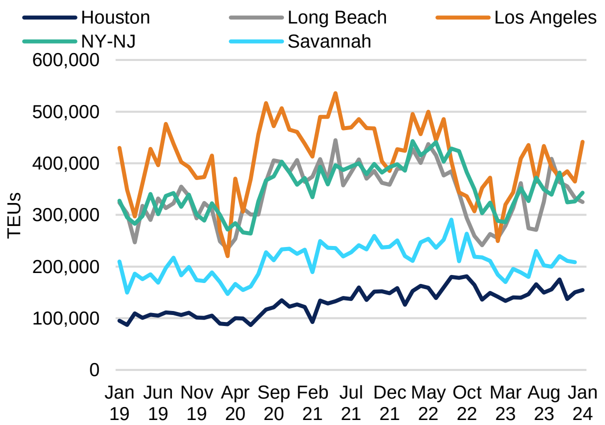


Source: Drewry

Air-sea routes from China to Europe via Dubai or Los Angeles (LA) have become more popular for cargo delivery. While this option is three times more expensive than pure ocean cost, it saves three weeks in transit time. Los Angeles has benefitted from the rerouting of vessels that would have otherwise gone through Suez and Panama Canals. As a result, the shipping cost from Shanghai to LA now exceeds the route destined to Rotterdam, at $4,272/40ft container vs $3,650, respectively. According to the port of Los Angeles, January imports increased by 16% YoY to 441,763 TEUs, marking the second-best January on record, prompting the port to operate at 75% capacity. The port authorities estimate that around 2.2m containers will be delivered into LA port in Q1 2024, given the pre-Lunar NY boost, marking a 20% YoY increase. While we expect the overall delivered capacity to LA to soften, the overall performance is likely to remain elevated for the majority of 2024. The port's efficiency in keeping vessels docked only for 4.5 days should further increase the port's ability to increase turnover and fulfil capacity demands quicker. This should keep shipping rates elevated. After that, goods destined for Europe are expected to travel via rail/road transport services to the East Coast before continuing on the sea route.

Loaded Import Containers at Select US Ports

Since the start of this year, LA port has imported the highest amount of goods in comparison to other ports.



Source: Bureau of Transportation Statistics

Our View

Although the current statistics may appear alarming, the situation might not be as dire as it seems. As of March 3rd, almost all 4m tonnes of daily capacity that has been lost through the Suez Canal is now being shipped through the Cape of Good Hope, which suggests little overall disruption on global supply chains. In 2024, the capacity of the global fleet is expected to increase at a pace exceeding demand growth, potentially leading to excess capacity, according to UNCTAD. This surplus could put downward pressure on the rates that shipping lines can charge their clients. For the time being, global supply chains seem to be reallocating resources effectively, as evidenced by spot rates continuing to fall from the recent peaks in late January 2024. We anticipate this trend to persist, regardless of ongoing tensions in the Red Sea.

A Snapshot of Current Ship Transits

The number of ships transiting to Europe via South Africa and from US has increased in recent months.

Source: Esri, USGS, TomTom, FAO, NOAA, visual by Arcgis As of 14.03.2024

Still, container ships are experiencing delays, diverging from their scheduled timelines, and causing disruptions along maritime routes. However, the situation is likely to normalise once the adjustments for the extended travel routes are fully integrated into logistical planning. The overall impact of these disruptions is expected to be limited, as the industry has been dealing with overcapacity since 2022, and the current diversions are only absorbing some of the excess capacity. For now, the industry is entering its slow season, which should alleviate some of the capacity that has been soaked up from longer transit times. This, coupled with subdued global demand for goods, poses less of a threat to supply chains. Although shipping rates are expected to remain above last year's averages as long as diversions continue, shipping rate softness is likely to persist into a strong peak season in the second half of the year. If the disruptions continue to persist, this could cause shipping costs to plateau until 2025.

Impact on Inflation

Is the recent spike in freight costs likely to reignite inflation in Europe? Given the impact of pandemic-induced bottlenecks, it's understandable why such a concern is arising. However, the current scenario is not as critical as it was a few years ago. While studies show that spikes in global shipping costs are followed by sizeable and statistically significant increases in both headline and core inflation (IMF, 2022), the recent increase in freight charges was only at a quarter of the peak reached in 2022. Indeed, according to Oxford Economics, if the Red Sea was to remain closed and freight costs were to remain elevated, this could add 0.7pps to the UK's inflation rate by the end of the year. This is not enough to stoke inflation, given the relatively subdued overall demand. While shipping costs are easing, monitoring the longevity of disruption is important, as this may cause knock-on effects further down the line that can contribute to inflation stickiness. While the increase in shipping costs will not completely derail the inflation trajectory, it will make things more complicated by pushing inflation further away from the government's target in Europe.

Furthermore, while disruptions along maritime routes have led to fewer ships arriving in European ports, with Rotterdam witnessing a 25% drop in docked ships in January 2024 compared to the 2023 average, the global volume of shipped goods at the start of 2024 increased. According to the Kiel Institute for the World Economy, January saw over 14 million standard containers shipped, nearing the peak levels observed at the end of 2021, indicating that global trade remains resilient. While certain businesses may be affected by shipping delays, there is no imminent threat of shortages in raw materials or consumer goods that would lead to soaring prices. We expect the Red Sea crisis to have a muted impact on price pressures in the Eurozone, allowing the central bank to start monetary easing in the second half of the year.

Stay on top of change

Sucden Financial Research Services

Our research team and the firm's experienced trading professionals produce commentary and analysis covering a broad range of markets.

Complimentary Research

We offer an extensive range of free reports to assist with market knowledge, offering price forecasts, data and in-depth market analysis

Daily Base Metals Report

- Commentary on LME aluminium, copper, lead, nickel, tin and zinc
- Summary of the day's trading activity on the LME
- Overview of major macro-economic trends for that day
- Includes energy and precious metals commentary
- Price data in table format

Quarterly Metals Report

- Expert views and price forecasts for base, precious and ferrous metals
- Metals market analysis
- In-depth macroeconomic outlooks for the global economy
  - Central Bank activity, analysis of manufacturing PMIs, geo-political changes
- Detailed forecasts available on request

Soft Commodity Technical Charts

- Technical analysis comments and charts for sugar, cocoa and coffee contracts for both New York and London
- Produced three times a week
- Outline of key support and resistance levels
- Views on future potential price moves

Coffee Market Outlook

This report drills down into the detail of the coffee market and is produced three times a year, we also produce shorter more concise updates. We undertake a macroeconomic assessment of major consuming and producing regions before analysing the recent earnings reports from Starbucks, Nestle, Luckin Coffee, Dunkin Donuts, and Costa. This helps us highlight new sales and marketing techniques and any consumption changes, which has been particularly popular during COVID-19. The largest chunk of this report is where we assess the Supply and Demand outlook using our primary data for the coffee market and where we apply our fundamental models. We showcase our crop forecasts and highlight any changes before providing prices forecasts and trading strategies with futures and options.

EV and Battery Materials Reports

A suite of reports looking at how the global automobile market is changing, and as vehicle manufacturers look to transition to a more environmental fleet of autos we have outlined how prepared the energy markets in the U.S., China, Japan, and Europe are to aid this transition. Electric vehicles go a long way reduce GHG emissions in the auto market, we are not disputing this, and when you factor in the lifecycle of batteries EVs are a lot greener. However, these reports assess the energy mix in these specific regions and outlines what governments are doing to promote renewable energy and transition away from fossil fuels. Using the energy mix we provide emission analysis for different EVs compared to ICE vehicles in that country.

Daily FX Report

- Concise morning update covering fundamentals and technicals for USD, EUR, GBP, JPY and CHF
- Highlights key upcoming events
- Key intraday support and resistance levels

FX Monthly Report

- Commentary on recent developments on major currency pairs, including a macroeconomic overview.
- Unique insights and trading strategies from our FX desk.
- Precious metals outlook.
- Technical analysis on key currency pairs.

Market Insights

- Dynamic ad-hoc insights in response to market events and trends
- Provides clarity and trading ideas in uncertain times
- We welcome requests for topics from clients, trading and client teams.

Bespoke Analysis

We can accept specific client requests for bespoke research on a range of interesting topics and we welcome the challenge to provide intelligent analysis and our expert opinion on forecasts, backed up with data and historical referencing.

Direct access to the Research Team

Whether you wish to schedule a daily, weekly, monthly or yearly call to discuss a particular market issue, talk trends or gain access to data, we are able to offer a direct line and a dedicated team member for an in-depth discussion.

Contact our team for further information.

Tel: +44 20 3207 5294
Email: **research@sucfin.com**
www.sucdenfinancial.com

Disclaimer

United Kingdom
Sucden Financial Limited
Plantation Place South
60 Great Tower Street
London
EC3R 5AZ

Tel: +44 (0)20 3207 5000
Email: info@sucfin.com

Hong Kong
Sucden Financial (HK) Limited
Unit 1001, 10/F
Li Po Chun Chambers
189 Des Voeux Road Central
Hong Kong

Tel: +852 3665 6000
Email: hk@sucfin.com

USA
Sucden Futures Inc.
156 West 56th Street
12th Floor
New York, NY 10019
United States

Email: ny@sucfin.com

sucdenfinancial.com