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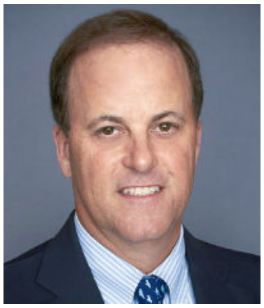
Industry Impact of Houthi Attacks in the Red Sea

BENS MEMBER INSIGHTS: Industry Impact of Houthi Attacks in the Red Sea

Iran-backed Houthi rebels in Yemen have intensified assaults on commercial vessels traversing the Red Sea, deploying sophisticated weaponry such as ballistic and anti-ship missiles, drone swarms, and naval assaults. Consequently, this surge in attacks has severely disrupted global trade, prompting major shipping companies to redirect their routes around Africa, resulting in significant extensions to shipping schedules. The prolonged trip durations and increased operational expenses have led to notable spikes in costs, potentially exacerbating inflationary pressures and consumer prices. BENS recently interviewed industry leaders Robert Sappio, CEO of SeaCube Container Leasing; William Kunkler, Executive Vice President of Operations at CC Industries; and Edward Floyd and Calum Cheyne, Partners at Zeiler Floyd Zadkovich, to garner their perspectives on how the Houthi attacks have impacted their respective businesses and industries.

Robert Sappio
CEO, SeaCube Container Leasing



William Kunkler
Executive Vice President, Operations, CC Industries

Edward Floyd
Partner, Zeiler Floyd Zadkovich

Calum Cheyne
Partner, Zeiler Floyd Zadkovich

Interviews have been edited for length and clarity.

The Houthi attacks have caused major shipping companies to avoid the Red Sea route. Has this impacted your company/industry? If so, in what ways and what changes to operations has this caused?

Robert Sappio: Over my 42 years in container shipping, I witnessed the remarkable growth of containerized trade, facilitated by the freedom of navigation. However, this foundation is now under threat, particularly in crucial maritime arteries like the Red Sea, the Black Sea, and to some extent, the South China Sea.

The implications of these challenges reverberate across the global network that underpins the movement of goods. Specifically, the container trade, which has been my primary focus, bears a significant burden. Approximately 15% of global maritime trade traverses the Red Sea and the Suez Canal, with nearly 30% of containerized trade passing through the latter. Disruptions force vessels to circumvent the region and go around Africa's Cape of Good Hope, adding an average of 10 days to transit times from Asia to Europe, the Mediterranean, or North America. The extent of these delays varies depending on the destination, ranging from up to 14 days for North Europe and the Americas to around seven days for other regions.

Edward Floyd: The industries that we focus on advising are predominantly the ship owning and operating industry as well as the commodities trading industry. In the shipping industry, there are several types of vessels involved in transporting goods: containerized, bulk, and variations within these categories. Containerized trade involves ships carrying standard containers, while bulk carriage transports unpackaged goods. Within containerized trade, some shipments are arranged on a spot basis with fixed prices, while others are part of longer-term service contracts with major suppliers. The routes from the countries in the Far East to the US are significant, due to the volume of products produced in the Far East and consumed in the US. These distinctions in contracting methods reflect different sectors within the shipping industry, each with varying resilience and responsiveness to challenges such as choke points. Similarly, the bulk commodity industry further divides into dry bulk and wet product transportation.

Across the various sectors, there's a distinct reaction to the recent attacks in the Red Sea. These responses differ depending on the operators involved, their specific industry subsector, the pressures they face, and the contractual flexibility they have established. The shipping industry is inherently cyclical, characterized by alternating periods of significant profits and slim margins, often leading to losses. With recent years marked by various challenges impacting global trade, starting with the pandemic, followed by the Suez Canal grounding in 2021, and more recently, attacks on shipping routes. Concurrently, the Panama Canal has faced historically low water levels due to drought, further hindering its capacity to facilitate trade, particularly from east to west. These multifaceted challenges underscore the industry's resilience amidst fluctuating conditions but also highlight the ongoing need for adaptation and preparedness in navigating the complexities of global commerce.

William Kunkler: A company I own a part of manufactures valves and fittings, with two plants in China. Surprisingly, freight rates for shipments from China to the West Coast are being affected by the situation in the Red Sea. This revelation was quite shocking to me. During the various stages of COVID, the rates experienced significant fluctuations. Initially, they skyrocketed to unprecedented levels, then dramatically dropped to below $2000 for a 20-foot container. Now, they've doubled to about $4000. While we ship hundreds, not thousands, of containers yearly—a considerable volume, with several hundred bound for the US—the recent events have unexpectedly caused rates to double.

Calum Cheyne: The Houthi attacks in the Red Sea have led major shipping companies to avoid this route, impacting the industry significantly. For liner companies accustomed to regular shipments between Asia and Europe or the US, this disrupts their entire network for ocean carriage, delaying transit times by weeks. The effect of the delays is similar to an overnight capacity reduction of approximately 10% for some container liners. Consequently, there's a reduction in overall capacity, leading to inevitable price increases. These price hikes ultimately affect consumers, causing ripple effects throughout supply chains.

In this environment, two developments emerge. Spot-focused carriers, who benefit from heightened demand with higher spot prices. And service-contract-oriented carriers, whose rates may be less responsive to sudden changes. Some service contracts might allow for surcharges or link to shipping rate indices, helping carriers offset increased costs.

Despite the complexities, this period presents opportunities amid challenges for the shipping industry. Historically, periods of disruption, such as the pandemic-induced container shortage, have translated into significant profits for shipping companies as freight rates skyrocket. While navigating logistical hurdles, some industry players are capitalizing on the demand surge, which all highlight the resilience and adaptability of the shipping sector amidst geopolitical and environmental uncertainties.

How well do you think the shipping and trading industries are prepared to deal with sustained instability in a critical chokepoint like the Red Sea? What areas do you consider to be most vulnerable?

Robert Sappio: The containerized shipping industry has displayed remarkable resilience, notably during the COVID-19 pandemic. In 2021, as demand for consumer goods soared in Europe and North America, the industry grappled with severe congestion, as evidenced by around 100 container ships lining-up off the coast of Los Angeles for unloading. Because of this surge, nearly 6 million new containers were introduced into the market. This year, approximately 300 new shipping vessels are scheduled to be delivered, bolstering the industry's capacity to maintain weekly services despite extended transit times resulting from events like the closure of the Suez Canal and issues at the Panama Canal due to water shortages. Moreover, increased container production has further supported the industry's ability to handle disruptions. However, potential labor disputes, such as the upcoming contract renewal for the International Longshoremen's Association on the US East and Gulf Coasts, could exacerbate challenges faced by the global container network – underscoring the need for continued adaptability.

Edward Floyd: The shipping industry appears well-equipped to handle sustained instability in the Red Sea region. However, the broader impact on global commerce and inflation raises significant questions. Projections suggest that continued Houthi attacks will force vessels to reroute around the Cape of Good Hope indefinitely, potentially increasing inflation by up to a percentage point over the next year. This would notably affect prices, particularly for goods like electric vehicles in Europe. The ramifications extend to the interaction between industry and geopolitics, as seen in Egypt's dwindling Suez Canal traffic and subsequent loss in revenue. This decline, a major income source for Egypt, remains a concern both regionally and globally. The implications of these developments underscore the delicate balance between industry and geopolitics.

William Kunkler: I won't see the impact much personally, but the shipping and trading industries face significant challenges in dealing with sustained instability in critical chokepoints like the Red Sea. China, heavily reliant on trade, is particularly vulnerable. The presence of Chinese interests in the region, coupled with concerns about targeting by groups like the Houthis, adds complexity. The flow of oil through this route impacts European nations, highlighting global trade vulnerabilities. Addressing these challenges requires a coalition effort involving multiple countries, including Saudi Arabia.

Calum Cheyne: The shipping industry is inherently cyclical and flexible. That approach is deeply ingrained in the market participants' psyche. Despite the logistical challenges, capacity restrictions can paradoxically benefit the industry by destabilizing capacity levels. Factors like geopolitical tensions and recent events such as the pandemic and attacks on commercial shipping have tightened capacity, leading to a surge in vessel orders. Ship owning companies are poised to adapt to a potential new normal, potentially favoring routes around the Cape of Good Hope over the Suez. However, when stability returns to affected regions and vessels can again transit the Red Sea, we may see a return of the issues caused by oversupply of capacity. This cyclical pattern raises questions about the future challenges for ship owners and carriers, as additional capacity continues to enter the market. While I advise on legal matters rather than economic trends, it will be intriguing to observe how the industry navigates these dynamics in the coming months and years.

Some experts estimate that a sustained Houthi disruption in the Red Sea could add up to 2% to global goods inflation. How might this impact your company/industry? Are you able to absorb higher costs?

Robert Sappio: Sailing another 7 to 14 days around the Good Hope is considerably more expensive than going through the Suez Canal. You've got fuel burns, ship time, crew time. It is more expensive and the longer the transit, the more equipment and ships are required to keep the network fluid. Shipping companies have been able to raise their prices, certainly in December and January time frame on the run up to the Lunar New Year, when people were anxious about high demand. The shipping lines did raise their prices to try to recoup some of the cost of the detour. However, we have already seen freight rates peak in February and begin to moderate as the system settles and shippers get accustomed to that longer transit time.

Edward Floyd: The Federal Maritime Commission (FMC) regulates much of the liner trade. Typically, alterations to published tariff rates require a 30-day lead time, affecting Non-Vessel Operating Common Carriers (NVOCC) and freight forwarders. However, certain liners have been granted special dispensation by the FMC to expedite rate adjustments in response to urgent situations. Regarding the impact on trade, data from industry journals suggests that rate increases for cargo bound to Europe have been notably higher compared to those bound for the United States. This is in line with observations of increased voyage lengths. Freight rates to Europe have seen significant spikes, while the increases for the US have been comparatively lower.

William Kunkler: China's significant reliance on trade could make it particularly vulnerable, a fact I've noted from recent observations of its presence in affected regions. This prompts questions about the targeting of shipping routes and the broader implications for global trade. While the disruption may not directly affect the United States, European nations could face challenges. My family-operated businesses are primarily domestic and minimally impacted. However, I stress the need for a coalition response beyond the US and Britain and raise questions about Saudi Arabia's approach to the Yemen conflict.

The broader geopolitical concerns, such as tensions between Russia and Ukraine and China and Taiwan, could have more direct impacts. Recent fluctuations in shipping rates from China to the US demonstrate a domino effect that greatly concerns me. Additionally, the situation with Iran, especially considering Israel's perspective on Iranian proxies, should be approached, possibly through diplomacy. It's vital for Iran to grasp the seriousness of its actions.

Calum Cheyne: In terms of pure days of delay, trips are more badly affected for the routes between Asia and major European ports, than routes between Asian and the East Coast of North America. Therefore, the impact of transit delays on goods is more significant for Europe. However, I would expect that the quantity of affected containers is much higher for US trade due to the larger volume of imports. While I haven't examined this distinction closely, one aspect I've observed is liner companies seeking special permission from the Federal Maritime Commission in the US to impose surcharges on their rates. The uniqueness of the current Red Sea issue has prompted the Commission in some cases to recognize the need for additional charges and the FMC has granted permission to add surcharges on an expedited basis to service contract rates, showing how seriously this is being taken at a regulatory level. This is the extent of my involvement regarding the US impact.

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