NEW ZEALAND
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Implications of shipping disruptions in the Red Sea: a view from Europe

MARKET INTELLIGENCE REPORT

Summary

- Further to our report on the implications of shipping disruptions in the Red Sea, this report analyses the impacts that Houthi attacks are having on commercial shipping in Europe.

- Reports of significant delays and spikes in shipping costs are consistent across Europe. In the short-term, firms have been able to adapt, avoiding the widespread goods shortages seen in parts of the COVID-19 pandemic in 2021.

- Should the conflict continue or escalate in the long-term, some inflationary impact is likely as supply chains reorient and adjust. This is particularly true for some Mediterranean countries which were previously privileged by their proximity to the Suez Canal.

- To avoid continued disruption, the European Union and allies have escalated their defence support for commercial vessels travelling through the Red Sea. The EU's announcement that its main joint defence mission will operate for at least one year indicates an expectation of ongoing disruption for the foreseeable future.

- New Zealand exporters, particularly those which trade in counter-seasonal perishable goods, are likely to be impacted as supply chains continue to adjust.

Report

Shipping costs have increased among delays and pressures on two-way trade routes with Europe

Houthi attacks on commercial shipping in the Red Sea have caused significant disruptions to traditional maritime trading routes. The International Maritime Organization (IMO) reports that in the 7 days from 29 January to 5 February alone, Gulf of Aden ship arrivals were down 71%. Meanwhile between the beginning of December 2023 and the first half of February, Suez Canal transits have been reported as falling by 82%. At the same time, Cape of Good Hope arrivals were up 74% when compared to the average for the first half of December 2023. Sustained droughts caused by El Niño conditions in the Panama Canal have further exacerbated pressure on shipping routes.

Despite the additional pressure on shipping times and capacity, shipping cost increases have remained below the peaks seen during the COVID-19 pandemic. The exact extent to which the conflict is having an impact on inflation remains uncertain. However, an escalation or sustained level of disruption in the long term could generate some marginal inflationary impact while supply chains adjust to a 'new normal.'

The OECD reports that highest increase in global shipping costs since Q4, 2023 were for routes between Europe and Asia. The Suez Canal is an essential route for the transport of energy supply and raw materials used in manufacturing supply chains. It is also the main route for exports of cereals from the EU, Ukraine, and Russia through to Asia. European countries have differing levels of exposure, ranging from 10% of total trade usually passing through the Suez Canal (Germany, Spain), through to as much as 40% of imports and exports (Italy).

Across Europe, significant delays to container shipping continue to be reported. According to an S&P survey, 12% of companies in the **United Kingdom** (UK) consider that delivery times have worsened due to the crisis in the Red Sea, compared to 9% of companies in **Greece**, and 8% in **France** and **Germany**. While the **Spanish** National Bank initially considered Spain the third most exposed EU country to the crisis, the impact has so far been limited.

In **Germany**, key ports such as Hamburg and Bremerhaven initially saw the number of incoming ships decrease by 25%. Looking beyond Chinese New Year, one Hamburg-based container platform noted that exporters could anticipate ongoing blank (cancelled) consignments and capacity reductions. While high demand for freight capacity and increased shipping costs pose medium-term challenges, analysis indicates that these disruptions are not likely to carry through into the long-term. The current gap in capacity may be resolved if the conflict in the Red Sea continues and longer detour routes become more embedded into supply chains.

One leading **Swiss** freight forwarder noted its expectation of ongoing disruptions, stating that even if the Bab el-Mandeb Strait were safe for transit from today, it would take at least two months before ships could resume normal patterns. In the UK, some anticipate it could take as long as 6 months after hostilities end for a state of normalcy in trading to resume.

In **Denmark**, the Danish Critical Supply Agency is keeping a close eye on the situation, however, given the majority of Denmark's imports come from South East Asia via the Suez Canal. One major Danish shipping enterprise has reported impacts across "every aspect" of operations with delays adding to already poor returns from the latter half of 2023. It anticipated that the snowball effect of recent shocks to shipping will have business impacts for "years to come." In **Sweden** and **Norway** transport costs of two-way trade have been reported as spiking between 100 and 200%.

In the **Netherlands**, shipping costs have tripled, though this may not necessarily be passed on to consumers. In the long term, however, the European economy may shrink by as much as 0.9% due to the disruption to normal trade. In response to shipping delays, the Netherlands' Exporters Association (EVOFENEDEX) reported that the sector is finding alternatives for the Red Sea route without affecting prices too heavily, but prolongation of the conflict could lead to adverse effects in the future. Government contacts advise that the sector is broadly accepting of the threat assessment (currently Level 3 "do not enter" for the southern part of the Red Sea, the Bab-el-Mandeb and Gulf of Aden). There are also financial risks involved for the sector, which is looking to the government to play a balancing role through communicating the rationale for its assessments.

Once advantaged by proximity to the Suez, there are heightened concerns among Europe's Mediterranean ports. The Port of Marseille is worried about becoming a less attractive shipping destination with the possibility that ships rerouting around Africa may seek alternatives closer to the Atlantic to disembark containers. Those fears may be warranted given the cost of a shipping container from Shanghai to Genoa (northern **Italy**) has reportedly risen from €1,000 to €4,000 thanks to increased insurance costs, additional fuel, and the consequent increase in CO_2 emissions fees under the EU's Emissions Trading Scheme. Significant price increases have also been reported in **Spain** for new shipments between Asia and the Mediterranean ports of Valencia and Barcelona.

Businesses have adapted so far, though long-term impacts remain to be seen.

Beyond the increase to shipping prices, the Red Sea disruptions have had modest impacts on key European industries to date. Partly this is due to businesses having taken the salutary lessons from COVID-19 supply chain disruptions (and the more recent disruption caused by the 6-day grounding of the Ever Given in the Suez Canal). Two-way supply chains are now much more diversified and resilient, allowing much greater manoeuvrability in shocks like the Red Sea attacks. That may not hold though, with some **UK** manufacturers already reporting that shipping cost increases are beginning to have an inflationary effect. Should the Red Sea attacks continue or escalate in the long-term, the OECD estimates that it could add 0.4 percentage points to consumer price inflation (CPI) after a year of diverted trade.

In January, car manufacturer, Volvo, announced a three-day suspension for electric car production at its plant in Ghent, **Belgium**, citing supply delays caused by the Houthi attacks on merchant vessels. This was followed by Tesla, announcing a similar two-week suspension at its German factory. Meanwhile, in Italy the fashion industry has been among the hardest hit by delays [1]. According to the Bank of Italy, one-third of the sector's imports pass through the Red Sea to reach Europe, with crucial inputs such as fibres, fabrics, components (like zips), and semi-finished or ready-made garments coming from Japan, India, China, and Southeast Asia [2].

In the food sector, delays are both making products more expensive, and also causing the deterioration of goods. Fresh produce is more likely to rot in transit and **Italian** exporters are struggling to deliver perishable goods to foreign markets on time. The most affected routes are those in the Middle East (where Italy exports 350 thousand tons of fruit and vegetables), India, and South East Asia (where Italy ships 120 thousand tons of Italian fruit – mostly apples and kiwis - valued at €100 million).

In Germany, discount supermarket chain, Aldi, reportedly dropped some marketing campaigns for (non-food) products out of fear it may not receive the goods in time, with importers also reporting delays of supplies from the Asia-Pacific region. UK food prices are less likely to be impacted as the UK imports most of its food products from Europe.

In response, Europe and its allies have stepped up their defence plans

In response to the heightened risk of ship attacks, the EU and its Member States have announced a range of joint and individual naval programmes to secure Red Sea shipping routes. Principal among these is the EU's Operation Aspides (coming from the Greek plural of 'shield'). Launched on 19 February, the operation will be active along the main shipping routes in the Bab al-Mandeb Strait and the Strait of Hormuz, as well as the Red Sea, the Gulf of Aden, the Arabian Sea, the Gulf of Oman, and the Persian Gulf.

The operational plan for Aspides includes information exchange and cooperation with the US led Operation Prosperity Guardian, and the EU's counter piracy Operation Atalanta. Aspides has a mandate to neutralise unmanned threats and repel manned threats to merchant vessels at sea. So far, Italy, the Netherlands, Greece, France, Germany, Belgium, Denmark, Sweden, Norway have all deployed or committed naval, personnel, and financial resources to the various missions in the area in the hope that an increased defence presence will stabilise the situation and provide confidence to shipping companies (and their insurers). While Aspides will potentially extend support to any merchant vessel in the area, it may have to prioritise shipping of interest to the EU in particular. The operation has initially been launched for one year.

Implications for New Zealand exporters and businesses

So far, the impact on New Zealand businesses has been consistent with global trends. Delays in shipping routes to Europe (both around Africa and through the Panama Canal) combined with higher costs for both shipping and insurance have had a clear but variable impact. While some export sectors are better able manage delays, such as those dealing in frozen goods, a protracted conflict could begin to impact sectors which offer counter-seasonal supply of perishable goods to Europe.

As previously reported in February's Market Intelligence report on 'Implications of shipping disruptions in the Red Sea' though, Red Sea disruptions have resulted in some cancelled consignments. Anecdotal reports from several Europe-based importers of New Zealand counter-seasonal goods have emerged reporting some difficulties with cancelled shipments.

[1] The National Chamber of Italian Fashion estimated that in 2023, the import of goods used in made-in-Italy fashion, including costume jewelry and eyewear, will exceed €50 billion.

[2] Among New Zealand's main exports to Italy in 2023 were hides, leather, and textiles products (wool) are largely employed in Italy's fashion industry.

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