Insights
Geopolitics and Policy

February 2024

Will Red Sea Trade Disruptions Be a Pandemic-Level Shipwreck?

Simona Mocuta
Chief Economist of State Street Global Advisors

The shipping upheaval in the Red Sea is an adverse supply shock that has ignited worries about inflation, oil price shocks, and manufacturing delays — some of the same challenges that stifled the economy during the COVID-19 pandemic. Market participants are rightfully concerned; the Red Sea is home to major choke points for international trade, including the Suez Canal and the Bab el-Mandeb Strait (Figure 1). Still, we believe that the Red Sea conflict is not going to lead to anything close to pandemic-level supply chain challenges. While data shows that maritime shipping rates have leapt higher, disruptions are limited to select shipping portions of the global supply chain, greatly diminishing the ultimate inflationary impact at the global level.

Figure 1
When ships transit through the Suez Canal, they usually navigate the waters of the Red Sea. The massive traffic passing through the Canal represents:

12%	7–10%	8%
of global trade	of the world's oil	of the world's liquified natural gas
1M	1B	4X
barrels of oil daily	tons of cargo annually*	the tonnage transiting the Panama Canal*

Source: Market Report, New Zealand Foreign Affairs and Trade, per the New Zealand Embassy in Cairo. April 18, 2021.
* Based on 2019 data.

Flashback: COVID Supply Chain Woes

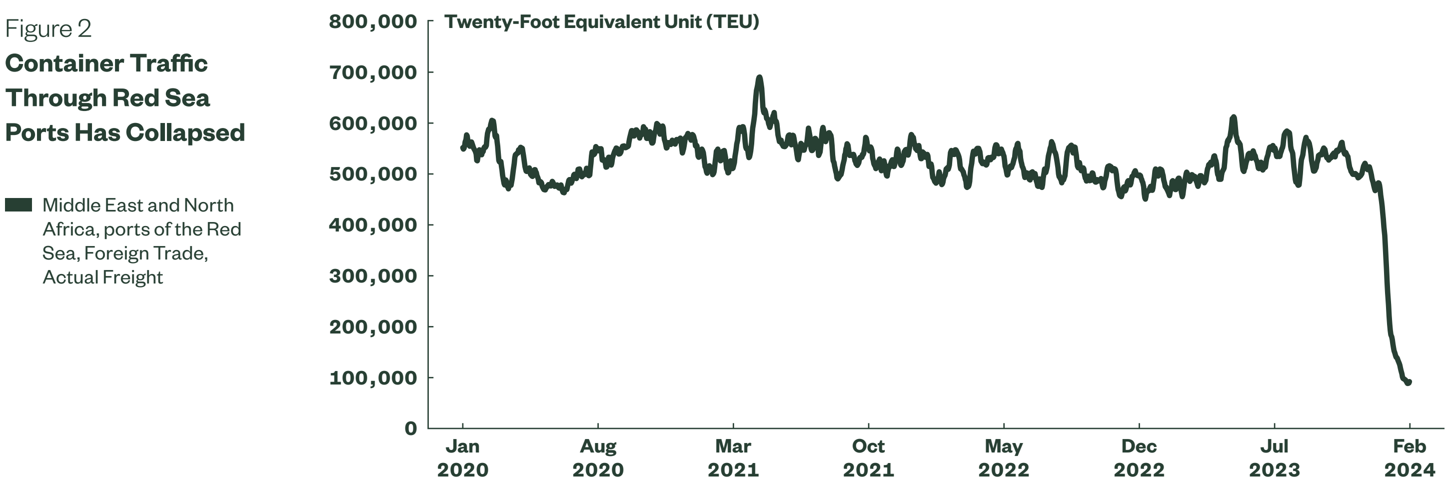
Ongoing shipping disruptions in the Red Sea have triggered dire warnings of a repeat of the 2021–2022 soaring shipping costs and severe global supply chain problems. Those fears are exaggerated for two main reasons: (1) Shipping cost increases have been more moderate and localized this time around, and (2) most importantly, there has been no negative impact to global productive capacity in this episode.

Comparing the Rise in Shipping Costs

First, while swift, the latest increases in shipping costs has been but a fraction of the COVID-era surge, largely because this is a localized crisis and alternative routes exist. Indeed, there are some tentative signs that a peak may have already been reached. Europe appears more vulnerable to both supply chain disruptions and related inflationary impulse compared to the US.

Since the Red Sea crisis began last November, maritime container traffic through Red Sea ports has collapsed by about 80% (Figure 2). These volumes have not simply vanished — they are being diverted to alternative routes, mostly around the Horn of Africa.

Figure 2
Container Traffic Through Red Sea Ports Has Collapsed

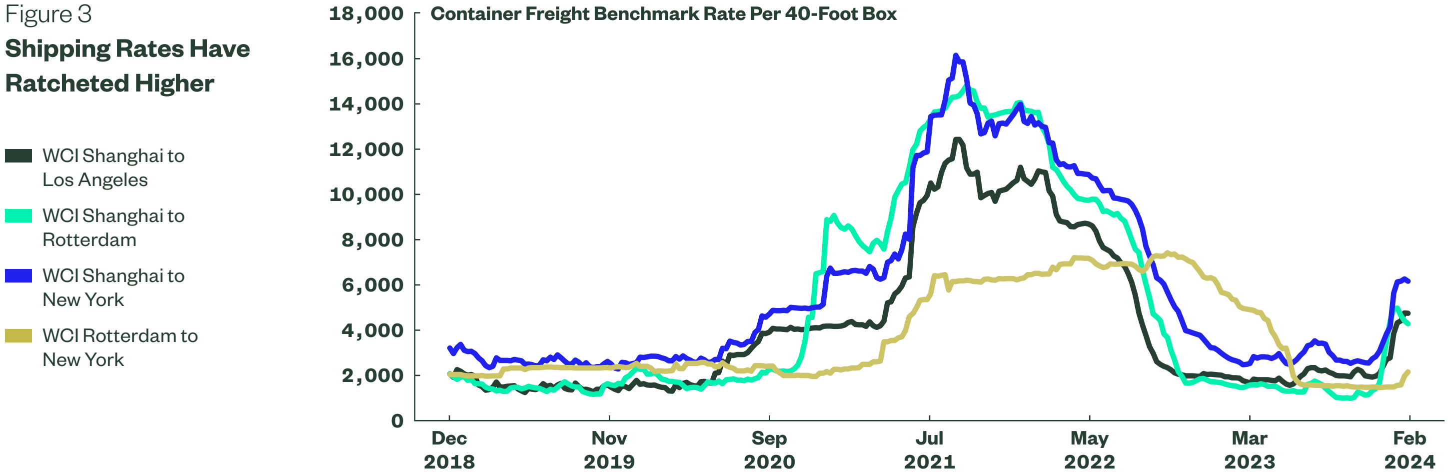


Sources: Macrobond, State Street Global Advisors Economics, IfW Kiel (Kiel Institute), CPB. Updated as of February 13, 2024.

This rerouting, which extends the trip time from Europe to Asia by one to two weeks,[1] comes with higher costs. According to the World Container Index by Drewry, between early December and early February, spot container freight rates for a 40-foot box have risen by 128%, 146%, and 230%, respectively, for the Shanghai to New York, Shanghai to Los Angeles, and Shanghai to Rotterdam routes (Figure 3). Benchmark rates for Rotterdam to New York have risen 31%.

At face value, these rate increases are concerning, but they pale in comparison to the magnitude of increases experienced during COVID. Admittedly, the surge has been somewhat swifter, but this makes sense given that this Red Sea shock occurred at a time when traffic was quite heavy, so exporters needed to act quickly to ensure goods reach their destinations as soon as possible. During COVID, the initial ramp up in costs was more gradual, because in the early stages of reopening there was ample idle shipping capacity available. Not so today. But, importantly, one should not interpret the speed of change as indicative of the ultimate magnitude of change. In fact, the latest available weekly data suggest a tentative plateauing or even mild reversal in some of these rates.

Figure 3
Shipping Rates Have Ratcheted Higher

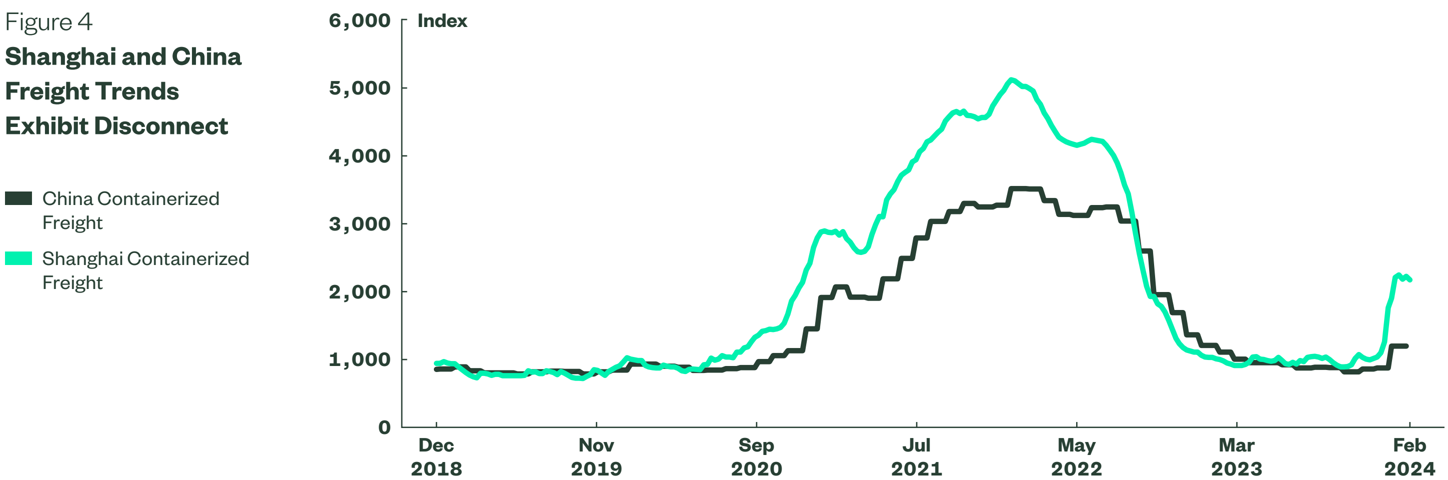


Sources: Macrobond, Bloomberg, Drewry. Data for the Drewry World Compositive Index (WCI). Updated as of February 13, 2024. China and Shanghai Shipping Exchanges, Shipping, Indices.

Shipping Cost Increases May be Overstated in Some Metrics

There are also some question marks around the representativeness of Shanghai benchmark rates (shown in Figure 3) for global shipping costs. Evidently, not all trade routes are being impacted, as there has been almost no change to Europe-Americas routes. But there is also some disconnect between Shanghai and broader China freight rates, suggesting that the Shanghai numbers may exaggerate the actual increase in average shipping costs out of China (Figure 4). Indeed, according to these broader China metrics, there has been little visible increase in the cost of shipping services to either the East or West Coast in the United States (Figure 5). This underlying route data further supports the idea that the rise in shipping costs is not as much of a supply chain crisis as the one that occurred during the pandemic.

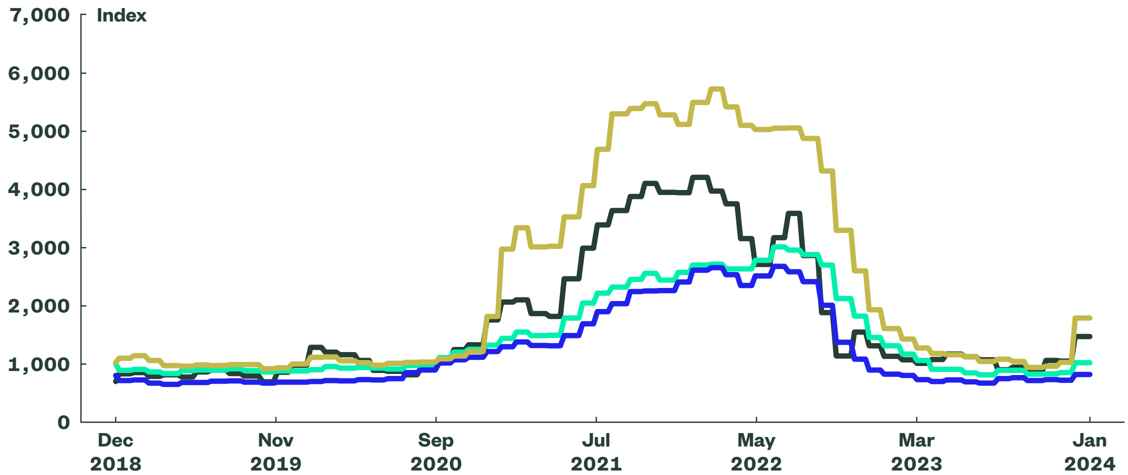
Figure 4
Shanghai and China Freight Trends Exhibit Disconnect



Sources: Macrobond, State Street Global Advisors Economics, China Ministry of Transport (MOT), Shanghai Shipping Exchange, as of February 5, 2024. China, Shanghai Shipping Exchange, Shipping, Index.

Figure 5
Shipping Rates from China to the US Have Shown Little Change

Persian Gulf/ Red Sea Service
East Coast America Service
West Coast America Service
Europe Service



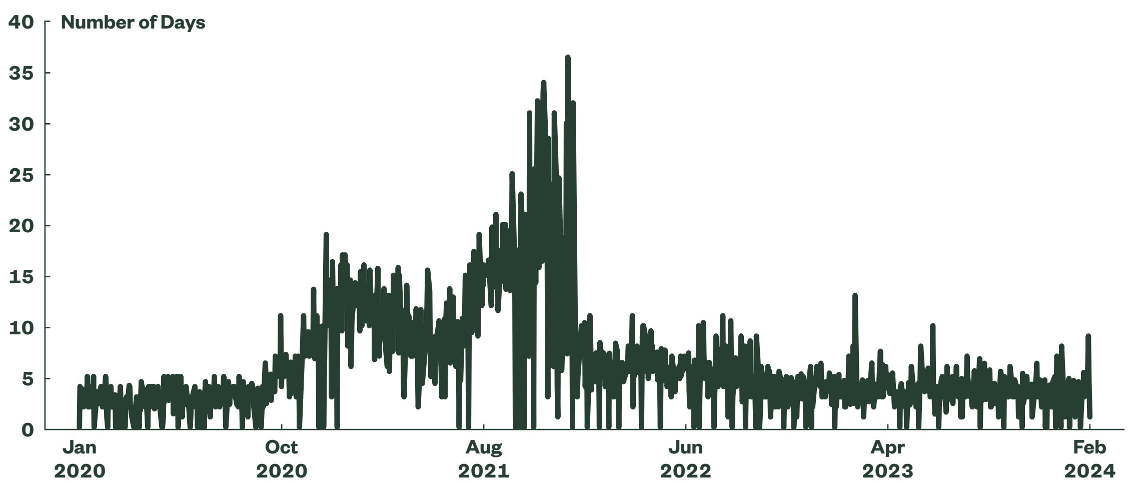
Source: Macrobond, State Street Global Advisors Economics, China Ministry of Transport (MOT), as of January 29, 2024. China, Freight Indicators, Index.

The Bottom Line

The current situation is a logistical headache but not a full-scale logistical crisis. Productive capacity is not impacted. Factories are producing and global supply chains are functioning, if adjusting to the delays associated with shifting to alternative shipping routes. The complexity of the task at hand pales in comparison to the pandemic challenge of entire sections of the global supply chain going dormant for weeks, or months, due to lockdowns. Figure 6 supports that the delays are not occurring across the entire global supply chain.

Figure 6
No Shipments Are Delayed at US Ports

United States, Traffic, Ports, Los Angeles, Average Days at Anchor & Berth



Sources: Macrobond, State Street Global Advisors Economics, Port of Los Angeles. Updated as of February 13, 2024.

Shipping costs may have risen somewhat, but congestion has not (Figures 5 and 6). This is an exercise in redistribution and some loss of efficiency, not one of overtaxing the system as a whole. For all the reasons discussed above, the ultimate inflation impact is likely to be limited and, for many items — especially high value tech gadgets — even immaterial. Figure 7 illustrates the decline in prices since the pandemic.

Figure 7
Prices Remain Below Pandemic Highs

Source: Macrobond, State Street Global Advisors Economics, S&P GSCI. World, Commodity Indices, S&P GSCI, Price Return, Close, USD. All indices rebased to January 2022.

Bulky items like grains may see a slight uptick in prices, but given the substantial price retrenchment experienced by broad commodity indexes since the 2022 peak, a modest upturn from here would not unravel the ongoing global disinflation narrative.

Endnote

1 Flexport, per CNN Business, as of February 9, 2024.

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- Start with rigor
- Build from breadth
- Invest as stewards
- Invent the future

For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 29 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's fourth-largest asset manager* with US $4.13 trillion† under our care.

* Pensions & Investments Research Center, as of December 31, 2022.
† This figure is presented as of December 31, 2023 and includes approximately $64.44 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

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ID2019699-6414720.3.2.GBL.RTL 0224
Exp. Date: 02/28/2025