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Air and Ocean Rates React to Red Sea Disruption

SUMMARY

The Houthi attacks in the Red Sea are not only driving up sea freight rates — air freight rates are expected to get higher, too, as global trade flows are increasingly disrupted.

BACKGROUND

Since the war between Israel and Hamas broke out in Gaza in October, some observers have been warning that the localized fighting could erupt into a regional conflict. These warnings seem to have been realized in November when Hezbollah launched rockets into Israel from Lebanon and in December when Iran-backed Houthi rebels in Yemen attacked commercial vessels in the Red Sea. The Houthis have said they are aiming to block Israeli ships from passing through the Red Sea until Israel halts its military operations in Gaza.

Ship traffic in the Red Sea and Egypt's Suez Canal has decreased by 30% since the beginning of 2024. This rerouting adds cost and time to vessel journeys. Choosing a route that avoids the Red Sea could impact transit time from nine days to two weeks, depending on the port of origin and destination. Oil prices and war risk insurance premiums have spiked as a result. Cargo traveling via the Cape of Good Hope adds 10 to 15 percent shipping costs for the additional fuel and increased transit time.

The strikes on commercial shipping come as drought conditions force the Panama Canal, another trade chokepoint, to limit transits because of insufficient water to operate the massive locks. Vessel operators that recently shifted services to the Suez route to avoid Panama transit delays are now in a double bind.

CURRENT STATUS

Under the U.S. Shipping Act, all ocean carriers must give a 30-day notice before imposing surcharges or GRIs. However, the Federal Maritime Commission has waived this requirement for shipments from Asia being rerouted around South Africa's Cape of Good Hope. This diversion adds seven to 14 days' sailing time to Europe and five to seven days to the U.S. East Coast, but transits could be longer because the tip of Africa often has rough seas and storms. Although carriers will save $400,000 to $700,000 in Suez Canal tolls, the 3,000 extra nautical miles to go around Africa to Europe will add $1 million in fuel costs per vessel. The diversion has also resulted in a chain reaction that includes knocking vessels off scheduled arrivals, vessel bunching in ports, terminal congestion, and difficulty repositioning containers worldwide. More shippers are expected to start avoiding the U.S. East Coast and favor the West Coast ports due to the Middle East issues.

In December, plans to detour around South Africa briefly pushed ocean freight rates up to $10,000 per 40-foot container. New data from Freightos Terminal released in January shows that rates for shipping goods from Asia to Northern Europe surged 461% compared to mid-October before the diversion of vessels in the region began. Rates from Asia to the North American East Coast and West Coast have also skyrocketed, climbing 130% and 97% since the end of October. Liner companies ZIM, Hapag-Lloyd, and Maersk are now charging a war risk surcharge of between $20 and $100 per container.

The Houthi attacks in the Red Sea are not only driving up sea freight — air freight rates will also get higher as global trade is increasingly disrupted. While air freight rates have remained relatively stable during the off-peak season that has coincided with the shipping crisis, air rates on a route between China and Northern Europe increased 91 percent week-on-week to $3.55 per kilogram, according to data from freight booker Freightos on January 16. Air cargo demand saw its most robust year-over-year growth in almost two years in November, rising 8.3 percent to 22.4 billion cargo to kilometers (CTK) over the year prior, according to data from the International Air Transport Association (IATA).

IMPACT

High inventories and consumer spending pullback have slowed the global shipping industry. Before the Red Sea attacks, global shipping container rates had more than halved in 2022, a stark reversal from the boom following the pandemic. Lars Jensen, CEO of consultancy Vespucci Maritime, said the combination of robust Chinese New Year demand and the decrease in global container capacity resulting from the diversion around Africa could lead ocean rates to triple. Interviewed on CNBC, Jensen predicted the average international rate would double to about $3,000. Global businesses, uncertain how long the shipping crisis in the Red Sea will last and unsure about the availability of vessels for the export rush before China's New Year celebration, are scrambling to shift some cargo to airlines, according to logistics specialists. With no end to the Gaza war and tensions rising, air cargo providers could see a surge in business. Peter Sand, the chief analyst at Xeneta, said on January 12 that in the short term, "things will get worse before they get better for ocean freight supply chains." He warned that a resolution could take "months rather than weeks or days."

RESOURCES:

- How Houthi Attacks in the Red Sea Impact Shipping in the Suez Canal (Reuters)
- Who are the Houthis and why are They Attacking Ships in the Red Sea? (NPR)
- Ship Traffic Decreases 30% in Egypt's Suez Canal (Ahram Online)
- Weak Demand Leads to China-US Freight Rate Cuts Despite Red Sea Crisis (CNBC)
- Red Sea Troubles Could End Shipping Recession as Freight Rates Spike (CNBC)
- Retailers Seek Air Cargo Services as Red Sea Shipping Disruptions Continue (The National News)
- Global Shipping Rates Skyrocket as Red Sea Crisis Deepens (Fox Business)
- Gradual Increase in Air Freight Expected as Red Sea Crisis Could Last Months (Air Cargo News)
- Red Sea Risks Point Shippers to Air Freight (Sourcing Journal)
- Red Sea Shipping Disruptions Pushes Cargo to Air Carriers (FreightWaves)