

Red Sea Attacks: Impact on African Trade and Macroeconomic Stability

Afreximbank Research

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Highlights/Key Takeaways



Shipping services are important shock propagation channels

The Houthi attacks on the Red Sea and the consequent longer travel time and freight costs emphasize the role of global shipping services as important shock propagation channels via which the spill-over effect of geopolitical tensions and other disruptive developments, such as the COVID-19 pandemic, are transmitted to the rest of the world.



Resource reallocation among countries

In Africa, the attacks have produced a reallocation of resources among countries on the continent, depending on what side of the pendulum they sit. While shipping traffic and revenue have crashed significantly in the Suez Canal, there has been an increased demand for bunkering and restocking service in alternative routes along the Southern Cape of Good Hope, producing the effects of a pseudo zero-sum game.



Need for critical investments in Africa's port infrastructures

However, the inefficiencies and fragmented delivery of bunkering and restocking services in response to the demand have once again exposed the weak port economics of most African countries, making a strong case for the critical need for investments in Africa's port infrastructures.



Africa's real trade to shrink and inflationary pressures to deepen

On the macroeconomic front, we expect the geopolitical tension on the Red Sea to cause real trade to shrink and exacerbate inflationary pressures. In addition, the development may further create instability that can potentially stall the optimistic outlook for growth in the region.

The risks Ukrainian UAVs pose to Russian Refineries and global Diesel supply may also impact the cost of manufacturing in Eastern, Central Europe, as well as some parts of South-East Asia. The reluctance of Poland to allow passage of Ukrainian grain may continue to impact the prices of wheat and flour used especially in North & West Africa—where inflation continues to pose systemic risks.



Higher freight costs to filter into consumer prices globally

Since the Israel/Palestine war may drag beyond mid-2024, the solidarity attacks of the Houthi Rebels may continue disrupting trade flows on the Red Sea route. This will affect the availability and affordability of essential commodities as the higher freight costs filter into consumer price inflation globally. This can potentially stall the realization of earlier expectations of rate cuts or even necessitate another round of monetary tightening that could keep a lid on global growth in 2024.

The extra 10-days it takes for a vessel to sail through the Cape of Good Hope into the South or North Atlantic Ocean, without proper restocking or bunkering infrastructure to refuel older ships that use mostly diesel or LPFO poses a risk on the prices of freight, that may bring us a little closer to shipping prices post-covid.

Red Sea Attacks: A background

01

Red Sea Attacks: A background

The broader Red Sea region, encompassing African ports in Sudan, Eritrea, Djibouti, and Somaliland, is grappling with challenges stemming from reduced vessel availability and heightened freight costs and insurance premiums.

The Israel/Palestine war and the consequent solidarity attacks by Yemen-based Houthi Rebels have kept the Red Sea in the global spotlight in recent times. Since November 2023, Houthi Rebels have continued to protest against Israel's killing and displacement of Palestinian civilians by targeting commercial vessels, disrupting international trade in the shortest shipping route between Europe and Asia. The impact of these attacks has continued to reverberate across the globe because of the strategic role of the Red Sea in global trade. The Red Sea accounts for an estimated 12% of global trade valued at \$1 trillion and about 15% of global shipping traffic. This route typically manages more than 95 percent of maritime traffic between Asia and Europe, playing a crucial role in facilitating approximately 30 percent of global container traffic.

Since the start of the solidarity attacks, not less than 60 assaults and 50 commercial and military vessels have been attacked by the Houthi Rebels. Despite the operations of the US-led Operation Prosperity Guardian (OPG) maritime task force and several counter-strikes by the US and UK governments, the attacks by Houthi rebels have continued unabated and seem poised to drag until a sustainable resolution to the Israel/Palestine war is reached. UNCTAD reported a significant decline in monthly transits through the Suez Canal, with a decrease of up to 50 percent year-on-year in January and February 2024. Additionally, the Suez Canal Authority observed an estimated 40 percent year-on-year decline in revenue during the same period.

Consequently, major ocean carriers, such as Maersk, Hapag-Lloyd, and MSC, have largely halted their Red Sea transits and have cautioned clients to brace for extended disruptions in the region. They foresee a crisis that could persist well into the latter half of 2024. The ongoing OPG activities may not prove adequate for significant shipping firms to resume operations in the Red Sea. Furthermore, there are concerns that the Houthis will intensify their military actions during the Islamic holy month of Ramadan.

Houthi attacks on commercial shipping

(hijackings, drone strikes and missile strikes)

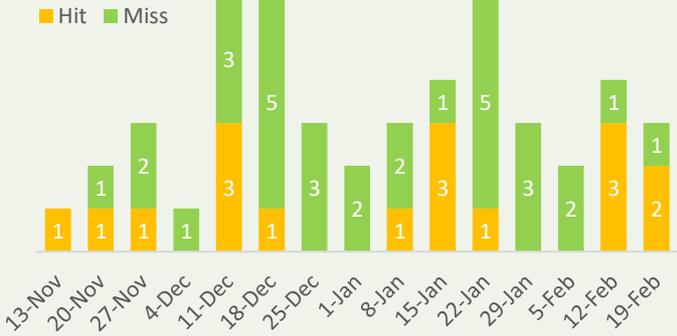


Figure 1: Houthi attacks on commercial shipping

Source: EIU

Shipping routes

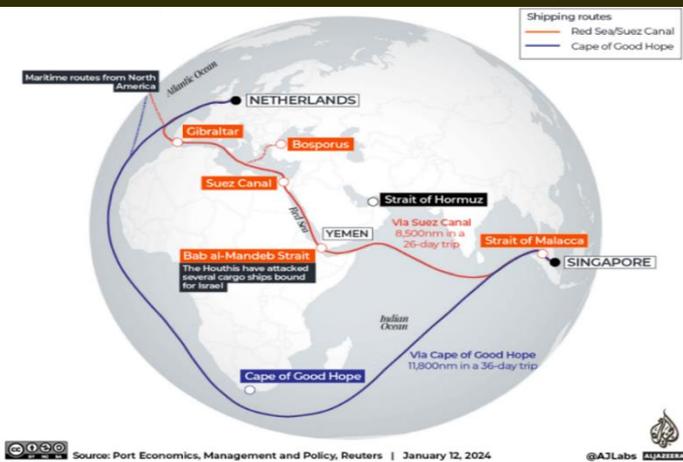


Figure 2: Shipping routes

Sources: Port Economics, Management and Policy, Reuters, Aljazeera

Premiums (% of ship's value)

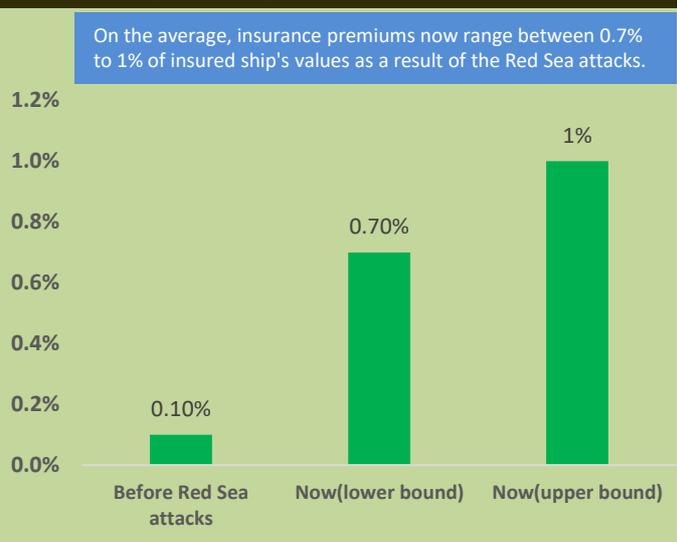


Figure 3: Insurance Premiums

Source: Pangea-Risk

Red Sea Attacks: A background

Nearly all industries have suffered exposure from the effects of the disruptions on the Red Sea. The consequences are being severely felt by key players in various industries such as consumer and retail, agribusiness, autos, oil and gas, and logistics. Commercial vessels have been forced to reroute from the shorter Suez Canal and the Bab al-Mandeb Strait to the longer alternative route around South Africa's Cape of Good Hope, requiring an additional 10 days to cover the extra 4,000 miles. As such, carriers now expend an additional \$1 million per vessel for each round trip around Africa's southern tip, primarily driven by higher fuel expenses associated with the longer journey. Beyond the longer travel time and higher transport costs, companies are also confronted with higher insurance costs on commercial vessels, tighter terms for insurance coverage, and delayed delivery of critical inputs.

Rising security concerns translate into higher insurance premiums for ships. Recent incidents have led to a significant increase in premiums, ranging from 0.7 to 1 percent of the ship's value, up from about 0.1 percent. Additionally, there has been a tightening of coverage terms, notably reducing war risk coverage duration from seven days to just 24 hours. This change imposes substantial extra costs, often tens of thousands of dollars, reflecting the direct impact of security risks on insurance pricing.

These developments further emphasize the role of global shipping services as important shock propagation channels via which the spill-over effect of geopolitical tensions and other disruptive developments, such as the COVID-19 pandemic, are transmitted to the rest of the world. However, it is widely documented that the magnitude of the supply chain disruptions and higher freight costs associated with the Red Sea disruptions are still below those recorded during the COVID-19 Pandemic.

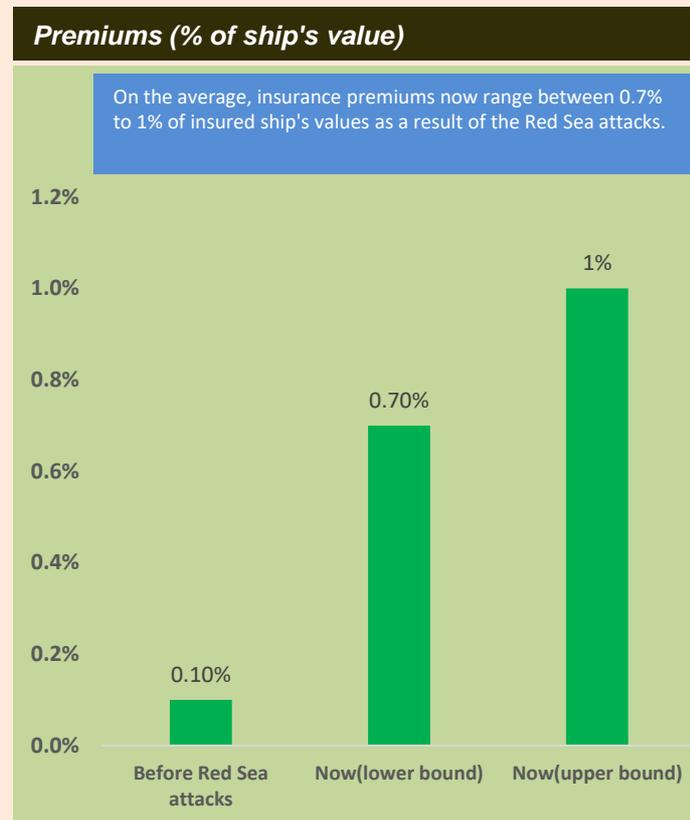


Figure 3: Insurance Premiums

Source: Pangea-Risk

Red Sea Attacks: A background

The blow dealt to trade along the Red Sea route and the maritime industry at large may be far from peaking as the March 6 attack by Houthi Rebels on the Barbados merchant ship, situated approximately 93 kilometres away from the Gulf of Aden, marked a fatal turn in the history of the tensions on the Red Sea. Apart from damaging the ship, the assault resulted in three fatalities and at least four injuries. The development could provoke further military counter-strikes in the region.

With the Israel/Palestine war probably dragging beyond mid-2024, the solidarity attacks of the Houthi Rebels on the Red Sea may continue to disrupt international trade with the risks of stoking up inflation as the higher freight costs filter into consumer prices globally. This could significantly set back earlier expectations of rate cuts or even necessitate another round of monetary tightening that could weigh on global growth in 2024.

Recent increase in shipping costs by routes

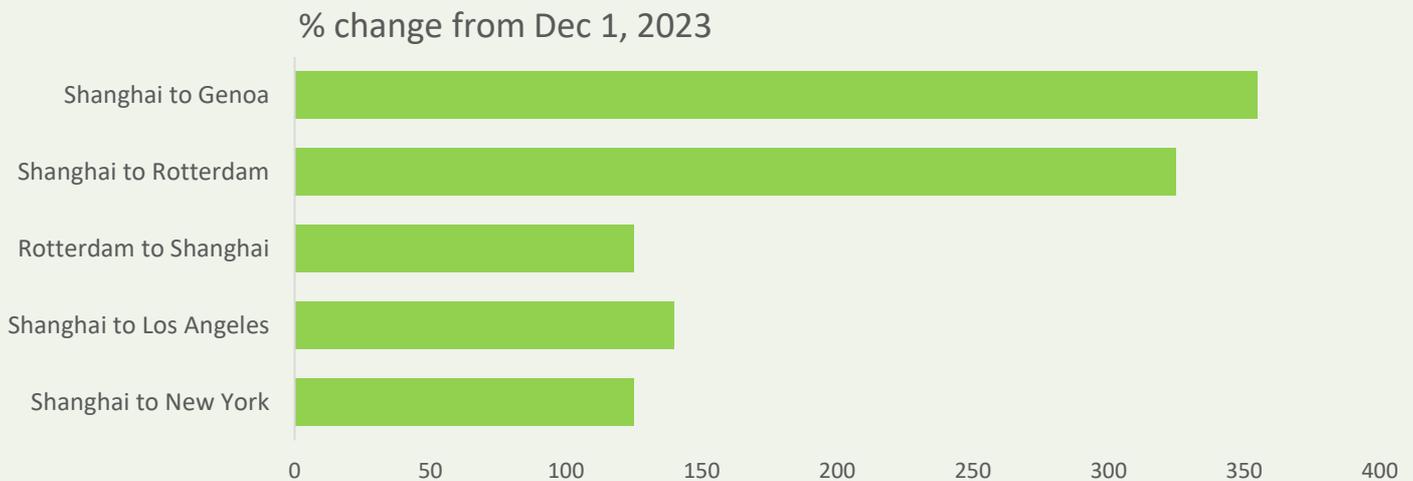


Figure 4: Shipping costs by routes

Sources: Drewry World Container Index, J.P. Morgan

Container freight rates (USD per 40-foot container)

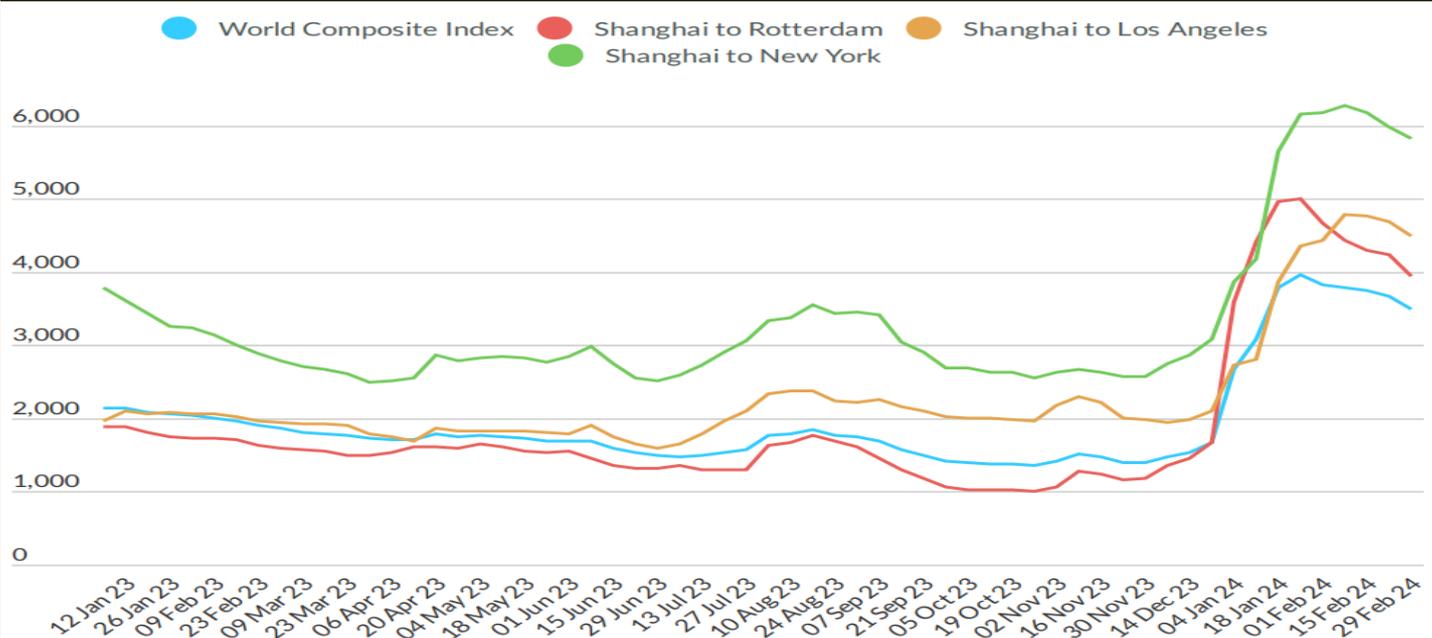


Figure 5: Container freight rates

Sources: Fitch ratings, Drewry, Haver analytics

Red Sea Attacks: The African Perspective

02

Red Sea Attacks: The African Perspective

The ongoing attacks in the Red Sea have produced distortions to African trade and may have deeper implications for the region's macroeconomic stability in the short to medium term. On African trade, the crisis has given rise to a reallocation of resources among countries on the continent, depending on what side of the pendulum they sit.

Egypt's economy remains the worst hit by the Red Sea tensions because of the direct impact of the attacks on the Suez Canal, a major source of revenue and foreign exchange for Egypt. The Suez Canal typically accounts for about 15% of shipping traffic between Asia and Europe. In the 2022/2023 financial year, Egypt made a total of \$9.4bn from the Suez Canal alone. However, shipping traffic in the Suez Canal has reduced by 30% while dollar revenue has plummeted by close to 40% this year due to the attacks by Houthi Rebels on the Red Sea. This compounds the woes of the North African country already confronted with heightened inflationary pressures amidst steep currency depreciation and debt challenges.

Similarly, countries in East Africa whose trade and fortunes are linked to the Red Sea are equally affected by the development. Countries such as Kenya, Uganda and Ethiopia, that rely on the Suez Canal route for most of their imports of chemical products and machinery from the European Union (EU) may face higher costs and delays in the delivery of these essential items, including critical manufactured goods.

For exporters in the region relying on the trade route, inventories may begin to accumulate because of delays in the transportation of exports to Europe with negative implications for their revenue streams. Ethiopia is especially vulnerable because of its reliance on the Port of Djibouti along the Red Sea for a significant fraction of its trade.

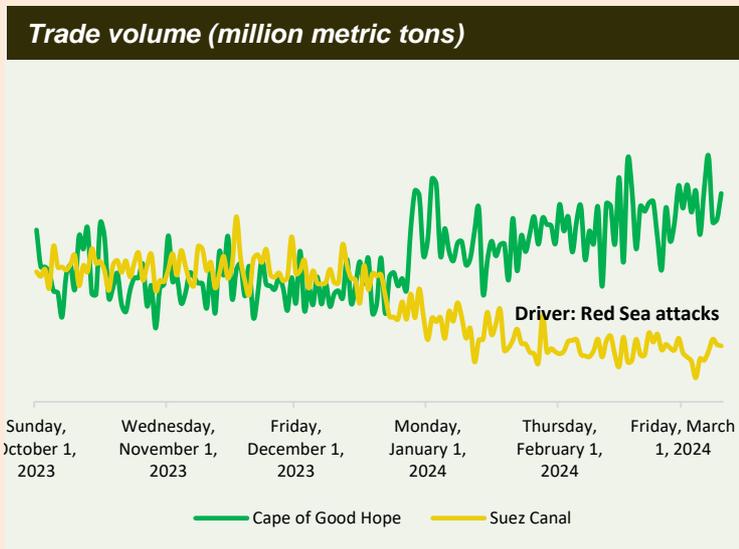


Figure 6: Trade volume (million metric tons)

Source: IMF PortWatch

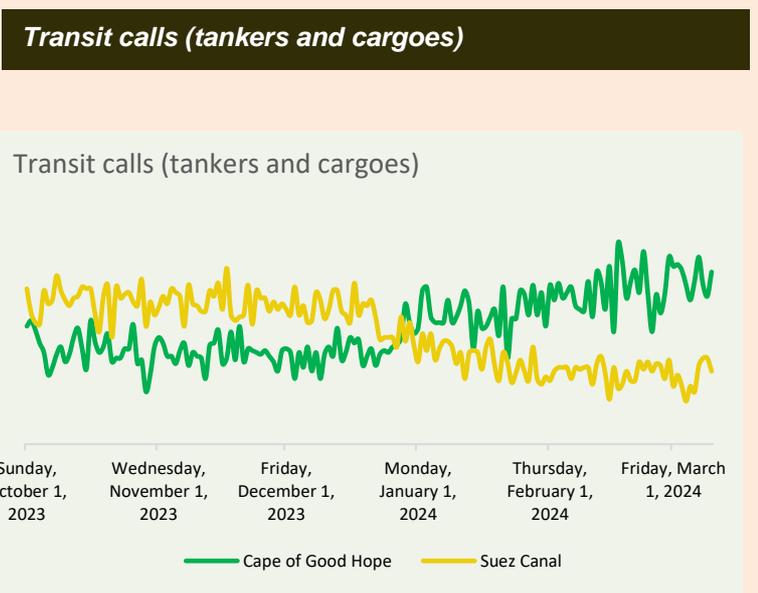


Figure 7: Transit calls (tankers and cargoes)

Source: IMF PortWatch

Red Sea Attacks: The African Perspective

Yet, the disruption will increase foreign exchange earnings for others. This is because the crisis is compelling commercial vessels to seek alternative neighbouring ports, avoiding the Red Sea. While a country like South Africa has benefitted significantly from the rerouting of vessels through the Cape of Good Hope, its ports such as Cape Town, Durban, and Gqeberha remain largely constrained by the country's protracted power sector crisis, port congestion and inefficiencies. Also, countries like Namibia (Walvis Bay), Madagascar (Toamasina), and Mauritius (Port Louis), have seen increased demand for their port's bunkering and restocking services because of their strategic location on the route that connects Asia to Europe as major ports are unable to absorb the entire surge in demand for port services.

The redirection of maritime traffic away from the Red Sea, to link destinations east and west of the Suez Canal, has led to the utilization of alternative east-west routes. Consequently, business at major African container ports saw improvement in the fourth quarter of 2023 compared to the previous year, marked by increased vessel calls and container movements. However, this surge in activity has placed additional pressure on terminal and port infrastructure in the region. Despite some exceptions, many African terminals struggled to handle the growing calls and container volumes, resulting in prolonged ship waiting times and decreased ocean and yard productivity at several of the continent's key ports.

The inability of major ports located around the axis to effectively meet the demand for bunkering and restocking services without a fragmented delivery has once again exposed the weak port economics of most African countries, making a strong case for the need for critical investments Africa's port infrastructures.

03

Implications for African economies

Implications for African Economies

On the macroeconomic front, the development is expected to have the following implications for trade, inflation, growth, and exchange rate stability:



Regional Trade

In terms of trade, the attacks in the Red Sea has have prompted a reallocation of resources, producing gainers and losers as trade shifts from the Suez Canal to routes along the Cape of Good Hope. This shift reflects the quest of global shipping companies to avoid the volatile region. Early data from the first few months of 2024 shows that trade volumes through the Suez Canal have plunged by 50% while trade volumes in the Cape of Good Hope skyrocketed by 74% year-on-year.

Also, the development may repress the growth of African trade by forcing stakeholders to rethink their strategies considering the exposed vulnerabilities of trade to geopolitical tensions in the region. This may trigger divestments from the region if costs rise above the competitive levels obtainable in other regions. Already, we expect the region's trade volume to contract by half year.

Beyond the immediate trade implications, the attacks in the Red Sea have reverberated throughout the global supply chain. Companies are now forced to reassess the reliability and security of their shipping routes, leading to potential disruptions and delays in the movement of goods. Additionally, heightened insurance premiums and increased operational costs may further strain supply chain efficiency and profitability, impacting businesses across various industries worldwide. As a result, there is a growing imperative for supply chain stakeholders to enhance resilience and adaptability to navigate these evolving geopolitical risks.



Inflation and monetary tightening

We note that the higher freight costs caused by disruptions in the Red Sea are not only set to filter into consumer prices globally, but also poised to heighten inflationary pressures on the African continent. The higher freight costs resulting from the rerouting of Africa-bound vessels through the longer Cape of Good Hope may lead to higher inflation due to elevated import prices. Also, since the composition of most items exported from the continent is largely primary products as against processed items, the additional costs incurred by exporters may gradually filter into consumer prices through a second-round effect of processed items resold in local markets.

With most African economies already devastated by inflationary pressures linked to currency depreciation crises, the disruptions on the Red Sea may further heighten inflationary concerns and raise the odds in favour of rate hikes. It could also delay rate cuts by Central Banks across the continent.



Regional growth

The attacks on the Red Sea create a bleak outlook for Africa's growth in 2024. The diversion of trade from Egypt's Suez Canal may further temper the country's growth and raise the downside risks for regional growth because of Egypt's weight as one of the major economies in Africa. Although some countries in the continent have benefitted from the resource allocation induced by the decline in traffic on the Suez Canal route, we are concerned that these gains may be offset by the costs. Moreover, the brewing inflationary pressures arising from the tensions on the Red Sea which raise the likelihood of monetary tightening may also weigh on the region's growth for the year.



Exchange rate stability

Depending on what side of the pendulum African countries sit, as a net gainer or loser, the attacks on the Red Sea can have mixed effect on exchange rate stability. While a net loser like Egypt continues to grapple with FX shortages, net gainers like South Africa, Namibia, Madagascar, and Mauritius who have recorded increased demand for their bunkering and restocking services are expected to accumulate reserves that could provide some short-term cushion to their FX challenges. Countries in East Africa such as Kenya and Ethiopia are likely to experience pressure on their exchange rate and on the prices of goods following the increased shipping costs to the region.



Commodity Prices

For commodity prices, the transmission channel of the Red Sea attacks is through an increase in shipping costs as shipping companies opt for longer routes around Southern Africa. Already, large oil companies have paused transits through the Red Sea while others have rerouted vessels. The increase in shipping cost is expected to lead to high commodity prices if there is an escalation of the attacks. Commodity exporters on the continent therefore will gain from such higher prices while commodity importers particularly those in East Africa will suffer losses.

Red Sea Attacks: The implications for Energy Cost

As aforementioned, Egypt & Ethiopia are among the two countries in Africa whose trade and macroeconomy have been most hit by the crisis in the Red Sea area. However, it can very easily spread to other countries on the continent through contagion.

Egypt has had to contend with not only a depreciating Egyptian Pounds from lower FX revenues that have dropped 40% YTD on the Suez Canal, but has to also deal with the soaring cost of food imports coming in from South East Asia and Eastern Europe from the disruptions in the bob el mandeb strait that leads into the Suez.

Ethiopia is heavily exposed to inflation linked to higher energy cost and currently undergoing fiscal challenges like some other African countries. The Red Sea disturbances may worsen this given the fact that it is disrupting their ability to use the Ports of Djibouti making it harder for many of its traditional sources of refined petroleum products including Kuwait, Saudi Arabia, China, and United Arab Emirates, to get supply to them.

The Ethiopian Airline business that generated \$6.1bn in the FY 2023 may also face challenges from higher Jet A-1 and Aviation Turbine Kerosene (ATK) costs eating into ordinarily tiny aviation margins and making it difficult for them to compete with bigger Middle Eastern carriers like Qatar and Emirates. The fact that Ethiopia is landlocked, doesn't produce its own crude oil, doesn't have a functional refinery and only just signed an agreement with Somali Land (offering them a stake in their airlines in exchange for access to the Sea-Port) poses a major system risks for vessels bringing in critical energy supply that are key to maintaining its aviation business which remains a major source of FX earnings for the country

These challenges linked to the importation of key energy and food commodities come at the same time that Ethiopia is battling an internal crisis that has impacted heavily on primary production for food (especially Wheat) as well as enterprise manufacturing for its FMCGs. The difficulty of not earning sufficient FX, linked to the Red Sea attacks, may therefore impact negatively on the ability of the Ethiopian Central Bank to fulfil its balance of payment obligations to corporates who play in the economy and repay its external loans which it has already defaulted once.

The inadequate bunkering and restocking infrastructure around ports in the Eastern Maritime Flank to the ships sailing through the most southern tip of Africa into the Atlantic shows a serious need for critical maritime investments that will boost Intra-Africa trade from the current about 20% to targeted 70% over the next decade. One of the greatest stumbling blocks to growth within the African continent is a lack of seaport infrastructure and a common customs union. Investing in Infrastructure to enable the movement of goods within countries in the continent will impact positively on inflation, and GDP and lead to an improvement in per capita income.



04

Conclusion

Conclusion

The Red Sea is a major global trade route, accounting for about 15% of global shipping traffic. The recent attacks on commercial vessels will have a huge consequence on the economies of African countries, especially those in North and East Africa such as Egypt, Ethiopia, Djibouti and Kenya, among others. African countries cannot afford another major global disruption. With the COVID-19 pandemic and the war in Ukraine, the budgets of African governments have been overstretched. Many countries on the continent are experiencing mounting debt problems, exchange rate instability and inflationary pressures. The attacks on the Red Sea will further complicate the fiscal and broader economic situation of many African countries, heightening the possibility of a food, debt and energy crisis, if left untamed. Therefore, the international community must intensify efforts in seeking a peaceful solution between Israel and Palestine, as this could reduce tensions in the Red Sea. The crisis also presents an immense opportunity for African governments to prioritize the development of port infrastructure and implement reforms to ease trade bottlenecks within and across countries.