

Industrials/Multi-Industry

Red Sea impact on US multi-industrials

Industry Overview

Red Sea route used by ~28% of global container trade

Since mid-December, shipowners have been diverting away from the Red Sea and Suez Canal due to attacks by Houthi rebels. Approximately 28% of global container trade goes through the Red Sea. While transpacific shipping to US West Coast ports is unchanged, the US East Coast ports will likely see disruptions. Approximately two-thirds of US imports arrive via a Red Sea route to these East Coast ports. We view these disruptions as broadly inflationary.

What is so bad about a few extra days? Less capacity

Container ships traveling through the Red Sea have fallen 90% y/y (January 2024 data). Re-routing via the Cape of Good Hope adds 7-20 days per leg. With container ships taking more time between ports, this lowers the effective capacity of the global fleet. Already, container spot rates have risen over 100%. BofA Global Research's Asia-Pacific Transportation analyst, Nathan Gee, estimates that if all container ships divert away from the Red Sea, global container demand would rise 9%.

SE Asia supply chain – electrical, semis, forging & castings

To gauge the risks to supply chains, we focus on intermediate goods (e.g., components used by US manufacturers). Intermediate goods imports from Southeast Asian countries represents ~10% of total. India alone is the 5th largest exporter of intermediate goods to the US. Looking at areas relevant for our US multi-industrials coverage, imports of electrical equipment, semiconductors, and forging & castings from this region are meaningful. As ITT's CEO Luca Savi said at a March 2023 conference, "If you make pumps and you are sourcing casting, you will keep on sourcing casting out of China and India. There is no way that you would be able to compete otherwise."

European manufacturing more exposed

The impact may be more acute for US firms' European manufacturing locations, given a greater reliance on the Red Sea route. So far in 2024, Telsa, Volvo, Suzuki, Michelin have temporarily halted production at European manufacturing sites due to supply chain delays. The auto industry, with its just-in-time supply chain, makes it particularly vulnerable to shipping delays. For a more in-depth discussion, see BofA Global Research's European Capital Goods analyst Alexander Virgo's 1/29 note here.

Medium-term: another push for near shoring

We view these disruptions in global trade as another reason for US manufacturers to shorten supply chains. Higher shipping costs and the need to increase safety stock levels of inventory reduce the cost advantage from using imported components. An October 2023 survey of 1,000 businesses found that 69% are reshoring supply chains. A separate survey of 800 businesses found that 53% increased domestic or nearshore supply chains in 2023, with 54% planning for further increases in 2024. The trend is showing up in trade data as well. Mexico overtook China as the largest US trade partner in 2023.

29 January 2024

Equity
Americas
Industrials/Multi-Industry

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Timestamp: 29 January 2024 01:21PM EST

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