

## LatAm Thematic

## The butterfly effect – LatAm and the Red Sea

Equity Strategy

**Red sea bottlenecks: Covid Déjà vu?**

The current situation on the Red Sea is creating supply chain bottlenecks that are reminiscent of Covid times, although we see no product availability issues so far. In LatAm, oil companies could eventually benefit from a spike in oil prices (not yet materialized) but we see limited impact for other raw commodities. Higher freight costs could eventually hurt protein exporters and industrials, and higher commodity prices could potentially add to domestic costs and inflationary pressures. See summary in Exhibit 1 and sector deep dives in [LatAm Natural Resources](#) and Consumer Staples reports.

**Oil: limited impact so far, but situation is volatile**

The ongoing conflict in the Red Sea adds to a severe drought affecting the Panama Canal operations. Oil prices haven't increased yet as demand concerns have prevailed coupled with strong output in recent months, but prices could change very quickly if the conflict leads to a major supply disruption in the Middle East.

**Materials: limited impact on re-routing and long contracts**

Exports from Brazil to China are not directly impacted since they are not exposed to the red sea route. On exports to and from Europe, most products such as pulp and paper have long term shipping contracts, so impact seems limited. The increase in transportation costs could lead to higher regional steel prices and support prices in Brazil, but more volumes from Asia could be diverted from Europe to LatAm.

**Protein exporters could be negatively impacted**

LatAm protein companies who mostly export to the Middle East and Asia could be negatively impacted. The exports of grains and sugar are relatively more diversified, while beverages and packaged foods are more locally produced.

**Domestic companies likely to pass through higher costs**

Airlines could face higher oil prices and industrials higher freight expenses (although freight represents less than 3% of Brazil industrials revenues). Homebuilders could face higher construction material costs (mainly steel) and cost pass-through capabilities are different among mid-high and low-income names. Retailers could eventually have minor impacts related to higher freight costs, but it would be passed through prices.

**Upward pressures for inflation**

We think the Red Sea situation could prove temporary but is a risk to inflation and the timing of the easing cycles in LatAm. Geopolitically induced spikes in commodities or freight costs can be among the most challenging exogenous shocks for markets due to their potential stagflationary impact. See [Global rate cuts lost at \(Red\) Sea?](#)

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**Exhibit 1: Impacts of Red Sea disruptions across LatAm industries**

Global commodities could eventually benefit from higher international prices.

Sector	Most exposed	Potential beneficiaries	Comments
Financial Institutions			No direct impact but if a major company is impacted then it could impact banks
Retail			LatAm retail companies are not directly exposed to the red sea shipping route. Companies could eventually have minor impacts related to higher freight costs, but it would be passed through prices.
Homebuilders & Real Estate			No direct exposure. Risk is for higher steel prices affecting costs.
Healthcare & Education and Telecom & Media			No expected impact
Mining, Steel, Paper & Packaging		In the case of pulp prices support: Klabin, CMPC e Arauco. In the case of steel prices support: Usiminas, CSN, Gerdau	Exports from Brazil to China are not directly impacted since they are not exposed to the red sea route. On exports to and from Europe, shipping costs have been seeing some pressure, particularly via containers, but most products such as pulp and paper have long term shipping contracts, so impact seems limited. Long steel exports from Türkiye could see some pressure as well, but since the earthquake in 2023 its steel exports to Brazil shrank substantially. The increase in transportation costs could lead to higher regional steel prices and support prices in Brazil, but more volumes from Asia could be diverted from Europe to LatAm. Separately, the indirect inflationary impact from the crisis, particularly from higher oil prices, could hurt all companies. Details in our report: <a href="#">LatAm Natural Resources: The inflationary potential of Red Sea and Panama Canal trade disruptions</a> .
Oil&Gas		3R Petroleum, Ecopetrol, Enauta, Petrobras, PetroReconcavo, PetroRio and YPF.	The Red Sea is a key energy trading route. We note, however, that oil prices haven't increased yet as demand concerns have prevailed coupled with strong output in recent months. At the same time, it is important to highlight that escalating tensions in the region pose a serious risk to oil flows, and prices could change very quickly if the conflict leads to a major supply disruption in the Middle East. Details in <a href="#">LatAm Natural Resources: The inflationary potential of Red Sea and Panama Canal trade disruptions</a> .
Agribusiness, Food & Beverage	JBS, Marfrig, Minerva, BRF		LatAm agribusiness/Food & Beverage companies are not directly exposed to the red sea shipping route. Companies could eventually have minor impacts related to higher freight costs. Details in US Consumer Staples: Red Sea potential impacts to Consumer Staples.
Transportation & Capital Goods	Azul, Volaris, Copa, Weg, Randon		Limited impact. Eventual oil spike could impact airlines in the short-term. Transportation costs could be higher for names that import from China (WEG). We see as not material. For airlines, eventual oil spike could impact companies in the short-term.
Utilities			Any cost increase (given higher fuel costs) would be passed-through prices

Source: BofA Global Research

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**Commodities: two vital shipping lanes impacted**

Global trade has been pressured by escalating tensions in the Red Sea which adds to a severe drought in the Panama Canal. We explored the impact for raw materials in our report: [LatAm Natural Resources: The inflationary potential of Red Sea and Panama Canal trade disruptions](#)

**Oil & Gas: muted impact so far but prices could rise fast**

The Red Sea is a key energy trading route. Still, oil prices haven't increased yet as demand concerns have prevailed coupled with strong output in recent months. Escalating tensions in the region remain a serious risk to oil flows, and prices could change very quickly if the conflict leads to a major supply disruption in the Middle East.

**Steel could see some pricing support but imports a threat**

Although the Red Sea is not really an important route for South American trade flows, we see some potential indirect effects. Asia accounts for ~52% of steel imported into the EU, while China last year exported a net of 83.6Mt of steel. Extended lead times/higher freight costs could ultimately support global steel prices, particularly as regional prices are mostly set based on either import or export parity. On the other hand, we note the risk of some Asian exports being redirected to Latin America as Europe becomes a less accessible and more costly destination (given higher freight). This offers some cushion to Chinese exports and thus iron ore demand.

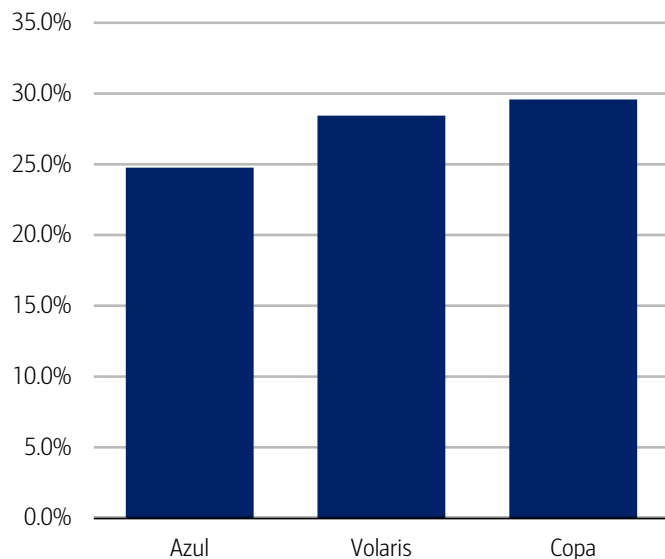
### Protein exporters could eventually face challenges

In Latam, the protein companies (JBS, Marfrig, Minerva and BRF) who mostly export to the Middle East and Asia could be negatively impacted. The exports of grains and sugar are relatively more diversified, while beverages and packaged foods are more locally produced. See more details in US Consumer Staples: Red Sea potential impacts to Consumer Staples.

## Industrials: trickle down impacts of higher oil and freights

### Exhibit 2: LatAm airlines fuel costs (as % of 2024E revenues)

Fuel costs represent around 28% of LatAm airlines revenues

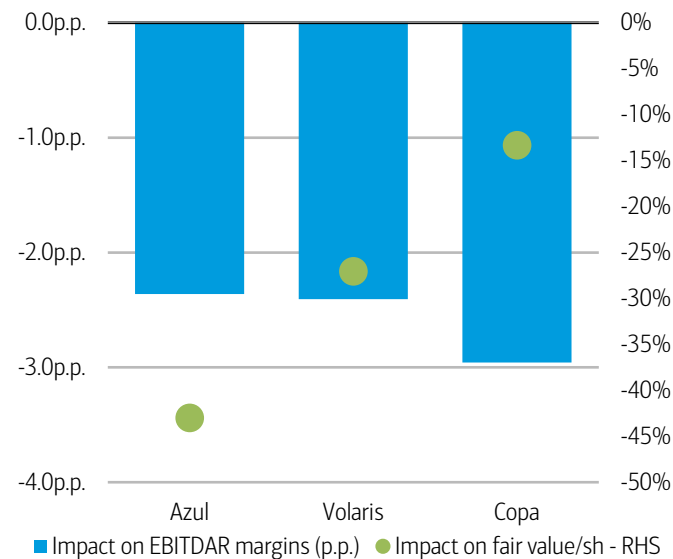


Source: BofA Global Research Estimates

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### Exhibit 3: LatAm airlines impact of a 10% increase in oil prices

Azul would be the company most affected by higher oil prices



Source: BofA Global Research Estimates

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### Airlines: eventual oil spike could impact companies in the short-term

The main impact on LatAm Airlines is an eventual spike in oil-prices. Until now, BofA US Oil & Gas team note that there was no oil supply loss on to Red Sea disruptions, with the main side effect being longer trade routes (see [OIM# 654: A lot to catch up on – start with why oil can't get >\\$80 despite the Red Sea](#)). Moreover, they see OPEC + spare capacity as an overhang that could limit higher oil prices given Red Sea tensions.

We calculate that fuel costs represent on average 28% of our 2024E revenues for LatAm airlines, and an increase of 10% in oil prices would reduce their margins by ~2.5-3.0pp. The company most impacted by higher oil prices is Azul. Assuming no pass-through to fares, we see a 10% spike in oil reducing Azul's fair equity value per share by 43%, Volaries' by 27% and Copa's by 13%.

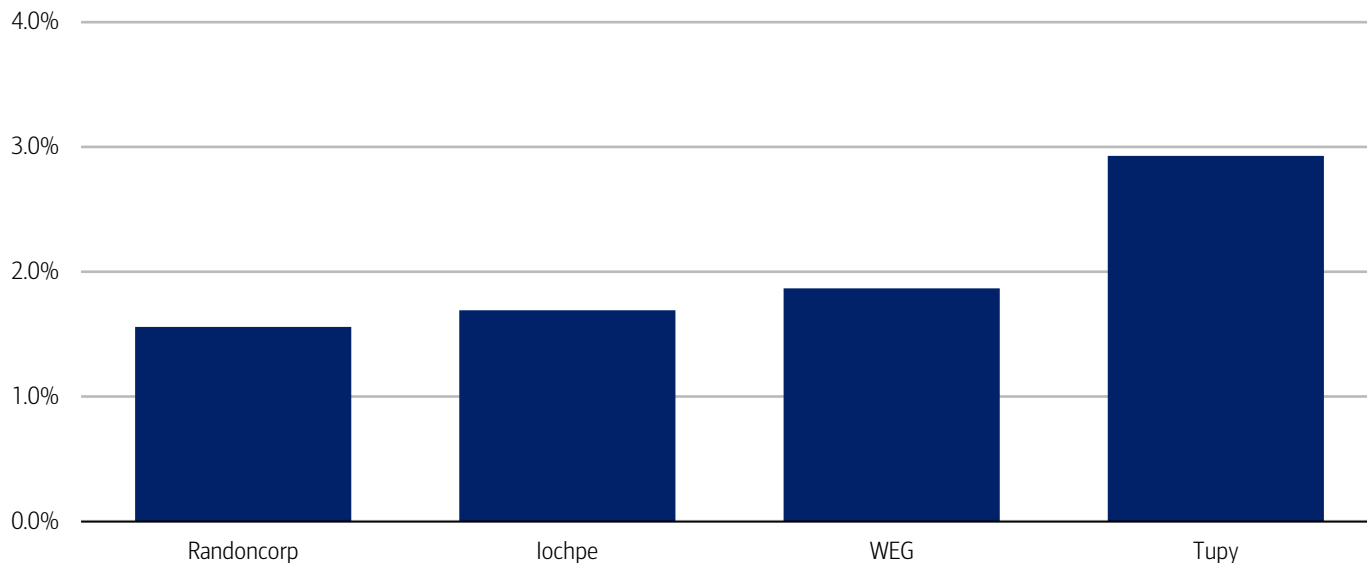
### Brazil Industrials: a softer impact than COVID disruptions

We see Red Sea tensions' impacts on Brazilian Industrial companies (WEG, Iochpe, Randon and Tupy) as similar to those that took place amid COVID supply chain disruptions, tough at a softer intensity, as there are no product availability issues this time and demand in industrials main markets are weakening. Furthermore, we note that freight expenses represented less than 3% of Brazil industrials 9M23 revenues, limiting eventual impacts on company's P&L from higher spot freight rates.

The most obvious impacts are higher lead times for imports of inputs and for exports of final products, especially in routes from China to Europe. Increases in raw materials prices could be a side effect. Most affected companies should be WEG and Randoncorp as they export products from their hubs in China to other markets. For WEG, we note that the company should be less affected than its peers given that its verticalized structure reduces its dependence on foreign supply of products.

#### Exhibit 4: Brazil industrials freight expenses (as % of 9M23 revenues)

Freight expenses represented less than 3% of Brazil industrials 9M23 revenues



Source: Companies, BofA Global Research

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