



ODDO BHF

## FOCUS on Geopolitics

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### *Attacks in the Red Sea: a new threat to supply chains. Europe's sovereignty in question.*



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The interruption of most of the traffic on the Red Sea-Suez route following the attacks on merchant ships by the Houthis in Yemen is a major issue for Europe.

#### **Red Sea events as seen by our ODDO BHF Metals business.**

Through its non-ferrous metals business - ODDO BHF Metals - (aluminium, copper, zinc, etc.), **the Group has been supplying part of the European metal industry since 2006.**

**For aluminium, as for energy, Russian supplies to Europe were reduced to a minimum** (from 30% to less than 10%), **while volumes purchased in Asia** (Persian Gulf, India, Indonesia, Malaysia, Australia, etc.) **grew by more than 30%.**

#### What happened?

On Friday 15 December 2023, two of the world's largest shipping lines, MAERSK and CMA CGM, announced that they were stopping the transit of their container ships via the Red Sea and Suez. They are reacting to a series of attacks by Yemen's Houthis on ships bound for the Babel-Mandeb Strait. They will be followed by the major shipping lines HAPAG LOYD and MSC.

Some ships waited at the entrance to the Strait hoping for an improvement, others headed for the

Cape of Good Hope, while others unloaded part of their cargo to transfer it to other routes bypassing Africa.

On Saturday 16 December 2023, we received notification from a major Middle Eastern producer that it was withdrawing all its offers for Europe until further notice.

*We quickly calculate that 40% of our aluminium supplies transit through the Suez Canal (India, Indonesia, Malaysia, Persian Gulf, Australia, New Zealand).*

*The following week is used to discuss alternatives with world producers.*

The Indian producers decide to continue the flow via Bonne-Espérance immediately. The Saudi Arabian producer raises the possibility of transporting aluminium ingots by road from the shores of the Persian Gulf to Jeddah on the Red Sea in northern Yemen.

Delays lengthened, beyond the extra 10 days needed to circumnavigate Africa, and transport disorganization and transshipments increased delays to a month or more. Subsequently, reloading capacities became insufficient for subsequent shipments. Ships are mobilized for the return trip around Africa. Bulk carriers are mobilized to replace container carriers.



Sea freight costs doubled, and in some cases tripled. The relative cost of aluminum in Europe, represented by the premium, soared. Lead times have stabilized, but are now around 15 days and one month for Oceania.

*We succeed in securing deliveries for our clients by mobilizing our safety stocks and using the flexibilities of other long-term contracts.*

*This is the role of the ODDO BHF Metals business, to secure supply chains even in the face of geopolitical events that are difficult to predict.*

## **An essential supply route for Europe is cut off.**

The events in the Red Sea come almost two years after the outbreak of open warfare following Russia's invasion of Ukraine in February 2022. The sanctions on Russia, in addition to the pre-existing sanctions on Iran, can be likened to a kind of iron curtain cutting off the Eurasian continent from the Arctic Ocean to the Indian Ocean.

**Alternatives to the Red Sea-Suez axis for supplying Europe from Asia are limited.** From China, the Arctic sea route would be the shortest (8,000 nm), but it is not operational and will remain under Russian control. Even rail traffic from China to Germany via Kazakhstan and Russia has been halved.

**That leaves only the Cape of Good Hope route, which adds another 3500 to 4000 nautical miles to all the sea routes from Asia to Europe.**

**The Red Sea-Suez route was the link between Europe and exports from all over Asia:** oil and gas from the Persian Gulf, textiles and pharmaceuticals from India, metals and raw materials from Indonesia and Oceania... **and last but not least, manufactured goods from China.**

- The value of goods transiting the Red Sea exceeded 1 trillion dollars annually. Europe imports between 500 and 600 billion Chinese manufactured goods a year, with a trade deficit of around 300 billion.
- This route carried 12% of world maritime trade, but around 30% of container traffic. It also carried 10% of the world's oil and 8% of its gas.
- The Suez Canal brought Egypt between \$10 and \$12 billion in royalties every year...

## **Geopolitical issues surrounding the Suez Canal**

The issues at stake are complex, with interests that are often contradictory beyond what is wrongly simplified as a confrontation between the "West" and a so-called "Global South".

The Houthis justify their attacks on merchant ships by supporting the Palestinian cause in the context of Israel's invasion of the Gaza Strip - an invasion which itself followed the Hamas attacks of 7 October. The deterioration of the situation in Gaza leaves little hope of a rapid resolution on this front. **The Houthis' rhetoric is clearly "anti-Western", and they have made it clear that Russian and Chinese ships need need no fear of attack. As a result, Chinese container ships seem to be the last to use the passage regularly.**

Iran is the main supporter of the Houthis, particularly in terms of military equipment. As a result of sanctions, Iran sells 90% of its oil to China.

**China therefore plays a central role in resolving this conflict.** Its diplomacy was instrumental in the ceasefire negotiated between the Houthis and Saudi Arabia in 2022 after 8 years of war.

**Being asked by the United States to put pressure on Iran is in itself a symbolic victory in the rivalry between these two great powers.** But on the other hand, too great a deterioration in the situation would cost China, which uses this route for 10% of its exports.

Russia may see these conflicts as a diversion for the West from the war in Ukraine. But Russia now exports 90% of its hydrocarbons to India and China. It has also been penalised by the closure of the route from the Black Sea to India.

Saudi Arabia has made it clear that it will not call the ceasefire into question and will not resume the war against the Houthis. Its open sea fronts on both the Persian Gulf and the Red Sea allow it to escape the blockade.

The United States has deployed its naval air forces around the Bab El Mandeb Strait and is the only country - along with the United Kingdom - to retaliate against Houthi land positions. As Joe Biden has said, these counter-attacks are imperative for the world's leading power, which must enforce the free movement of ships, but we are aware that this will not bring a solution, at least in the short term.



In reality, the direct economic and strategic stakes involved in closing the Red Sea are low for the United States, and the continuity of its intervention could be called into question depending on the outcome of the presidential elections in 2024.

For Europe, on the other hand, this route is crucial in strategic and economic terms. It is even more so for the Mediterranean countries (42% of Italy's exports pass through the canal, for example). While supporting the United States, Europe has refused to place its forces under a unified command and to conduct land-based responses, instead organising convoys of ships. Although it has sought to retain its autonomy, European diplomacy remains somewhat invisible for now.

### Immediate and longer-term consequences:

The immediate consequences were relatively mitigated in a context of marked industrial slowdown across Europe. The same event in 2021 or 2022, when supply chains were already under strain, would have led to a cascade of plant shutdowns.

Nevertheless, Tesla has announced a three-week production shutdown, while Volvo has announced a one-week shutdown. Analysts estimate that the rise in logistics costs could contribute to an increase of around 0.5% in European inflation.

In the longer term, the closure of this route will weaken Europe and distance it from the economic centre of the planet, the two great powers, China and soon India. It is also a long-term loss of competitiveness for Europe.

And, of course, this fragility should encourage Europe to amplify the worldwide movement towards industrial "re-shoring", which consists of shortening supply chains by favouring local subcontractors. The ambition to reduce the trade deficit with China, as the United States has begun to do, will be one of the main thrusts.

### Conclusion:

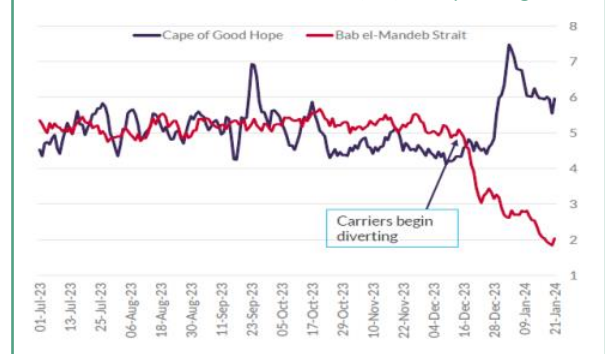
In two years, under the pressure of events, Europe's international positioning has undergone a profound change.

The cut-off of Nord Stream gas deliveries was not the catastrophe we had predicted, but our electro-intensive industries are still struggling to recover from rising energy costs. A new industrial challenge will be to make the most of our new intermittent power sources (56 Gw of installed capacity in 2023 alone).

Europe has also become aware of the need to be able to defend itself largely autonomously. And, of course, the outcome of the American elections could force us to accelerate this trend.

Relying on greater energy independence and greater defense capacity, Europe will also have to build a stronger, more autonomous diplomacy, as the events in the Red Sea remind us. It will need to forge strong ties with countries that share common interests, such as India. Europe must remember that isolationism is not an option.

Cap of Good Hope and Bab-el-Mandeb Strait - transit trade volumes, Tonnes (mn), 7-day average



Sources IMF, PortWatch, BMI

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