Red Sea conflict worsens, forcing more ship detours around Africa

Houthi ship attacks continue amid ongoing coalition air strikes in Yemen

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The aircraft carrier U.S.S. Dwight D. Eisenhower is very active in anti-Houthi operations. (Photo: U.S. Navy)

U.S. and U.K. airstrikes on Houthi positions in Yemen have not made the Red Sea any safer for shipping. “Red Sea issues are getting worse, not better,” said Stifel shipping analyst Ben Nolan.

The dry bulk carrier Gibraltar Eagle, owned by Connecticut-based Eagle Bulk (NYSE: EGLE), was struck by an anti-ship ballistic missile in the Gulf of Aden on Monday. The Greek-owned dry bulk carrier Zografia was hit by a missile in the southern Red Sea on Tuesday.

Energy shipper Shell (NYSE: SHEL) halted all Red Sea transits on Tuesday, as did the big three Japanese tanker and bulker owners: MOL, NYK and K-Line.

A Tomahawk missile launches from destroyer U.S.S. Gravely on Friday. (Photo: U.S. Navy)

Container-ship diversions around the Cape of Good Hope now appear likely to last for months. Spot rate gains from diversions will almost certainly extend into the period when 2023 annual trans-Pacific contracts are negotiated, pushing up contract rates.

The Red Sea effect on tanker trades remains uncertain, although a tipping point may be very near. If crude and product tankers divert away from the Red Sea and Suez Canal to the same extent as container ships, tanker spot rates should rise, because longer voyages would soak up tanker capacity.

Will tankers follow container ships around Cape?

"There has already been a sharp decline in container ships approaching the Gulf of Aden, which feeds into the narrow Bab-el-Mandeb Strait, and there are likely to be major declines across other shipping segments as well in the coming weeks," predicted Omar Nokta, shipping analyst of Jefferies, in a client note on Tuesday.

Ship-position data shows container transits down precipitously, tanker transits down modestly, and dry bulk transits down very little if at all.

Container-ship arrivals in the Gulf of Aden were at their lowest level on record last week, down 90% from the 2023 average, according to Clarksons Securities.

In contrast, bulk carrier arrivals in the Gulf of Aden were in line with the historical average, and tanker arrivals were down 20% versus 2022-2023 levels, according to Nokta, who cited Clarksons data.

According to data from commodity analytics group Kpler, the moving average of tanker transits of the Suez Canal had fallen to 14 per day as this week, the lowest level since May 2022 and down from an average of 22 per day a month ago.

In other words, there are detours on the tanker side, which are positive for rates, but still nothing close to what's being seen in container shipping.

Potential for 'widespread rerouting' of tankers

"So far, most tanker owners remain unwilling to commit to a costly rerouting around the African Cape," said ship brokerage BRS on Monday.

"Since the events of Friday [the beginning of coalition strikes in Yemen], shipping data implies that only a handful of tankers heading from east to west have definitely changed course away from the Red Sea. Most other tankers in the Middle East scheduled to head west appear to be delaying their passage.

“Accordingly, there remains the potential that widespread rerouting could occur over the coming days. If this were to take place, it would provide a significant injection of ton-miles [demand measured in volume multiplied by distance] into the market,” said BRS, which sees the highest potential rate upside for tankers carrying refined products from east to west.

Skyrocketing insurance premiums could tip the scales

Spiking insurance costs could ultimately tip the scales for tankers toward the Cape route, said Frode Mørkedal, shipping analyst at Clarksons Securities.

“War risk insurance premiums for ships have skyrocketed,” Mørkedal wrote in a client note on Monday, prior to the attacks on the Gibraltar Eagle and Zografia.

“In the past few weeks, premiums have increased from 0.1% normally to 0.5% of a ship’s hull value. With the escalation of tensions in the Red Sea, we would not be surprised if insurance premiums increase to 1% of the ship’s value.”

Mørkedal cited the example of a 10-year-old LR2 (Long Range 2) product tanker valued at $60 million. The premium is now $300,000, quintuple the usual $60,000. If premiums rose to 1% of hull value, the cost would jump to $600,000. And on top of insurance, the Suez Canal transit fee for an LR2 is around $500,000.

In comparison, the extra fuel cost of taking an LR2 around the Cape at 12 knots would be $250,000. “Shipowners and charterers may find that rerouting around Africa is more cost-effective than incurring the combined costs of Suez Canal transit fees and insurance premiums,” said Mørkedal.

Richard Meade, editor in chief of Lloyd’s List, a publication that covers both shipping and insurance, wrote late Tuesday that Red Sea premiums have now risen to 1% of hull value, that a “tipping point has been reached,” and that further diversions of tankers and bulkers should be announced within the next 24 hours.