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THE RED SEA CRISIS: IMPLICATIONS FOR THE INDIAN ECONOMY

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Introduction

The Red Sea crisis began on 19 October 2023, when the Iran-backed Houthi movement in Yemen unleashed missiles and armed drones at Israel, requiring an end to the invasion of the Gaza Strip. Iranian-backed Houthi militants' attacks on vessels passing through the southern Red Sea have choked trade through the Suez Canal.

The Red Sea crisis continues to impact global trade adversely as commercial ships don't have any other alternatives but to take routes of treacherous waters to evade potential threats posed by Houthi rebels of Yemen. Vessels don't have any other alternatives but to opt for the longer route with delays in shipments with soaring sea freight costs. Space constraints and logistical challenges continue, worsening the stress on supply chains already struggling with the consequences of the crisis.

Trade through Suez and Panama Canal has declined severely, disrupting supply chain and trade. Globally salt exports got affected, groceries and food suppliers faced challenges in ingredient sourcing and transportation. Chemicals and fertilisers sectors also grasped with troubles.

Implications for the Indian Economy:

Disruptions in maritime trade routes would increase shipping costs and causing delay in shipments. Global retail supplies, energy, automotive, groceries and food and salt industries are most vulnerable to such crisis.[1] The Indian exports have to some extent been immune to the crisis by diverting sailing of ships carrying containers via the Cape of Good Hope route. Many logistic companies have adopted different strategies including diversifying routes, enhancing risk management practices, collaborating with partners among others. Some interesting innovative strategies include advanced automation solutions to streamline operations and reduce costs amidst the crisis.

There is a significant impact of the Red Sea crisis on the Indian businesses, particularly concerning the route's crucial role in global trade, with about eighty per cent of India's trade with Europe passing through it. Logistics companies are carefully working together with exporters and businesses to mitigate the crisis's impact by moving goods via air routes. However, this shift seems to be expensive, leading to increased prices in air freights across airlines, aggravated by congestion caused by events like Easter in Europe and Ramadan in Saudi Arabia. Such shifts further put pressure on these air routes due to the surge in demand following the switch from sea to air transportation.

Disordered trade routes and rising shipping costs has resulted in shipment delays, material shortages,[2] and increased prices for goods across various sectors like textiles, leather, capital goods, and fertilisers. To help affected exporters and businesses, logistics companies are applying strategies such as multimodal transportation, route optimization, and even employing less complex components to mitigate geopolitical risks and delays. These measures aim to ease the burden on businesses by safeguarding smoother logistics operations amidst the crisis, relieving the challenges posed by disrupted trade routes and increased shipping costs.

India’s merchandise exports declined 3.1 per cent year-on-year (YOY) in 2023-24. Imports in March were down 5.98 per cent to $57.28 billion. Services exports contracted 6.25 per cent in March’24 to $28.14 billion and imports of services were down 6.57 per cent to $15.84 billion. While India’s exports and overall merchandise trade balances have improved in recent years, the hiccup is due to the external headwinds, especially the geopolitical challenges.

As a fallout of the crisis, there is increase in transit time, insurance costs, and overall shipping expenses. Supply chain disruptions may lead to production slowdowns and shortages in raw materials. Furthermore, as a key route for crude oil imports, uncertainty in the region could cause instabilities in global oil prices.

[1] According to industry leaders as well as various media reports.

[2] Such as cocoa for confectionery companies.

In recent years, since the inception of the Russia-Ukraine tussle, geopolitical risks have become most crucial, that is manifested in red sea crisis, Iran-Israel tussle. Such unanticipated geopolitical challenges are hindering the rate softening expectations and ending the hype "higher for longer." Globally, the 'de-escalation' effort should be expedited, in order to pre-empt retaliatory impact, which would amplify the complexity of the issue. There could be a chain reaction, that might affect the entire supply chain. This could cause an entirely unwarranted hike in input costs across the supply chain.