

South China Sea

Geopolitical Analysis and Scenarios

March 2024

About Onyx

A unique global network

We are a division of Expeditors, one of the world's foremost supply chain companies. Our core team of global, regional and industry experts is complemented by our extended network of logistics and supply chain practitioners on the ground in 350 locations in 100+ countries globally.

Quantifying impact is at the heart of our value

We believe that geopolitics and macroeconomics can shape any business. But understanding them is only half the story: we combine qualitative analysis and proprietary data to quantify impact on your business and produce actionable insights.

We focus on actionable insight

We fully integrate macroeconomic and geopolitical analysis, unlike any other consulting firm. Our approach is tailored to the issues, geographies and industries you care about. We focus on getting to the so-what of politics – so you don't have to.

Executive summary

Ocean faces an accumulation of risks, especially from geopolitics


- **Ocean has faced several disruptions**, including recent instability impacting Suez, and the Panama Canal drought
- The most significant **geopolitical tensions** (some active, some frozen) across the world have one key trait in common – **almost all impact ocean** with a few exceptions
- **Asia and the Middle East** are key focal points

South China Sea: status quo still likely, but escalation risks deep global effects

- In the short to medium-term, we expect the **current status quo to continue**
- **Nonetheless, minor skirmishes are possible** given increased military activity and buildup in the region, as well as the related potential for accidents
- **In a full escalation scenario**, estimated impact to **shipping capacity could be up to ~20%, potentially tempered by new capacity coming in; countries in the region could face GDP contraction of 5-35% before sanctions**

Ocean trade faces an accumulation of risks

In particular in Asia and Middle East

 Our focus today

Risks	Key chokepoints/lanes	Share of global volume ¹ %, 2021, non-cumulative
Middle East instability (Israel-Hamas, Red Sea, Iran, Yemen)	Strait of Hormuz Bab-el-Mandeb Strait Suez Canal	25-35%
South China Sea dispute China-Taiwan	South China Sea Taiwan Strait Malacca Strait	20-30%
East China Sea dispute	East China Sea	10-20%
North Korea	Korea Strait Tsugaru Strait	2-5%

Other, more targeted issues and nearby ocean chokepoints to keep in mind include:

- Russia/Ukraine (impacting mining, food and fertilizers): Black Sea/Bosporus Strait, Arctic potential
- Middle East/Lebanon (spillover from Israel-Hamas): East Mediterranean

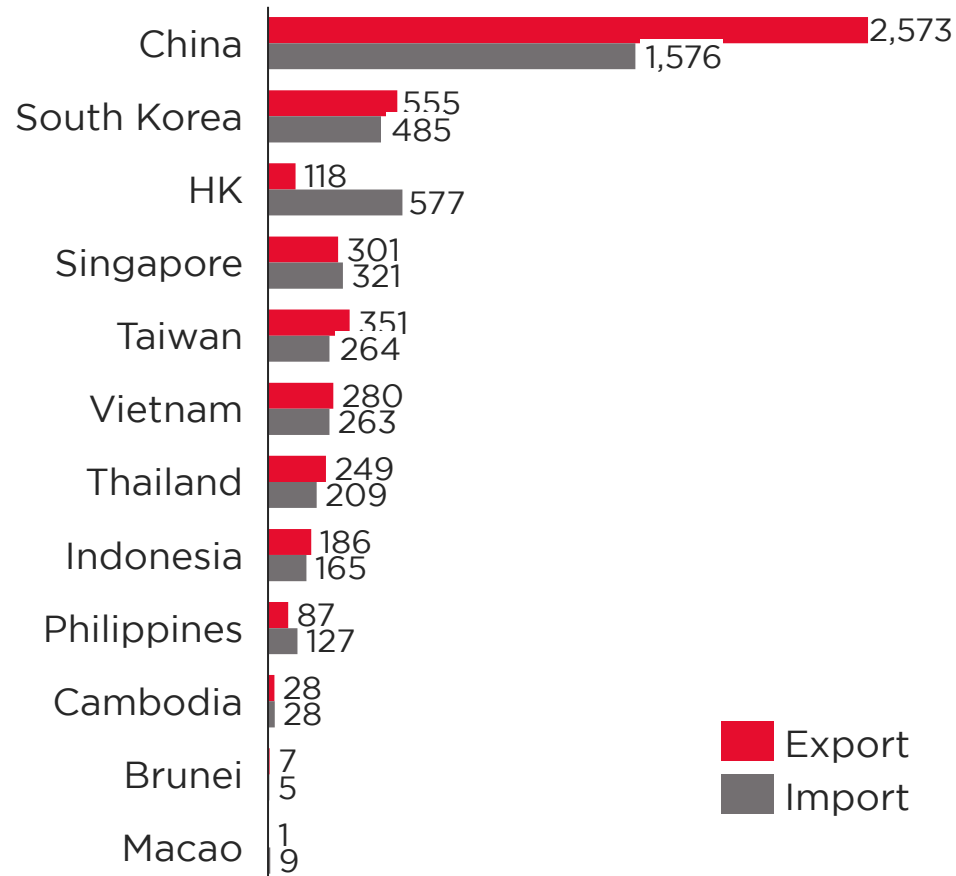
(1) Includes high-level estimates of throughput in top ports and overall trade volumes.

China-related trade dominates the South China Sea route

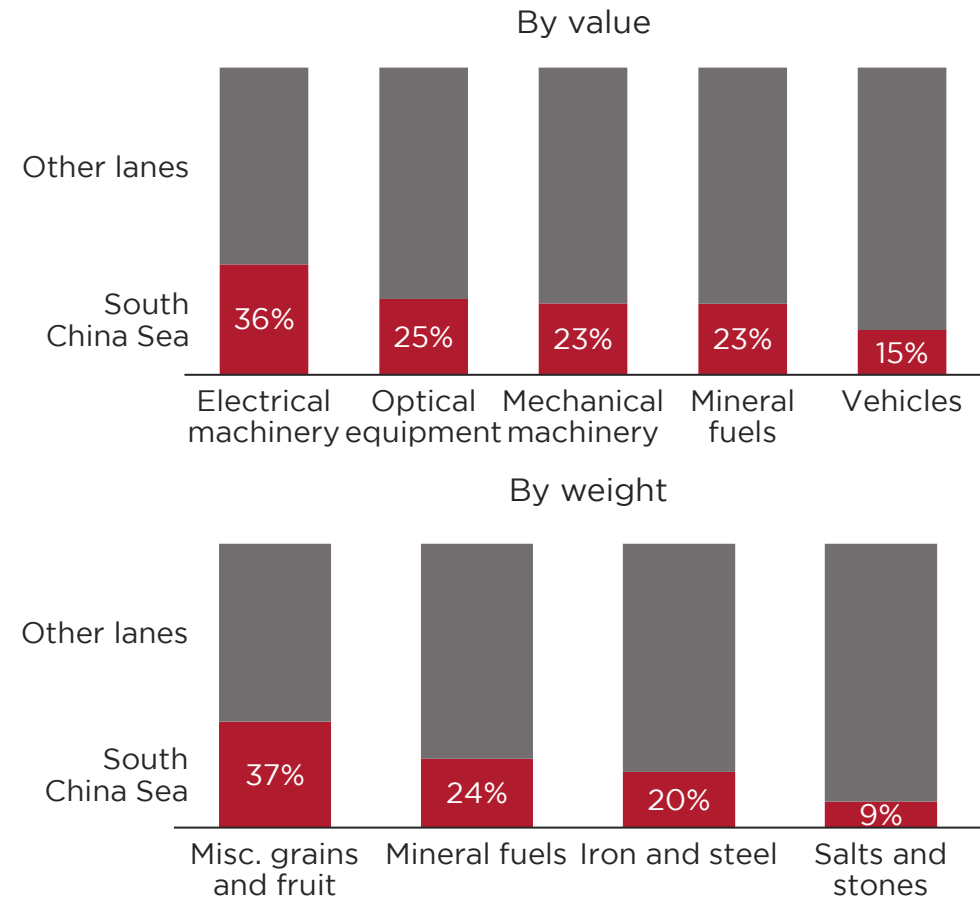
Top products moved via SCS route are machinery and commodities

TRADE VALUES MOVED THROUGH SCS BY REGION

Billion US\$ - 2019



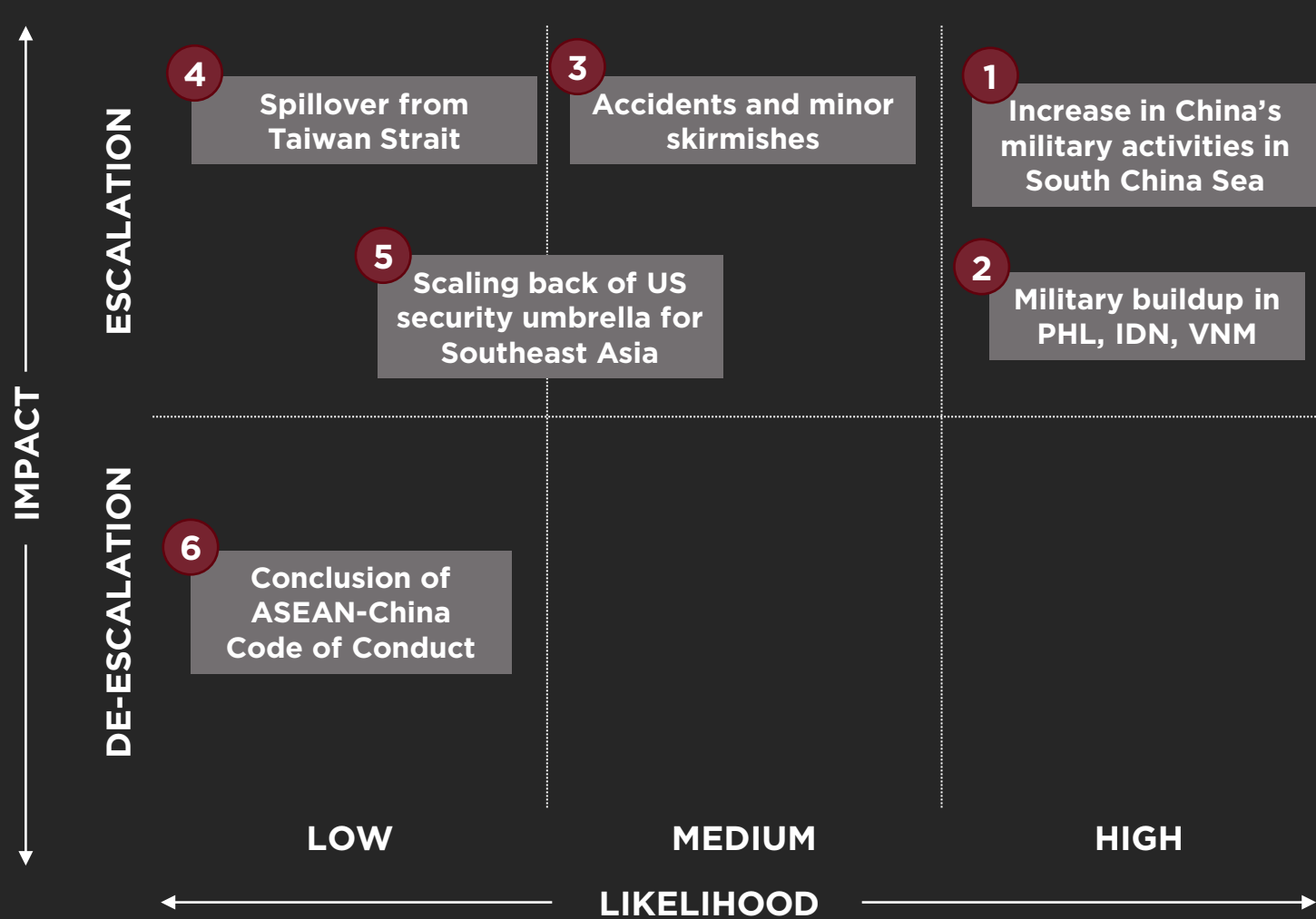
TOP GOODS MOVED THROUGH THE SOUTH CHINA SEA IN 2019 AS % OF TOTAL TRADE



Source: Duke University, Onyx

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Risk of escalation stems from a potential ramping up of military activity



RISK	SIGNPOSTS
1	<ul style="list-style-type: none"> China builds structures in contested waters Rise in frequency, duration of Chinese military presence
2	<ul style="list-style-type: none"> Increase in military budget of ASEAN countries Increase in joint exercises between ASEAN and allies
3	<ul style="list-style-type: none"> Increase in frequency of military patrols in South China Sea
4	<ul style="list-style-type: none"> Ramp up in Chinese patrols of the Taiwan Strait Ramp up in US FONOPs in Taiwan Strait, South China Sea
5	<ul style="list-style-type: none"> US no longer offers credible deterrence Reduces resources, personnel dedicated to Indo-Pacific
6	<ul style="list-style-type: none"> Negotiation moves closer to mutual agreement in ASEAN US underscores defense commitments to allies

Continuation of current status quo still most likely in short to med-term

Across three potential scenarios

Not exhaustive

BASE CASE

Most likely

Potential paths

- Dispute remains frozen – economic calculations prevail
- Potential accident or minor skirmish still a risk. In that scenario:
 - Crisis between two claimants without involvement from other parties

MODERATE ESCALATION

Less likely

Potential paths

- Small-scale naval conflict occurs between two claimants
- Others involved, including Five Eyes or allied assistance

FULL ESCALATION

Unlikely

Potential paths

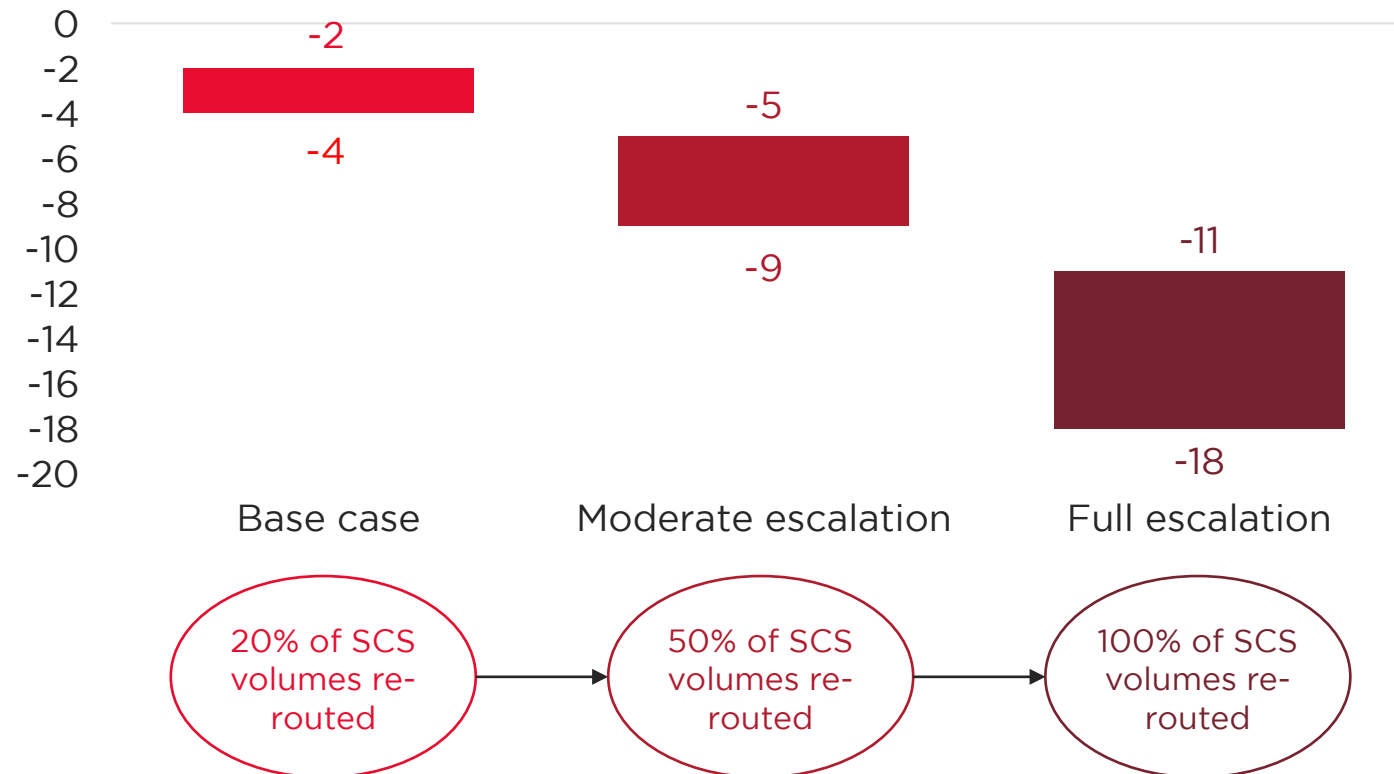
- Large-scale naval conflict occurs between two or more claimants
- Involving Five Eyes or allied assistance

Scenarios: initial disruptions and shocks in shipping

South China Sea accounts for 20% to 30% of global volumes

IMPACT TO CONTAINER SHIPPING SUPPLY*

% LOSS COMPARED TO PRE-CRISIS LEVELS



TOTAL IMPACT RANGE

- Loss in global shipping capacity more muted than Red Sea
- Reallocation of capacity globally drives knock-on effects

MARKET CORRECTION?

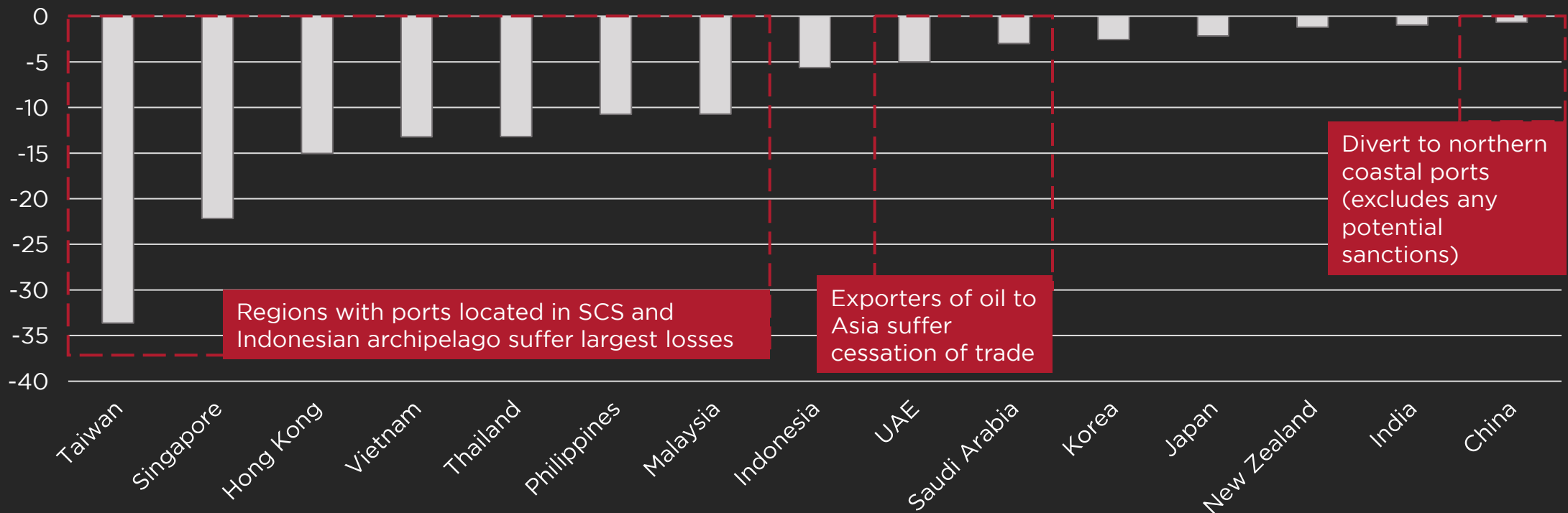
- Scheduled capacity increases of 5-9% in 2024 may balance shortfall from potential conflict
- Potentially offset by slower demand and sailing speeds

* This model estimates initial shocks to the market and does not consider reactions that will return the market to equilibrium.

Full escalation scenario: impacts to GDP

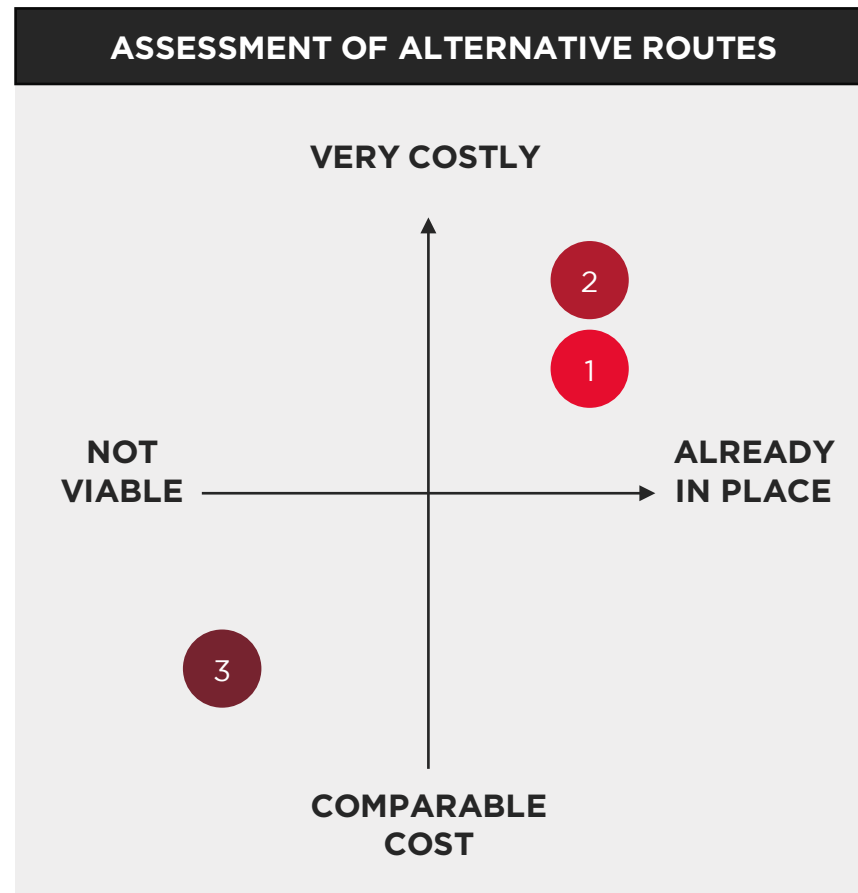
TOP REGIONS IMPACTED BY FULL SHUTDOWN OF SHIPPING THROUGH SOUTH CHINA SEA AND EAST-WEST PASSAGES IN INDONESIAN ARCHIPELAGO*

Projected real GDP loss (%)



* Assumes trade that normally travels through Malacca Strait or SCS detours around south of Australia, increasing distance and trade costs; does not include sanctions and other war effects

No silver bullet: alternatives to South China Sea and Taiwan Strait



1

REROUTING TO AUSTRALIA / INDONESIAN ARCHIPELAGO

- 3 possible paths: detour to Malacca or Sunda Strait, if not, the Lombok Strait, or finally via south of Australia
- Malacca and Sunda Straits likely to face capacity constraints given narrow and shallow depth; ships with deep drafts or >100,000 DWT fail to pass

2

PARTIAL CONVERSION TO AIR FREIGHT

- Sea-to-air conversions may face higher air freight rates depending on capacity and passenger demand for air travel
- Onyx modelling suggests impact of a geopolitical shock on air freight spot rates peak after two months and moderate after around 10 months

3

KRA LAND BRIDGE

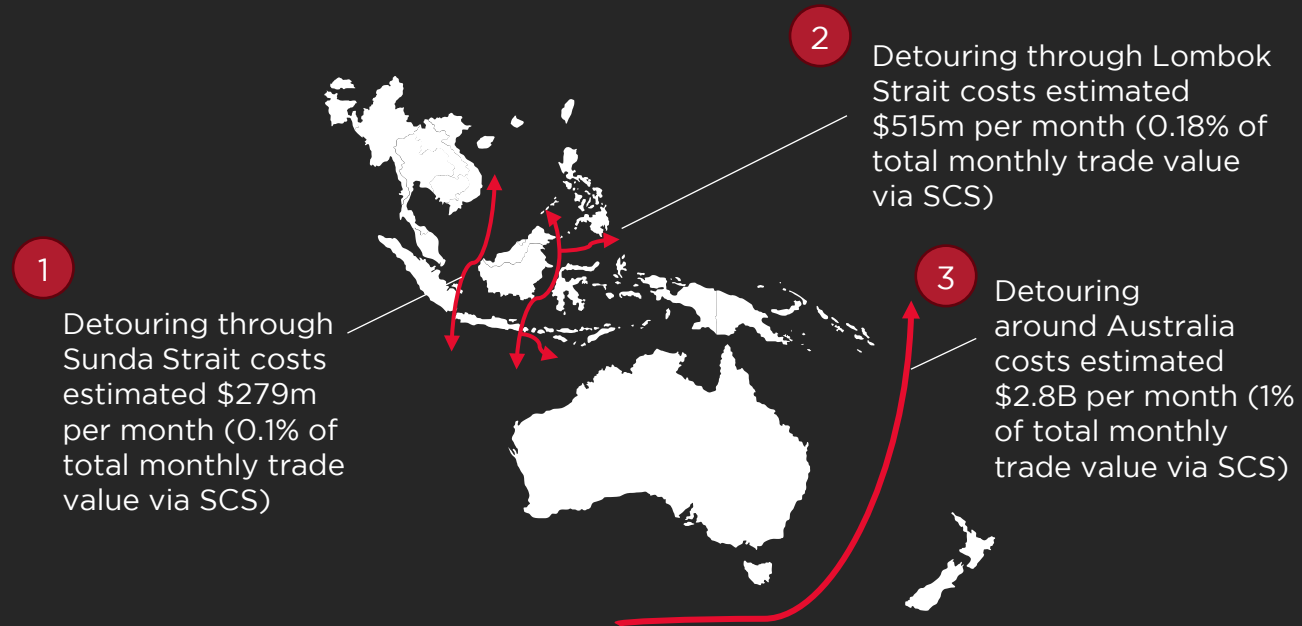
- Aim to connect Andaman Sea with the Thai Gulf
- Reduce ship journeys by 6-9 days that otherwise route through Malacca Strait
- Economic viability is an issue; no major investors yet
- Political instability a risk to project longevity

FEASIBILITY

Alternative routes to South China Sea and costs

REROUTING COSTS

- 1 Reroute to Malacca Strait or Sunda Strait
- 2 If closed, reroute to Lombok Strait
- 3 If closed, reroute to south of Australia



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