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Greg Miller

The lessons of Panama Canal drought for future shipping routes

GAC Panama managing director Alexei Oduber talks drought fallout and what's next

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INTERVIEWS

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THE historic Panama Canal drought is over. Now it's time to assess how long it will take for traffic to fully recover, what are the lessons learnt, and how shipping can navigate the next drought, which will surely come.

Ship agents shifted from a more passive role to proactive problem solvers amid the water crisis. For perspective on how the drought played out and what happens next, Lloyd's List spoke with Alexei Oduber, managing director of GAC Panama.

Oduber gave his views on prospects for the main segments — containerships, LPG, LNG and dry bulk — as well as his take on the Long-Term Slot Allocation (LoTSA) programme introduced by the Panama Canal Authority (ACP), and the Rio Indio reservoir project, which is designed to inject much more water into the system in the medium term.

A key message for shipping today, said Oduber, is that the canal is being underutilised. There are more daily slots available than actual transits.

"On any given day, one to two transits are not being used," he said. "You can transit through the regular booking process. You're not going to auction."

Container shipping

Container lines faced major disruptions due to the drought. First, draught restrictions forced liner operators to transit with fewer containers. Then transit reductions forced Asia-US east coast services to the Cape of Good Hope.

The liners handled the disruption very well, and their experiences will help them in the next drought, said Oduber.

"The malleability of the shipping industry and its ability to adapt is remarkable. We lived through it during Covid, when the Panama Canal was a solution, but this time was different, because the canal was the problem. We were the bottleneck."

He said the drought was a good "teaching lesson" for the ACP because the canal authority realised "it can only go so far", and saw "how elastic" ship routing can be. In other words, once liners face too many hurdles, they can find another way.

When draught restrictions forced carriers to limit the number of containers on board their ships, they used the transhipment hubs on both coasts of Panama, and cross-isthmus rail and road connections to bring boxes to the other side.

When transit restrictions curtailed services, liners used slot-sharing agreements to maximise flows on services that remained, increased use of rail and road connections across Panama, used more Caribbean transhipment hub capacity for services that shifted to the Cape of Good Hope, and tapped the cross-Mexico railway system.

The net result, given liners' deft ability to reroute, was that the ACP and shipping customers are now "working together more to fix the problem", said Oduber. "One of the lessons learnt is that Panama needs to listen to the market."

The LoTSA programme — which allows ship operators to have certainty on future transit costs and schedules — "is one example of listening to the market", he said. Container shipping bids for the LoTSA programme, which covers bookings via the neopanamax locks in 2025, were fully subscribed.

LPG shipping

Very large gas carriers that transit the neopanamax locks shifted away from Panama during the drought. Delays caused VLGCs on backhauls to miss their laycans in the US Gulf, prompting owners to switch to the Cape of Good Hope for ballast runs from Asia.

VLGCs switched to the Cape of Good Hope for fronthauls as well, as the situation worsened.

VLGC economics were also heavily impacted by the auction process, with one LPG operator paying $4m for a transit in November 2023 and many others paying $1m-$2m in 1H24.

According to Oduber, VLGC owners “were basically obligated to pay these outrageous amounts — millions — for a transit to be scheduled. They were very upset. They thought, ‘This is the only way to get through? It’s not right. It’s not fair.’

“I think the canal has now realised that yes, this is income, but this is not sustainable nor desirable. They’ve realised, in my opinion, that they don’t want to be seen as an auction-only product. They want to be seen as a reliable and certain product.”

He said that “many of the LPG and LNG players have now become accustomed to the route around the Cape of Good Hope — it works and it’s predictable. They have certainty.”

Even so, LoTSA programme slots have been fully subscribed by LPG and LNG companies. The long-term booking process will be “extremely helpful for LPG and LNG because they know they’re not going to be subject to a volatile auction process”.

Oduber opined that once LoTSA is in place, it could be further improved by switching from an annual period of bookings to quarterly. He recounted a recent conversation with a client who did not participate in LoTSA. “I asked what would work for you? He said: a shorter window.”

Consider the case of the VLGC market, which is highly volatile, and is a tramp not liner business. The complication with booking a long-term window a year out is that the VLGC market could be terrible by then. “If that happens, you’re stuck with the slot and have to pay 100% of the fee,” noted Oduber.

Neopanamax VLGC transits — as with neopanamax containership transits — have now rebounded to pre-drought levels. Many VLGCs “are transiting the Panama Canal northbound, on the empty leg, through the normal booking process. They’re not going to auction.”

And there’s room for more, said Oduber. The biggest challenge is to convince the shellshocked VLGC segment that “space is available so there is an opportunity here”.

LNG shipping

LNG shipping, unlike LPG and container shipping, has failed to return to the neopanamax locks following the end of the drought.

LNG cargoes from the US Gulf shifted toward Europe and away from Asia in the initial aftermath of the Russia-Ukraine war, but no longer. Most US cargoes are once again headed to Asia, but they have overwhelmingly stuck to the longer Cape of Good Hope route.

According to Oduber, this is not only because LNG shippers have become comfortable with that route, but also because LNG carriers face more transit restrictions in the canal than any other vessel category.

“LNG shipping is heavily restricted in the Panama Canal, with the highest precautions and no nighttime transits because of the nature of the cargo. It is limited for booking allocation purposes to two transits per day, one southbound and one northbound, or two northbound.”

The canal will become a more attractive option to LNG shipping when the ACP is comfortable enough from a safety perspective to “allow more flexible transit operations” and offer “two or three southbound transit slots per day, including a nighttime transit”.

Even without such an increase, the LoTSA programme should support more LNG carrier transits next year, he added.

The need to cater to LNG shipping customers is about to intensify. An enormous amount of LNG liquefaction capacity is under construction in the US Gulf states, with US LNG exports poised to double between 2024 and 2028. Some of that new volume will go to Europe, replacing Russian pipeline gas, but much will head to Asia, creating a future growth opportunity for the canal — if it can handle more LNG ships.

Oduber highlighted the importance of the Rio Indio reservoir project to support future LNG carrier transits in the medium term. The project will happen “without a doubt”, he affirmed. It is scheduled to boost the canal’s water supply when completed in five to six years.

“That solution will provide assurances that we will have water reserves during the summer, which would in turn allow a higher commitment for LNG transits. The [US] LNG production process will come into play earlier than that, probably as early as two years from now, so in the meantime, the canal is using better water utilisation systems to allow for 15% to 20% less water per transit."

Dry bulk shipping

Dry bulk was yet another shipping segment heavily impacted by the drought. Restrictions caused a major shift of US Gulf grain aboard panamaxes to the Cape of Good Hope, as well as a rerouting of US crop exports to Pacific ports.

Bulker transits through the canal have increased over recent months, and there is speculation that there will be a wholesale return to the Panama Canal in the upcoming US grain export season in late 2024 and early 2025. If so, this would have a negative effect on panamax spot rates due to lower tonne-miles.

Oduber does not see this happening, based on his conversations with customers.

"The bulkers were affected in two ways during the drought," he said. "One was that the panamax-plus vessels with beams that could transit either the neopanamax or panamax locks were taken out of the auction process and they were not getting a reliable product.

"The second part was that bulkers' ranking is very low," he added. The canal uses a customer index based on frequency of transits and amount of toll payments, with containerships ranking highest. "Dry bulk's ranking is very low because it doesn't have the combination of high frequency and high tolls, which made them very disadvantaged when it came to competition [for slots].

"And of course, when the market turned to auctions, bulk carriers do not have the economics to support $2m auction fee. So, it was a triple-hit.

"We are seeing a bit of a return of some bulk carriers, but it's a modest return. In my opinion, they're being cautious," he said. In the upcoming grain export season, he expects many to "sit back and watch", then return the following season if all goes well.

"I think it's just too late for the market to take a gamble on transits out of the US Gulf for this season. It was a big slap [during the drought]. I don't think they feel comfortable enough yet."

Oduber believes the ACP's bulker business would benefit from more segmentation within the booking process — by specifically reserving slots for dry bulk in light of its inherently low ranking on the customer index — as was done temporarily when drought congestion was extremely high.

He also believes bulkers should be offered special deals, given that all the available transit slots are still not being used.

“If a bulker was to show up and want a transit, give them a $45,000 booking as a kind of last-minute sale. It should be a manageable solution, for this segment only, with certain conditions. The canal has the capacity.”

Food exporters face major fallout if US dockworkers strike

East and Gulf coast ports handle almost half of US containerised agricultural exports

22 Sep 2024

ANALYSIS

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US IMPORTERS had the flexibility to frontload cargoes to offset the risk of a strike at east and Gulf coast ports on October 1; US exporters of containerised agricultural goods did not have that timing flexibility.

Importers of consumer goods can pass along extra freight costs resulting from a strike to consumers. Exporters of containerised agricultural goods have no such ability. If exporters raise their price — or miss their delivery window — they will lose the sale.

"The east and Gulf coast ports are absolutely critical," said Peter Friedmann, executive director of the Agriculture Transportation Coalition, a group that represents food and forestry products exporters.

While there are rerouting options, AgTC members "are very worried", Friedmann told Lloyd's List in an interview on Friday.

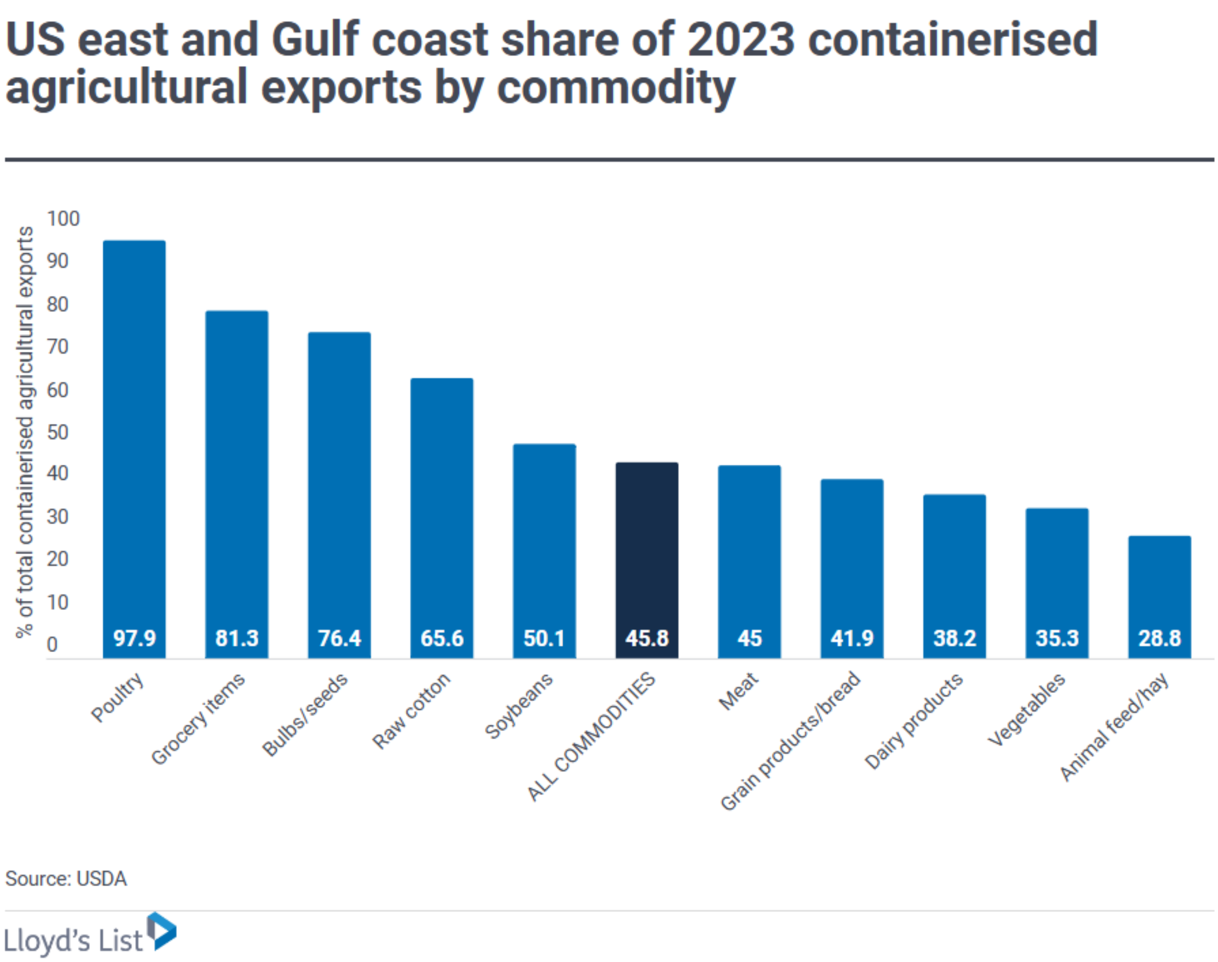
"What I'm getting from around the country is: 'We don't know what's going to happen and this uncertainty is killing us,'."

US Department of Agriculture statistics underscore the potential severity of strike fallout.

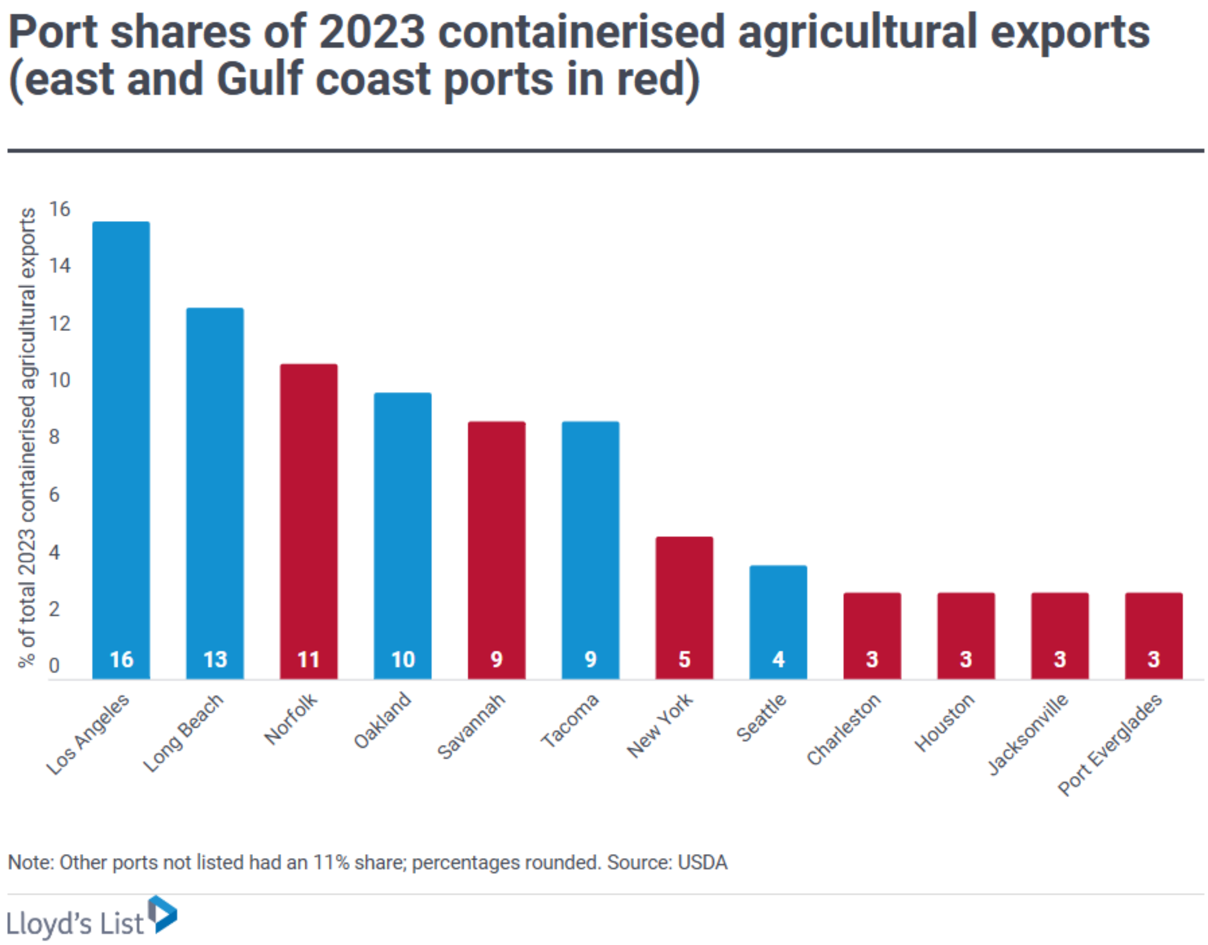
Containerised shipments account for 25% of all US agricultural exports by volume and 55% by value. In 2023, east and Gulf coast ports handled nearly half — 46% — of US containerised agricultural export volume.

Soyabeans accounted for the largest volumes through east and Gulf coast ports, followed by poultry, animal feed and hay, raw cotton, and meat.

US poultry exports are by far the most exposed to a potential strike: 98% currently flow through east and Gulf coast ports, with 40% of all US poultry exports moving through a single port: Savannah. Grocery items are the second-most-exposed category, with 81% using east and Gulf coast ports.



Virginia's Norfolk is the most important gateway on the east or Gulf coasts for containerised agricultural exports, handling 11% of the country's total, followed by Savannah with 9% and New York/New Jersey with 5%.



Ag exports do not have timing flexibility

"Ag is under a lot of pressure because virtually everything is perishable," explained Friedmann.

"People don't think soyabeans are perishable, but what is perishable are the hogs and cattle that eat the soyabeans. If you don't get them their food on time, they perish. You cannot sustain delays."

Time constraints are not just downstream in the supply chain — they are upstream as well.

“If you look at the supply chain for chilled or frozen pork, there’s a whole set of people who raise the piglets and the hogs that go into the processing plants.

“That’s got to keep moving. You’ve got to get them into the processing plants before they get too big because the plants can’t handle oversized hogs.

“You can stop making toys but you can’t stop making a hog grow,” added Friedmann.

In the case of a strike, processed pork would go into cold storage “but the cold storage facilities fill up very quickly”.

The same applies with other agricultural commodities: “The apples will keep growing, whether you like it or not. The hay will keep growing.”

If there is a strike, and exporters cannot use other routes out of the US due to transport cost or capacity issues, the alternative is “dumping it in the domestic market”, said Friedmann. That is what happened during the supply chain crisis.

“If you’re dumping it in the domestic market, nobody makes any money because people don’t necessarily need that product. The supermarkets already know what US shoppers want and they’ve already fulfilled that.”

Rerouting options using rail to other ports

Ag exporters’ strategy in the case of a strike will be to reroute around shuttered ports. Friedmann said exporters do have some flexibility and warned that it could have lasting consequences for east and Gulf coast ports.

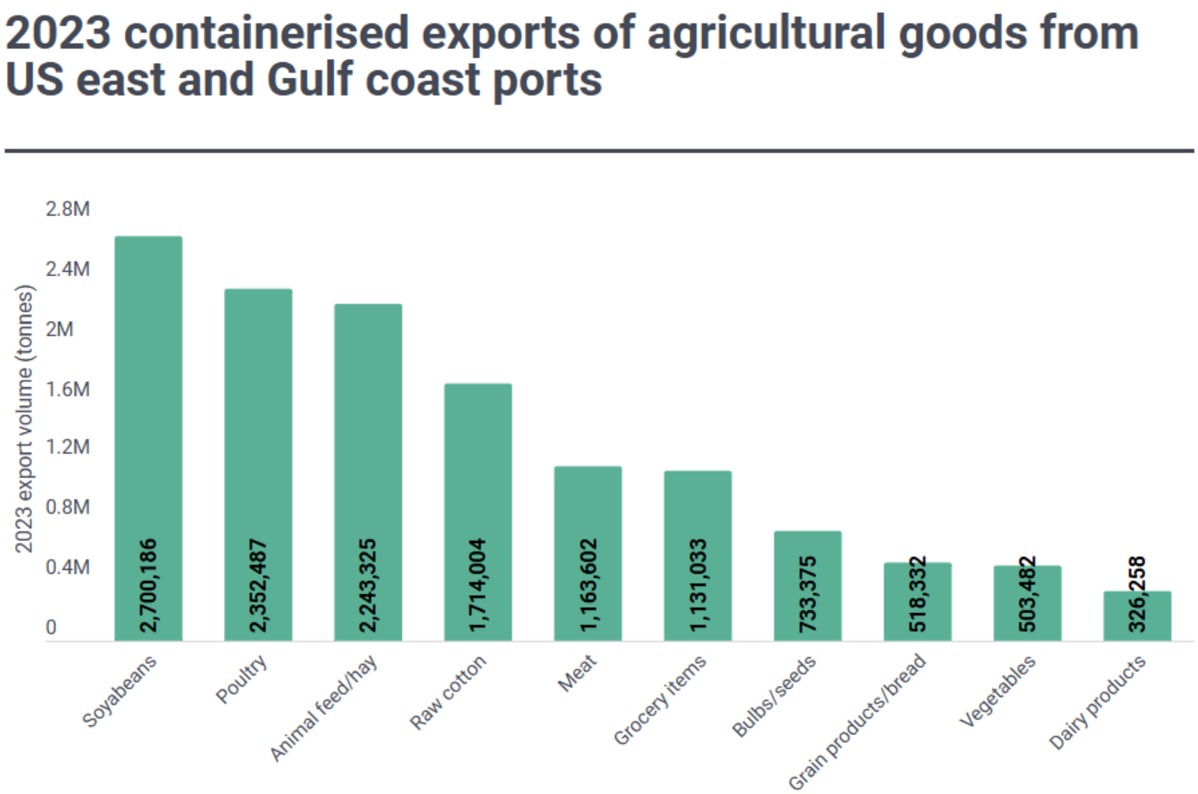
Prior disruptions — the supply chain crisis, the west coast labour scare, the Panama Canal drought — have already caused a sustained shift in the other direction. Containerised ag has shifted from west to east.

“We are now using the rail option to go to east coast ports from further and further west, including from the west coast, which five years ago was unthinkable,” said Friedmann.

“I never expected people within two hours of west coast ports to rail all the way across the country, but that’s what we’re seeing.

“The same thing can happen in reverse. If there’s a strike on the east and Gulf coasts, people will find options.

“Don’t presume that because a port is closest to origin that people can’t find alternatives. We have more flexibility and options in the supply chain than we’ve ever had before.”



Note: Featured data is only for top 10 export commodity categories. Source: USDA

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Exporters would shift to eastern Canadian ports or west coast ports in the US, Canada or Mexico, he explained. That said, capacity of both rail and ocean shipping would create rerouting limitations.

“Our ag products are very heavy and railroads are very constrained by weight, so the ability to load on rail is limited. And the supply chain for agriculture is always sort of at capacity; rail carriers don’t have extra capacity sitting there idle.”

On the ocean shipping front, carriers set deployments based on import demand, not demand for exports, which have much lower cargo value. The question is whether carriers would deploy extra capacity at non-US east and Gulf coast ports “to allow ag to move the other way”.

There is also an issue related to reefer container availability at alternate ports, he added. “Whether it’s chilled or frozen, you need reefer containers, so that makes it more complicated.”

Higher transport cost could price out US ag exports

The other big constraint, beyond capacity, is transport cost. An alternate supply chain route does ag exporters no good if the added cost of taking that route prices their product out of the market.

“We can’t ship ag exports at any cost. It’s not like you’re buying a Christmas present for your kid and paying $15 instead of $12 [to cover higher freight costs]. We just don’t have that flexibility in price.

“There’s nothing we can produce here that cannot be produced somewhere else in the world. If we can’t deliver it affordably and dependably, our foreign customers will find another source. If it costs a few pennies a bushel more, we’re gone. We’re out.”

Ag exporters west of the Rocky Mountains could shift back to the all-water route via the Panama Canal for their Mediterranean buyers, but it will cost more than the rail-to-east coast route.

Incremental transport costs would be even higher for exports originating in eastern states that are railed west, then shipped via ocean back eastward through the canal.

Furthermore, ocean carriers are introducing a wave of new surcharges and general rate increases timed with the strike threat. CMA CGM will add a surcharge of $800 per teu for exports from east and Gulf coast ports starting October 11. It also announced a $200 per teu GRI for exports from all US ports, effective October 15.

MSC announced a GRI of $250 per teu for all US exports starting October 15, with higher GRIs to South America ($500 per teu to the west coast, $1,000 per teu to the east coast).

HMM announced a GRI effective October 15 of $270 per teu for all exports from the US east and Gulf coast ports to Asia, and a GRI of $160 per teu for exports from the west coast to Asia.

Yang Ming announced a GRI for all exports from the US and Canada to India of $500 per teu, starting October 14.

“If you have an agricultural cargo that generates $300, you just can’t afford these,” said Friedmann. “It’s not like consumer goods where you can increase the price.”

He also believes that if a strike occurs, ocean carriers will dust off the detention and demurrage fee playbook that served them so well during the supply chain crisis.

“We understand there are additional costs, but to make this a profit event is really bad,” said Friedmann.

“I’ve already been talking with the Federal Maritime Commission about this. We think there’s going to be a huge problem.”

How US grain exporters worked their way around two blocked canals

More US corn bound for Japan and South Korea loading in Pacific Northwest

23 Apr 2024

ANALYSIS

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THE past few months have been unprecedented for US agribulk exporters, with a drought blocking bulkers from the Panama Canal and Houthi attacks in the Red Sea pushing those same ships away from the Suez Canal.

"It is back to the way it was in the early 1800s, before we had either canal, when everybody had to take the long way around both continents," said Jay O'Neil, head of HJ O'Neil Commodity Consulting, in an interview with Lloyd's List on Monday.

The US wasn't exporting millions of tonnes of soyabeans, corn and wheat around the Cape of Good Hope to Asia in the early 1800s — it was exporting a few thousand tonnes of slave-picked cotton across the Atlantic to the UK. Today's agricultural supply chain situation is truly unique.

"People are making it work. The market is getting along pretty well — surprisingly so," said O'Neil. "Buyers have adjusted their logistics to what you might call the 'new normal', which I hope is temporary."

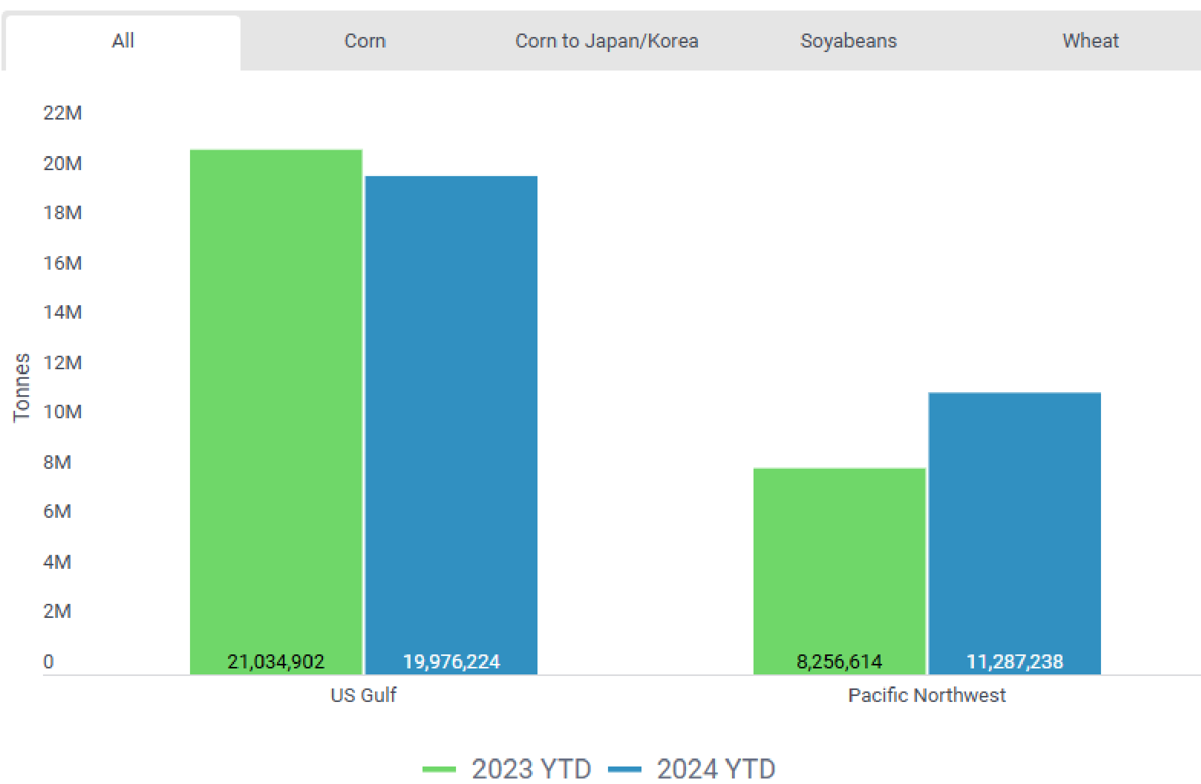
Grain cargoes aboard panamaxes and supramaxes that used to transit the Panama Canal to Asia are taking much longer to reach their destinations via the Cape of Good Hope, yet this has not reduced total US exports, nor has it led to a spike in grain freight rates.

Some shifting between coasts

There has been some shift in volume from the US Gulf to the Pacific Northwest (PNW) this year, but the changes are highly concentrated, not broad-based.

The US Department of Agriculture compiles weekly data on bulk exports by region of loading, measured in tonnes of cargo inspected. Bulk agricultural exports were up 7% year on year through April 11, according to this data. The US Gulf accounted for 51% of volume year to date, the PNW 28%, and other regions 21%. During the same period in 2023, the mix was 57% US Gulf, 23% PNW, 20% other regions. US Gulf grain export volumes were down 1.1m tonnes or 5% year on year through April 11, with PNW volumes up 3m tonnes or 37%.

US Gulf vs Pacific Northwest agribulk exports



Source: USDA based on export cargo inspections. Data through April 11.

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The coastal swing was almost entirely driven by a single trade: US corn exports to Japan and South Korea. These volumes rose 3.4m tonnes or 521% year on year from the PNW, and fell 840,028 tonnes or 41% from the US Gulf.

“I had expected a much more substantial shift from the US Gulf to PNW for cargoes going to China, but we haven’t seen that,” said O’Neil.

Despite shorter transit times and lower freight rates out of the PNW, “the lion’s share of US grain is going out of the US Gulf to Asia”, he said, citing two reasons why export flows have not changed more.

First, there is limited PNW capacity. “You can’t ship everything from the PNW.” Second, US export companies are, in practice, not fully flexible.

Grain exporters traditionally balance cargoes between various loading regions based on destinations and grain qualities. “So, they will continue to ship out of the US Gulf even when it appears less attractive than going out of the PNW.”

Grain transport rates have not spiked

O’Neil noted that grain loaded in the US Gulf will take around 38 days to reach China via the Panama Canal, 52 days via the Suez Canal and 56 days via the Cape of Good Hope. Thus, the effective transit time has increased by 18 days or 47%.

Dry bulk spot rates have risen due to routing diversions but haven’t spiked as they have in container shipping.

US Gulf-to-Japan rates averaged $58.95 per tonne of grain cargo in February, up 21% year on year, according to the USDA. PNW-to-Japan rates averaged $31.50 per tonne in February, up 16% year on year.

“Why haven’t rates really popped despite the problems at the canals? I would attribute most of the reason to the China business not being robust enough. China, economically, has still not recovered from the pandemic,” said O’Neil.

That said, the canal situation has had an extreme rate effect on one particular trade: US Gulf to West Coast South America. Rates doubled, from $30-$32 per tonne prior to the Panama drought to $59 per tonne currently. Transit times quadrupled from nine to 10 days via the Panama Canal to 42-43 days via the Strait of Magellan.

“Those poor guys in the West Coast South America trade really took it in the face,” said O’Neil.

Expectations are positive for the second half of this year as water levels in Panama are predicted to rise.

“The expectation is that the rainy season will come, and will be normal, and will help recharge the reservoirs. But we’re not there yet. The rainy season in Panama doesn’t start until May and doesn’t really kick in until June. And we all know it’s impossible to predict the weather.”

According to data from the Panama Canal Authority, 66 bulkers transited the panamax locks in March, up 22% from the low point in February but still 60% below transits in October 2023, the month prior to transit slot restrictions.

“We are seeing some grain vessels start to sneak through the Panama Canal again,” said O’Neil. “But it’s just here and there, not wholesale.”

Demand headwinds in the years ahead

O’Neil is hopeful canal issues will be temporary. He is markedly less optimistic on demand for US grain exports in the years ahead.

“US wheat exports have declined because of the Black Sea. The US will continue to lose market share to the Black Sea, Australia, and other markets. The world doesn’t need US wheat as much as it used to, so exports are going to suffer,” he predicted.

“The newer phenomenon is what’s happening with corn and soyabeans. Brazil continues to expand, and with that expansion, together with political and trade issues, the US is losing market share.

“With soyabeans, there is also a new expansion of US soya crush capacity, so we are going to use more soyabeans domestically year by year, which translates into declining export volumes.”

Meanwhile, corn exports continue to be weighed by domestic consumption for ethanol production. There is now a push to use ethanol for production of sustainable aviation fuel. The use of ethanol for SAF “would mean we’d consume more corn domestically, a negative effect for exports”.

Add it all up, said O’Neil, “and I would not be excited about owning a US grain export elevator anytime in the next five to 10 years”.