POTEN TANKER OPINION

A Watershed Moment For The Canal

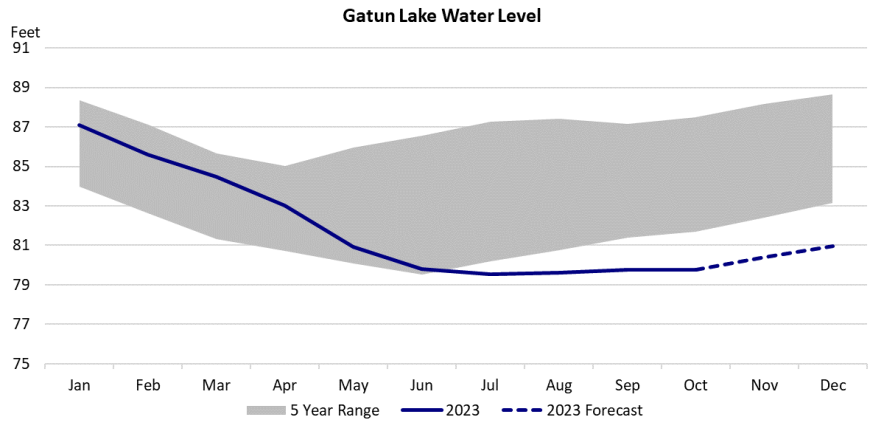
Impact of the Panama Canal struggles on the tanker market

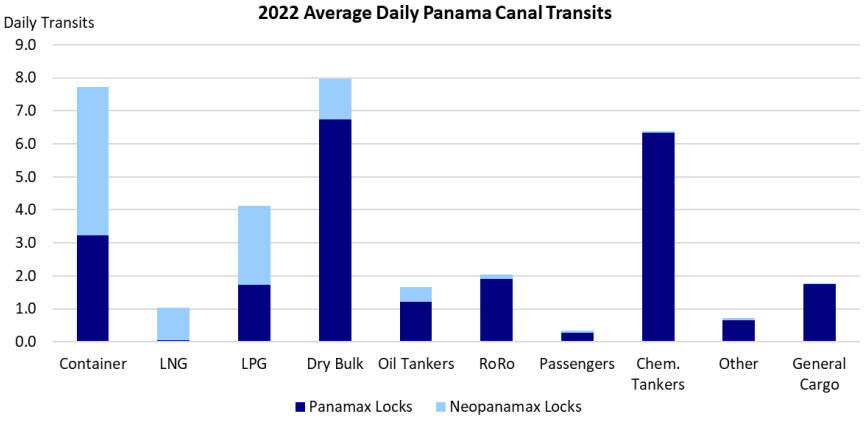
The 51-mile-long Panama Canal is an important shipping artery connecting the Atlantic Ocean with the Pacific. An estimated 5% of global seaborne trade passes through this waterway. The Canal has been in the news lately because the Panama Canal Authority (PCA) has had to lower draft restrictions as well as reduce the number of transits due to the lack of precipitation in the Canal watershed. The Panama Canal is used by a wide range of vessels, from cruise ships and car carriers to reefers and general cargo ships, but the "power users" are the container vessels, dry bulk ships and gas carriers (both LPG and LNG vessels). Chemical tankers are also frequent users, but product and crude oil tankers only use the Canal on a limited basis. How will a further cutback in transits affect the tanker market?

The Panama Canal was built more than 100 years ago. Construction began in 1904 and finished 10 years later. The Canal proved to be a great success, but as time progressed, trade flows changed and the number of vessels that were too big for the Canal grew quickly. An expansion project, designed to double the Canal's capacity, was approved in 2006 and completed in 2016. In June of that year, the container ship "COSCO Shipping Panama" was the first vessel that officially passed through the new Neopanamax locks of the expanded Panama Canal.

In the years since 2016, the volume of traffic through the Panama Canal has gradually increased. The maximum capacity of the Canal is 38-40 transits per day. PCA data for 2022 show 35.4 daily transits on average. Dry bulk carriers take up the largest share of transits with 22.5% of the total, followed closely by container ships (22%). Chemical tankers are third with 18% market share. Oil tankers are relatively minor participants. However, it is important to look at the large Neopanamax locks separately from the smaller (regular) Panamax locks. The Neopanamax locks are completely dominated by container ships and gas carriers. This is not surprising given that very large container ships dominate the round-the-world services. Large LNG and LPG vessels are also using the Neopanamax locks to take advantage of the shortcut from the U.S. Gulf to their main markets in Asia. The tankers that use the Neopanamax locks are Suezmax and Aframax tankers. Many of these large tankers are in ballast, with owners using the Canal to reposition their vessels in the U.S. Gulf after discharging on the U.S. West Coast.

Very few of the Suezmax tankers pass laden through the Canal, which is at least partially caused by the fact that the Canal is not able to operate at design draft due to low water levels for most of the period. For example, we estimate that





Source: Panama Canal Authority

at a maximum draft of 44 feet, as currently in effect, a modern Suezmax tanker can carry about 107,000 Metric Tons, only about 12,000 tons more than an Aframax. This is not a compelling economic proposition. And it will only get worse as the PCA will tighten restrictions further.

Since July 30, capacity has been reduced to 32 transits. According to the PCA "The recorded precipitation for October has been the lowest on record since 1950 (41% below), and so far, 2023 ranks as the second driest year for the same period." Therefore, the number of booking slots has now been reduced to 25, with scheduled reductions to 24 (next week), 22 (December), 20 (January 2024) and finally 18 (starting Feb 2024). At this point, Neopanamax slots with be down to 8 per day, which will mostly be taken up by container vessels with the occasional gas carrier. Large oil tankers will not feature in this trade anymore. They will not be able to schedule in advance like container ships do and they can likely not compete for the auction slots (a recent auction was "won" by a VLGC for $2.85 million).

The stark reduction in slots will push many of the tramp vessels (including tankers and dry cargo ships) away from the Canal. This will lead to more ton-mile demand and possibly changes in segment utilization as longer hauls may stimulate the use of larger vessels.