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Assessment of tomorrow

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No immediate solution to the Panama Canal's bottleneck - a disruption affecting global trade

Due to reduced capacity, a bottleneck has developed in the Panama Canal, one of the key maritime trade routes, and there is neither a cheap nor easy solution to unclog it.

A prolonged and unexpected drought in an otherwise rainy part of the year has caused the canal to reduce the number of ships passing between the Pacific and the Atlantic Oceans. Even though situated in one of the rainiest regions of the world, Panama has had almost 50% less rainfall than the historical average since the beginning of the year.

More than 200 ships queued up in line to pass through the Channel in mid-August, having to accept the most unfavourable options - a long wait, searching for another sea route, or transhipment of cargo to rail.

The drought that hit the Panama Canal region is unprecedented in its history, which will mark its 110th anniversary next year.

Its peculiarity at the time of its construction, but also decades later, appears to be an existential risk for the Panama Canal due to climate change.

Unlike similar mega-structures, it runs on fresh water from nearby lakes, not from the seas and oceans it connects, so regular traffic requires pumping a gigantic 100,000 cubic meters of water.

Strict restrictions on the passage of ships

The water supply decreased due to a severe drought, so the Canal administration was forced to reduce the daily flow of vessels to 32 at the end of July from the usual 40, as during 2022.

Also, restrictions on the maximum load have been introduced, reducing the permitted draught of ships from 50 feet to 43 feet (about 13 meters).

The Panama Canal Authority (ACP), the state-owned company that runs operations, has been forced to implement restrictions that will cost at least $200 million in revenue over the next year due to reduced cargo volumes.

In addition to the smaller number of ships passing through and limiting the draught, ACP temporarily changed the booking regime for passage through the canal at the beginning of August to enable faster passage of vessels without prior booking.

”This crisis is unusually severe. Significant restrictions will be in place until September next year”, said Ricaurte Vasquez, canal administrator.

This means that, in the long term, shipping companies will have to consider the risks they will be exposed to when passing through the 80-kilometer-long channel.

A solution in 10 years

The Panama Canal administration has been taking steps to address these risks, but the solutions are expensive, and what is more worrying for global trade, none will result in improvement in the next 10 to 20 years.

It took a full 9 years and cost about $5.5 billion to expand the waterway, which has been providing the passage of large container ships (about 10 per day) through new locks since 2016.

With this project, the Panama Canal tried to be more competitive with the Suez Canal and managed to shorten the journey from East Asia to the US East Coast by 7 days, and to redirect about 10% of the cargo from the ports on the West Coast of the US to its East Coast.

However, the prolonged drought and a reduction in the canal's daily capacity, both in the number of ships and in their capacity, threatened to nullify the increased benefits of the Panama Canal.

The management hired the U.S. Army Corps of Engineers, the original canal builder, and allocated $2 billion for a project to divert water from 4 additional rivers into the canal.

According to the ACP, it is a job that, under normal circumstances and in an unchanged climate, could be completed in 25 years, but under the pressure of disruption, it will have to be completed in 10 years.

”We have to find other solutions to remain a relevant route for international trade. If we don't adapt, we are going to die”, said Vasquez.

Carriers have been adapting and raising prices

Carriers will search for alternatives to the Panama Canal bottleneck, as they are already doing. Bypassing the canal will slow down deliveries and raise the cost of transport and, as a result, the cost of goods, but it is the only option left.

Exporters of time-sensitive food deliveries, those on the west coast of South America, for example, have been particularly affected by the Panama bottleneck and have had long waits for passage, which can last several weeks.

Food and drink (wine from Chile, bananas from Ecuador, for example) make up almost 80% of container shipments from the Pacific coast of South America to Europe, so some of them will search rapidly for an alternative to the passage through the Panama Canal.

Gas transporters from the US East Coast are diverting routes to avoid the Panama Canal, so their cargo ships sail through the Suez Canal, which lengthens transportation but does not expose them to the uncertainty of long waits for passage through the canal.

However, these cases are less frequent because shipping companies continue to choose to transit via this significant corridor, which accounts for around 6% of global trade.

Their plans will be altered by the lengthy nature of these restrictions, which will naturally result in an increase in shipping costs and the final price that customers pay.

Problems in the Panama Canal have already caused an increase in the cost by one-third of the transporting price of a standard 40-feet container from China to the US East Coast this summer.

This kind of adaptation to disruptions in supply chains will continue, which, due to the volume of goods that rely on transport through the Panama Canal, will undoubtedly affect the growth of inflation globally, particularly regarding food.

s going s likely to [overlapping text] “ to happen again and again”, said Jonathan Roach, container market analyst at shipbroker Braemar.