Freight Volatility Increases on New Panama Transit Reductions

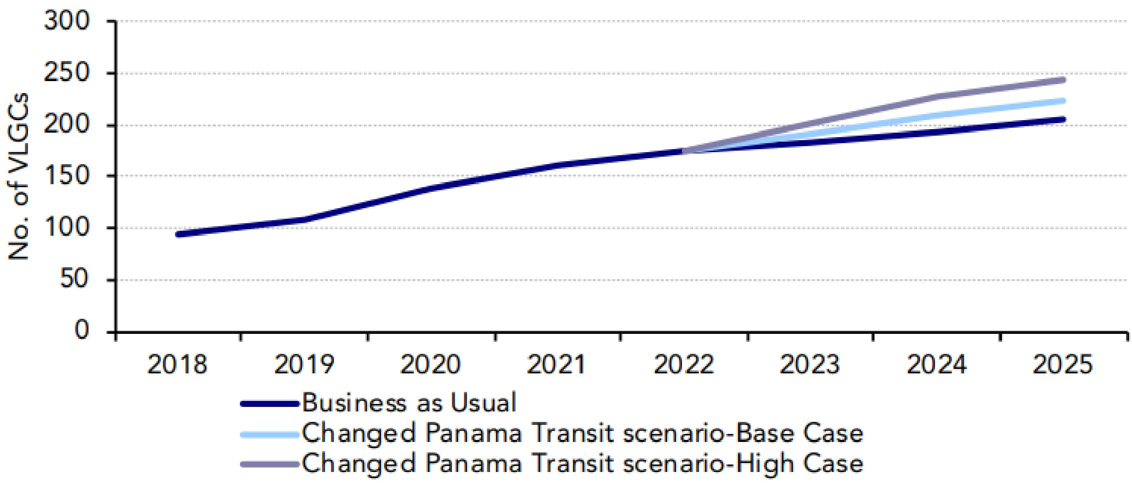
VLGC freight rates have become extremely volatile in the past few months. The situation is likely to be exacerbated following the decision by the Panama Canal Authority (ACP) to further reduce the number of transits for the Neopanamax locks from November.

Despite all the measures taken so far, Gatun Lake's water levels have continued to decline to exceptionally low levels for this time of the year, on record droughts. Moreover, current rainfall forecasts indicate the situation will not change for some time, according to ACP.

Therefore, from Nov. 3, 2023, to Nov. 7, 2023, the number of booking slots will be reduced to 25 from 31, with eight slots for the Neopanamax locks. The gradual reduction will continue in the weeks following thereafter. By Feb. 1 2024, and until further notice, the number of booking slots will be reduced to only 18 slots per day, with five allocated for Neopanamax locks, which is about half of the normal capacity.

For booking dates November 8-14 and in January and February of 2024 the number of Panama Canal transits allocated to Period 3 will be reduced to zero, according to the ACP. This will effectively eliminate the ability of any unbooked vessel to participate in the special auction to reserve a transit slot, which means all unbooked vessels will by default have to transit the longer route on both laden and ballast voyage.

VLGC Demand for US LPG Exports (No. of Vessels)



Additionally, the reduced number of slots allocated for Period 1.A and Period 2 will increase competition with other vessel classes like container ships or LNG carriers, which have a higher ranking. The news of the slot reductions sent strong bullish signals to the forward freight market. Spot rates also rose as charterers are trying to fix ships in anticipation of further rate increases.

Even before this new reduction goes into effect, auction fees paid by some unbooked VLGCs to transit the canal jumped as high as $2.85 million during the last week of October which adds more than $63/t. Some market players are still willing to pay that amount since the arb between USGC and Far East markets are quite wide.

As fewer auction slots are available one northbound slot for early November transit was bid up close to $4 million, according to sources. Once there are no slots available for auction from January a majority of the VLGCs delivering cargoes from the US to Asia will most likely be taking the longer routes (both laden and ballast) which will significantly increase ton-mile demand.

Although ton-mile demand will increase, whether this will significantly increase freight rates in 2024 is still uncertain. The uncertainty surrounding Panama transits imparted volatility to VLGC freight markets, which may reduce once stakeholders will be more certain about transit routes. Even though more ships will be taking longer routes via the Cape of Good Hope or via the Suez Canal, the unpredictability regarding vessel arrival times at discharge/load ports can limit upside in freight markets.

Poten has done some scenario analysis for possible changes in VLGC demand based on various rerouting options available for vessels loading in the US. Our model assumes that it will mainly be the US-Far East voyages (including Australia and New Zealand) that will be affected by the latest changes in Panama transit slots.

For the sake of simplicity, we have assumed vessel speed at 16.0 knots for both laden and ballast legs, and that a major share of VLGCs loading in the US and scheduled for discharge in the Far East will be moving either through the Panama Canal or the Suez Canal.

On the commodity side of the equation, tighter vessel availability could result in fewer cargo liftings out of the US in 1Q, further depressing Mont Belvieu prices. Meanwhile, delayed arrivals in the Far East will increase prices in the region, widening price spreads. It will be interesting to see if the East-West arbitrage adapts to freight rates, or if the freight rates will adapt to narrower arbs. Another factor to consider is that the upside potential for Far East prices will depend on Chinese demand – which is currently depressed due to negative PDH margins, forcing several PDH to shut down recently.

Cargoes sent from the US Gulf to Latin America could also face some challenges, with fewer Panama Canal slots.

Traders might send more US cargoes to Northwest Europe or the Mediterranean region to avoid the Panama Canal, weighing on prices in that region.

However, this at best can be considered an immediate response, as LPG demand in the Far East is currently weaker amid at least 10 PDH shut downs in China and high auction fees at the Panama Canal. Nevertheless, as the situation develops, market players will continue to evaluate the most efficient way to re-route vessels.