Aurora Macro Strategies – Giants Jockey for an Isthmus
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The Tearsheet

- Talk of reestablishing direct U.S. control of the Panama Canal faces significant diplomatic and legal barriers. The 1977 Torrijos-Carter Treaty, which transferred the Canal to Panama in 1999, cemented Panamanian sovereignty.
- U.S. military intervention would be the only viable path to directly retaking operational control over the canal and such a scenario would be exceedingly unlikely. The Trump 2.0 playbook is far more likely to favor exploiting economic leverage—trade sanctions, retaliatory measures, and bold rhetoric to extract concessions.
- Reassertion of U.S. control is largely a red herring; the real issue is Sino-Panamanian ties. U.S. concerns focus on the two Hutchison Ltd. contracts and the planned fourth bridge over the canal.
- Panama's economic vulnerability strengthens U.S. leverage. Its fully dollarized economy depends on a steady flow of USD even for local debt payments. Already under fiscal strain from external climate shocks and self-inflicted reputational damage like the Cobre Panama closure, Panama remains highly susceptible to financial pressure.
- Given this fragility, Panama's concessions on immigration and U.S. vessel access are unsurprising. We expect the Raúl Mulino government to ultimately fall into line under Trump administration pressure—curbing China's influence over key projects and concessions via judicial decisions and various administrative authorities.

1. U.S. Interest in the Canal

- President Trump has made U.S. access to the Panama Canal a key foreign policy issue, vowing to "take back" the Canal and accusing China of exerting undue influence over it.
- The Trump administration's hardline stance on Panama—despite its right-wing leadership and generally favorable view of Trump—can at first blush seem incongruous, particularly given its more lenient approach toward overtly hostile actors like Russia and Venezuela. This remains a key question.
- Severe drought, driven by the 2023-2024 El Niño, crippled Canal operations. Record-low water levels in Lake Gatún forced the Panama Canal Authority (PCA) to impose vessel size and weight restrictions, reducing transits by 30% and cargo volume by over 40%. At peak congestion, more than 100 vessels idled daily, creating severe shipping bottlenecks.
- This congestion increased fees and intensified bidding for transit slots. Foreign firms, unbound by U.S. anti-corruption laws, may have resorted to facilitation payments to expedite processing—an option prohibited for U.S. companies under the Foreign Corrupt Practices Act (FCPA), another Trump target. This is the closest approximation we find to claims of unfair U.S. treatment.
- Migration via the Darién Gap might have factored into Trump's focus on Panama, but President Mulino had already shut it down, stopping 94% of illegal crossings before Trump even took office. Yet, Trump's rhetoric remains centered on Canal access and alleged unfair treatment by the Panamanian government.

- Trump's fixation may partly stem from a lingering personal grudge over the contentious Trump Ocean Club dispute, a revanchism that would have fit in nicely with the Reaganite wing of the U.S. foreign policy establishment's longstanding focus on Panamanian security.
- Alternatively, or additionally, to this: Panama fits well into a greater diplomatic framework seeking to target "weak links" among China's regional influence—countries like Panama where geopolitical strategic relevance dovetails with vulnerability against US pressure.
- The U.S. controlled the Canal until December 31, 1999, when it was transferred to Panama under the Panama Canal Treaty of 1977.
- Since then, the Canal has been fully managed and operated by the Panama Canal Authority (PCA). The U.S. relinquished all rights, titles, and interests, with initial transit fees and revenue distributions set under a framework allowing for future adjustments. The PCA, established under Panama's Law No. 19 of June 11, 1997, succeeded the original governing commission.
- Trump has called the Treaty a mistake and seeks to restore U.S. primacy over the Canal. While Washington has yet to outline a concrete vision for control, it has not ruled out any measures—including direct seizure.
- We perceive no real intent for an outright takeover. Rather, threats to "take back" the Canal serve as a bargaining position. The core issue is U.S. economic and national security concerns over Chinese involvement in Canal operations, infrastructure, and technology.
- The Canal is vital to U.S. economic and military interests. Some 40% of U.S. container traffic passes through it, with 75% of total cargoes bound for the U.S. It also serves as a critical logistical node for the U.S. Navy.
- Negotiations will likely focus on two key objectives: (1) securing preferential access for U.S. vessels, especially given recent (possibly climate-related) disruptions that have raised transit costs and limited passage, and (2) curbing Chinese influence by restricting FDI, canceling operator contracts, and reducing Chinese vessel transits through higher fees or direct limitations.

2. The China Grievance

- There is no official Chinese presence in the Canal itself. However, a subsidiary of Hong Kong-based Hutchison Holdings operates the largest ports on both ends of the Canal—Balboa (Pacific) and Cristóbal (Atlantic).
- Hutchison Ports won management concessions for these ports in the 1990s through an international bidding process as Panama prepared to assume full control of the Canal. The company has operated them since 1997, when the Canal was still under U.S. control via the Panama Canal Commission, and Hong Kong was transitioning from British rule to Chinese sovereignty.
- U.S. concerns over Hutchison's presence have grown in recent years. The U.S. Navy relies heavily on the Canal, and congressional investigations have flagged potential espionage threats linked to Chinese operators and infrastructure providers. In our view, U.S. interest in "taking back" the Canal is driven less by disputes over transit fees or preferential access and more by national security concerns regarding China.
- Panama began engaging with China during the 1990s in a slow process of fits and starts that accelerated when—under the leadership of the particularly China-friendly politician, Juan Carlos Varela (2014-2019)—it switched its longstanding diplomatic recognition policy

from Taiwan to Beijing, joined the Belt and Road Initiative (BRI), and even explored some limited security collaborations with the PRC.

- Under the BRI, Chinese firms have pursued major infrastructure projects in Panama, including high-speed rail, bridges, container terminals, ports, copper mining, and digital infrastructure through companies like Huawei.
- While subsequent Panamanian governments have attempted to backtrack somewhat on Varela-era engagement levels, such as by shuttering various projects under U.S. pressure—most notably a container terminal—others, including a proposed fourth bridge over the Canal and a high speed rail project nominally remain ongoing.

Table 1: Sino-Panamanian Relations Over the Years

President	Relationship Milestones During Tenure
Guillermo Endara (1989-1994)	Panama maintained diplomatic recognition of Taiwan, and its economic interactions with the PRC were limited during Endara's presidency. The U.S. had strong influence over Panama following its 1989 . invasion, and strategic engagement with China was not a priority.
Ernesto Pérez Balladares (1994-1999)	Diplomatic ties with Taiwan continued, but Panama began exploring commercial relations with the PRC. The 1997 port concession to Hutchison Whampoa marked a key milestone, with the company operating ports at both ends of the Panama Canal, raising concerns in the U.S. about Chinese influence.
Mireya Moscoso (1999–2004)	Moscoso upheld diplomatic recognition of Taiwan but continued to balance this with growing Chinese commercial engagement. Hutchison Whampoa's operations persisted, and China gradually increased trade and investment.
Martín Torrijos (2004–2009)	Torrijos retained ties with Taiwan but opened discussions with the PRC, particularly in trade and investment. He laid the groundwork for future economic cooperation, though significant projects remained limited during his term.
Ricardo Martinelli (2009–2014)	Martinelli strengthened economic ties with the PRC, particularly in logistics, finance, and trade. Reports of considering a shift in diplomatic recognition emerged, but the formal switch did not occur during his tenure.
Juan Carlos Varela (2014–2019)	Varela made the pivotal decision in 2017 to formally recognize the PRC and sever ties with Taiwan. Panama joined the Belt and Road Initiative and signed multiple agreements for infrastructure, trade, and tourism development, signaling a dramatic shift toward Chinese alignment.
Laurentino Cortizo (2019–2024)	Cortizo continued Varela's agreements, overseeing the implementation of major Chinese investments. However, he took a slightly more cautious stance by pausing certain projects, including discussions of a free trade agreement with China.
José Raúl Mulino (2024–Present)	While still early days, Mulino's administration has to date increased scrutiny of Chinese influence. In February 2025, Panama announced plans to exit the Belt and Road Initiative and audit Chinese-operated port concessions, reflecting growing U.S. pressure and potentially opening the door to a nationalization.

- The Panama Canal Authority in 2021 renewed Hutchison's port contracts for another 25 years, despite some objections from Panama's private sector as well as from the U.S. security establishment. .
- China's 2020 Hong Kong National Security Law heightened concerns about Beijing's control over Hong Kong-based companies, raising doubts about Hutchison's independence from the Chinese Communist Party.
- Panama's political and business elite prioritize trade, investment, and infrastructure over geopolitics. Chinese capital and large-scale projects align with Panama's economic

development goals, naturally advancing China's broader strategy to consolidate influence in Latin America and challenge U.S. dominance.

- We see U.S. concerns over China's role in Panama as part of a broader strategic contest in Latin America. China has become the region's largest trading partner and a key financier of energy and infrastructure, reinforcing U.S. fears of China's tightening grip over Latin America, a region which the U.S. has long considered its backyard, albeit a neglected one.

3. Concessions and Compromises

- President Mulino has denied any official Chinese presence in the Canal and reaffirmed the Canal Authority's adherence to neutrality requirements under the Treaty. He emphasized Panama's "integrationist" stance, neutrality in global geopolitics, and commitment to free trade.
- Panama maintains that Canal ownership is non-negotiable and argues that transit fees are set by market conditions and operating costs, not geopolitical pressure.
- However, following U.S. Secretary of State Marco Rubio's visit, Mulino made key concessions, ratcheting up uncertainty especially for two major Chinese-linked projects: Hutchison's port operations and the fourth bridge over the Canal.
    - The Canal Authority pledged to "optimize transit priority" for U.S. Navy ships but denied reports that Panama agreed to waive transit fees.
    - Panama expanded migration cooperation with the U.S. Mulino granted access to an airstrip for repatriation flights and committed to reducing migrant flows. The first repatriation flight occurred on February 13, deporting 119 migrants to Panama, with 360 more expected. Panama will temporarily house them before transferring them to their home countries.
    - On February 4, U.S. Secretary of Defense Pete Hegseth and Panama's Security Minister Frank Abrego agreed to expand security cooperation against organized crime and illegal migration.
    - Following Rubio's visit, Panama's General Controller also announced an audit of Hutchison's affiliate, Panama Ports Company (PPC), further deepening uncertainty around Chinese-linked projects.
- Hutchison's Balboa and Cristóbal port contracts, originally signed in 1997 and renewed in 2021, have also come under significantly greater scrutiny. On February 4, two Panamanian lawyers petitioned the Supreme Court to annul Law No. 5, arguing that PPC's contract violates the Constitution. The Court has previously struck down controversial agreements, as seen in the Cobre Panama case.
- **Our Base Case: The Hutchison Contract is Unlikely to Survive.** The audit may justify contract abrogation or even expropriation under administrative law. Even if no legal cause is found in the audit, the Supreme Court could move to annul PPC's contract, easing U.S.-Panama tensions, or else some other administrative route will be found.
- On February 6th Panama also reaffirmed its formal exit of China's Belt and Road Initiative (BRI). While Mulino publicly denied any U.S. pressure behind the decision, Rubio openly welcomed the move as a diplomatic win.
- China condemned Panama's BRI withdrawal as U.S. interference. A Foreign Ministry spokesperson accused Washington of "Cold War tactics" and reaffirmed support for Panama's sovereignty, noting that over 20 Latin American nations remain in the BRI.

- The fate of ongoing BRI projects remains unclear, particularly regarding the China Communications Construction Company (CCCC).
- In 2018 the China-funded fourth bridge project was awarded to CCCC (through Consorcio Panamá Cuarto Puente). Construction has been plagued by delays. In August 2024, Mulino pressed the consortium to complete the project, and we expect criticisms to be ongoing ultimately leading to the shuttering of the project.
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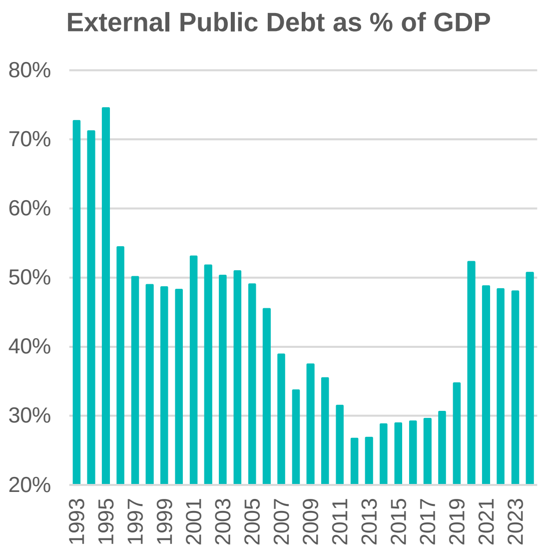
- A ruling against Hutchison would build on the precedent set by the recent Minera Panama decision, further entrenching the court's authority to unilaterally nationalize foreign assets in the public interest. While the United States and the Mulino government would welcome this specific outcome, it would also serve to normalize a judicial power they might later find inconvenient—allowing the court to further expand its influence without immediate pushback.
- Despite occasional friction between Panama's currently left-leaning courts and the current executive, the Panamanian judiciary has historically upheld a strategic kind of corporatist institutionalism that predictably strengthens its own independence and authority relative to other branches when it can.
- Alternatively, the government could use administrative measures to modify or terminate the agreement, as seen in the 2022 takeover of Landbridge's Panama Colon Container Port.
- **Our Base Case: BRI projects, including the fourth bridge, face significant risks.** While the CCCC contract is not directly tied to Canal operations, it represents China's most tangible influence in the zone, making it a likely target for U.S. pressure. The Panamanian government may seek a middle ground by canceling Hutchison's contract while allowing Consorcio Panamá Cuarto Puente to complete the bridge. However, with the project already experiencing delays, an early termination would be less costly both financially and politically.
- Any move to withdraw from or alter Chinese contracts will likely trigger investment disputes. Legal challenges to Hutchison's contract could escalate, while issues related to China Communications Construction Company (CCCC) projects may be handled through diplomatic channels in line with China's soft-power approach.

4. First Quantum of Solace

- As of early 2025, the Cobre Panamá mine remains closed following the Panamanian Supreme Court's November 2023 ruling that declared the mining concession contract unconstitutional. The closure has had significant economic repercussions, as the mine previously contributed nearly 5% of Panama's GDP and accounted for 75% of its exports and has also triggered legal actions.
- First Quantum Minerals (FQM) has expressed a strong interest in engaging with Panama's new government under Mulino, and the new government has indicated that resolving the mining issue will be a priority in 2025. Our base case is a settlement, given both parties' overwhelming interest in resuming mining operations.
- The Trump administration might have an indirect stake in these disputes due to the America First policy. On one hand, the U.S. will staunchly oppose any agreements involving Chinese

investments that aim to restart mining operations. On the other hand, to secure the supply chain for critical minerals, the U.S. may seek to expedite the settlement of the claims.

- Panamanian bonds remain investment grade, trading near par with a low sovereign spread to UST (~270 bp). Total external public debt stands at $44.3 billion, of which $32.8 billion are bonds. Maturities are well-spaced, with principal payments due over the next four years at $1.25 billion, $980 million, $975 million, and $1.25 billion, respectively.



Source: Panama Ministerio De Economia Y Finanzas

- Panama's fully dollarized economy makes it uniquely vulnerable to U.S. financial pressure. Any restriction on dollar access, similar to what neighboring Colombia was briefly threatened with back in January, would be economically devastating. Panama's primary exports are likewise services—e.g. finance and the Canal—which are relatively painless for the U.S. to sanction at negligible domestic cost.

- S&P recently downgraded Panama to BBB-, the lowest investment-grade rating, citing fiscal deficit concerns, largely due to Canal expansion costs, COVID-19 expenditures, and revenue shortfalls caused by the recent drought.

- IMF projections indicate a sharp decline in gross foreign reserves, falling from $9.93 billion in 2020 to a projected $4.94 billion in 2024. Import coverage has deteriorated from 4.9 months in 2020 to a projected 1.6 months in 2024. Despite this, the IMF still assesses Panama's reserves as adequate, especially considering its sovereign wealth fund, which holds about 2% of GDP in foreign assets.

- The IMF's latest debt sustainability analysis flags medium-to-long-term risks, citing ongoing reserve depletion and uncertainties about future growth, given the copper mine closure and climate-related disruptions to the Canal.

- **Our Base Case: Panama's concessions signal a larger coerced shift away from China amid mounting U.S. pressure.** While the Mulino government may attempt to balance interests by allowing some Chinese projects—like the fourth bridge—to continue, others, particularly Hutchison's port concessions, face existential risk. The audit and potential legal challenges could justify contract cancellation or expropriation, easing U.S.-Panama tensions. Washington's broader goal is clear: systematically rolling back Chinese influence in the region starting with "weak link" locations like Panama. All eyes should now be on Beijing's response—whether through investment disputes, diplomatic pressure, or quiet retrenchment.

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