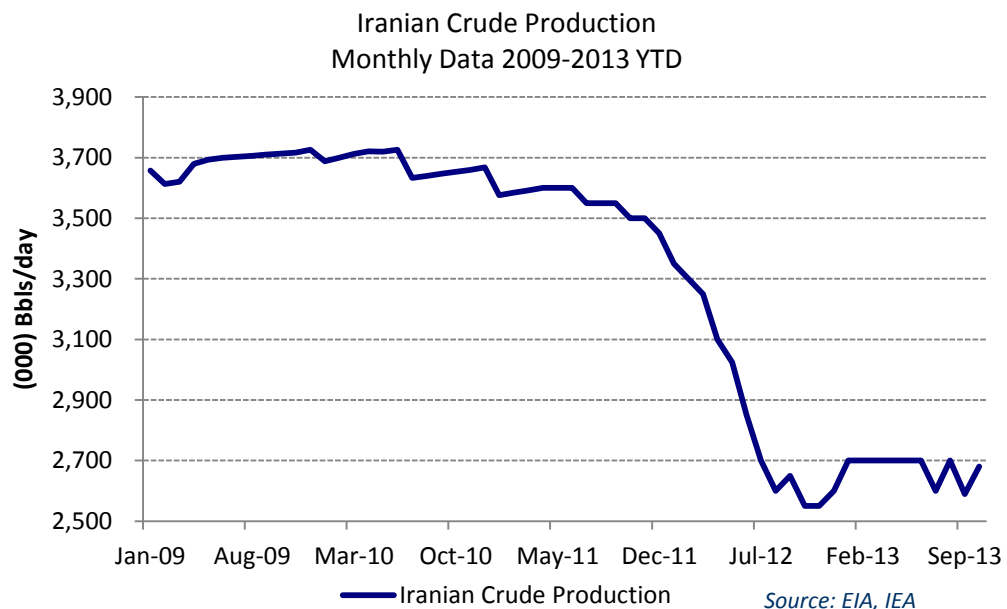


An Unsanctioned Iran?

What would the impact to shipping be if sanctions on Iranian crude exports are relaxed?

United States and European Union-led sanctions against Iran have significantly reduced Iranian crude oil exports since they were first introduced in 2010 and then substantially tightened in 2012. In 2005, Iranian production amounted to nearly 4 million bbls/day, today production stands at around 2.6 million bbls/day shown in the chart below. During the past two months, exports have reportedly dropped to 715,000 bbls/day down from 1.17 million bbls/day in September. In apparent attempts to rejuvenate trade opportunities Iranian leaders made recent overtures to the international community suggesting they would moderate their nuclear enrichment programs. The election of the politically moderate Hassan Rouhani could be seen as the first step of a change in course. This is a sharp contrast from the rhetoric seen in 2012 when the country repeatedly threatened to close the Strait of Hormuz, a key shipping lane for Arabian Gulf exports. While the prospect of increased crude exports from the Arabian Gulf would seem like a net positive for VLCC demand, the impacts on the market are not that straight forward.



Relaxation of sanctions does not mean production can ramp up immediately.

Iranian production has fallen sharply since the latest round of sanctions was implemented by the European Union in June of 2012. Even if sanctions are lifted, it is important to note that crude oil production would take some time to return to pre-sanction levels since restarting flows takes time and additional investment. Many Iranian fields have been declining at 8-13% annually, according to the EIA, and require enhanced oil recovery techniques that Iran has not developed.

China, India, and other Asian countries are main buyers currently.

Most of the current Iranian exports are bound for India and China, with the remainder headed to other Asian countries. China continues to take the lion's share of Iranian oil, estimated by the EIA to be 300,000 bbls/day in October. Indian buyers were reported to be active until October when a waiver that permitted Iranian protection and indemnity insurance to cover Indian vessels expired.

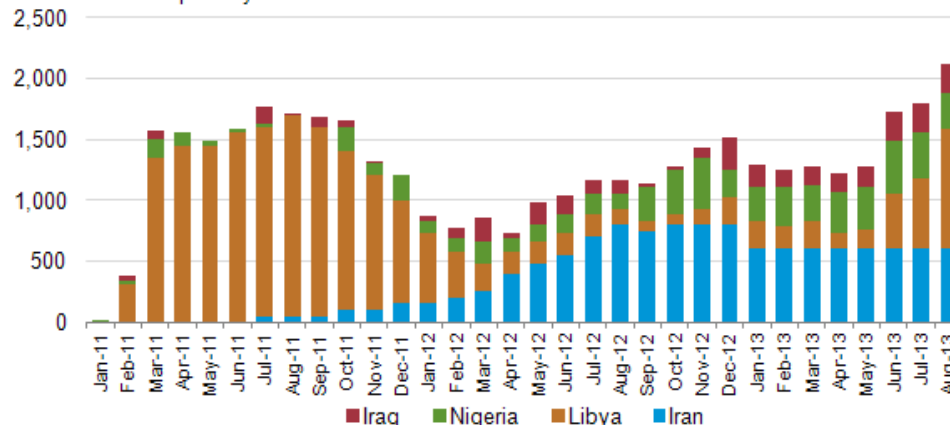
The state of the NITC...

One of the greatest uncertainties of resumed Iranian exports is the utilization of the national fleet. The National Iranian Tanker Corporation (NITC) has a large fleet that consists of approximately 37 VLCCs, nine Suezmaxes, and five Aframaxes. Many of the vessels are either currently at anchor acting as floating storage offshore of Iran and China or in layup. At the moment, the IEA reports that 37 million barrels are held in floating storage, approximately 43% of the total fleet capacity. The resumption of crude exports from Iran has raised the concern among some market participants that the full NITC VLCC fleet could return to active service, adding 6% capacity to the VLCC supply. However, a review of satellite position records shows that only 16 VLCCs are being used for storage, which would only add 2.5%-3%. Furthermore, the vessels will have to be brought out of near layup conditions, which will take additional time and money. As such, it is unlikely that these 16 vessels will enter the market at one time.

Possible longer term relief for European refiners and CPP exports from the Continent.

Relaxed sanctions could lead Iranian flows back to Europe, possibly boosting refinery utilization rates in the region, which reportedly range from 50% to 60% at the present time. Unplanned crude oil production outages have been trending higher in 2013 as Libyan and Nigerian production disruptions have removed approximately one million bbls/day from the world market, as shown in the chart on the next page. Iranian oil ranges from a 28-35 API, a similar density to Libyan grades. The recent fluctuation in Libyan exports has introduced supply uncertainty for European refiners. This could help the relatively anemic crack spreads that European refiners have been experiencing, which would increase utilization rates, and ultimately help the clean product export markets from the Continent.

Estimated unplanned crude oil production disruptions among OPEC producers
thousand barrels per day



Source: EIA

Impacts of relaxed sanctions would not be immediate.

As for now, the full return Iranian crude oil to the international markets lies in the hands of the diplomats involved. The recent impacts of the sanctions on the Iranian economy suggest that this situation cannot remain static, but there's no clear path to resolution at the moment. The Iranian nuclear program remains at the heart of the negotiations, as Iran wrestles with internal viewpoints on whether to maintain enrichment activities. Both Israel and Saudi Arabia have also expressed concern about rapprochement and are sceptical of Iran's motives. Regardless, significant headway appears to have been made in the recent Geneva discussions and additional meetings are scheduled for senior level diplomats on November 20th; however, sanctions on oil and gas are not on the table yet. Even if restrictions are lifted in the coming months, impacts to the shipping markets may be more muted than it would initially seem.

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