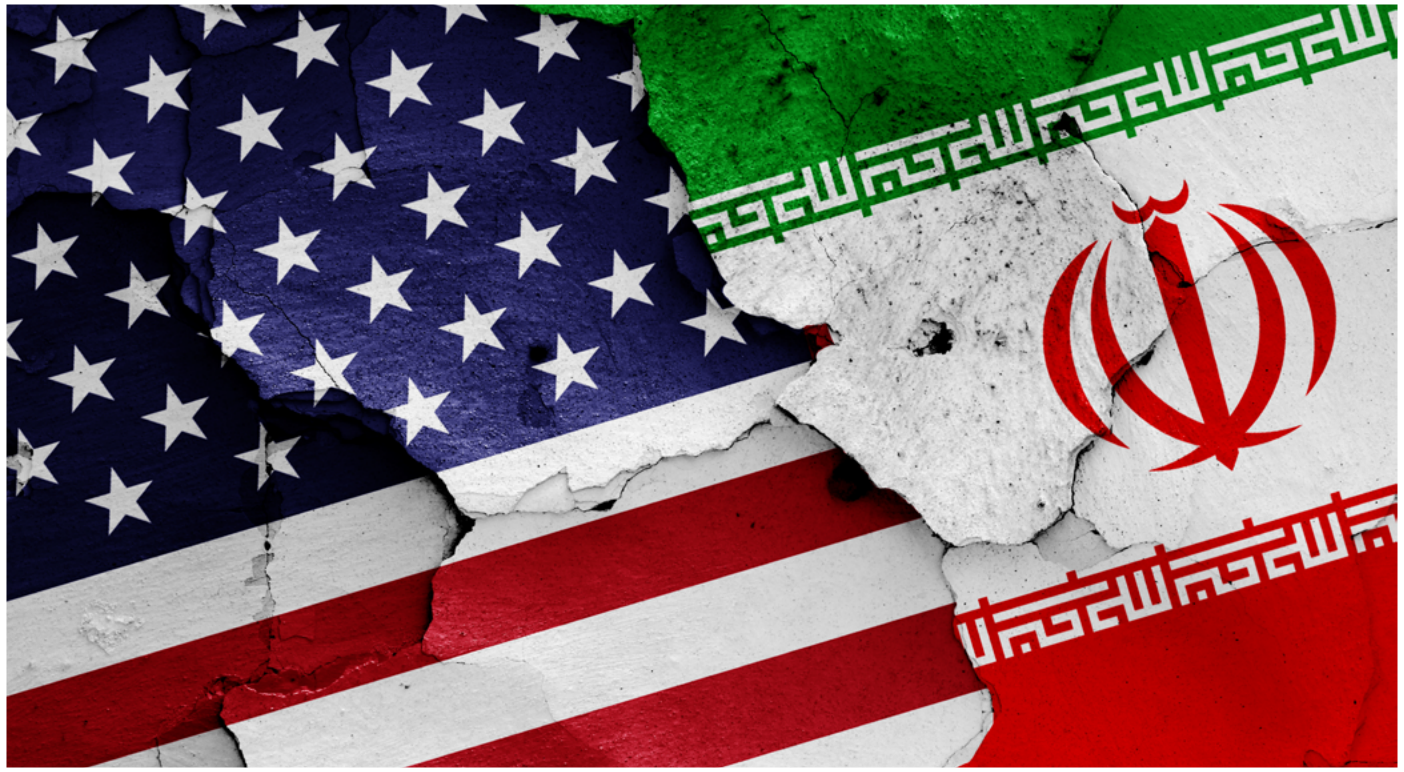

HOW WILL US RELATIONS WITH IRAN IMPACT BASE OILS?

Tensions between the US and Iran continue to mount, causing concern for many industries – but how does this strained relationship impact the global base oils market?

By Cameron Roberts

Tensions been the US and Iran were taken to new heights when an airstrike by the US in Baghdad killed a senior officer in the Islamic Revolutionary Guard, and the head of its Quds Force, General Qasem Soleimani.

The fallout on the petrochemicals industry was immediate, as crude saw a price rise of over 4%. This surge was mitigated by changes in global crude oil dynamics.

"The increase has been well within normal ranges so far. After the drone attack on the Saudis, and oil prices jumping $8/bbl for a short time before returning to normal, investors may be more cautious [on betting on a sustained rally]," said James Ray, Vice President of Consulting – Americas, ICIS.

"Considering the continued stock build of liquid fuels, and that the drivers of oil prices have shifted to more of a marginal producer mechanism, prices are likely to be more stable and less subject to sentiment driven spikes," he added.

Previous tensions between the US and China have seen region-wide fluctuations in Asia, will these more recent events lead to similar or more dire consequences for the base oils market globally?

Ajay Parmar, Senior Analyst, ICIS, said: "The response from Iran will likely bring further instability to the Middle East which has already seen significant turmoil in recent years. If conflict spreads to neighbouring countries (such as Iraq which produces around 4.7m bbl/day of crude oil), the potential threat to oil supply is even greater."

THE STRAIT OF HORMUZ

The main pain point for the global base oils industry will be the Strait of Hormuz. In the past, Iran has threatened to close the strait – which would likely lead to a significant decrease in supply globally.

I spoke to Will Beacham and Shashank Shekhar of ICIS, to find out how this closure could shift base oil dynamics on a global scale.

Will Beacham
Deputy Editor
ICIS Chemical Business

"Military action leading to closure of the Strait of Hormuz between Iran and Saudi Arabia could seriously disrupt global trade in chemicals and oil products, with a knock-on effect for the world's already fragile manufacturing economy.

"The US killing of General Qasem Soleimani, head of the Iranian Revolutionary Guards' overseas forces, on 3 January threatens to further stoke up tensions in the Middle East. On 8 January Iran fired over a dozen missiles at US forces based in Iraq to retaliate for the assassination, which the US insists was a defensive action to prevent attacks on US citizens in the region.

"The Strait of Hormuz is an important shipping lane, linking Middle East oil and chemical exporters to the rest of the world. More than 20% of global petroleum liquids and a significant proportion of chemicals are transported through the Strait."

Shashank Shekhar
Head of Middle East markets
ICIS

"Broadly speaking, the base oils market has remained stubbornly unimpacted because of the recent flareup of tensions in the Middle East. One outcome of this event in Europe was that the margins for producers took a further hit as crude soared sporadically and prices of some other refined products like gasoil shot up. In the US, an impact to base oil prices could trickle in if crude sustains the highs it touched. However, crude has slid down. In Asia Pacific, there were scarcer spot offers for certain grades of base oils as some refiners had altered production to produce more of low sulphur fuel oil.

"Supplies of base oil and any other petroleum or petrochemical product out of the region will be impacted if the Strait of Hormuz is closed as the Middle East is responsible for 7-10% of global base oil supplies with Iran being a major producer.

"Stability in the region is of interest to everyone including Iran. If Iran takes steps that brings shipping traffic through the waterway to a halt, it also effectively stops its own supplies of a range of products including crude, petrochemicals and base oils. If this region returns to normality from the near brink of war, then the energy and commodities markets will be more assured of its maturity and probably be less volatile the next time tensions flare-up here."

SENTIMENT IMPACT

Iran is one of the main Group I base oils producing countries – therefore one might assume that any time concerns are raised surrounding its political situation the prices could take a significant spike.

Izham Ahmad and Tom Brown of ICIS detailed how prices were able to stabilise despite the turmoil.

Tom Brown
Deputy News Editor
ICIS

"Oil prices have spiked several times since hostilities between the two countries escalated on 3 December, particularly after the death of Soleimani and Iran's attacks on US military bases in Iraq, but have been quick to subside in the aftermath of both flashpoints.

"Prices on both occasions briefly rose above the $70/bbl mark before falling back to levels in the high $60s/bbl. Despite the significant concern over how the conflict might escalate, crude markets have largely been oversupplied for several years despite increasing production curbs by OPEC and partner countries.

"This is driven in large part by the growth of the US into one of the world's largest oil powers, which has dramatically increased global capacity at an extended period of weak economic growth. However, the US onshore oil and gas sector is more fragmented than traditional markets, and a test of producer capacity to move in a unified way to address global shortfalls has yet to materialise.

"While pricing has remained broadly subdued relative to the volatility of the geopolitical situation, any significant long-term shock could upend the status quo, increasing costs and cutting margins for petrochemicals producers.

"Closure of the Strait of Hormuz would have dramatic implications, and any significant disruption of oil output in Iraq, the second-largest OPEC producer and currently caught in the crossfire of the conflict and domestic political instability, could also push prices up."

Izham Ahmad
Senior Editor
ICIS Pricing Editorial

"Iran is a major Group I base oils producer in the region and there are currently four refineries actively producing base oils, mainly for the engine oil lubricant industry.

"Not all are actively exporting base oils but those that do typically move their cargoes to destinations such as the United Arab Emirates (UAE), Iraq and India.

"Still, supply of Group I base oils in the main Middle Eastern trading hub of Dubai remained sufficient to meet immediate needs in the onshore market, sources in the region said."

MOVING FORWARD

With the future of the relations between these two countries still uncertain, the situation still bears great relevance on a global scale.

Should the Strait of Hormuz be closed, for example, the base oils industry the world over will feel the impact in a big way – both political, price and sentiment changes could make for a variety of uncertain market conditions.

Outside of these two countries there is a global impact from the US' actions, with trade relations with China potentially worsening in the ensuing fallout.

Al Jazeera reported[1] that Chinese state-owned tabloid Global Times lashed out against President Donald Trump's administration, accusing it of using the Iran crisis to hurt China's economy.

"Its aim is to thwart China's development by implicating China or even dragging China into military clash," the paper said.

"The US-Iran conflict fits into this tactic because China has big and growing reliance on energy from Iran and other Mideast [Middle East] countries, which makes it vulnerable to regional strife and turbulence."

Though the market may have recovered quickly from the initial murmurings of conflict between Iran and the US, an escalating US/China trade war could be set to upend market conditions across the globe for those in the base oils space.

1 – https://www.aljazeera.com/news/2020/01/tense-iranian-relations-china-north-korea-200113043519574.html