Iran and the limits of creativity

Sanctions against Iran are not new – nor have they always proved bulletproof in the past. But now they have entered another stage, with a tougher stance against doing business with the Islamic republic than ever before. Platts staff in Europe, the Middle East and Asia ask: Is there still the will and the way to work round them?

Despite ongoing economic sanctions by the UN, the US and the EU, Iran has remained a key player in the global petrochemical markets. The oil and gas-rich nation produces a wide range of petrochemical products and has been exporting large quantities to Asia, Europe and Africa.

Petrochemical producers in Iran have been coping with the difficulties amid the sanctions, using local currencies such as Japanese Yen instead of the dollar – the international currency which has not been allowed to be used under US sanctions. In some cases, Iranian producers move their polymer products to Dubai first and export from there, allowing them to change the origin of the products.

But such "creativity" may come to an end this year as the international community is stepping up the sanctions against the Iran.

The European Union decided that from July this year, it will ban the import of crude oil and petroleum products from Iran. The ban is the latest measure among a wide range of sanctions adopted by the EU in recent years aimed at persuading Iran to drop its uranium enrichment program. The West believes Iran is trying to build a nuclear bomb. Iran says its nuclear program is aimed at generating electricity and that its purposes are peaceful.

Japan, which has been close to Iran and has been importing large quantities of crude from the country, is also moving to reduce the imports. Due to the latest decision by the EU, some Japanese trading houses are also moving away from trading with the Iran.

The EU oil ban will take effect on July 1 and will also cover investments in Iran's energy industry, as well as exports of equipment and technology to the country. But the ban on the import of petrochemical products from Iran, announced by the EU in January, starts even sooner, on May 1.

Many sources have admitted that doing business with Iran has become very complicated and this has turned off most consumers in Europe.

The latest EU penalties were also expected to have wider implications, as they would not only restrict Iran's business dealings abroad, but could also affect the country's domestic petrochemicals production, sparking concerns about supply reliability, they added.

"It's an issue of reliability of supply. Concerns about [the effect of the sanctions on trade flows] are making converters nervous. They would rather buy European products," said a polymer trader early February.

For over a year, "it's been difficult to get a bank to make a payment to an Iranian entity so that even if a European company wanted to buy product from Iran, it was too complicated to pay for the product," a benzene trader told Platts early February.

The US sanctions specifically target Iran's petroleum, petrochemical and banking sectors, in an attempt to make it tougher for the country to conduct its business overseas.

For petrochemicals, the US aims to prevent anyone from selling, leasing or providing Iran with goods, services, technology or any form of support to the domestic industry, which includes the production and trading of aromatics, olefins, synthesis gas and their derivatives.

The EU in December added 180 Iranian entities to the list of those whose assets in Europe have been frozen and which have been banned from travel in any of the EU's 27 member states. It is also broadening existing restrictions on Iran, this time specifically targeting the country's energy sector.

The UK government was one of the EU countries that immediately responded to the US call and since November, banned all financial institutions from doing business with Iran, including the Iranian central bank.

Industry sources within Iranian petrochemicals accept that the strongest impact that the sanctions will have in the long term will be on aspects like project financing, shipping and availability of spare parts.

To soften the impact, Iran's sovereign wealth fund, the National Development Fund has begun giving loans to new petrochemical projects at about 5% interest. The repayment terms are quite relaxed and there are no hidden or extra costs such as management fees and insurance fees. Meanwhile, Abdolhossein Bayat, Iran's deputy Petroleum Minister and managing director of the country's National Petrochemical Company said in Tehran recently that the country should become self-sufficient in manufacturing equipment used in petrochemicals plants and called for an investment of $50 billion for the purpose by 2015.

METHANOL RANKING CHALLENGED

Iran is one of the largest methanol producers in the world, with a combined production capacity of more than 5 million mt/year. The country supplies about half of China's 5.7 million mt of methanol import requirements in 2011, and around 15-30% of South Korea's 1.6 million mt

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requirements in the same year. In India, Iran's share is estimated to be around 30-40% of the import market.

However, Iran's position as a key supplier is seriously threatened in 2012 due to the new round of sanctions. Currently, South Korea feels the pinch the most, but weak Chinese demand for downstream products has offset the drop in methanol supply. In India, the opposite is true as the country is still seemingly able to accept Iranian methanol. This has led to a glut in supply, and resulted in falling methanol prices.

In addition, the latest statistics showed a clear demand decline from Asia for Iran-origin methanol.

For example, South Korea imported 162,412 mt of methanol in January, up 23% from December, Customs data showed. However, Saudi Arabia stayed South Korea's top supplier in January, after beating Iran to take top spot in December.

Iran, which delivered some 30% less methanol in January compared to December at 18,379 mt, ranked as South Korea's fourth largest methanol supplier in January. Last year, Iran was South Korea's top provider of methanol six months out of the whole year.

The trend may accelerate, with term methanol purchases by South Korea from Iran expected to drop drastically in 2012, as some South Korean buyers have canceled term contract volume, while others halved their term needs from Iran.

A source close to a methanol producer in Iran said at the end of February that the dramatic cutback in demand for Iranian methanol from South Korea was the result of ship owners being unwilling to call at Iranian ports following the imposition of sanctions by the EU and the US.

A Japanese importer was also heard early this year to have slashed its yearly contractual volume of Iranian methanol for 2012 in half, from 180,000 mt to 90,000 mt.

Many bigger South Korean and Japanese companies have large business exposure in the US so that the latest step forced them to cut business with Iran.

An industry source said end February that the main problem for the buyers was finding a vessel, as many ship owners don't want to come to Iranian ports.

"After [the sanctions], selling cargoes to South Korea is difficult," an industry source in Iran said mid February, adding that some Iranian companies are shifting their business to China and India.

Nevertheless, some traders in South Korea said they have been offered Iranian methanol with the option to mask its origin by changing the bill of loading to reflect a port that is non-Iranian.

But no such deal is known to have been concluded yet, with larger traders in South Korea particularly wary of the consequences.

"We are afraid of our company image, and it looks so risky," said a source at one of South Korea's major methanol importing companies early February. But, he wondered, "For smaller traders? Perhaps they might think it OK."

According to several methanol traders early February, sellers had told them it was possible for the cargo's country of origin to be changed to India, the United Arab Emirates, or Oman, on the bill of lading, without providing details.

A bill of lading indicates, among other information, a shipper's details, the consignee details, and the load and discharge port details.

"It's not hard to do, but illegal," said a ship broker end February, noting that doing so would be considered fraudulent and buyers could file a claim if a loss was suffered.

At the same time, another shipbroker said one way to do so would be to ship the cargo from Iran to an acceptable port, and reload from there. The additional cost, he noted, would be small relative to the producer's margins.

ETHYLENE STILL HAS BUYERS

In the Asian ethylene market, Iranian producers are still able to export their cargoes to Asia. Key importers of Iran-origin cargoes in Asia are Southeast Asian nations such as Indonesia or the Philippines, which have less strict rules against the imports Iranian products.

Because of that, the situation in the Asian ethylene market is seen to be different from methanol – as market players there are expecting more spot cargoes to come from Iran to Asia amid the economic sanctions.

Typically, Iran exports around 15,000-20,000 mt of ethylene per month to Europe. These cargoes find homes mainly in Eastern European countries, such as Romania. European end-users typically buy Iranian origin cargoes in order to cover net short term positions.

But market sources said spot ethylene demand from Europe for Iran-origin cargoes somewhat faded after the decision by the EU.

"The oil embargo will be effective from July so technically the European buyers can still import Iranian cargoes," said a trader mid February. "But they are already avoiding taking cargoes. They do not want to get into any possible trouble."

In this case, according to market sources, such quantities would go to Asia instead. Asia typically imports already around 40,000-50,000 mt of ethylene every month from Iran.

An Iranian producer said mid February that there has been no change in export volumes going to Europe in February, stressing that nothing had changed "at the moment." However, he noted that the supply situation will change after mid-year when the EU sanctions come into effect.

As in the case of methanol, a big barrier in moving volumes out of Iran could be shipping-related. A trading source said most ethylene tankers are owned by companies located in European countries, which leaves a limited number of Japanese and Taiwanese-flagged vessels to carry cargoes from Iran to Asia.

In a sign that moving cargoes from Iran may be faced with numerous hurdles, another market source said mid February: "It's not just [finding ships], but finding insurance as well."

Shipping and insurance has been a matter of concern for those dealing in Iranian petrochemical products. Several European major shipping lines and insurance companies have stopped dealing with Iran. "Currently Iranian producers and traders are themselves managing the shipping aspect. Products are mostly being sold on a CFR basis rather than on FOB basis," a Dubai-based trader explained mid February.

Some market sources pointed out that ethylene flows from the Middle East may shift after the embargo. "More ethylene cargoes from Saudi Arabia or Qatar may move to Europe in order to cover the import shortfall from Iran. If it happens, less Saudi or Qatar-origin cargoes will come to Asia," said an industry source early February.

Ethylene-derivative monoethylene glycol will also impact supplies in Europe, especially in the Mediterranean region, and those cargoes could move to Asia. Sources said that Europe imported 20,000-25,000 mt of MEG from Iran in 2011, accounting for about 4-5% of total imports for the year.

"The outcome of the ban will be felt more in the Mediterranean region rather than [Northwest Europe]," an industry source said mid February.

Sources, however, added that the consequences in Europe would be limited as buyers had already begun trimming imports of MEG from Iran since 2010. "Before 2010, imports from Iran [in Europe] amounted to as much at 50,000-75,000 mt/year. After the US began to impose sanctions many buyers were reluctant to lift Iranian product," an industry source said.

China is already the biggest destination of Iran's MEG exports, with the country having imported more than 523,000 mt during 2011, according to statistics from Chinese Customs. The figure represents 7% of China's total MEG imports in 2011. The biggest source or origin for China's MEG imports was Saudi Arabia with over 3.465 million mt.

POLYMERS EXPORT DWINDLES

In polymers, the EU's embargo was generally seen as unlikely to have that severe an effect as imports from Iran have already dwindled over the past year or two due to previous sanctions as well as the demand slump brought about by the eurozone financial crisis.

The financial turmoil in Europe and the weak euro dramatically depressed demand for imports, including from Iran, last year, sources said. In addition, previous sanctions by the US and other Western states, introduced with the express purpose of derailing Iran's nuclear program, have already made business dealings with Iranian companies difficult.

For polyethylene, Iran's exports of the low density grade – the biggest PE grade that Europe buys from Iran – into the continent was halved to 62,064 mt in the January-October period in 2011 from a year earlier, Eurostat data showed.

In Turkey, which is also a major importer or Iranian PE, the sentiment over importing from Iran is deteriorating fast. "Payments [for Iranian imports] are becoming tougher each day," a supplier in Turkey said, adding more and more buyers were becoming wary of the "perils" of doing business with Iran.

"I'm not saying it [offers for Iranian supply] has stopped... but it's certainly much less now," he said.

Turkey's LDPE imports from Iran reached 44,687 mt during January-November 2011, or around 23% of Turkey's overall LDPE imports of 193,320 mt, official statistics showed. For high density PE, they totaled 104,880 mt, or 19% of the total.

Iranian suppliers have now shifted mainly to China, where markets remained generally healthy and unaffected by the Western sanctions, polymer traders said.

In 2011, China imported 297,815 mt of LDPE and 409,725 mt of HDPE from Iran, according to statistics from the Chinese Customs department.

"If the Iranians get pushed out of the European market then you could have more Iranian product moving to China rather than less," said Sriharsha Pappu a Middle East-based research analyst with HSBC Bank last December.

TARGET INDIA

Market sources said the Indian market would likely import more Iranian products as a consequence from the sanctions, and was a good example of the "creativity" of the market players.

A major reason is that the Indian government has not banned imports of Iranian oil or petrochemicals, and leaves it to the banking industry to decide by itself whether to finance Iranian deals. Many of the Indian banks, especially those with public sector undertakings have shied away citing exposure to US and European markets.

The close proximity of the huge Indian consumer market of 1.2 billion people was another reason, not just because of the size, but also as this makes transport by smaller vessels more economical, and due to the relative short voyage, more prompt trade could be possible as well.

The diverse trading communities in both Iran and India are finding means to match demand with supplies, and new solutions are emerging.

For instance, petrochemical traders in the Middle East and India are trying to open LCs with banks that have no exposure to US and European markets, such as for instance India's Kolkata based UCO Bank. Although the bank has overseas branches in many parts of Asia, and is intending to set up a joint venture in Dubai, it has no exposure to US and European markets.

Traders talk of several other solutions for payment hurdles. A Dubai-based trader said early February that often money is being paid through checks in Dubai to a nominee of the Iranian producer. That nominee is usually a UAE-registered entity with no direct links to Iran. "Sanctions can hardly impact there," the trader said. "Sometimes the amount is being paid in cash – 30% of it in advance and 70% later after the cargo is shipped."

The age old practice of "hawala" is also being used. Hawala involves paying the amount to be remitted to an agent in the sender's country, and later, the agent's appointee in the country where the money is to be remitted makes the end-payment.

In addition, traders are also using a network of currency exchanges and online transfers to pay for Iranian cargoes. Altogether, it shows that there are still many creative ways to do trade with Iran. But it is clearly getting a lot more troublesome.

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