Analysis: Venezuela sanctions may ripple through Asian crude markets

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US sanctions on Venezuela's state-owned PDVSA are expected to affect crude markets in Asia as the South American country could be forced to redirect nearly half of its exports away from the US, its single largest customer.

PDVSA's Asian customers, mainly private refineries in western India and Chinese independents, are expected to show buying interest for around 500,000 b/d of Venezuelan heavy crudes, partly to make up for giving up Iranian grades last year.

"The move could possibly shift over 500, 000 b/d to more distant and lower-valued markets, the majority of which would likely head to China and India," said Lim Jit Yang, director of Asia-Pacific oil market analysis at S&P Global Analytics.

The sanctions could also boost competition for heavy crudes from the Middle East, such as Iraq's Basrah Heavy, Bahrain's Banoco Arab Medium and Saudi Arab Heavy. However, if Middle East producers choose to trim their allotments to Asia and boost supply to the US, the market will tighten.

It will not be easy for PDVSA to redirect exports to Asia, where oil refineries are configured to process mostly medium sour grades from the Middle East, and only a few refineries actively seek heavy grades on the spot market.

For instance, Mumbai-listed Reliance Industries and Nayara Energy operate high complexity refineries in western India designed to process discounted heavy crudes, and receive a steady flow of Venezuelan crude through their contracts.

"With the PDVSA sanctions in place now, my first instinct is that more Venezuelan crudes will flow to the Indian private refiners. But we have to wait and see if that becomes a reality," a senior executive at an Indian oil company said.

"Anyway, Reliance and Nayara are hardly taking anything from Iran now. So they would be looking for opportunities" to replace Iranian barrels.

PDVSA's crude exports fell to 1.28 million b/d in the fourth quarter of 2018, down from 1.46 million b/d at the start of the year and from 2.19 million b/d in 2016, according to Barclays data. The US accounted for 43% of Venezuelan exports, India accounted for 19% and China 22%.

CHINESE INDEPENDENTS

China imported 16.63 million mt of crude from Venezuela in 2018 and independent refiners took about 9.566 million mt, down 24.9% from 12.73 million mt in 2017, according to S&P Global Platts data. The producer was China's ninth largest crude supplier in 2018, with a market share of about 3.6%, down from 5.2% in 2017.

The independents are supplied mostly by PetroChina, which imports Venezuelan crude in return for more than $55 billion of loans given since 2007. PetroChina also sends Venezuelan crude to its own refineries, along with state-run Sinopec and CNOOC.

China's independent refineries receive around three to four VLCCs of Merey crudes every month, which is in line with the monthly average, according to a trader with ChinaOil, PetroChina's trading arm. The trader said that for the time being there has been no impact from the sanctions.

Chambroad Petrochemical, one of the largest independents, is a major consumer of Venezuelan crude, accounting for around 2.3 million mt of imports last year. Other Chinese refineries along the eastern coast also have the ability to process a wide range of crudes, and could show interest in discounted Venezuelan barrels.

So far the market has not seen new Venezuelan crude offers into Asia, but there is big chance it will happen, a trader for a South American oil company said.

HEAVY FUEL

Assuming that Venezuelan production does not slip further and it can maintain exports despite the US market getting cut off, it could potentially put some downside pressure on medium and heavy sour Middle Eastern crude price differentials in the Asian spot market, according to market participants.

The key Venezuelan export grades that could be incrementally sold to Asia are: Santa Barbara, a light sweet crude with a typical API gravity of 36 degrees; Mesa 30, a medium sour crude with API gravity of 30; and Merey, a heavy sour crude with a gravity of 16 API.

Traders said Mesa 30 and Merey will likely attract the attention of plenty of Asian buyers if PDVSA decides to regularly offer the grades in large volumes in the Far East. These crudes have consistently traded at a steep discount to the key Middle Eastern grades sold in Asia.

The outright spread between Platts Mesa 30 crude assessments and the corresponding monthly official selling price for Saudi Arab Medium averaged minus $5.25/b in December, minus $5.67/b in November and minus $4.70/b in October, S&P Global Platts data showed.

Mesa 30 could compete with other medium and heavy sour grades in the Persian Gulf spot market, including Qatar's Al-Shaheen, Abu Dhabi's Upper Zakum and Iraq's Basrah Light, while the influx of cheap Merey could steal Asian buyers' focus away from similar quality Persian Gulf grades, traders said.