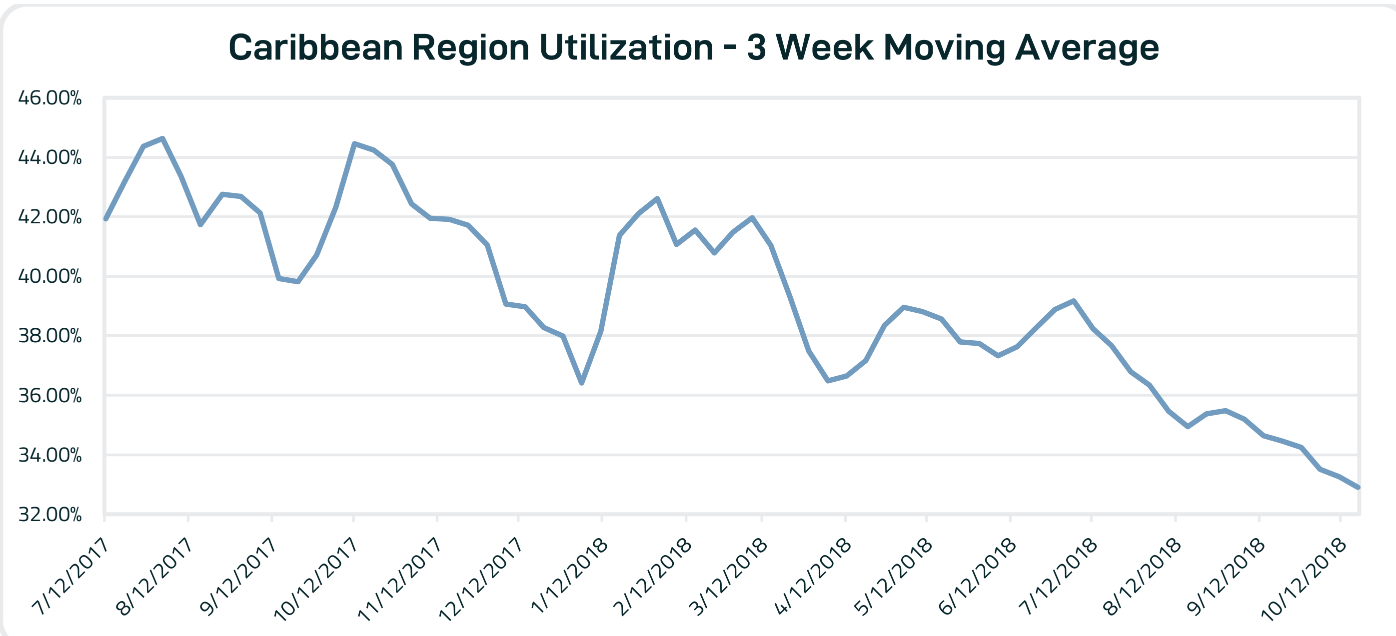
WINDS SHIFT FOR CARIBBEAN AS OIL STORAGE HUB

The slow collapse of the Venezuelan economy has been felt in Curacao where the sharp drop in crude oil shipments from South America has left the Caribbean island short of feedstock needed to operate a major refinery. The Isla refinery is a source of fuel, jobs and income for the 159,000 people in Curacao, as well as a generator of hard currency. Designed to process 335,000 barrels of crude every day, only about 8% of the refined products made by the Isla refinery is consumed domestically. The rest is exported. But can Curacao survive as a refining and oil storage hub with all the problems facing Venezuela?

The same question can be asked across the Caribbean. PDVSA also leases or owns storage tanks in Bonaire, Curacao and St. Eustatius, as well as refineries in Aruba, Dominican Republic and Jamaica.



Oil storage as percentage of capacity based on Ursa data

Venezuela used to own a stake in a refinery in Cuba and had a storage contract in the Bahamas. Both were terminated because of financial problems. More assets could be lost over unpaid bills and legal battles, dealing a blow to PDVSA which utilizes this network of refineries and storage tanks to sell products and crude. Refined products are shipped around the world from the Caribbean. As for crude, the barrels not used for refining are re-exported, mostly to the US Gulf Coast.

This flow has declined sharply in 2018. Not much crude has arrived, but not much has left either, offsetting the impact on inventories. Combined stocks from Bonaire, Emmastad (Curacao), Sint Nicolaas (Aruba) and St. Eustatius have been approximately 14-18 million barrels so far in 2018, according to Ursa data. That figure has trended lower since July putting stocks mid-September at the lower end of the range equivalent to 35% of total capacity.

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Ursa measures oil storage levels on a weekly basis at 150 sites around the world using synthetic aperture radar (SAR) technology. Other monitored storage sites in the Caribbean include Castries (St. Lucia), Freeport (Bahamas), Pointe-a-Pierre (Trinidad and Tobago), Penuelas (Puerto Rico) and St. Croix (British Virgin Islands).

The Caribbean's deep ports allow for VLCCs to transfer crude to onshore tank farms. This physical infrastructure is a selling point for the Caribbean especially when crude futures are in contango and traders can make a profit by keeping barrels in storage. The Caribbean is an ideal place to execute the cash-and-carry trade considering the storage available and tanker-friendly ports. There was high demand for Caribbean storage during the period of contango from 2014 to 2017. OPEC supply cuts eventually tightened the global oil market leading to backwardation and removing the financial incentive to store barrels.

Attention remained on Caribbean storage because everyone wanted to know how much crude was leaving the tanks and whether the market could absorb it. The next time crude futures trade in enough of a contango to make cash-and-carry trade profitable, the allure of Caribbean storage should be very strong because of US oil exports. This is a new development. Legal restrictions on US crude exports were lifted in late 2015, but it wasn't until 2017 that US crude exports exploded. The supply glut caused by the shale revolution mostly stayed inside the United States causing inventories to reach a record 535 million barrels in March 2017. At the time, Caribbean tanks filled with oil mostly from Latin America and West Africa. That should change as the flood of oil set to leave the US Gulf Coast commences. US production has topped 10 million barrels per day and continues to climb. New pipelines and export terminals are being built across Texas and Louisiana meant to facilitate the movement of barrels from shale basins to the Gulf Coast.

How the Caribbean fits into this picture extends beyond contango to logistics, a value proposition that has attracted investors. ArcLight Capital and Freepoint Commodities purchased the former Hovensa oil complex in St. Croix, which includes an idled refinery, storage capacity of approximately 32 million barrels and a deep-water port. The new owners say they want to turn the facility, renamed Limetree Bay Terminals, into a "vital link at the crossroads of global energy markets." Accomplishing that goal got off to a quick start when China's largest refiner, Sinopec, signed a ten-year agreement to lease 10 million barrels of storage. Such a deal would have been unthinkable even a few years ago and represents a stark contrast with the Caribbean's origins in the oil industry. Almost a century ago, the first major refineries in the Caribbean were built by US oil companies in Curacao and Aruba to capitalize on the Venezuelan oil boom. Much has changed, yet the Caribbean has found ways to stay relevant in the global oil market.

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