

Russian supply risk upends the oil market

Russia's invasion of Ukraine and the sanctions which followed have led to a significant change in the oil outlook. Whilst current sanctions are not targeting Russian energy exports, the risk of further escalation means the potential for large supply disruptions. We have made significant upward revisions to our oil price forecasts



Filling up a car at an icy petrol station in Russia

The impact so far

The reluctance of refiners to commit to Russian oil is already very clear. Differentials for Russian oil have fallen to record discounts in recent weeks. This continued weakness reflects the risk that sanctions will get progressively more restrictive. In addition, banks are becoming less willing to finance the trade of Russian commodities, whilst shipowners are also reluctant to load in some Black Sea ports.

Therefore, even though sanctions are not targeting Russian energy exports, the risk of sanctions, along with possibly public pressure is leaving buyers reluctant to purchase Russian oil.

So, it seems clear that reduced Russian flows will occur with or without sanctions targeting oil exports. As a result, we expect a disruption in the region of 2MMbbls/d in the coming months for Russian oil supply.

What does this mean for oil prices?

The continued uncertainty, along with expectations of lower supply have led us to revise up our oil forecasts significantly. For 2Q22 we now expect that ICE Brent will average US\$102/bbl, whilst for the full-year 2022, we expect Brent to average US\$96/bbl.

There are some potential developments that could help to limit further upside. The most obvious and preferred from a humanitarian point of view would be a quick de-escalation in the Russia-Ukraine conflict.

Secondly, Iranian nuclear talks are ongoing, and a quick deal could lead to a sizeable increase in Iranian supply. A lifting of US sanctions against Iran could see supply growing from around 2.5MMbbls/d now to around 3.8MMbbls/d.

OPEC+ could also help the market by increasing supply more aggressively. However, all comments from members up until now suggest that the group is keen to stick to their current plan of increasing output by 400Mbbls/d in April. It is also important to remember that Russia is a part of the OPEC+ alliance and so would have some influence on what the group decides.

Finally, we could see further coordinated stock releases by governments around the world. The IEA in early March coordinated a 60MMbbls release. However, drawing down strategic reserves is a short-term solution and clearly, longer-term solutions are needed.

It could still get a lot worse

There is certainly the risk for further upside in prices. If we were to see a scenario where Russian energy exports are fully targeted this could lead to a situation where we see Brent trading up towards US\$150/bbl this year. The market would not be able to offset the full amount of Russian export supply lost, and so under this scenario, the market would be in deficit for the foreseeable future.

However, it is unlikely that Russian energy exports would fall to zero under oil sanctions. As we have seen with Iran, there are buyers still willing to purchase oil from sanctioned countries. Potential oil sanctions against Russia would mean that Russian oil falls to even larger discounts than we are currently seeing, which will be just too tempting for some buyers. Under such a scenario, we would expect China to increase its share of Russian oil purchases (China imported 1.6MMbbls/d in 2021), as well as possibly India. Under such a scenario, we would likely see Brent spiking significantly higher in the immediate term on the back of an announcement, but then trading towards \$115-120/bbl as we move through the year.

There is obviously plenty of uncertainty in the oil market at the moment, and the only certainty is that forecasts will change as the Russia-Ukraine situation evolves.

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