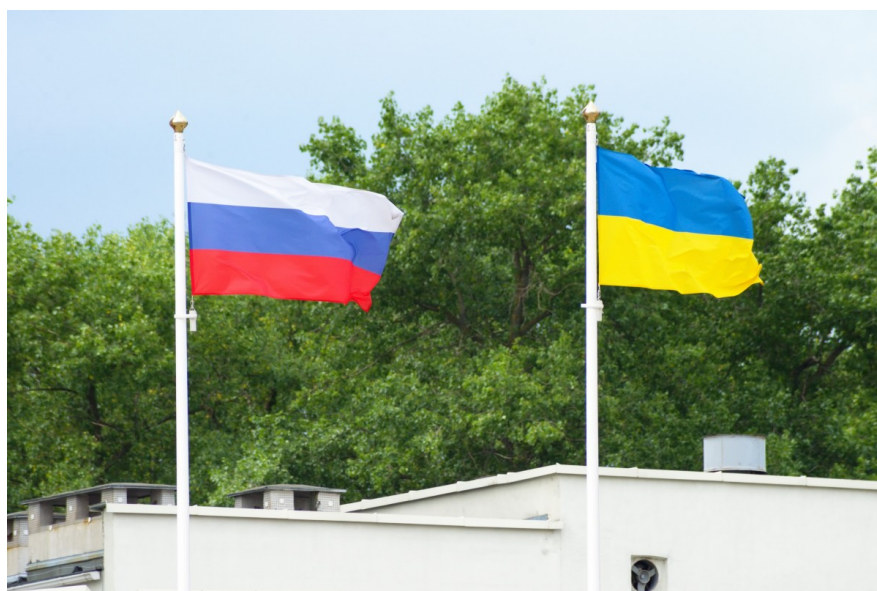


Russian uncertainty leads to drastic changes in the oil outlook

Russia's invasion of Ukraine and the sanctions which have 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 disruptions to oil flows. We have made some significant upward revisions to our oil price forecasts



Russia and Ukraine flags

The importance of Russia to oil markets

Russia is a key player in global oil markets. Oil output in 2021 averaged 10.52MMbbls/d, making it the third-largest producer, behind only the US and Saudi Arabia. It is also the second-largest oil exporter, with flows of more than 5MMbbls/d. In addition, Russia also exports a substantial amount of refined product, somewhere in the region of 2.5MMbbls/d. Therefore, any disruption to these flows has the potential to significantly impact the market.

Europe is the largest home for Russian crude oil, with about 53% of it ending up there. Whilst Asia is another significant buyer, with 39% going into the region. This Asian demand comes predominantly from China, with imports of around 1.6MMbbls/d in 2021.

What impact have we seen so far?

The reluctance of refiners to commit to Russian oil is already very clear. The Urals differential has fallen to a record low discount of US\$18.305/bbl to dated Brent, according to Platts. These differentials have been in freefall, given 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, it is pretty clear that 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. In recent days there have also been some sales tenders for Russian oil which have failed to attract any bidders.

So, it seems reduced Russian flows will occur with or without sanctions targeting oil exports. We had originally assumed a 1MMbbls/d reduction in supply from Russia, however, this appears as though it may be too conservative. As a result, we now expect a disruption in the region of 2MMbbls/d in the coming months.

Oil prices set to remain elevated

The continued uncertainty along with obviously lower supply has led us to revise higher our oil forecasts. 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 which 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 surge in Iranian exports in the short term, as inventories that were built in recent years (due to sanctions) are drawn down. In the medium term, we could see supply growing from around 2.5MMbbls/d currently 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. At the moment, some in the group are of the view that the current high price environment reflects geopolitical risks rather than supply and demand imbalances. 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 this week coordinated a 60MMbbls release. However, drawing down strategic reserves is a short-term solution, and clearly, longer-term solutions are needed.

ING oil price forecasts

	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23
ICE Brent (US\$/bbl)	96	102	94	92	80	77	79	75
NYMEX WTI (US\$/bbl)	93	99	91	89	77	74	76	72

Source: ING Research

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. This would come at a time when global inventories have already been drawn down to historically low levels.

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. We would expect China to increase its share of Russian oil purchases (they 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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