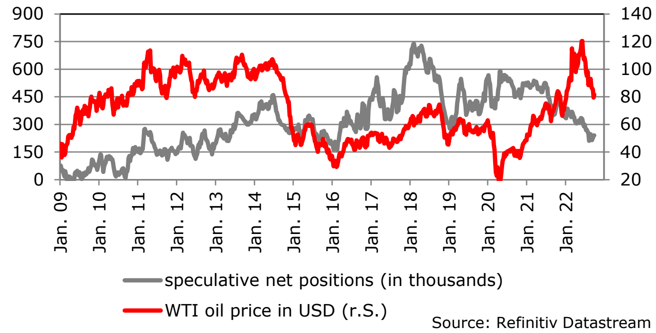
ECONOMIC SITUATION AND STRATEGY

18 November 2022

Oil sanctions against Russia: a success or a flop?

The oil price increase triggered by the Russian war of aggression to around USD 120 per barrel in the summer of 2022 has corrected again in recent weeks to a level of around USD 85 per barrel, in particular due to concerns about the economic situation. The oil price cap announced by the G7 countries and the EU is intended to ensure that Russian oil will have to be purchased at a lower market price from December. As things stand at present, this would lead to a restriction of oil supplies by Russia and a shortage of supply on the world market. The question therefore arises as to whether the current oil price level can be maintained in a corridor of USD 80 to 90 per barrel of oil in view of the announced oil price cap at the beginning of December 2022 or whether significantly rising prices can be expected again next year.

WTI oil: net speculative positions and oil price

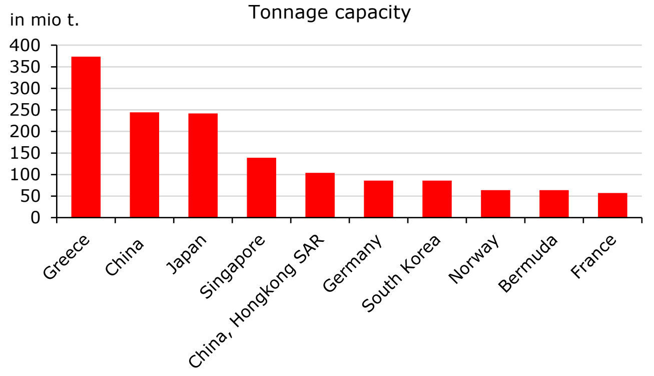


Source: Refinitiv Datastream

As of December 5, the European oil embargo agreed in the EU's 6th sanctions package, supplemented by the price cap for oil of Russian origin initiated by the G7 countries and adopted in the 8th sanctions package, will come into force. Currently, Russia is profiting from the high oil price and is not only financing its war of aggression with the excess profits, but is also stabilizing its overall economic expenditures with the revenues.

Currently, there are no exact details about the actual conditions that could be included in the sanctions package. Since the sea route is the most important access for Russian oil to Western markets, the price cap for oil transported by sea will apply until it is first sold to a buyer on land. When it is subsequently resold, the cap would no longer apply. U.S. Treasury Secretary Janet Yellen announced a likely price cap of $60 per barrel of Russian oil in mid-October. Third countries that resist future sanctions are threatened with, among other things, permanent exclusion from potential future European service tenders.

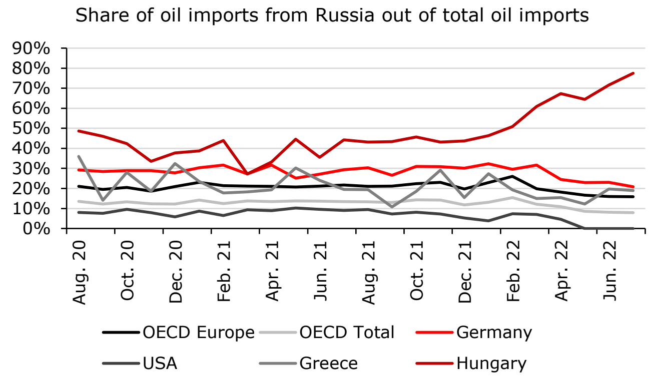
In principle, the G7 countries and Australia are planning to ban third countries from transporting Russian oil if the current Russian oil price is above the ceiling. Greece owns the largest number of oil tankers in terms of the total global tanker fleet (around 27 percent), making it one of Russia's most important partners for the transportation of oil. At present, Russian oil continues to be transported by Greek tankers, and Greek ship owners have recently even expanded their capacities. According to calculations by the International Institute of Finance, around 35 percent of Russian oil exports were transported by Greek ships before the start of the war, but this figure has risen to 55 percent, even though the volume of Russian oil exported in the summer months was significantly higher than the average for previous years. Furthermore, Western marine insurers are not allowed to reinsure tankers carrying Russian oil. John Neal, CEO of Lloyds (the world's largest marine insurer), has already announced that they are joining the EU sanctions and the resulting insurance bans.



Source: UNCTADstat (UNCTAD, 2021); Clarksons Research.

However, it is questionable whether the expected restrictions will lead to a drop in demand for Russian oil in the future. Experts assume that the majority of Russian oil will bypass the oil embargo. This is due to attractive sales alternatives on the Asian market. India and China have drastically increased their demand in recent months. Russia is already granting the countries a discount of up to 30 percent. China also owns the world's second-largest shipping fleet and could insure its ships itself. India could also have its ships insured by Chinese or Russian reinsurers. China's currently very high demand for crude oil suggests that the country will not give up on the commodity. The government's zero-covid policy is prompting more and more Chinese to use the safe car for their own transport in order to proactively prevent regional lockdowns and the resulting restricted personal freedom. Analytical reports indicate that demand for shipped Russian oil has increased by around 25 percent in recent months. There has also been an increase in demand from Turkey, which does not support Western sanctions. Imports of Russian oil increased from an average of 98,000 barrels per day in 2021 to more than 200,000 barrels per day in 2022. In addition, according to a report by the independent Centre for Research on Energy and Clean Air, exports of refined oil products to European countries or the U.S. increased by 85 percent in September and October relative to July and August.

We Europeans ourselves also ensure that Russian oil continues to be dumped in Europe. For example, there are reports of so-called "transfer operations" in the Laconian Gulf of Greece. This means that a Russian tanker delivers its oil to a Greek tanker on the high seas, so that the supervisory authorities can no longer clearly determine from where the loaded oil of the Greek tanker originates. Even customers no longer know whether the oil meets their own requirements. Shell, for example, assumes that the oil is Russian if more than 50 percent of the loaded oil can be traced back to a Russian origin. At present, the Greek government assumes that its ship owners will not be negatively affected by the sanctions coming into force.

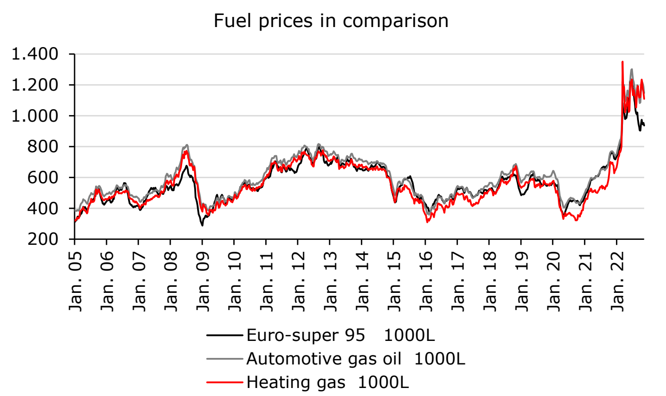


Source: International energy agency (IEA)

The presumably set price limit of USD 60 per barrel must also be questioned critically. The price limit would make sense if the current market price were below the upper limit. If the market price is above the upper limit, there will be a shortage because other countries will not be able to compensate for the unchanged demand with lower supply. The latter scenario is best illustrated by an example. Assuming a market price of 100 USD per barrel of oil, it is still attractive for countries such as India or China to buy Russian oil at a discount of up to 39%. For the European countries or the countries that have introduced the price cap, it is not possible to buy Russian oil at a price of 61 USD per barrel, because the price is above the price cap. Nevertheless, the oil demand of the countries remains the same, with a self-made supply shortage. In the meantime, even the U.S. doubts that the price cap will be implemented successfully. A clear signal of this is the announcement of the concrete design only after the midterm elections on November 8. It is also questionable whether the current market power of the G7 countries, the EU and Australia will be sufficient to influence the price efficiently, even if they together account for around 50 percent of total demand for crude oil.

In summary, we do not expect the resolutions to have a major impact on Russia. It can be assumed that India and China will benefit and that the oil price for the West will steadily increase. A price explosion, as would occur if the sanctions were successful, is not to be expected. However, it is difficult to make concrete statements regarding the development of the oil price. We expect the oil price to settle in a corridor between USD 100 and 120 per barrel of Brent oil in the coming quarters.

In addition, the ban on the import of processed oil products, which was also adopted in the 6th sanctions package, will come into force on February 5, 2023. Although exemptions have been created for products delivered to Central Eastern Europe by pipeline, these are of little significance. The ban could therefore have a massive impact on Europe in particular. As early as the summer of 2022, the shortage on the product markets led to a significant increase in the price of oil distillates. However, such developments are hardly noticed by political decision-makers at the international level, in contrast to crude oil prices, which led to a tank discount in Germany in the summer. At the same time, OPEC cuts, the reduction of stockpiles, the EU oil embargo and the potential price cap of the G-7 countries are trying to influence consumer prices via a commodity that hardly any consumers actually use. Rather, it is the distillates included in the consumer price index, such as gasoline, diesel and heating oil, that influence consumer behavior. Here, the oil embargo that has been passed meets with a glaring lack of investment at refineries, which is exacerbated by closures and interruptions due to maintenance work or weather conditions. Unlike crude oil, there are no large storage facilities, no OPEC for refineries and no short-cycle solutions such as the extraction of distillates from shale rock. This means that from February onward, price developments on product markets may decouple from those on crude oil markets, making political control of crude oil supply less effective in controlling consumer prices. For Germany, such a scenario could place a further burden on future inflation developments. The reason for this is Germany's disproportionately high dependence on Russian diesel fuels. More than 14% of Germany's total demand is currently covered by imports from Russia.



Source: European Union

Forecasts and current information indicate that oil stocks in northwestern Europe will be at their lowest level for 12 years as early as summer 2023. Politicians are currently hoping to use the winter months to increase diesel stocks so that prices do not rise too sharply in the spring of next year as a result of the consumption of the accumulated diesel stocks. However, this is probably wishful thinking, as analyses suggest that diesel stocks will already be at an all-time low in March of next year.

The trend of future price development for diesel and other distillates can be read from this year's price development, unless new circumventions of the diesel embargo can be established. According to NDR research, the price information agency Platts (S&P Global Commodity Insights) already calculated Russian diesel out of the price model for north-western Europe last summer, which is said to have led to a theoretical shortage of diesel supply on the trading markets and thus to a significant increase in the price of diesel. It should be noted that the given constraints in refining capacity mean that the development of additional oil reserves or tax cuts bring only limited relief to consumers. Moreover, the "prisoner's dilemma" causes governments to protect their citizens to the detriment of others and prevents necessary international cooperation.

We would like to thank Julian Pollmann for his active support for this article.

Market data

Stock marktes	As of 18.11.2022 11:07	Change versus 11.11.2022 -1 week	17.10.2022 -1 month	17.08.2022 -3 months	17.11.2021 -1 year	31.12.2021 YTD
Dow Jones	33546	-0,6%	11,1%	-1,3%	-6,6%	-7,7%
S&P 500	3967	-0,6%	7,9%	-7,2%	-15,4%	-16,8%
Nasdaq	11145	-1,6%	4,4%	-13,9%	-30,0%	-28,8%
DAX	14391	1,2%	13,8%	5,6%	-11,4%	-9,4%
MDAX	25564	-1,6%	11,2%	-7,2%	-29,2%	-27,2%
TecDAX	3081	-0,3%	11,4%	-1,7%	-22,0%	-21,4%
EuroStoxx 50	3914	1,2%	13,7%	4,2%	-11,1%	-8,9%
Stoxx 50	3699	1,1%	8,2%	0,9%	-2,9%	-3,1%
SMI (Swiss Market Index)	10988	-1,2%	4,7%	-1,3%	-12,8%	-14,7%
Nikkei 225	27900	-1,3%	4,2%	-4,5%	-6,0%	-3,1%
Brasilien BOVESPA	109703	-2,3%	-3,5%	-3,5%	6,6%	4,7%
Russland RTS	1146	-1,0%	11,5%	0,9%	-36,4%	-28,2%
Indien BSE 30	61675	-0,2%	5,6%	2,3%	2,8%	5,9%
China CSI 300	3802	0,3%	-1,2%	-9,9%	-22,2%	-23,1%
MSCI Welt	2642	-1,2%	8,7%	-6,4%	-18,0%	-18,2%
MSCI Emerging Markets	942	0,7%	8,8%	-7,2%	-26,8%	-23,5%
Bond markets						
Bund-Future	140,01	149	313	-1411	-3076	-3136
Bobl-Future	119,45	12	36	-648	-1561	-1379
Schatz-Future	106,68	2	-16	-281	-567	-535
3 Monats Euribor	1,80	40	115	189	237	239
3M Euribor Future, Dec 2017	2,21	-6	-9	0	276	3
3 Monats $ Libor	4,67	7	45	170	452	447
Fed Funds Future, Dec 2017	4,13	0	-9	0	405	3
10 year US Treasuries	3,80	-5	-21	90	222	231
10 year Bunds	2,08	-8	-19	106	232	226
10 year JGB	0,25	1	1	7	18	18
10 year Swiss Government	1,10	0	-24	59	122	123
US Treas 10Y Performance	581,67	0,6%	2,2%	-6,2%	-15,7%	-16,7%
Bund 10Y Performance	548,84	1,2%	2,3%	-8,0%	-17,7%	-17,1%
REX Performance Index	440,25	0,5%	1,1%	-4,8%	-10,7%	-10,3%
US mortgage rate	0,00	0	0	0	0	0
IBOXX AA, €	3,22	-11	-40	111	284	274
IBOXX BBB, €	4,46	-14	-53	125	366	359
ML US High Yield	8,91	-6	-53	129	407	401
Convertible Bonds, Exane 25	6629	0,0%	5,1%	-3,7%	-20,8%	-19,1%
Commodities						
MG Base Metal Index	403,06	-1,6%	8,2%	0,5%	-8,9%	-12,6%
Crude oil Brent	89,75	-6,7%	-2,2%	-4,3%	11,7%	14,5%
Gold	1764,03	0,1%	6,2%	0,1%	-5,4%	-3,2%
Silver	20,89	-2,9%	11,4%	5,8%	-16,8%	-10,2%
Aluminium	2365,00	-3,3%	6,1%	-1,8%	-10,0%	-15,7%
Copper	8072,25	-5,1%	5,6%	1,9%	-14,3%	-17,1%
Iron ore	93,09	2,5%	-1,9%	-11,8%	0,4%	-17,3%
Freight rates Baltic Dry Index	1228	-9,4%	-33,4%	-11,9%	-49,5%	-44,6%
Currencies						
EUR/ USD	1,0370	0,6%	6,5%	2,0%	-8,4%	-8,4%
EUR/ GBP	0,8698	-0,8%	1,3%	3,1%	3,6%	3,6%
EUR/ JPY	145,15	0,9%	0,1%	5,7%	11,8%	11,3%
EUR/ CHF	0,9865	0,2%	1,1%	1,8%	-6,3%	-4,5%
USD/ CNY	7,1173	0,2%	-1,1%	4,9%	11,6%	12,0%
USD/ JPY	140,20	1,0%	-5,9%	3,8%	22,9%	21,8%
USD/ GBP	0,84	-1,2%	-4,1%	1,1%	13,0%	13,6%

Source: Refinitiv Datastream

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