Energy Intelligence

Energy Intelligence Premium Weekly

Thursday, June 30, 2022

Oil Markets: Russian Oil Defies Western Crackdown

Russian oil production has recovered losses from Western restrictions imposed since the Ukraine invasion, as Moscow found workarounds and alternative markets, according to Energy Intelligence analysis. Pressures will mount with Europe's oil embargo from late this year and should ultimately hit output — but Russia has surprised with its ability to adapt.

- **Russian oil output has bounced back from a post-invasion drop.** Western sanctions initially disrupted operations, but Moscow has built workarounds through pricing discounts, covert trade and increased domestic refining, according to our analysis. Crude and condensate production took a 1 million b/d dive in April, but recovered to 10.7 million b/d in June, just 3.4% below prewar levels. Exports of crude and condensate increased by 12% from prewar levels to 5.05 million b/d — although June figures were 340,000 b/d below the April high of 5.4 million b/d. Product exports were hit by the US heavy fuel oil embargo, but domestic demand is picking up some slack. June refinery throughputs are up 340,000 b/d from May at 5.26 million b/d, although still 580,000 b/d off prewar levels. Russian auto and aviation demand is healthy, despite economic stress. EU sanctions on Russian oil imports (December crude, February 2023 products) will increase pressures, but Moscow has six months to find loopholes.

- **Discounts have unlocked major sales to India, China.** Russia has built heavy Urals crude sales to India and China through steep discounts — estimated by traders at around $35/bbl to Brent. Russian oil and gas statistics agency TsDU TEK shows the average Urals discount at $40/bbl for the first half of June. But high prices mean Moscow is still earning more, with discounted crude exports valued at $13.3 billion per month in the first half, versus $9.2 billion/month in 2021, per our estimates. India bought an average 910,000 b/d of Russian crude in the second quarter, up from just 43,000 b/d before the war. China took 1.99 million b/d of Russian crude in May, up from 1.6 million b/d prewar, the highest on record dating back 15 years. Early June numbers suggest Chinese imports could push past 2 million b/d. China is using cheaper Russian barrels to replenish reserves, while Indian refiners are running Urals to produce diesel for Europe.

- **Europe has kept buying ahead of a formal embargo.** Despite corporate pledges to drop Russian volumes post-invasion, trade data show EU buyers still taking significant volumes of both crude and products. EU imports of Russian crude averaged 1.7 million b/d in June, down 23% from 2.2 million b/d prewar. Germany and Poland are weaning refineries off Russian crude feedstock, depressing Druzhba pipeline offtake. EU product imports are holding up, given refinery constraints at home and elsewhere — diesel volumes were down by only 10% in June at around 500,000 b/d, although overall light products are down 20% at 960,000 b/d.

- **Creative practices have kept the oil flowing.** Several firms specializing in trading Russian oil, such as Lukoil's Litasco, have relocated staff or operations to Dubai to avoid European restrictions. At sea, vessels are reportedly carrying out ship-to-ship transfers to disguise the origin of Russian crude, now under intense public scrutiny. Estonia has emerged as a transshipment hub, handling 16 cargoes or 170,000 b/d of Russian dirty products in June, double February levels, per shipping data, with destinations like the UAE, Saudi Arabia and the Caribbean. Moscow has used state Russian National Reinsurance Co. to insure tankers to get around European and US shipping restrictions, with other state-controlled entities also stepping in.

- **Pressures will mount later this year.** Energy Intelligence's forecast sees Russian crude and condensate production ultimately bending under the strain of multiple measures and sinking to 10.3 million b/d by December (revised from 10 million b/d) and 8.8 million b/d by end-2023, versus 11.1 million b/d prewar. But Russia's proven ability to adapt means we will closely monitor this trajectory in the coming months. Our forecast assumes (1) insurance workarounds face limits; (2) Russia struggles to find a long-term market for the 4 million b/d (crude and products) displaced by US/European embargoes; (3) hubs like Estonia start cracking down; and (4) Russia's domestic demand eases in the fall. Moscow could offer even steeper discounts to maintain sales, but this could irritate Opec-plus allies and prove hard to sustain if global prices fall on demand weakness. US-European talks on a Russian crude price cap could hit Moscow's revenues if agreed but would be complex to administer.

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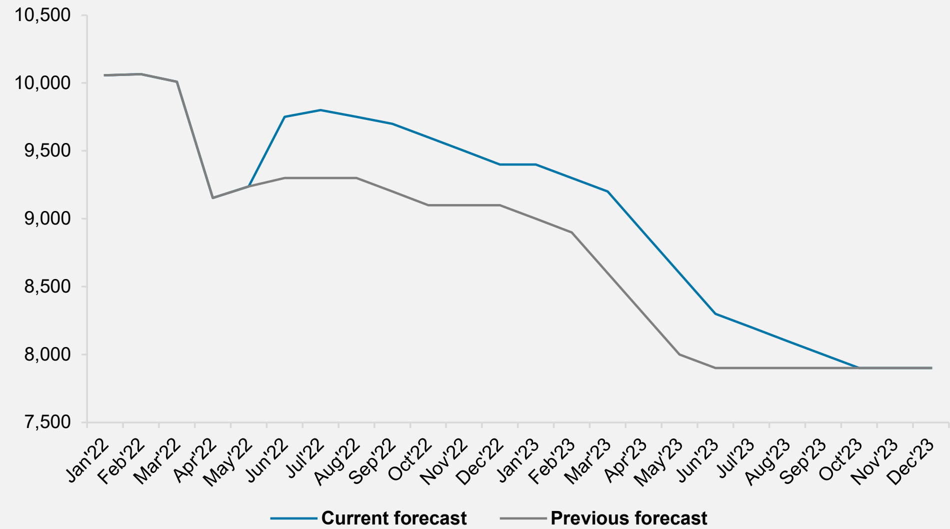
Russian Crude Production Holding Up for Longer

('000 b/d)



Source: Energy Intelligence

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