Oil market sanctions on Russia: easy for the US, much harder for Europe

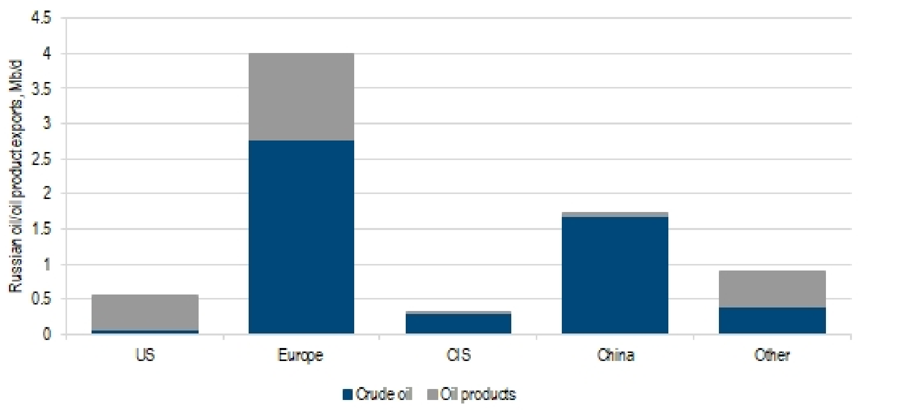
Summary

We discuss President Biden's decision to ban imports of Russian oil and its implications, following on from our research last week (link), concluding that removing all of Russian oil completely from the global oil market could happen, but it could take $200/bbl oil prices to destroy enough demand to do so. The US imports very little Russian oil - after all, the US is a bigger oil producer than Russia is - but Europe imports much more, and the redirecting of trade flows will cause a temporary dislocation in markets which could result we think in high oil prices- between $130-200/bbl - between now and the end of 2022.

Key Points

- **It's easy for the US to talk about sanctioning Russian oil because the US uses very little Russian oil, but it's much harder for Europe to do so.** The US uses c.0.5Mb/d of Russian imports, or c.2-3% of its total oil demand of just over 20Mb/d. The main Russian export markets are unsurprisingly Europe and China, with Russia supplying c.30% of European demand in 2020 (4Mb/d of c.13Mb/d), and c.12% of China's oil demand (1.7Mb/d of c.14Mb/d), as shown below:

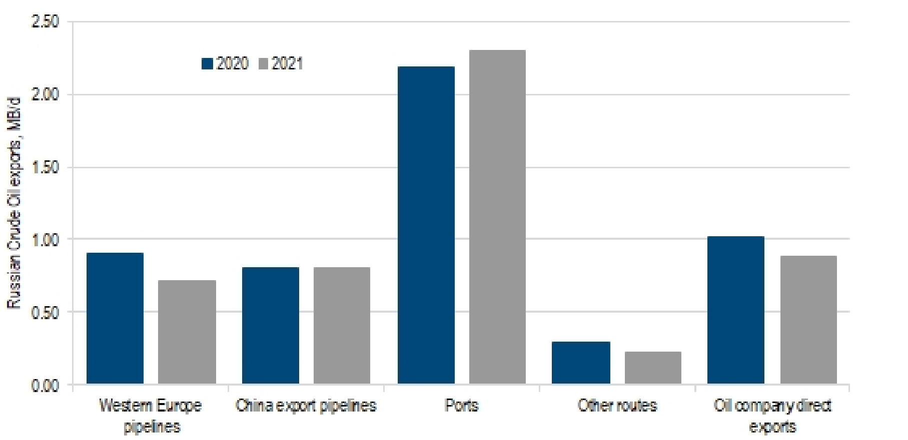
Russia's main oil export market is Europe, then China



Source: BP Statistical review of world energy, IEA, EIA, Stifel estimates

- Currently, Russia exports are predominantly through its ports system, split c.70% Europe/30% Pacific, but also with c.0.7-0.9Mb/d supplied direct into both Europe and China by pipeline, as shown below:

Russia crude oil exports predominantly via Western Russia ports



Source: Transneft, Stifel estimates

Chris Wheaton | +44 (0) 20 7710 7623 | chris.wheaton@stifel.com
David Round | +44 (0) 20 3465 1106 | david.round@stifel.com
UK Sales Desk | +44 (0) 20 7710 7600

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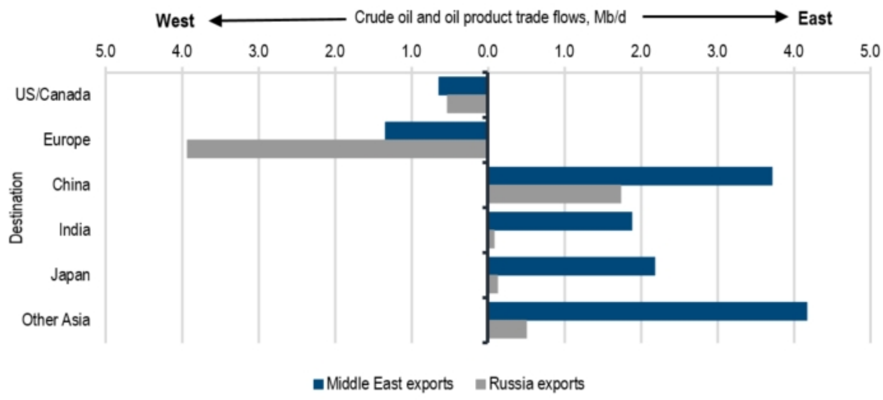
- **Replacing any of this Russian oil in European markets will we believe require an inversion of current trade flows in the oil market.** Currently, Russian trade flows are predominantly west, whereas flows from Middle East oil producers are predominantly east into the markets of Asia (as shown below). If Europe were to replace all of its 4Mb/d of oil supplies from Russia, that would need to be replaced from Middle East producers and from Africa.

Russian oil flows will need to be replaced by oil from Middle East and Africa



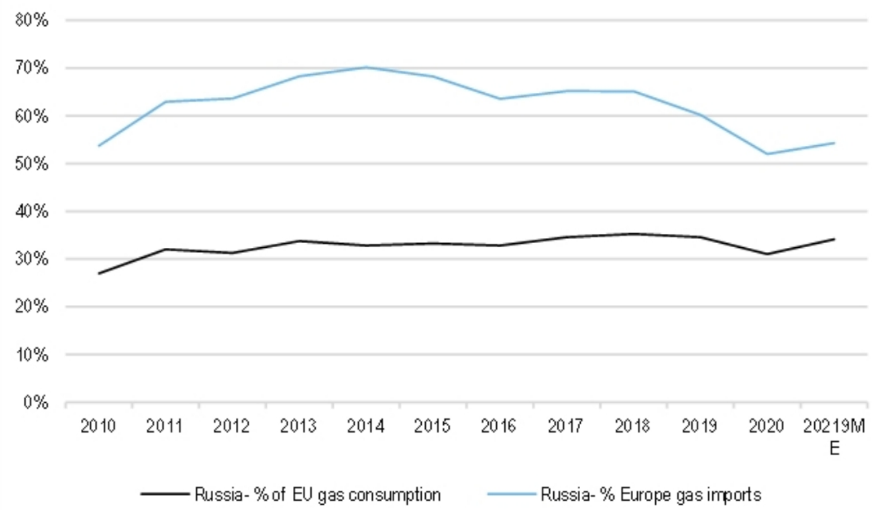
Source: BP Statistical review of world energy, Stifel estimates

- **If Russia had to redirect at a minimum the 0.9Mb/d that currently flows through the Druzbha pipeline west into Europe, it would have to be redirected through the three European ports** - Novorossiysk (Black Sea), Primorsk and Ust-Luga (both on the Baltic Sea). However, we estimate spare capacity across these ports of only 0.6Mb/d, a shortfall of 0.3Mb/d. There is limited pipeline capacity across Russia to take West Siberian production east - the Eastern Russia export routes service local production in the far east and the Kozmino port on the Pacific coast and the existing pipelines into China are operating at maximum capacity.

- **There is sufficient nameplate capacity in the European refining system to replace Russian oil product flows with locally refined crude but there will be a period of disruption** in the market, while new trade patterns emerge. We estimate c.4Mb/d of spare refining capacity (11Mb/d of refinery throughput against 15Mb/d of oil demand) vs just over 2.5Mb/d of Russian crude imported, though it is unclear if all this capacity can produce a product to the required specification of 10ppm sulphur content, and we think there is a "glass ceiling" of refinery uptime at c.95%. This could add an extra $1-2/bbl in shipping costs, we estimate, which is negligible given the apparent risk premium in oil prices.

- **Risk of contagion from oil into gas presents a much bigger risk to European economies.** It has been reported that the Russian foreign minister has made a direct link between a potential European embargo on Russian oil and reducing supply of gas into Europe. Over the last decade, Russian gas imports represented over 50% of EU gas imports and over 30% of gas demand, as shown below:

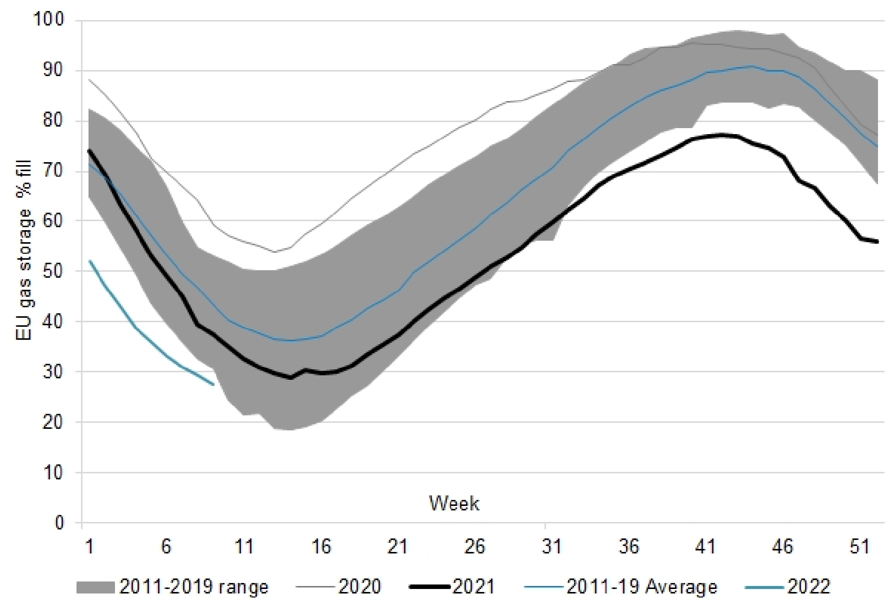
Russian gas imports are >30% of demand and >50% of EU's gas imports



Source: BP Statistical review of World Energy, Gazprom, Stifel estimates

- **Europe was already suffering gas stress before the Ukraine crisis,** with gas in storage well below historic ranges, as shown below, and only easing in 1Q22 thanks to a combination of accelerated delivery of LNG cargoes and mild weather:

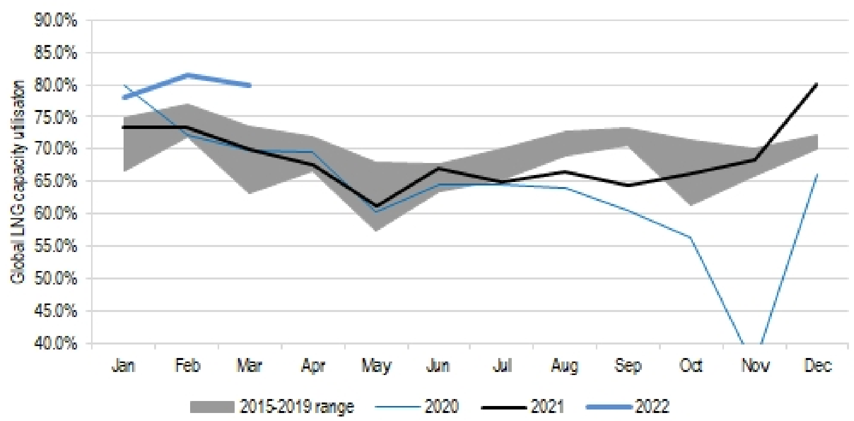
EU gas in storage deficit easing, but still well below historic levels



Source: Bloomberg

- **We think the LNG industry is bumping up against its own capacity constraints**, as it is currently producing at c.30Mte per month, c.80% capacity utilisation. We remain concerned that there is simply not enough LNG available to fulfill the EU's stated goal to refill storage to 90% full by October 2022 - especially when competing with Asian buyers of LNG:

LNG industry struggling to supply - issues with plants and feedstock



Source: Bloomberg, GIINGL Stifel estimates

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