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MACROCOSM

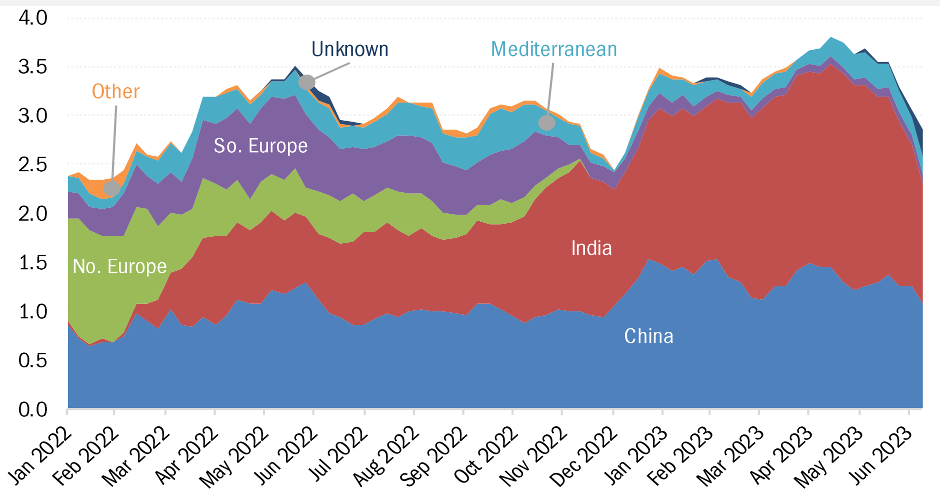
Has Wagner Made Russian Oil Radioactive?

Thursday, July 13, 2023
Michael Warren

India has slowed its deeply discounted imports of Russian crude since the rebellion.

Brent crude oil prices have recovered to above $80 from below $72 when we called the bottom in mid-June (see [“Russia’s Oil Miracle”] June 12, 2023), now more than half way to our lowered price target at $85. Some important dynamics have emerged at the margin of the supply-side, with Russia’s seaborne exports of deeply discounted crude falling back to December 2022 levels (please see the chart below). That was when the European Union first initiated its import ban and the G7 set its export price cap (see [“Europe: Winter of Energy Discontent”] December 5, 2022).

Russian seaborne crude exports (millions barrels/day)



Source: Bloomberg, TrendMacro calculations

- Sanctions take a while to become effective because sanctioned countries find extralegal wrinkles to evade them, and the countries trying to enforce them need to counteract these wrinkles to ensure that existing sanctions bite (or develop new ones that do). The passage of the [11th round of EU sanctions] in late June had eliminated some of the crude transport options recently orchestrated by Russia’s “shadow fleet” of tankers that had allowed the Kremlin to keep crude oil production and exports elevated.
- For example, the new transport measures specifically prohibit vessels access to EU ports that engaged in ship-to-ship transfers

Update to strategic view

OIL: Above $80, Brent crude is more than half-way to our $85 price target from when we called the bottom in mid-June. Russian seaborne exports have fallen back to their level before the invasion of Ukraine, as both China and India pull back imports, and reengineered sanctions start to bite on Russia’s “shadow fleet” of tankers. China has imposed more stringent regulations on smaller tankers in its ports. And India’s imports have fallen sharply since the Prigozhin rebellion in June, suggesting that the geopolitical risk of dealing with Russian trade has gone up. At the same time, modest US purchases to replenish the depleted Strategic Petroleum Reserve have belatedly been announced by the Biden administration. We reiterate our price target of $85, with discounted Russian exports the swing factor.

[Strategy dashboard]

merely *suspected* to be in breach of the Russian oil import ban, or if its cargo is priced over the G7 cap. And if a vessel completes a ship-to-ship transfer within 48 hours prior to entering within 12 nautical miles of "the zone" or manipulates its tracking beacon to avoid detection it could be *suspected* of breaching sanctions and/or the price cap. These *suspected* vessels could end up on the US Office of Foreign Assets Control list along with their owners and insurance providers. The short-term result of the EU sanctions adjustment has been a reduction in the number of vessels in the shadow fleet by [hundreds](#) and long-haul Russian crude oil cargo rates are [42% higher since mid-March and early-April](#) – equal to an additional $3.43 per barrel in transport costs.

While Russia could eventually find a way around the new round of EU sanctions and rebuild the number of vessels in its shadow fleet, other developments suggest that lower levels of crude oil exports might be here for a while.

- Russian Deputy Prime Minister Alexander Novak changed the metrics for long-standing threats of cuts from *production* levels to *export* levels on July 3. With this, he also recommitted to the threatened 500,000 barrels per day reduction in exports (instead of production) for the rest of the year. The distinction allows the Saudis to utilize so called "secondary sources" to effectively and accountably measure Russia's compliance.
- This was applauded by Saudi Energy Minister Prince Abdulaziz bin Salman. Russian production above its OPEC+ quota was a main reason why crude oil prices have been under pressure all year, resulting in Saudi's decision to make and then extend a million barrel per day unilateral production cut (again, see "Russia's Oil Miracle").
- The Russian government is also proposing a reduction in the subsidy to process crude oil into refined products by the end of this month. The older, less complex refineries in Russia should reduce crude runs in the third quarter. Coupled with lower exports, the reduction in refinery runs lowers overall crude oil production.

While there have been policies passed and sanctions tweaked to limit Russian supply of crude oil to global markets, there could be demand issues that impact Russian crude oil exports as well.

- The rebellion in Russia might have weakened Putin internationally, and shaken confidence in Russia as a trade partner. That may explain why some nations have decreased imports from Russia dramatically. Since the Yevgeny Prigozhin-led Wagner Group march on Moscow, key importers of Russian crude have cooled their purchases. Indian crude oil imports from Russia are down by 610,000 barrels per day from the week of June 18 and China is down by 280,000 (again, please see the chart on the previous page).
- We don't think that the Chinese import decline of Russian crude oil has much to do with the rebellion against Putin. It probably has

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more to do with new shipping standards enacted in May to "scrutinize" ships older than 15 years entering their ports. Nevertheless, it has contributed to a decline in Russian crude oil exports.

Finally, we note with more frustration than satisfaction that the Biden administration is finally buying crude oil to replenish the Strategic Petroleum Reserve. The current plan, among a galaxy of seemingly ever-changing plans, is to buy a mere 12 million barrels this year (after selling 221 million barrels last year).

We continue to think there's no downside for crude from the early summer's lows. As to the upside, we're going to stick with out $85 target for now, carefully watching the all-important marginal factor of discounted Russian exports.

Bottom line

Above $80, Brent crude is more than half-way to our $85 price target from when we called the bottom in mid-June. Russian seaborne exports have fallen back to their level before the invasion of Ukraine, as both China and India pull back imports, and reengineered sanctions start to bite on Russia's "shadow fleet" of tankers. China has imposed more stringent regulations on smaller tankers in its ports. And India's imports have fallen sharply since the Prigozhin rebellion in June, suggesting that the geopolitical risk of dealing with Russian trade has gone up. At the same time, modest US purchases to replenish the depleted Strategic Petroleum Reserve have belatedly been announced by the Biden administration. We reiterate our price target of $85, with discounted Russian exports the swing factor.