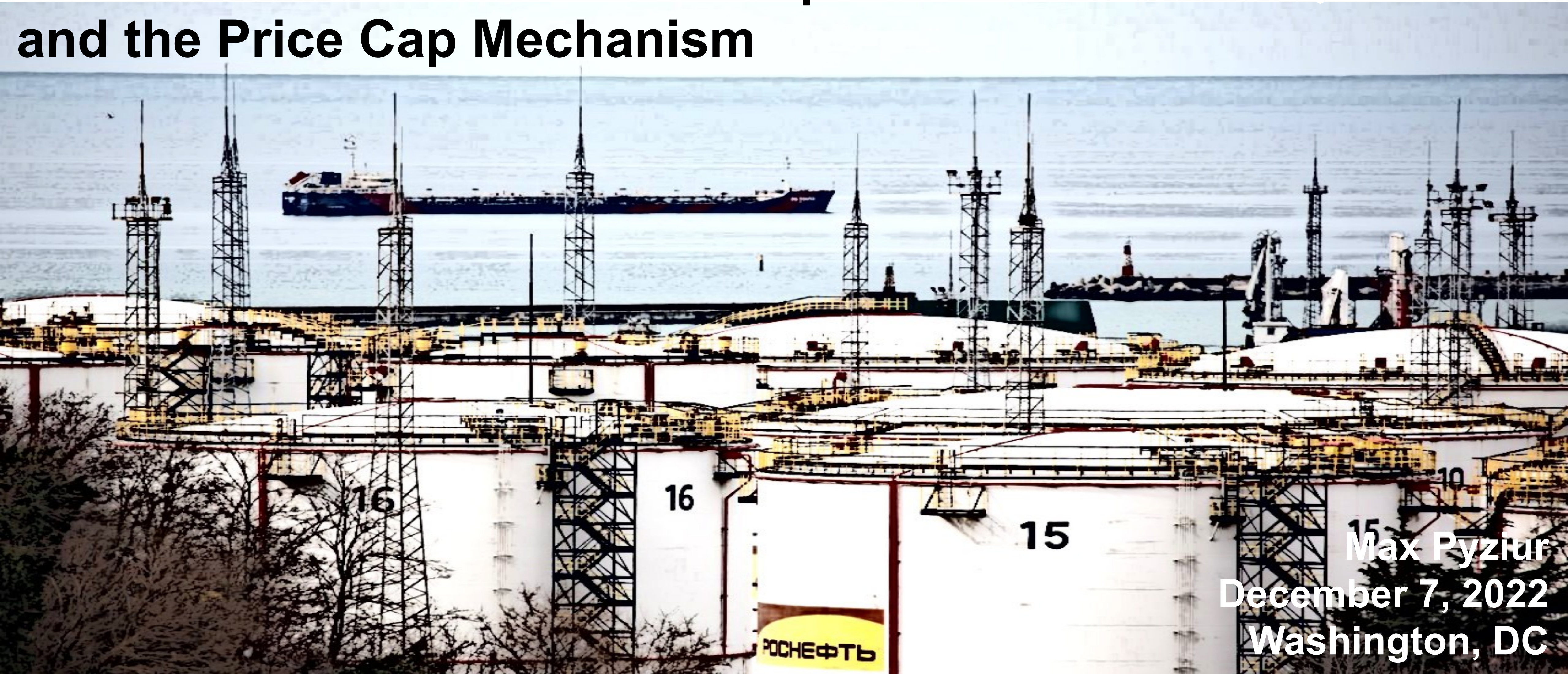
Chart of the Week #2022-46

Russian Seaborne Crude Oil Exports and the Price Cap Mechanism



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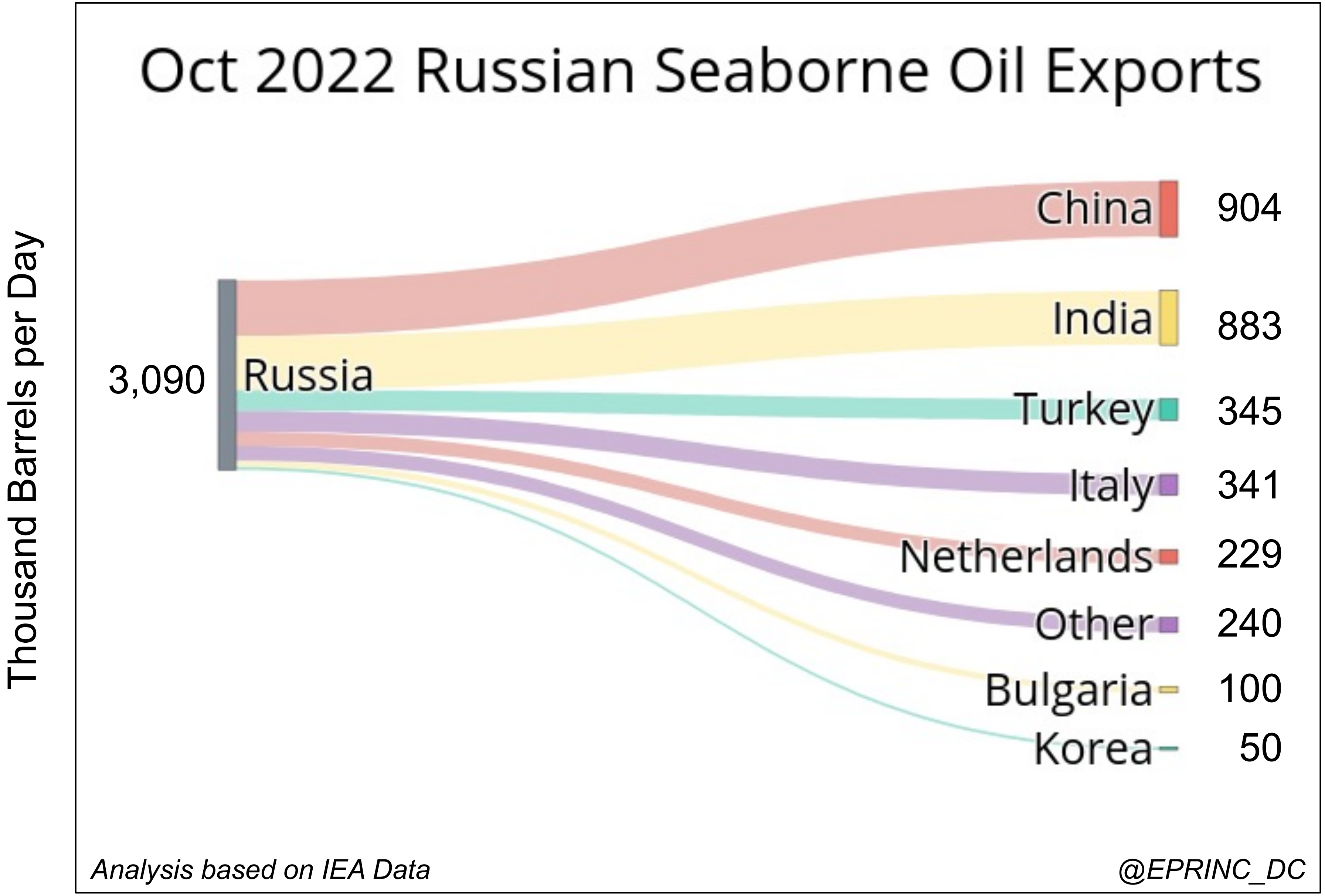
Oct 2022 Russian Seaborne Oil Exports
Thousand Barrels per Day
3,090
Russia
China
904
India
883
Turkey
345
Italy
341
Netherlands
229
Other
240
Bulgaria
100
Korea
50
Analysis based on IEA Data
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- **"Energy revenues are the key to all of Russia's political system." - eminent energy economist Thane Gustafson in a September 2022 Bloomberg interview.**
- **Russia has been subject to various coercive economic measures ("sanctions") since it illegally annexed Ukraine's Crimean Peninsula and occupied the DonBas region in 2014.**
- **Since Russia's aggression against Ukraine escalated considerably in February 2022, more sanctions have been enacted against various Russian economic sectors including trade in its natural gas, agriculture, and metals, in an attempt to limit, if not stop, Russia's war.**
- **With Russia's aggression persisting, and its current account surplus growing from its continued large crude oil exports, expected to reach $265 billion in 2022 and second only to China's, members of the G7, EU, and Australia, have debated devising appropriate and effective constraints on Russia's petroleum trade.**
- ***Continuing …***

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- **Of the estimated 10.8 million barrels per day (MB/d) of crude oil that Russia produces, 3.5 MB/d is moved by ocean-going vessels primarily to Asia and European Mediterranean countries, with a small remaining balance to the Americas. Market consultancies estimate that Russia's seaborne crude exports require about 240 vessels of varying capacities (mostly Aframaxes and Suezmaxes carry between 650 to 900 thousand barrels with some VLCCs - very large crude containers - capable of moving about 2 million barrels). Of the 240, Russia controls about 60, or 25%, of the vessels (but only 21% of total capacity).**
- **With the background of global inflation, especially from high energy prices, and potential recession, the key question to the sanctioning mechanisms has been how best to affect Russia's Treasury revenues with minimum disruption to its oil trade.**
- **Key types of coercive economic measures include embargos, import tariffs, and transfer caps. However, embargos and import tariffs have been generally eschewed because of possible supply shocks and inflationary price impacts.**
- ***Continuing …***

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- **In September 2022, the EU's Trade, Technology, and Energy Council formalized proposals for a price cap to be enforced on all Russian seaborne petroleum trade. The U.S. Department of Treasury Office of Foreign Assets Control concurrently announced similar measures.**
- **Key price cap components:**
  - **Dates: the price cap on Russian seaborne crude oil exports would go into effect on December 5, 2022; the cap on petroleum product exports would go into effect on February 5, 2023.**
  - **Mechanisms: a price cap that would be less than prevailing global benchmarks but above production costs. The final determination stipulated keeping the price cap at a minimum of 5% below market rates to be reviewed and adjusted every two months as necessary. Any vessel loaded with Russian crude prior to the price cap of December 5, 2022 needs to be unloaded by January 19th, 2023, an effective 45-day transition period. The IEA (International Energy Agency) will officially advise on appropriate price caps.**
- ***Continuing …***

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- **Key price cap components (continued):**
  - **Enforcement authorities: maritime insurers. G7 countries control between 90-95% of the market for global shipping insurance. With Russia controlling only a small number of the large number of vessels that it requires to ship its crude, the Russian oil trade would be within the jurisdiction of G7 entities.**
  - **Penalties: any vessel deemed out of compliance will be prohibited for a period of 90 days from any sort of maritime insurance, financing, and servicing. Stricter penalties will be levied against EU vessels subject to EU legislation.**

- **On December 2, 2022, the price cap was announced at $60/bbl. On that date, Russian Urals crude was trading at $48/bbl at St. Petersburg, well below the price cap.**
- ***Continuing …***

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- **Reactions – from Russia:**
  - **The Kremlin has announced the drafting of a presidential decree that will ban Russian companies and any traders buying the nation's crude from selling it to anyone that participates in the mechanism.**
  - **The attempt to expand Russia's tanker fleet to evade the price cap mechanism. Since February 2022, there have been transactions involving 66 vessels of 15 year-old or older vintages transferring control to entities assumed to be Russian. Despite the increase, this is still short by almost 50% of the capacity required to transport all of Russia's crude oil exports. Furthermore, many of these vessels are from a limited pool that already are used to transport sanctioned oil from Iran and Venezuela.**
- ***Continuing …***

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- **Reactions – the Baltic States and Ukraine:**
  - **Ukraine's President Zelensky objected to the leniency of the price cap, commending EU members Poland and the Baltic states for calling for more aggressive action.**
- **Reactions – OPEC:**
  - **OPEC held its 34th Ministerial meeting on December 4, 2022 a day ahead of the price cap level enactment. Without citing the price cap in its press release, the cartel resolved to adhere to the existing quotas. The next scheduled meeting of OPEC's monitoring group is February 1, 2023, and the next full Ministerial meeting is scheduled for June 4, 2023.**
- ***Continuing …***

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- **Expected consequences:**
    - **The realignment of flows and lengthening of voyages: already since February 2022 there has been the rerouting of seaborne Russian crude oil exports from European destinations to China, India, Turkey, and Southeast Asia. The price cap mechanism aspires to strengthen that trend.**
    - **The degradation of Russia's crude oil seaborne exports by 1.5 MB/d by the end of the first quarter of 2023. Even with Russia's expansion of the tankers it controls and the attempt to use its own insurers, other sanctions could complicate payment processes further impairing trade.**
- ***Continuing …***

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- **Potential unintended consequences:**
  - **Over-compliance; given the extensive amount of documentation that is required by G7 and EU regulators, some shipping companies' legal counsel could decide that the risks are too great to deal with Russian oil and will not forego moving cargos.**
- **This slide deck is available on the EPRINC Website. For more information on this chart, please contact Max Pyziur (maxp@eprinc.org).**