Russian Roulette with Every Chamber Loaded with Live Ammunition (11/17/22)

Once again, the Administration wants to test faith, not knowing how their actions will turn out. They are making risky proposals at a particularly vulnerable time. December 5th is right around the corner, and the E.U and U.S. want to implement the price cap on Russian oil without knowing how the Russians will react. Russia has threatened to cut off supplies to any country that complies. The fact that the Indians appear to have rejected Secretary Yellen's appeal to come on board strengthens Russia's hand and could lead to a spike in crude oil prices.

However, this is only part of the story. The Russians provide maybe as much as 35-40 % of Europe's diesel requirements: 500-550,000 B/D. Given the fact that diesel is in short supply, Europe can't afford to lose that supply this winter. The December 5th deadline should at least be moved to April1. This would give the market time to adjust to the implications of a price cap. It would give the U.S time to convince the Chinese and Indians to come on board and allow Europe to temporarily keep access to Russian diesel and get through the winter.

If Russia stops selling diesel to Europe, Europe will have to turn to Asia and the Middle East. At a minimum this would greatly increase shipping costs. It would not be unreasonable to assume some cut in Russian refinery runs. This would result in some loss of diesel output as well as other petroleum products putting further upward pressure on prices.

As risky as the price cap is, there are two other options the Administration is still toying with. They are still considering having oil companies hold minimum levels of inventory. In the current environment, this would materially raise the cost to end users. When the demand for a commodity is strong and supply is tight, you have what is referred to as a backwardated market. That is **prompt prices for physical supply**. Today sells at a premium to the front month futures price.

This would result in higher prices since companies couldn't hedge without locking in a loss. The companies would pass on the high prompt price. This month, the prompt premium got over $1/BBl. **A far better option would be to ask Congress to increase the heating oil reserve to 7-10 million barrels**.

If you say you are not satisfied and want more options from the Administration that would poison the well, look no further than an option that has been on the table for many months and won't die. That option is a ban on product imports. We have written extensively on this. The global markets are short products, primarily diesel. Refining capacity is stressed. A ban on exports would immediately create a bidding war among our allies. This would result in an excessive run up in prices, sending the world into a deep recession.

Yes, supply at the U.S. Gulf Coast would build ,forcing prices down. This would eventually result in lower refinery runs as margins collapse…**no one wins.**