Ahmed Mehdi

Research Associate
Oxford Institute for Energy Studies

Will an EU oil embargo on Russian oil consolidate into policy anytime soon?

There's growing political momentum for sanctions but it will be easier for these to take root on crude than on products and that's being reflected in the policy framework that they're putting forward with regards to timelines. But regardless of how EU sanctions talks go this week, we already have the financial sanctions from mid-May and we have to be cognizant of what the Russian marketing has looked like in April. We saw a lot of re-direction of flows, we saw Rosneft come out with more direct tenders, and that's really signaling the buildup of pressure because there was a little bit of a wind down from trading houses taking part in marketing term barrels. That withdrawal of the trading houses will have a big impact. The other issue is related to the insurance complicating the Russian supply chain and increasing costs. Average ton mile demand will go up and a lot of that will be either reflected in even higher differentials discounts or a rethink of how the marketing of those barrels will take place. So, pressure will certainly build up in May.

Outlook for further fuel oil and diesel tightness?

The European refining system is really stretched, and operational costs have gone up significantly since the beginning of the year. We have high gas prices, high hydrogen prices, high electricity prices and if you're going to get alternative grades for example, you may even get higher desulfurization costs. All refiners globally are in a different position today than they were a year or two ago where they had more flexibility to adjust. In this tight environment, any shift of yields becomes the rebalancing tool, and shifts the burden elsewhere, either onto the gasoline side or the jet side as travel and the driving season come back. There's no spare capacity in the refining sector except in China and the Middle East. As for the situation in fuel oil, that's a perfect storm. Ever since the US embargo on Russian fossil fuels, Russian refineries have had to cut their runs because the US market, which has the large coking capacity to take in that product, has closed. That effectively has meant that the US is now competing with Asia for those Middle East fuel oil cargoes. All in all, the situation across products is making supply chains very inefficient and so all costs are going up.

What redirection could we see of Middle East product?

We're seeing Saudi sending more diesel to Europe, particularly Poland. We're seeing players like Total which have equity cargoes in the UAE, redirecting some of those flows to Europe to their refineries. Iraq is looking at sending more Basra Medium, which is a good substitute for Urals, to Europe. If EU sanctions on Russian oil do go ahead, whether Middle East producers think of signing up more term contracts with Europe at the expense of Asia later this year is a genuine question within some of the NOCs. For years, they were just looking at the east of Suez market - now they may consider others. ■

**Paraphrased Comments*