PORTLAND MARKET REPORT

JUNE IN VIEW

THERE'S MORE THAN ONE WAY TO UNDERMINE THE RUSSIAN WAR MACHINE

We've hit the half-way point in the year, so a good time to review what has happened in the oil markets in the first half of 2023. In comparison to the extreme market disruption witnessed in the same period of 2022, this year has been refreshingly dull. This is despite the broadly agreed sentiment back in January, that 2023 demand would hit a historic high as the full extent of the post lock-down 'bounce back' was felt. At the same time, faltering global supply alongside western sanctions on Russian oil, would ensure that the chaotic market conditions of 2022 would surely continue?

Not so! The first 6 months of 2023 turned out quite differently, with demand sluggish and prices coming down. Crude has fallen from \$84 per barrel in January to \$74 per barrel at the time of writing this report (June), whilst diesel has fallen by around 15 pence per litre in the same period. The drop in the diesel price particularly took markets by surprise, where predictions of Q1 price carnage had reigned as a result of the complete European ban on Russian refined products from February 1st. The impact of the latest round of sanctions was, in fact, muted to say the least and Russian oil exports now actually surpass levels last seen before the invasion of Ukraine. China and India continue to underpin demand for almost all of Russia's crude, whilst Russian diesel has found new homes outside of Europe – predominantly in Africa and Latin America.

> "COULD THE GLOBAL MARKET SUCCEED, WHERE WESTERN SANCTIONS HAVE FAILED?"

On the surface this would seem a tremendous victory for President Putin, although there may be a perverse twist to this triumph that could still undermine the Russian economy. Product has indeed continued to flow, but by doing so, global markets have ended up being over-supplied and this has sent prices down. Arguably, a significant drop in the oil price has more potential to damage the Russian economy than the country selling less oil (through sanctions) at a higher price. We will call this the Russian conundrum, whereby the oil must absolutely keep flowing, but by doing so, the risk of trashing total oil revenues becomes greater. Could the global market succeed, where western sanctions have failed?

Over-supply issues in the first half of the year were so clear and obvious that OPEC announced two consecutive rounds of production cuts. President Biden immediately called these actions irresponsible, fearing that they would lead to an immediate hike in prices. But such is the current flaky nature of global oil demand that prices continued to fall. Soaring inflation and rising interest rates have created a 'double whammy' effect whereby disposable income and consumer spending continue to be choked. Industrial output is down and jitters around the banking network (again…yawn!) have tightened credit lines, which is another significant contributor to stifled growth. Fundamentally, it is still not clear whether Europe and the US will avoid recession and the result is a bearish market and falling oil prices.

How long will this situation continue and what happens if the West avoids a full-blown recession? The International Energy Agency (IEA) is sticking to its original prediction that overall oil demand in 2023 will still be up versus 2022. Asian volumes, in particular, are expected to grow in the second half of the year, with Chinese consumption increasing by more than 1m barrels per day. Some of this growth can be absorbed by high global stock levels, which have been deliberately built up by stock agencies (e.g., US Strategic Reserve) as a resilience play in the face of the ongoing Ukrainian conflict. But an increase in demand of between 1-2m barrels per day by the end of the year would soon eat up those stockpiles and could easily send prices northbound once again. Once again, it would seem that the market is on a knife-edge…

> "THE MARKET IS ON A KNIFE-EDGE"

The expectation that sanctions would keep Russian oil 'off the table' and thus push prices upwards in 2023 has simply not materialised in the first half of this year. Ditto the predicted diesel price spike that would follow the strictest ever EU embargoes on refined products. Instead, Russia has continued to lubricate the Indian and Chinese refining industries with copious amounts of crude whilst, at the same time, successfully finding new diesel export destinations. Nonetheless, with global prices currently falling back and, just as importantly, Russian products still being sold at heavy discounts to global benchmark prices (around \$10 to \$15 below Brent), the failure of sanctions does not necessarily mean success for Russia's war machine. The world economy could do without a renewed increase in energy prices, but Russia increasingly needs one…

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