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EU Announced Russian Oil Embargo Leading Brent to Top $120/bbl

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On May 30, the European Union announced that EU leaders at their extraordinary meeting agreed on additional Russia sanctions including an oil embargo. The embargo will ban all Russian oil imports other than those via pipelines, accounting for about two-thirds of Russian oil imports into the EU. Of the remaining one-third, imports into Germany and Poland will stop within 2022. As a result, the embargo will cover about 90% of Russian oil imports into the EU.

The EU proposed to phase out Russian oil imports within this year on May 4 and coordinated details of the phaseout. Amid the growing recognition that tougher economic sanctions should be imposed on Russia that is continuing its military aggression into Ukraine, EU countries thought that their continued oil imports from Russia would amount to the provision of funds for the aggression and that they had no choice but to embark on a Russian oil embargo even if it meant suffering a backlash.

Nevertheless, the latest EU agreement excluded pipeline oil imports from the Russian oil embargo for the immediate future, indicating a compromise to respond to Hungary's opposition to the proposed embargo. Hungary that depends heavily on pipeline oil imports from Russia opposed the proposed embargo for the reason that the embargo would threaten its energy security, holding the key to the latest EU agreement. The EU has given priority to reaching agreement by admitting the special measure for Hungary. Reportedly, another measure has been prepared to allow Hungary to keep its oil supply unaffected even in the event of disruptions to pipeline oil imports from Russia.

The EU's latest additional sanctions also include the removal of Sberbank, Russia's largest bank, from the Society for Worldwide Interbank Financial Telecommunications, an international payment system known as SWIFT. The EU had excluded Sberbank from the SWIFT sanction just after Russia's invasion into Ukraine in consideration of its energy security, attracting global attention. By rescinding the exclusion, the EU clarified its stance of enhancing sanctions on Russia further.

The Russian oil embargo by the EU as Russia's largest export destination has a great impact, even though with the exception. In the future, Russia will explore alternative export destinations for oil subjected to the EU embargo. The alternative destinations are major oil-consuming countries that have not joined the Russian oil embargo. Of them, China and India may attract attention. Amid market participants' concerns about the Russian oil embargo, Russia as a weak oil seller has been forced to discount oil prices. The latest EU embargo may require Russia to further discount oil prices to secure sales channels. For China and India as oil buyers, there are opportunities to get big oil price discounts at a time when international oil prices are high. For these great oil-consuming countries, oil procurement at deep discounts is an attractive option. For China, Russia is a key strategic partner at a time when China's confrontation with the United States is escalating. In this sense, China may be induced to expand oil imports from Russia.

However, there are two points to note regarding China's oil imports from Russia. First, the

Chinese economy might have greatly decelerated under the grave impact of the COVID-19 disaster. While China's economic reopening has started on the end of the prolonged Shanghai lockdown, its energy demand might have slowed down due to COVID-19 lockdowns. How the Chinese economy would recover must be watched closely. Second, China may exercise a sense of balance, becoming reluctant to provoke Western countries by providing Russia with too much support. Anyway, we must closely watch how much Russian oil China would purchase.

India's future moves attract attention regarding similar points. India is now in an extremely advantageous position, being asked by Russia, Western countries and China to cooperate with them. India will consider how much oil it should import from Russia with which it has maintained close political, military and economic relations. It may develop a strategy to maximize its national interests, while paying attentions to Western countries' eyes on India.

China and India may thus increase oil imports from Russia but fall short of covering a substantial decline in the EU's Russian oil imports. The shortfall is expected to lead Russian oil supply to decrease. If additional Chinese and Indian oil imports from Russia are less than the decline in the EU's Russian oil imports, the EU may fail to offset the decline in its Russian oil imports with Middle Eastern and other non-Russian oil imports to be made available thanks to the expansion in Chinese and Indian imports from Russia, leading the overall oil supply-demand balance to tighten. This is the reason crude oil prices are rising in the international market.

On May 30, the front-month futures contract on the benchmark Brent oil closed above $120 per barrel for the first time in about three months since March 25. It finished at $121.67/bbl on May 30 and at $122.84/bbl on May 31. On March 7, the key Brent futures price shot up beyond $139/bbl on the United States' announcement of a Russian energy embargo (followed by similar actions by Canada and the United Kingdom), reaching the highest level after the global financial crisis. As market participants later understood that the United States, Canada and the United Kingdom were not major energy importers from Russia, the Brent price fell back to a $100-110/bbl range. However, the EU's Russian oil embargo is exerting upward pressure on crude oil prices.

As a matter of course, however, it is difficult to forecast any future crude oil price trend. A key point is how Chinese oil demand would change. As analysts are growing pessimistic about the future Chinese economy, the direct impact of the COVID-19 disaster and lockdowns is likely to exert downward pressure on oil prices. Attention must be paid to the potential deceleration of the global economy as well. We would also have to pay attention to what action the Organization of the Petroleum Exporting Countries would take in response to the Brent price's surge above $120/bbl and the Russian oil supply fall. The OPEC-plus group has so far refrained from meeting oil-consuming countries' request for a greater production increase. Another key point is Russia's response to oil-consuming countries' enhancement of Russian energy embargoes. Depending on what Russia would do after its initiative to cut gas supply since late April, international energy markets could destabilize greatly. In the presence of various possibilities, international energy markets will remain unstable and strained.

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