Rodney's Take

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The Oil Pain

Vladimir Putin might not be laughing as he watches a much smaller army spoil his war plans, but he's probably at least smirking as he watches his current account balance balloon. The price of oil remains above $100 per barrel, even though there's enough supply to meet current demand. In response to limited sanctions and some private companies turning away business, Russian oil production has fallen by a mere 10%, which leaves the Kremlin earning lots of cash to finance its war effort. But the European Union is making plans to turn the screws, and at the same time, the Chinese government is lifting COVID restrictions and Americans are hitting the road for summer travel. The added demand in the face of potentially falling supply could send prices much higher this summer. Consumers will pay for the sanctions on Russia even if Putin doesn't feel them, at least in the short run.

An estimated 35 million Americans hit the road over Memorial Day weekend, even as the average price of gas reached $4.62 per gallon. Nowhere in the nation has posted prices below $4.00, and one location in California now charges $8.00. In Washington state, the 76 brand of gas stations updated their pumps to accommodate prices above $9.99 per gallon.

On the other side of the planet, after several days with no COVID-19 related deaths, Shanghai officials lifted the health restrictions that had kept the community of 25 million people out of stores and restaurants. As officials reduce and eliminate restrictions on travel and outdoor movement, Chinese demand for oil and gas should quickly increase.

While Americans and the Chinese are bracing for higher energy consumption, the Europeans are trying to figure out how to use less. The members of the economic bloc agreed to end seaborne oil and refined product imports from Russia by the end of the year and to reduce pipeline-based imports, although no one gave a clear answer as to how the countries either would source the oil elsewhere or would reduce consumption so drastically. The reductions are to be phased in between now and year-end. If the heads of state across Europe can make this happen, it will cut Russian oil and refined product exports by an estimated 2.5 million to 3 million barrels per day.

It would be very difficult for China, India, and other buyers who have no qualms about purchasing Russian oil to buy all of the oil and other products dropped by the EU. That could happen only if some countries drastically reduced how much energy they buy from countries like Saudi Arabia and the U.A.E. and instead bought from Russia. Even if countries wanted to import more seaborne oil from Russia, the new sanctions from the EU include forbidding financial firms from insuring seaborne oil exports. Not many people are willing to ship $200 million worth of cargo without insurance.

The combination of rising energy demand in the U.S. and China and possibly less supply from Russia could push oil prices back near or even above $150 per barrel this summer. Whether this causes immediate pain for Putin and the Kremlin depends on how much oil the Russians can sell and at what price. But we know one thing for sure. As oil prices march higher, gas prices also will climb and consumers will bear the cost at the pump. We'll pay more to fill up our tanks and pay more for every item that must be delivered, from electronics via Amazon to food at the grocery store.

Let's hope that the Europeans come up with a way to cut Russian energy imports and that eventually Russian energy sales fall dramatically and rob the Kremlin of cash. Let's hope that gas prices don't shoot higher for three to six months and then Russia agrees to a ceasefire in exchange for lifting sanctions. Such a scenario wouldn't punish Russia at all. Instead, it would keep the current trend going, wherein global consumers pay the price for Russia's invasion and the Kremlin comes out of this with a full bank account.

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