

Oil Market Report: June 2022

We've hit the half-way point of the year and what a 6 months it's been. Memorable...but for all the wrong reasons. Oil and Energy markets at the beginning of the year were already high, getting higher and in fact, were already showing the early signs of overheating. And that was before the Russian invasion of Ukraine. Since that event, pretty well every commodity market has experienced spectacular price rises and unprecedented volatility. Wholesale gas prices went up to the equivalent of \$500 per barrel (\$30 per MMBtu = Metric Million British Thermal Unit) in March, whilst crude oil prices struck \$140 per barrel in one morning, before falling back to \$115 by the afternoon of the same day! On top of this, non-energy commodity commodities such as finished metals (up 20%), wheat (40%) and fertilisers (over 75%) have also experienced economy-shifting price movements since 1st March.

We've covered these headlines already this year, so it might be more interesting to look at the less-understood market drivers that are having an impact on the price of fuel. The first factor is the complete (and again unprecedented) dislocation of refined petroleum prices from the crude oil price. Traditionally there is of course a correlation between (say) petrol prices and crude, but they are still individual markets, each with their own separate supply and demand dynamics. The "crude market" is made up of oil producers (the suppliers) selling their product to refiners (the demand). This is a very different set-up to the "products market", which sees refineries making usable products (petrol, diesel) which are then supplied to the end-user (consumer demand).

As Middle-Eastern and US producers increase their oil production to fill the gap left by Russian sanctioned oil, the pressure is beginning to come off the crude market. This is why Brent seems to have topped out at the \$115-\$120 per barrel mark. At the same time, the story couldn't be more different on the product side of the equation. Here, there are huge gaps in production capacity because so much refined product was coming from Russia pre-invasion. For example, around 40% of European diesel in 2021 was of Russian origin and that product-flow has now either ceased or has significantly slowed. Simply increasing European refining capacity to produce more diesel (using manufacturing kit that is typically over 50 years old) is no easy task and as a result, an entirely predictable chasm between supply and demand has opened up. For the moment, Europe is massively reliant on diesel from the likes of India, whose refineries are making both a fortune and a mockery of the western sanctions regime. This is because they are buying heavily discounted crude from Russia and then selling it at record refined prices to the European countries, that are sanctioning the very same product from Russia...

In the UK, we also have the problem of the exchange rate, which is another little understood issue driving the fuel price in the wrong direction. In January, the £ was worth 1.37 US dollars and diesel at the time was trading at circa \$750 per tonne. Divide \$750 by 1.37 and you have January's £ GBP price for diesel (£547 per tonne). Diesel is now trading at around double January's price (\$1,450), but the exchange rate in the same period has plummeted to \$1.21 to the Pound. Do the same maths ($1,450 / 1.21$) and you now get a £ GBP price for diesel of £1,198, which is significantly above the doubling of price seen in the actual value of diesel itself. If you prefer your numbers in pence per litre (ppl), the decrease in value of the £ from \$1.37 to \$1.21, has added 11 ppl to the price of UK fuel.

Such is the pressure that consumers are now under with regard inflation, it is no wonder that the UK Government is looking for scapegoats and the first step has been to order the Competition & Markets Authority (CMA) to look into the actions of the petrol retailers. The specific brief is to investigate whether April's 5ppl duty rate cut has been applied, but in reality, it is as much about addressing the accusations of profiteering now commonplace in both mainstream and social media.

The definition of profiteering is "withholding product in an attempt to push prices up", so that should be relatively easy to deal with. Petrol retailers are more focussed on where their next load is coming from and besides, why would anyone withhold product when sanctions are already doing the same thing?! The duty cut is a more complicated situation. Historically, changes to the duty rate have always been applied from midnight on the day of the Chancellor's Budget announcement and that did not happen. Then again, on the day of the Budget itself, the market shot up by 4ppl and since then, prices have risen so much (see above factors) that the cut has now been totally lost in the "white noise" of the current market situation. It is understandable that a government desperately looking for ways to "take back control" might be keen on this type of market investigation, but they will soon discover the unpalatable truth that no-one (in the UK at least) is in control of this particular roller-coaster ride.