ENERGY SANCTIONS IMPACT SUMMARY – JULY 2024

Prepared by the KSE Institute Sanctions Team[1]

1. **Sanctions on Russian oil have imposed considerable costs on Russia.** These costs consist of two elements: "lost" export earnings due to a wider discount of Russian oil prices vs. global benchmarks, and the actual funds spent on the acquisition of the shadow fleet.

    a. Direct export losses: We estimate that Russia has earned a total of $78.5 bn less from oil exports than in a no-sanctions scenario (in December 2022 - June 2024, after the G7/EU embargo and price caps came into force). However, these losses have declined considerably since their peak in the immediate aftermath of the EU embargo and price cap's taking effect (see Figure 1). In January 2023, a dramatically wider discount caused Russia to lose $8.6 bn in oil exports. Since mid-2023, this number has declined to a monthly average of $2.8 bn. Total Russian oil exports losses (from war and sanctions) are estimated at $128 bn in March 2022 - June 2024.

    b. Shadow fleet acquisition: According to estimates, Russia has spent at least $8.5 bn on the build-up of its fleet of sanctions-proof tankers since the start of the full-scale invasion. A large share of these resources was spent in Q4 2022 to Q2 2023 (see Figure 2). KSE Institute finds that the Russian shadow fleet consisted of 435 vessels as of Q1 2024 (see Figure 3).

2. **Designations of shadow fleet vessels have proven to be very effective.** Recent sanctions by the U.S. Treasury Department have targeted shadow fleet tankers and the discount on Russian oil prices has widened somewhat in response to stricter enforcement.

    a. Vessel designation campaign: Shadow tankers that were designated by the US, EU, and UK have effectively been removed from commercial service. Of the 55[2] vessels in question, only one has begun and completed a voyage after the designation,[3] 10 ships are underway and/or have voyages planned (which may not be successfully concluded and require further monitoring), 2 are currently carrying out trips that started before the designations, and 41 are idle (see Figure 4).

    b. Effect on Russian oil prices: The discount on Russia's Urals grade of crude oil rose as a result of OFAC's vessel designation campaign – from $13.7/barrel in September-October 2023 to $18.3/barrel in January 2024 (see Figure 5). This effect was more than offset subsequently by higher global oil prices and Russia was able to generate higher export earnings.

3. **The pause in the designation campaign has allowed Russia to adapt.** OFAC paused its shadow tanker designation campaign in the spring of 2024 over concerns regarding the supply of Russian oil to the global market. This has allowed Russia to adapt to the measures and the discount narrowed again.

    a. Capacity replacement: Russia has acquired additional shadow tankers over the course of the last few months. In addition, a recent analysis by KSE Institute found that Russia has options to replace sanctioned vessels and to maintain/expand its shadow fleet (see Figure 6) – although this could come at a steep price and the acquisition could face practical difficulties.

    b. Price discount narrows: The spread between Russian Urals crude and North Sea Brent has narrowed once more since January. As of June 2024, it stood at $14.9/barrel. Somewhat lower global prices helped the coalition's efforts to constrain Russian oil export earnings, however.

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[2] Analysis does not include eleven vessels sanctioned by the UK on July 18, 2024, as it is too early to assess the effects.

[3] The completed voyage was conducted by the SCF Primorye (owned and operated by South Fleet Ltd., Russia and flagged in Russia), which loaded Russian crude oil in Novorossiysk on April 24, 2024, and transferred the cargo in an STS operation off the coast of Malaysia on June 3, 2024. The oil was ultimately delivered to Chittagong, Bangladesh, on July 2, 2024.

4. **The G7 price cap regime is at risk of completely losing its leverage.** Thanks to the growing share of shipments being carried out by shadow tankers, which are not owned, managed, or insured in sanctioning jurisdictions – and, thus, do not fall under the price cap – future prospects for the cap are dim in the absence of a stepped-up shadow tanker designation campaign.

    a. Shadow fleet share: The share of Russian oil transported by sanctions-proof shadow fleet vessels has risen considerably over the course of the past two years (see Figure 7). As of June 2024, 89% of crude oil volume and 38% of oil products were being shipped by Russia's shadow fleet. The respective numbers in H1 2023 were 45% and 29% – demonstrating the concerted effort undertaken by Russia to build its ability to evade the G7 price cap regime. The lower shadow fleet share for oil products is likely a reflection of the fact that prices for many products have been significantly below their respective price caps – making this less of a priority.

    b. Price cap compliance: KSE Institute's research has shown that the share of Russian seaborne crude oil sold below the price cap threshold of $60/barrel dropped sharply in the second half of 2023 as higher global oil prices and smaller discounts on Russian oil dragged Urals crude above the cap. In Q4 2023, only 2.0% of all seaborne exports under FOB Incoterms from Baltic Sea, Black Sea, Pacific Ocean, and Arctic ports were sold below $60/barrel.

5. **As of now, Russia's macroeconomic and fiscal stability are not at risk.** At current oil prices, it is extremely unlikely that Russia is going to face meaningful macroeconomic challenges.

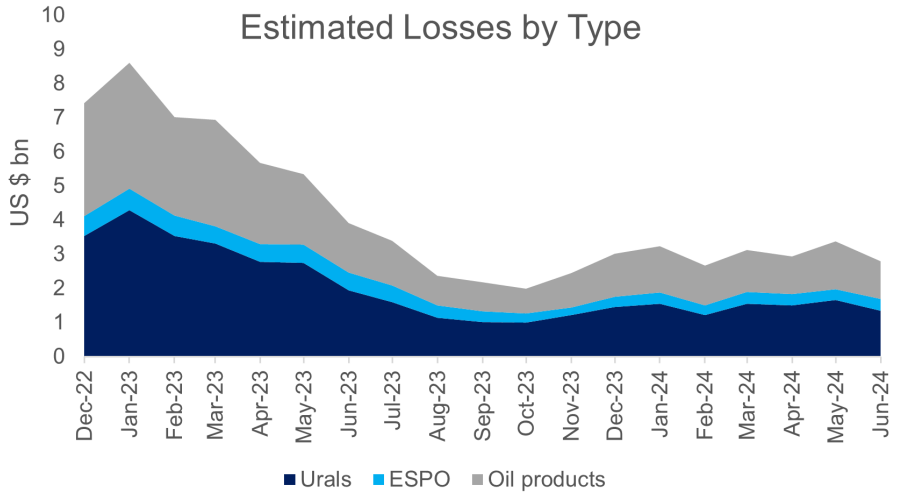
    a. External environment: According to the IEA, Russia earned an average $17.3 bn per month from oil exports in H1 2024. That's the same as in H2 2023 but 22% more than in H1 2023 (see Figure 8). Over a full year, the fact that the price cap has failed to keep the discount on Russian oil at the level reached in early 2023 means Russia earned close to $40 bn from additional exports. Along with energy export earnings, the overall current account has also improved. The surplus reached $40.6 bn in H1 2024 (vs. $26.9 bn in H2 2023 and $23.3 bn in H1 2023). If nothing changes in H2, Russia will record a surplus of above $80 bn for full-2024. This helps explain – together with CBR rate hikes – the ruble's stabilization in recent months.

    b. Budgetary situation: Along with export earnings, budget revenues from oil have also risen considerably. In H1 2024, average monthly extraction taxes and export duties reached 867 bn rubles, roughly unchanged from H2 2023 but up 77% compared to H1 2023 (see Figure 9). Together with rising non-oil and gas revenues, this has contributed to a situation where Russia has been able to remain within its budget deficit target despite a sharp increase in war spending. As of June 2024, the cumulative federal government deficit stood at 930 bn rubles – 58% of the planned full-year deficit and 60% smaller than in H1 2023 (see Figure 10).

    c. Inflationary pressures: Inflation – both headline and core – has risen in the last 1.5 years following a sharp base effect-driven decline in early 2023 (see Figure 11). At 8.6% and 8.7%, respectively, inflation indicators are significantly above the CBR's target, which has triggered a cumulative 1050 bps in key rate hikes since mid-2023 (CBR further tightened monetary policy by 200 bps in July 2024). However, the ruble's stabilization due to an improved external environment and the CBR's policy changes (see Figure 12) has reduced inflationary pressures from import prices.

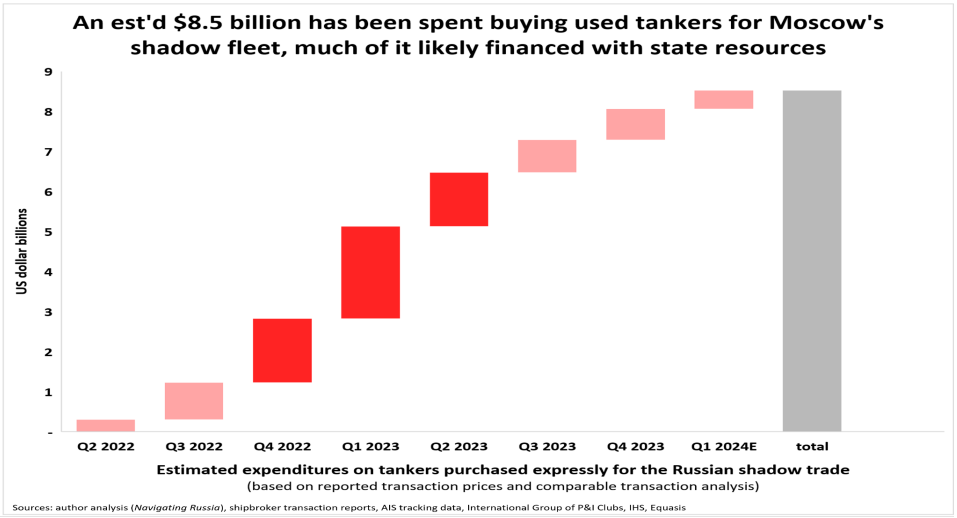
6. **Russia has lost its most important market for natural gas exports.** Russia's attempt to weaponize natural gas flows to Europe backfired. While prices rose sharply during 2022 and imposed significant costs on European consumers, the continent managed to diversify its supplies away from Russia and did not face any shortages. By 2023, European natural gas prices had largely returned to pre-full-scale invasion levels. For Russia, the implications are longer lasting, however. Russian state-owned Gazprom posted a loss for the first time since 1999 and lost sales to Europe are unlikely to be recovered for many years.

Figure 1: Estimated oil export losses, in $ billion



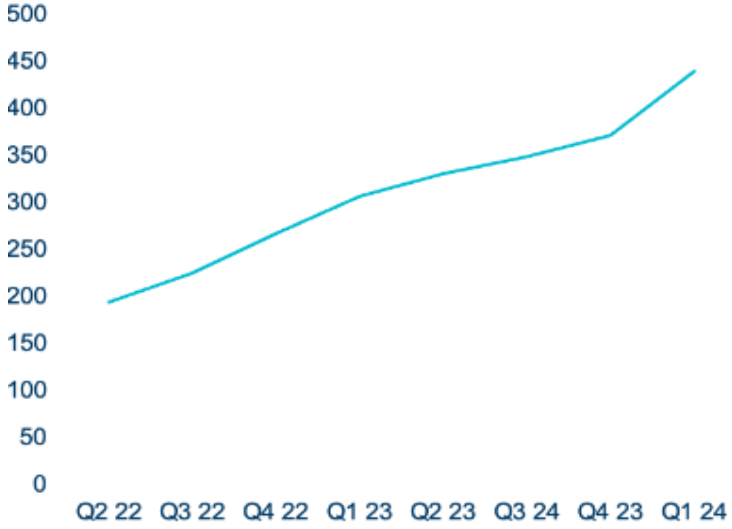
Source: KSE Institute

Figure 2: Shadow fleet acquisition costs, in $ billion



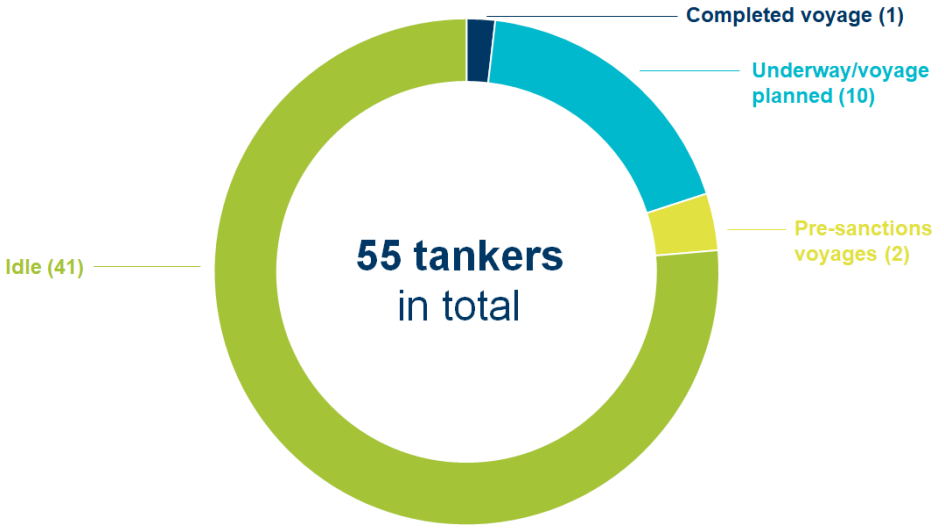
Source: Craig Kennedy

Figure 3: Number of Russian shadow fleet tankers



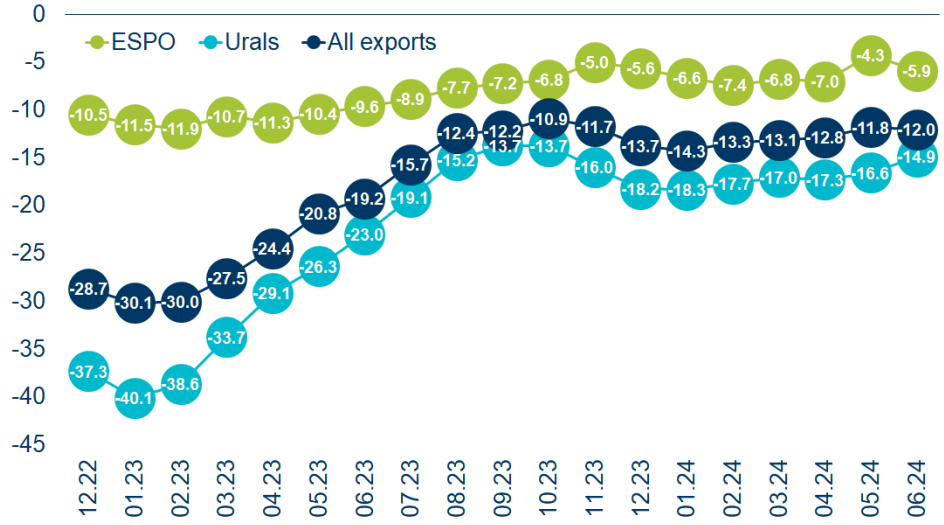
Source: KSE Institute

Figure 4: Current status of OFAC-designated vessels



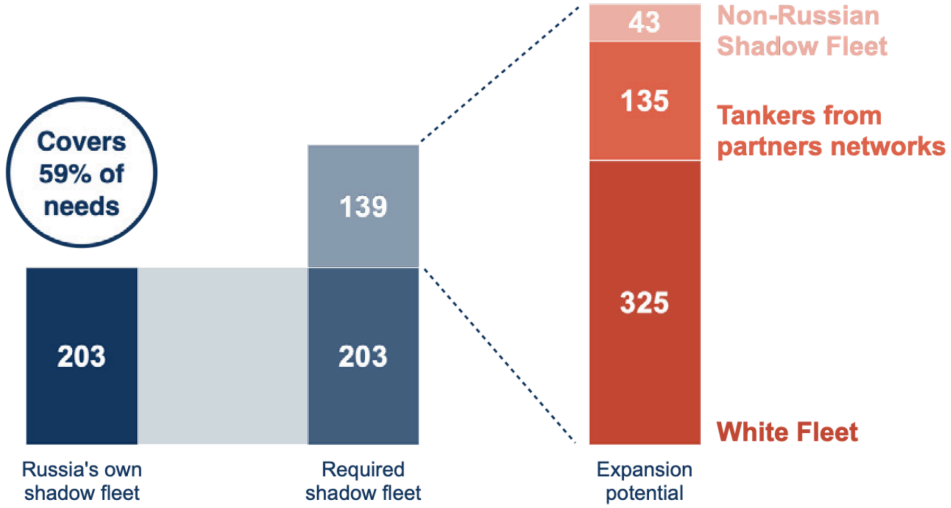
Source: KSE Institute

Figure 5: Discount on Russian oil export prices, in $/barrel



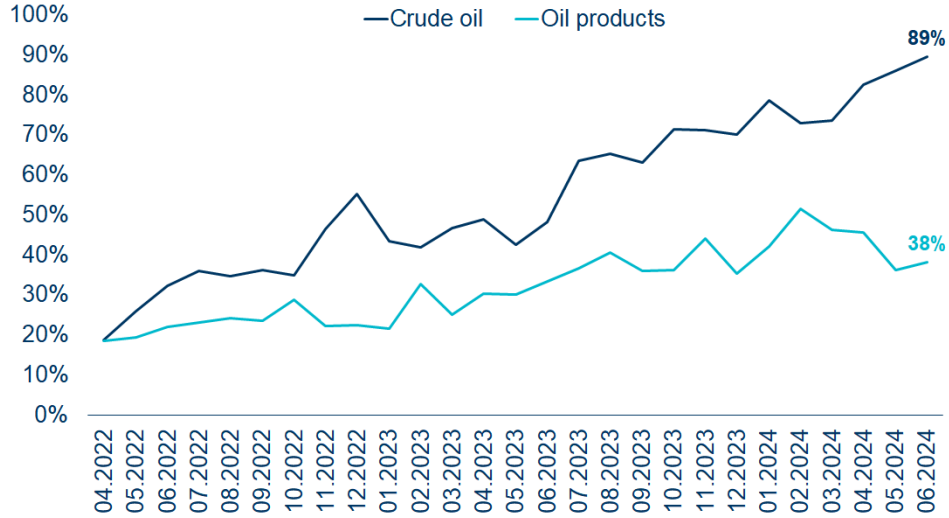
Source: International Energy Agency, KSE Institute

Figure 6: Shadow fleet expansion opportunities



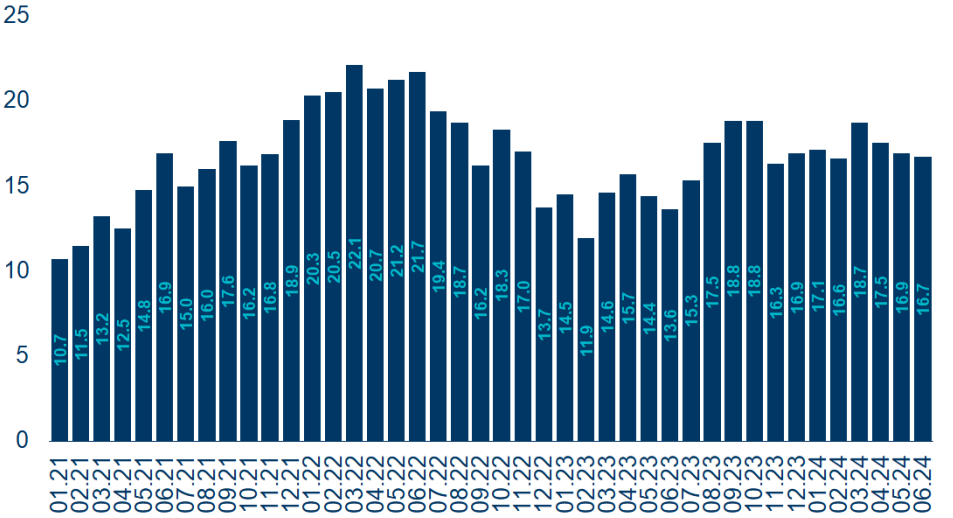
Source: KSE Institute

Figure 7: Volume share of the Russian shadow fleet, in %



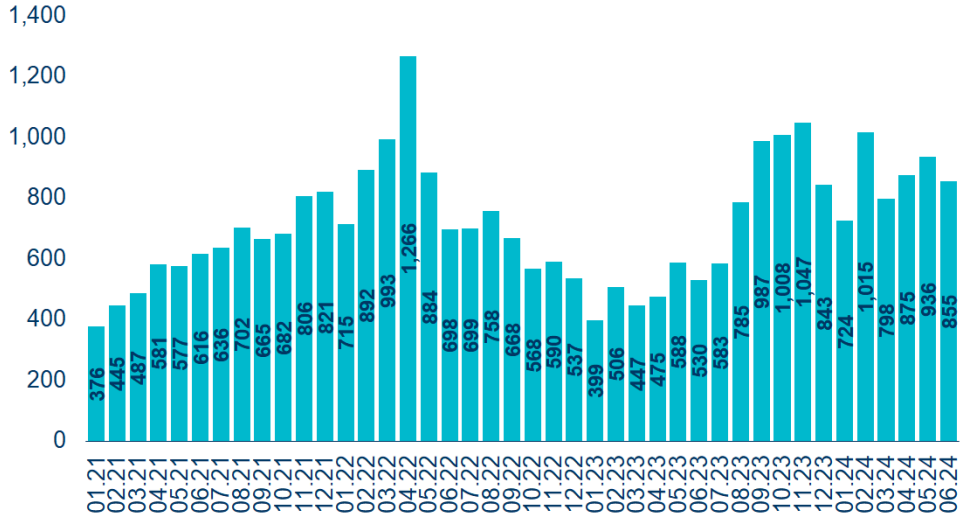
Source: KSE Institute

Figure 8: Oil export earnings, in $ billion



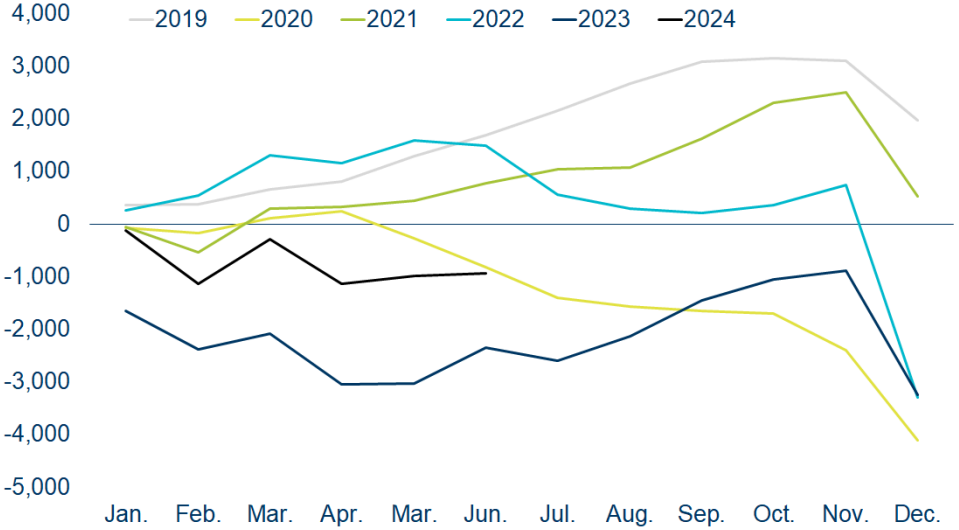
Source: International Energy Agency

Figure 9: Budget revenues from oil, in ruble billion



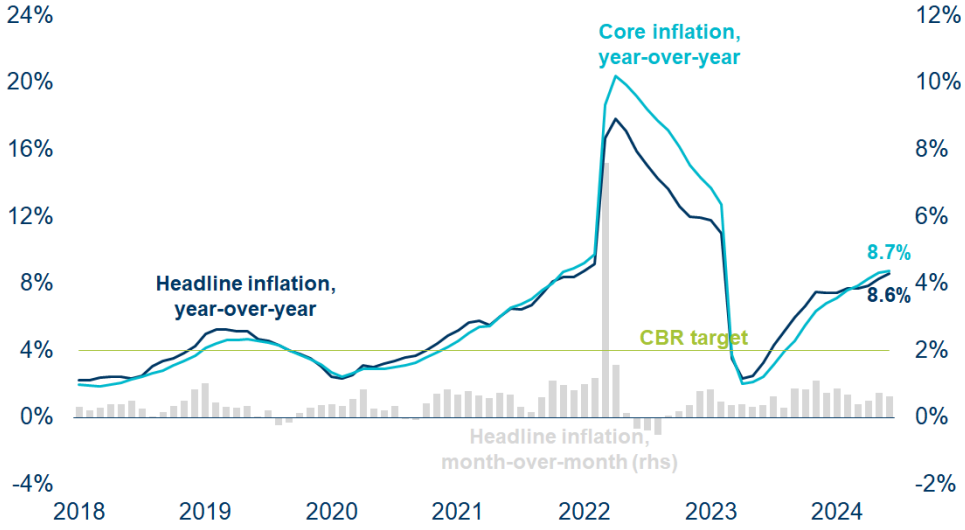
Source: Russian Ministry of Finance

Figure 10: Cumulative budget balance, in ruble billion



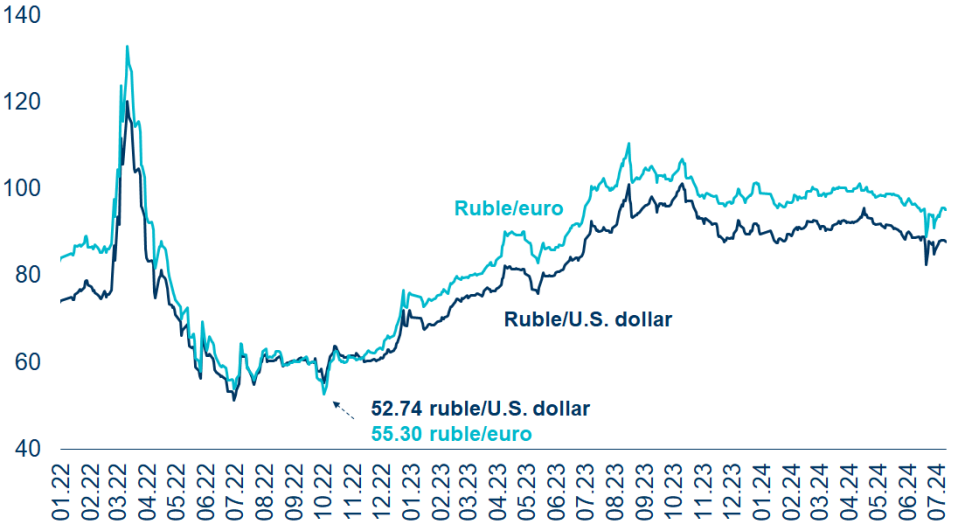
Source: Russian Ministry of Finance

Figure 11: Inflation, in % year-over-year



Source: Bank of Russia

Figure 12: Ruble exchange rate



Source: Bank of Russia