

Commodity Spotlight Energy

07 March 2014

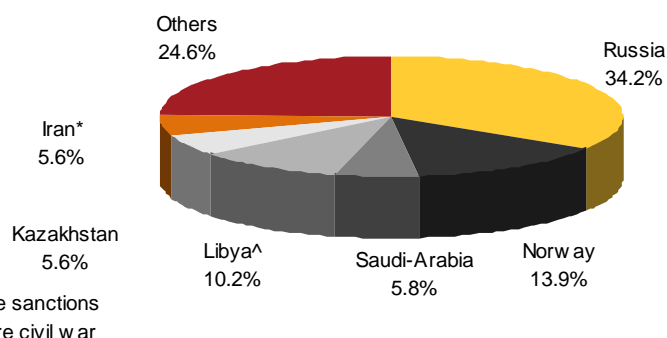
Russia, Ukraine & the EU: Interdependent

Russia and Ukraine play a key role not only in the energy markets but also in certain agricultural and metal markets as suppliers and as transit countries. The West should be able to cope with short-term supply disruptions. However, longer-lasting shortfalls would have serious consequences and cause prices to rise sharply. Yet dependence is not a one-way street: EU countries are the main customers for Russia's highly commodity-dependent export trade. It is therefore in the interest of both sides to avoid further escalation.

"Brotherhood" and "Friendship" are the names of the two most important natural gas and crude oil pipelines transporting gas and oil from Russia via Ukraine to the EU countries. But precious little in the way of either brotherhood or friendship has been felt recently in the conflict between the two most important and most populous former Soviet republics. That this conflict mainly revolves around the Crimean peninsula at present shows how bizarre the situation actually is. After all, it was the General Secretary of the time, Nikita Khrushchev, who "presented" the peninsula to his homeland Ukraine exactly 60 years ago as a sign of friendship and brotherhood. In Europe, the conflict has stoked fears of potential supply bottlenecks from Russia. Too fresh in everyone's minds are memories of the cold January 2009, when Russia completely stopped its gas deliveries via Ukraine and cut many European buyers off from imports. Even before then, in 2006 and 2008, Russia had used its "gas weapon" against Ukraine and cut deliveries. These actions had a major influence on European consumers.

After all, Russia supplies around one third of the gas consumed in Europe and is the EU's biggest gas supplier, outranking even Norway. Some 30% of total EU gas imports and almost 35% of EU oil imports originate from Russia (chart 1 and chart 3, p.3). Germany is even more dependent than the EU average: Russia accounts for more than 36% of German oil imports and nearly 39% of German gas imports (chart 2, p.2). About half of gas imports from Russia flow through Ukraine. This shows that Ukraine still plays a key role as a transit country, even though since the Nord Stream pipeline through the Baltic Sea became operative in late 2011, around one fourth of the former throughput finds its way from Russia directly to Germany. Since the pipeline furthermore uses only part of its throughput capacity of 55 Bn cubic metres of natural gas per year, it would be possible to partially offset a loss of Ukrainian transits.

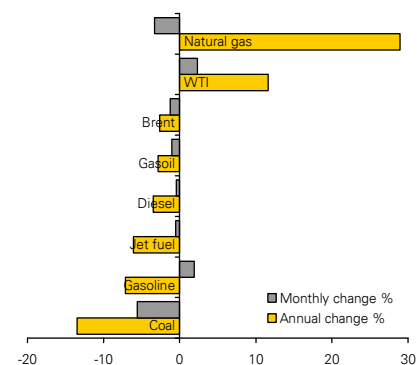
CHART 1: EU is highly dependent on Russian oil imports'
EU oil imports by countries of origin, as % of total oil imports (2010)



Source: EU Pocket Guide 2013, Commerzbank Corporates & Markets

Commerzbank Forecasts

	Q2 14	Q3 14	Q4 14
Brent Blend	105	105	107
WTI	99	100	102
Diesel	920	910	960
Gasoline (95)	950	970	940
Jet fuel	970	960	1000
Natural gas	4.5	4.5	4.5
Coal (API #2)	75	75	78
EUA (€ per t)	6.5	7.0	7.5
Phelix (€ per MWh)	35	36	37



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There are price risks, but...

But at present, such losses cannot be fully compensated via either alternative routes or alternative providers. What is more, a possible (negative) price effect on industry and households here should be taken into account. The risk of a potential escalation on the Crimea alone temporarily caused the Brent price to rise by 2% and pushed up European gas prices on the spotmarket by as much as 10%. With a daily output of 10.5 million of barrels, Russia is currently the world's largest producer of crude oil and even outranks Saudi Arabia and the US. In natural gas, Russia ranks second behind the US and provided nearly one fifth of global supply in 2012. Despite current spare capacities, the oil price would increase massively, and could even exceed the highs seen in 2008, if Russian deliveries were to be cut sharply.

...gas storage facilities are amply filled

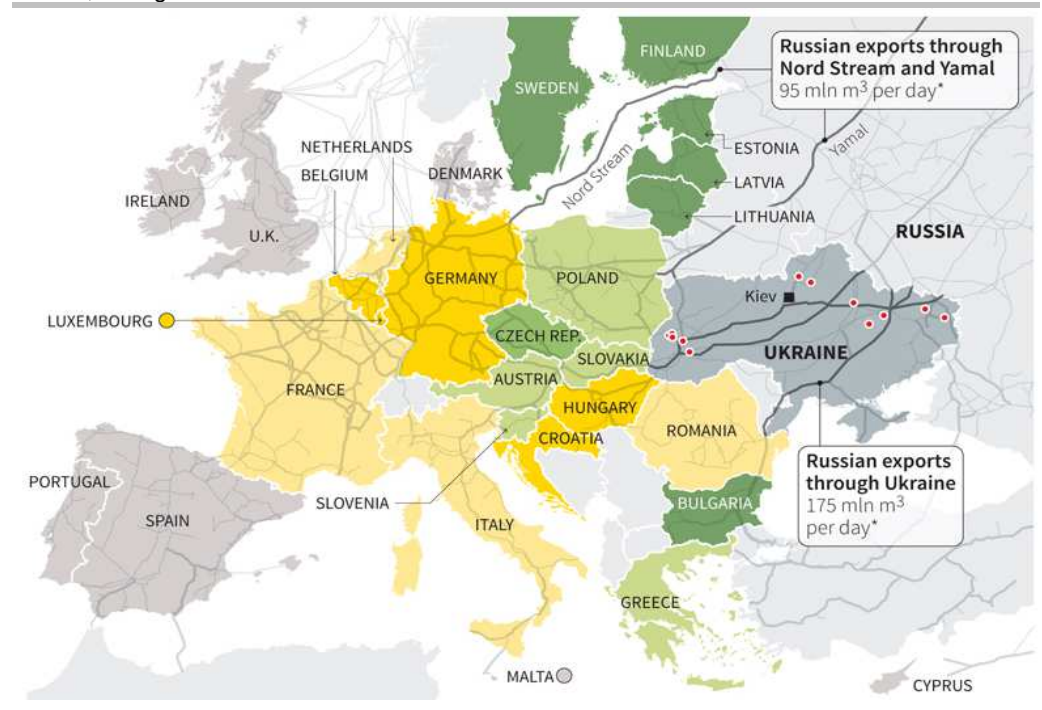
Nonetheless, fears of possible supply shortfalls are rather exaggerated on a short-term perspective. Even during the Cold War, Russia always fulfilled its supply contracts with the West. Moreover, with regard to natural gas in particular, a "gas glut" rather than a scarcity of gas was to be feared in Europe in recent years. European industry has yet to recover fully from the economic crisis of 2008/09. The mild winter, the increased availability of liquid natural gas (LNG) exports from the Middle East as a result of massively expanding shale gas production in the US and the turnaround in Germany's energy policy result in excess supply on the gas market, and so gas storage facilities in Europe – unlike in the US – are amply filled at present. They shall cover two to six months of demand, depending on the individual country. Since the heating season is simultaneously coming to an end, there is no need to fear a tighter market balance here near-term.

Russia and Ukraine are also important providers on various metal and agricultural markets

But the risks arising from reduced commodity deliveries from Russia and Ukraine should not be underestimated. For instance, Russia is not only an important energy supplier but, with an estimated annual volume of 16.5 million tons, it is currently also the world's fifth largest wheat exporter. Moreover, Russia also plays a very important role in metals. For example, it accounts for 40% of total mine production of palladium, a precious metal that is indispensable for catalytic converters for automobiles. Russia is also home to the world's largest nickel and aluminium producers. Ukraine is the world's sixth biggest wheat exporter and third biggest corn exporter with around 10 million tons of wheat and 18.5 million tons of corn. For this reason wheat and corn prices have already reacted to events in Ukraine by rising more than 10% since late January.

CHART 2: EU gas imports from Russia

Degree of dependence: Grey 0%; light yellow up to 25%; dark yellow up to 50%; light green up to 75%; dark green 100%



Source: Gas Infrastructure Europe, Reuters, Industry Data

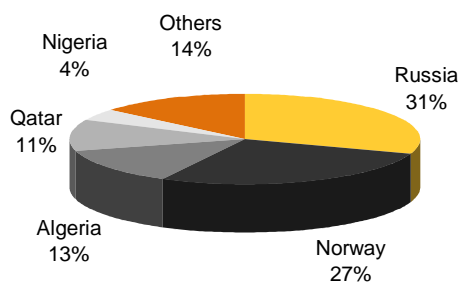
Russia is highly dependent on revenues from commodity exports

But a voluntary suspension of Russia's deliveries or EU sanctions in the form of commodity export limitations would be disastrous for the Russian economy above all and would far exceed the potential damage for the western world. Russia is extremely dependent on foreign exchange revenues from commodity exports. Last year, energy exports accounted for 70% of Russia's total exports, and total commodity exports even accounted for more than 85% of Russian exports (chart 4). Some 80% of Russian oil exports and nearly all its gas exports are delivered to Europe. Even though Russia is currently in a much better financial situation than during the crises of 1998 and 2008, its reserves will not last long. Without commodity exports, Russia's trade balance ran an extremely high deficit in the previous year with a shortfall of around USD 240 billion, or more than 10% of GDP. The recent softening of the Russian economy, with industrial production already having fallen in January, and the continuing capital outflows additionally illustrate the gravity of the economic situation in Russia.

Dependencies are too significant, and this also helps to prevent an escalation

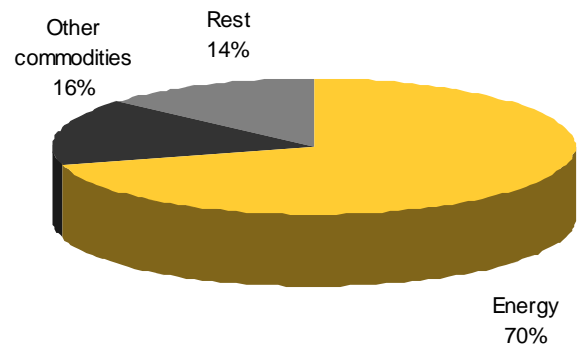
All in all, a further escalation of the Crimean conflict appears rather unlikely at present. The stakes are too high, the consequences too unpredictable and the reactions too threatening. Nevertheless, the latest events should alert European politicians, financial markets and consumers to the potential supply risks. It is therefore advisable to further diversify commodity imports, review existing supply chains and promote stronger autarchy. But perhaps the current conflict will also make it clear to all sides how much they depend on each other and that this makes it necessary to compromise. Mostly, the basis for trading and doing business with each other is mutual trust and reliability. At the end of the day, we should recall the words of the cartoon cat Leopold, a popular character in Russia: "Rebyata, davayte zhit' druzhno!" – "Boys, let us live together in peace!"

CHART 3 ... EU is also dependent on Russian gas imports
EU gas imports by imports of origins, as % of total (2011)



Source: EU Pocket Guide, Commerzbank Corporates & Markets

CHART 4 ... but so is Russia dependent on energy exports
Structure of Russian exports, total: 524 Bn USD



Source: CEIC, Commerzbank Corporates & Markets

At a glance

TABLE 1: Our Forecasts

	06-Mar	Forecasts								Yearly Average		
		1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	2013	2014	2015
Brent Blend (\$/bbl)	108.1	108	105	105	107	107	109	111	113	109	106	110
WTI (\$/bbl)	101.6	98	99	100	102	102	106	108	108	98	100	106
Diesel (\$/t)	924	940	920	910	960	970	960	970	1010	938	930	980
Gasoline (95 ARA) (\$/t)	964	950	950	970	940	940	980	1020	980	986	950	980
Jet Fuel (\$/t)	968	980	970	960	1000	1010	1010	1020	1050	989	980	1020
Natural Gas HH (\$/mmBtu)	4.66	4.7	4.5	4.5	4.5	4.5	4.5	5.0	5.5	3.7	4.5	5.0
Coal (API #2) (\$/t)	73.8	78	75	75	78	80	80	85	85	82	76	83
EUA (€ /ton)	6.8	6.0	6.5	7.0	7.5	8.0	8.0	9.0	9.0	4.5	6.5	8.5
Phelix (cal year,baseload) €/mWh	35.0	36	35	36	37	37	38	39	39	39	36	38

Source: Commerzbank Corporates & Markets, Bloomberg

TABLE 2: Inventories and imports

		Net change			% change		Comment
		1 month	1 year	vs. 5 -year-Ø	year	vs. 5 -year-Ø	
US inventories (mm barrels)							
Crude oil	363.8	6.2	-17.5	9.3	-4.6	2.6	Extrem cold winter in the US leads to strong inventory reductions in distillates and natural gas, their inventory levels are well below the 5-year average
of which: Cushing	32.1	-9.7	-18.7	-3.1	-36.8	-8.2	
Gasoline	229.0	-5.5	1.1	2.7	0.5	1.2	
Distillates	114.5	-1.7	-5.9	-29.8	-4.9	-20.8	
Natural gas (bn cubic feet)	1196	-989	-887	-610	-42.6	-34.5	
ARA inventories ('000 tons)							
Gas oil	1901	-144	-462	-453	-19.6	-18.6	Gasoil stocks in Western Europe well below the seasonal usual level
Gasoline	989	-57	27	78	2.8	9.6	
Imports and production (mm bpd)							
US imports	7.1	-0.9	-0.2	-1.4	-2.7	-16.8	US oil production exceeds US oil imports, Chinese imports increase to new record high
US production	8.1	0.0	1.0	2.2	13.9	37.2	
Imports China	6.6	0.3	0.7	2.2	11.9	48.8	
Refinery activity (mm bpd)							
Processing USA	15.2	-0.2	1.2	1.1	8.4	8.0	US crude oil processing extraordinary high
Processing China	9.9	0.1	-0.3	1.6	-2.6	19.9	

Source: Commerzbank Corporates & Markets, Bloomberg, US Energy Information Administration

TABLE 3: Historic prices of energy commodities

Energy	Latest	% change				1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	4Q13
		1 Week	1 Month	ytd	year ago								
Brent Blend (\$/bbl)	108.1	-0.8	-1.2	-2.3	-2.6	118	109	109	110	113	103	110	109
WTI (\$/bbl)	101.6	-0.4	2.3	3.9	11.6	103	93	92	88	94	94	106	97
Diesel (\$/t)	924	-1.5	-0.5	-4.3	-3.5	1010	943	979	984	974	889	949	942
Gasoline (95 ARA) (\$/t)	964	-2.7	1.9	-1.8	-7.1	1053	1034	1061	983	1029	963	1010	944
Jet Fuel (\$/t)	968	-1.8	-0.5	-6.0	-6.1	1062	995	1027	1025	1038	931	992	996
Natural Gas HH (\$/mmBtu)	4.66	0.2	-3.3	9.2	28.9	2.5	2.3	2.9	3.5	3.5	4.0	3.6	3.9
Coal (API #2) (\$/t)	73.8	3.0	-5.6	-8.6	-13.5	101	91	91	89	86	80	77	84
EUA (€t)	6.8	4.8	5.7	40.1	62.1	7.7	6.9	7.6	7.3	4.6	3.9	4.6	4.8

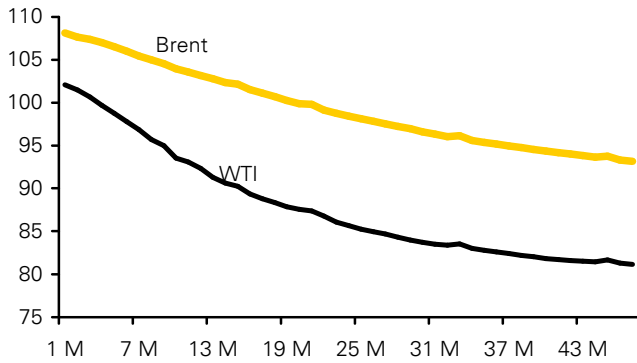
Source: Commerzbank Corporates & Markets, Bloomberg

TABLE 4: Upcoming events

12 / 19 March	USA	US EIA oil inventory data
13 / 20 March	USA	US EIA gas inventory data
11 March / 8 April	INT	EIA Short term energy outlook
12 March / 10 April	USA	OPEC oil market report
14 March / 11 April	INT	IEA oil market report
11 June	INT	OPEC meeting in Vienna, Austria

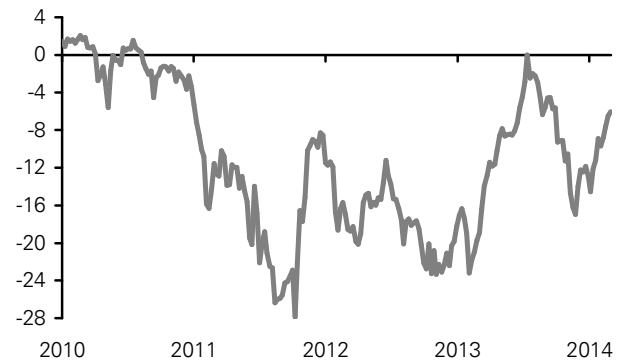
Source: EIA, IEA, OPEC, Bloomberg, Commerzbank Corporates & Markets, Bloomberg

CHART 5: Crude Oil - Forward Curves in US\$ per barrel



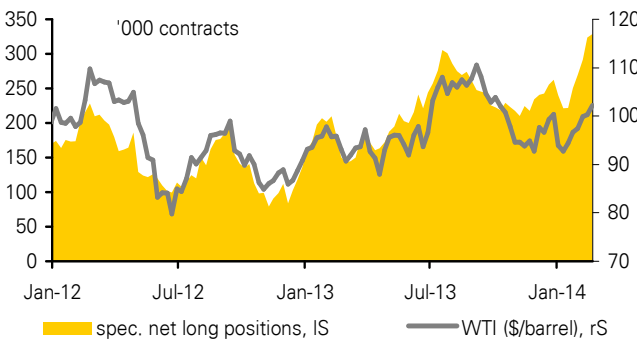
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 6: Price spread WTI and Brent Blend in US\$/bbl



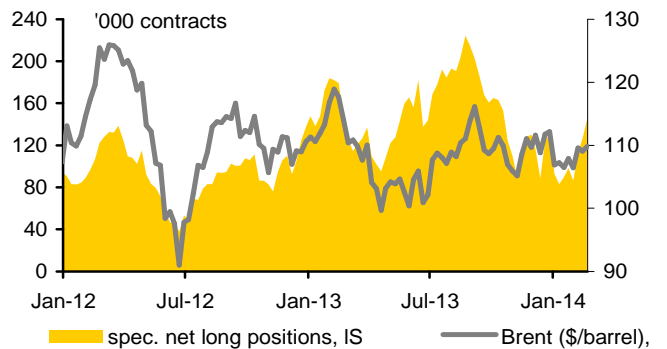
Source: Commerzbank Corporates & Markets

CHART 7: WTI: managed money net-long positions



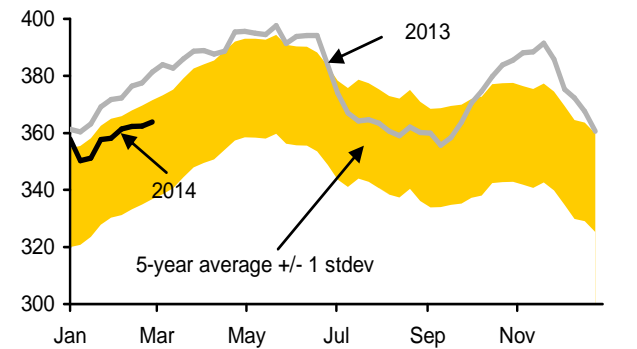
Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

CHART 8: Brent: managed money net-long positions



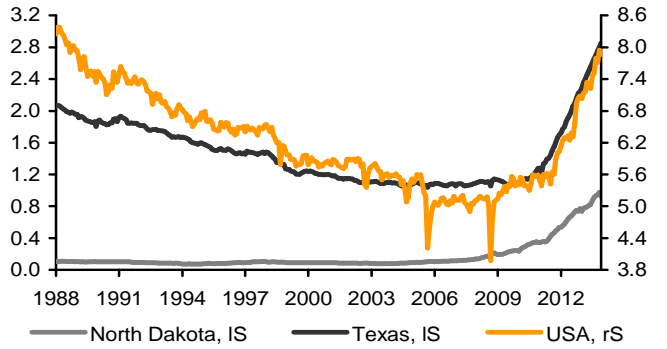
Source: ICE, Bloomberg, Commerzbank Corporates & Markets

CHART 9: Crude oil: US inventories in mm barrel



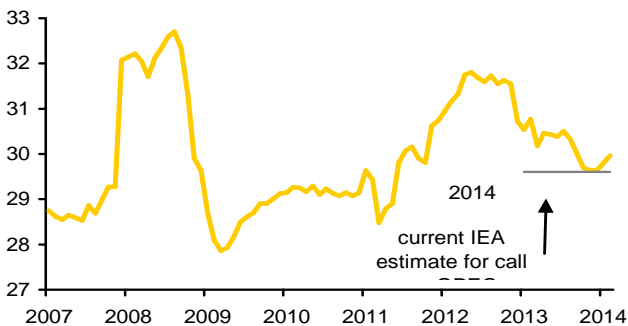
Source: EIA, Bloomberg, Commerzbank Corporates & Markets

CHART 10: US oil production in mm bpd



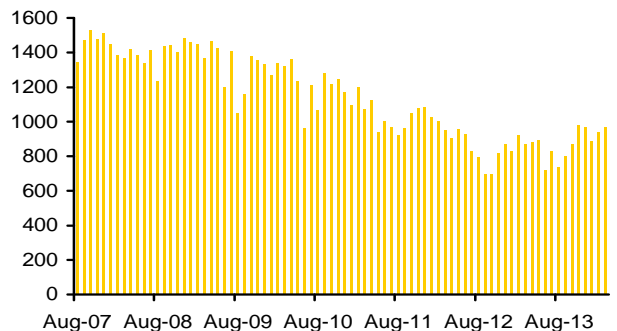
Source: EIA, Bloomberg, Commerzbank Corporates & Markets

CHART 11: OPEC oil production in mm bpd



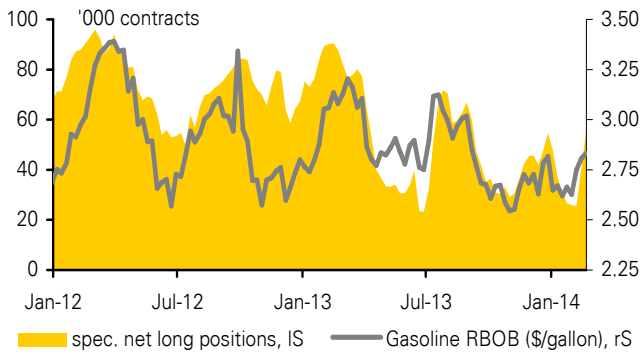
Source: Reuters, Bloomberg, IEA, Commerzbank Corporates & Markets

CHART 12: Monthly loadings of North Sea crude oil (Brent, Forties, Oseberg and Ekofisk) in '000 bpd



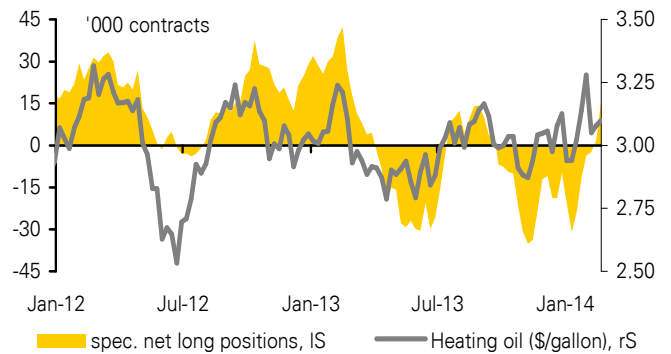
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 13: Gasoline: managed money net-long positions



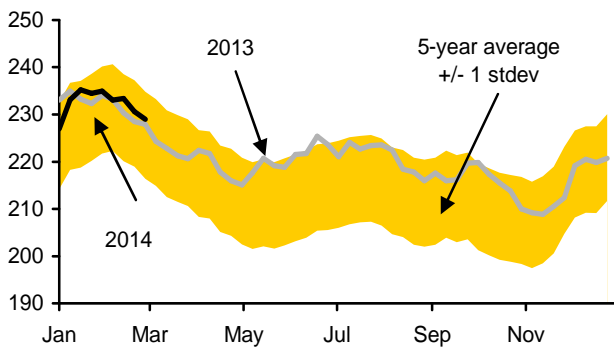
Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

CHART 14: Heating oil: non-commercials' net-long positions



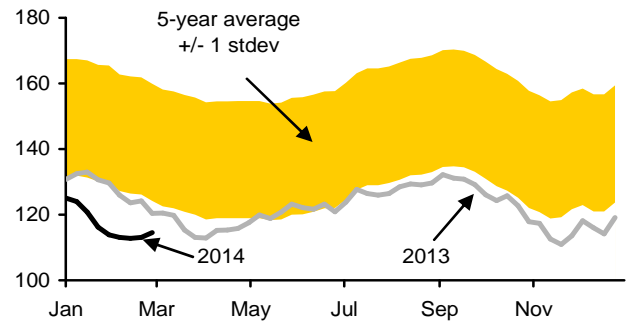
Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

CHART 15: Gasoline: US inventories in mm barrel



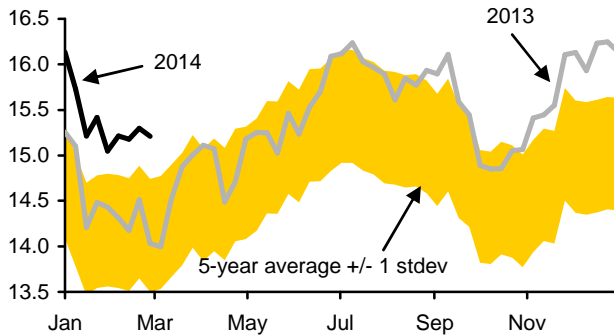
Source: EIA, Bloomberg, Commerzbank Corporates & Markets

CHART 16: Distillates: US inventories in mm barrel



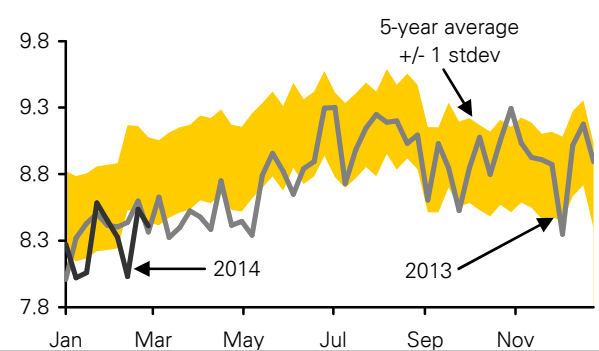
Source: EIA, Bloomberg, Commerzbank Corporates & Markets

CHART 17: US crude oil processing in mm bpd



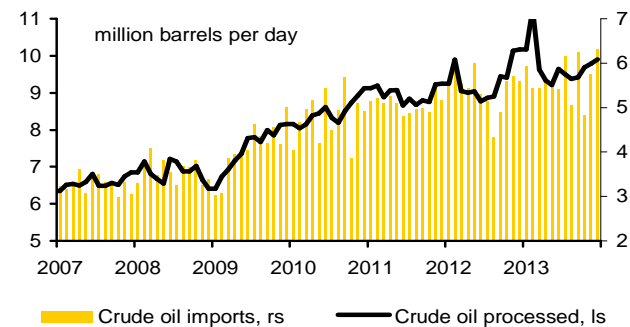
Source: EIA, Bloomberg, Commerzbank Corporates & Markets

CHART 18: US gasoline demand in mm bpd



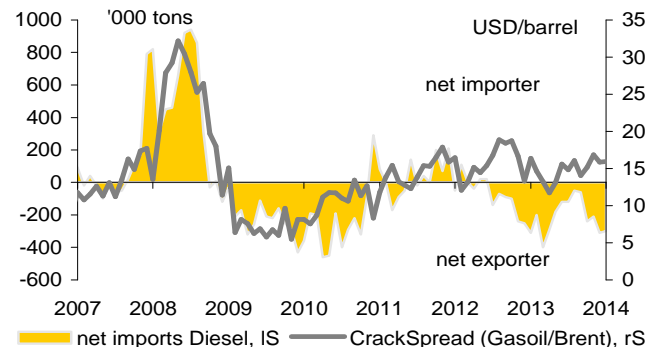
Source: EIA, Bloomberg, Commerzbank Corporates & Markets

CHART 19: China: crude oil processed and imports



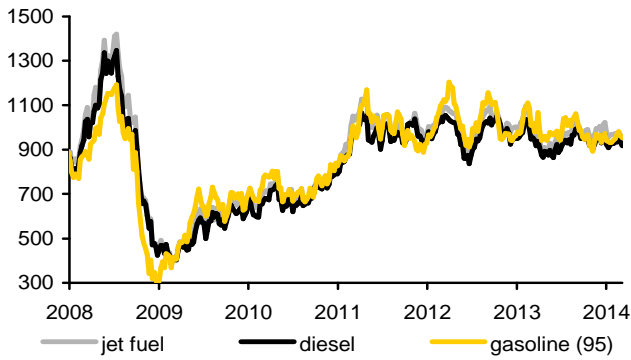
Source: China NBS, Chinese Customs, Commerzbank Corporates & Markets

CHART 20: China: Diesel imports and gasoil crackspread



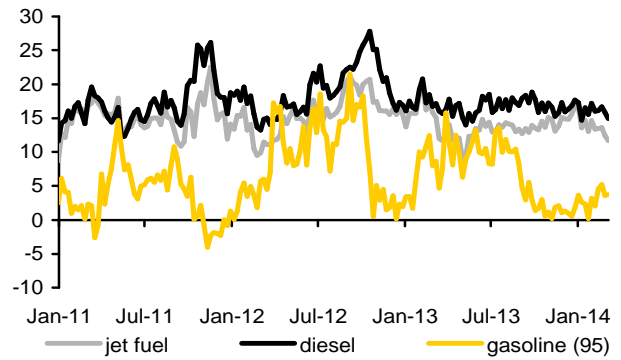
Source: Chinese Customs, Commerzbank Corporates & Markets

CHART 21: Prices of oil products in US\$ per ton



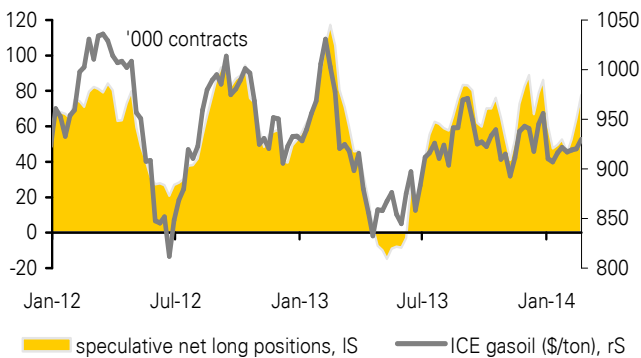
Source: Commerzbank Corporates & Markets

CHART 22: Price spread products to Brent in \$ per barrel



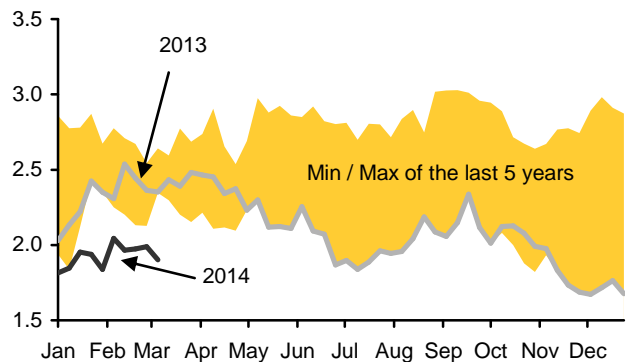
Source: Bloomberg, Commerzbank Corporates & Markets

CHART 23: Gasoil: managed money net-long positions



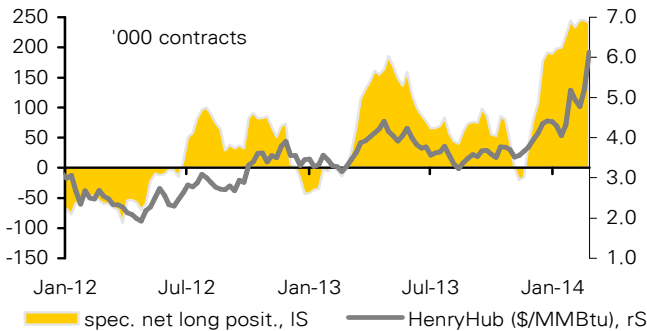
Source: ICE, Bloomberg, Commerzbank Corporates & Markets

CHART 24: ARA Gasoil inventories in million tons



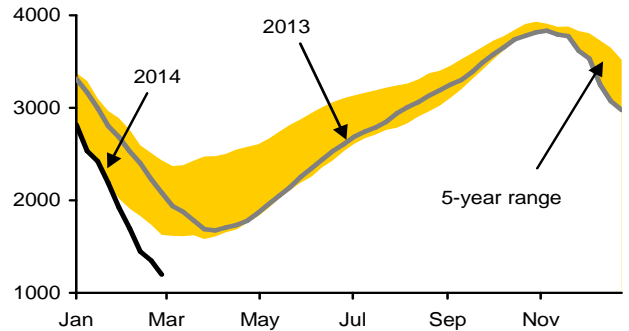
Source: PJK International, Bloomberg, Commerzbank Corporates & Markets

CHART 25: Nat. gas: non-commercials net-long positions (Futures and swaps)



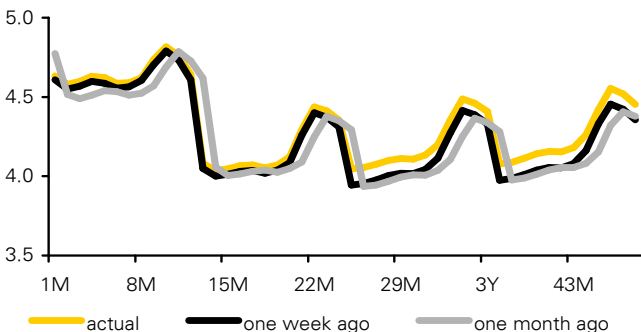
Source: CFTC, Bloomberg, Commerzbank Corporates & Markets

CHART 26: Natural gas: US storage in bn cubic feet



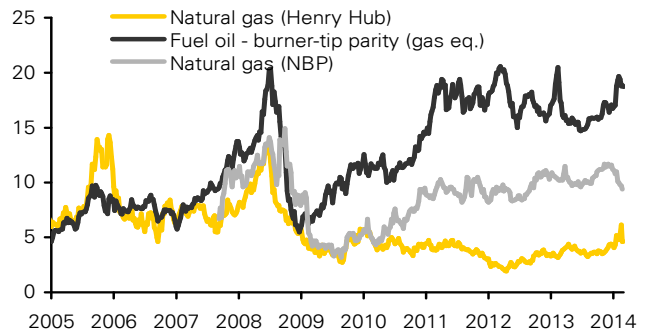
Source: EIA, Bloomberg, Commerzbank Corporates & Markets

CHART 27: Natural gas – forward curve (Henry Hub) in USD per mmBtu



Source: Bloomberg, Commerzbank Corporates & Markets

CHART 28: Burner-tip parity (natgas vs. fuel oil no.6) in USD per mmBtu



Source: Bloomberg, Commerzbank Corporates & Markets

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