

Center for Strategic and International Studies

TRANSCRIPT
Energy 360°
“Oil Market Update”

DATE
Monday, July 24, 2023

FEATURING
Adi Imsirovic
Director, Surrey Clean Energy

CSIS EXPERTS
Ben Cahill
Senior Fellow, Energy Security and Climate Change Program

Transcript By
Rev Transcript
www.rev.com

Adi Imsirovic: And a big, big question is now what happens? And this is absolutely crucial for the next six months of the oil market, is what happens if Russia does not cut.

Lisa Hyland: Hello and welcome to Energy 360°, the podcast from the Energy Security and Climate Change program at CSIS. I'm your host Lisa Hyland. This week our guest is Adi Imsirovic. He's joining us today to discuss developments in the global oil markets.

Adi is director at Surya Clean Energy and former global head of oil trading at Gazprom Marketing and Trading and he was a senior research fellow at the Oxford Institute of Energy Studies. He's also the author of Trading and Price Discovery for Crude Oil and editor of the book, Brent Crude Oil: Genesis and Development of the World's Most Important Oil Benchmark.

He's joined today by my colleague Ben Cahill. They look at the oil market developments in the first half of the year and look at demand assessments for the rest of the year, especially potential Chinese demand. They also discuss OPEC+ and Russia, what's driving that relationship, and whether this year could be a turning point. I'll turn it over to Ben now to lead the discussion.

Ben Cahill: Adi, thank you so much for joining us on the podcast today. I've read your work for years, so it's really great to have you with us.

Adi Imsirovic: Thank you, Ben. It's a pleasure to be here.

Ben Cahill: Before we jump into some of the details of the markets, I wonder if you could just start by telling us a little bit about your background, what you've done throughout your time in the industry.

Adi Imsirovic: All right, well, I'm very closely connected to the industry because most of my career I worked as an old trader, so it's about 35 years as an old trader in various places. From London to Singapore. I traded in Asian markets for about 13, 14 years. But originally I came from academia and sort of now as I retired a little bit earlier than usual, I put my foot back into academia and started writing books on the subject and papers and so on and so forth. So yeah, it's more of a hobby at the moment being back, but keeps me together with all my friends in the oil markets. I still meet quite a lot of traders. We talk, get together and I speak at various conferences, so it's quite enjoyable actually.

Ben Cahill: That's great. And we'll get into some of the details about recent work that you've done on the history and the evolution of trading. That'll be fun to talk about that. So let's talk about where we are in the market.

So we're recording this on July 14th, Brent Crude front month for instance, has been hovering around \$80 a barrel, a little above, a little below. Market sentiment seems to be shifting a little bit. We had production cuts from OPEC+ back in April, over a million barrels a day, including the Russian pledges. We had another voluntary cut, it was announced by Saudi Arabia a while back starting in July. That's been extended into August. It kind of feels like we're at a turning point in the market now. Sentiment seems to be changing fast. What do you make of this? Are we at a turning point?

Adi Imsirovic: I think we are at a turning point, Ben. I'm a little bit contrarian in terms of what I think the sources or the causes of the turning are. Obviously psychologically the talk of cuts helps, but we've had OPEC on OPEC+ talk about cuts since October last year, and yet the market's been sliding. The voluntary Saudi cuts that we've seen have not really materialized to the extent that they announced. I think they probably only cut about 400,000+. This cut rolls of million barrels that rolled into August is also, we have to wait and see because I think, I'm sure you've seen the announcements that the sellers gave all the Asian refiners full allocations at a price, whatever that means similarly to Europe. So it's very difficult to see what is actually going to happen.

But I think a lot of this bearishness in the market in the last 9, 12 months has been caused by the macro factors, primarily macro factors. There's been a lot of talk of recession and the people who trade the flat price are sort of the financial markets at the back of the curve or oil curve. They normally look at market what's whatever, 3, 6, 9 months from now. And we've had lots of negative, negative news out there. Obviously interest rates I normally say generally don't mix very well with commodity prices and we've had increases in the rates. And what has happened now is that the talk from the Fed is that it's very likely that we are going to see two more cuts to the end of the year and probably that's about it.

So I think the market is seeing light at the end of the tunnel and the views seem to be positive. There is also a bit of talk of China trying to spur up the economy a little bit, although I think market remains skeptical about that. We have seen a lot of buying coming from China for the most likely strategic petroleum reserves. So the market is definitely turning at the moment.

Ben Cahill: Yeah, that's interesting. So the macro signals have been driving the market sentiment has been negative. Do you think from a fundamental standpoint things are improving? Is it really just the interest rate guidance that's driving this macro sentiment and that's leading to the change now?

Adi Imsirovic: Well, that's what I would... Interest rates are driving the economy and the economy is driving demand, I guess. So the financial players always look way ahead and that's why they look at these early indicators of what's happening in the economy. Also, there are other indicators regarding volatility of the macro policy of the, not just economic policy but monetary policy and so on. So all these indicators have been rather bearish and I think we are turning slowly the corner there. Now obviously we have to be very, very careful.

Those are just some of the factors driving the oil markets, the front fundamentals, you've got the elephant in the room, which is OPEC and OPEC+. So all these factors have to be taken into consideration. But my simple point is that I don't think that factors that OPEC and OPEC+ have been a factor as much as it's very often alleged.

Ben Cahill: Yeah. There've been a lot of agencies and analysts who are anticipating a tighter market in the second half of the year for a long time. And of course a lot of that has to do with China and the demand forecast in China. But in general, if you look at the second half demand forecast from OPEC, from IEA, from a lot of the investment banks, they're really pretty bullish on demand. I don't think that has changed so much. So maybe if the financial market signals are improving a little bit that pairs with the idea that we're going to moving into supply deficit in the second half. Is that what you're anticipating?

Adi Imsirovic: Well, I think we'll have some deficit, but it's not going to be a particularly large deficit. And that's why I think it hasn't been driving the market so hard. If you look at the... Well, we now have most of the forecast, so we have, I think probably most realistic in my opinion is the EIA, which is 1.8 million barrels. Then you have International Energy Agency IEA, which is, what was it, 2.2.

Ben Cahill: Yeah, they recently downgraded I think from 2.4 to 2.2, but it's still a great number-

Adi Imsirovic: Yeah, that's the latest. And then we also have OPEC, which just came out of couple of days ago, which is on the high side. I think it's 2.4 or something. But let's face it in terms of supply, we do have a fair bit of supply as well, and most of the supply will come out of non-OPEC countries. So we have a lot of oil coming out of the United States. Whatever people say about, I mean there's been a lot of talk about shale and shale slowing down and not actually performing very well, but every time we see in spite of the rig counts coming down, we keep hitting record highs. So at the moment we are talking about production

of 12 and a half million barrels. That's massive. And for next year we're talking about 12.8, 12.9. So these are really big numbers that have to be taken into account. On top of that, we have Canada, we have Guyana, we have all sorts of other sources of supply, which I think is going to play a very important role in the market.

Ben Cahill: I think definitely a lot of people have been surprised by the resilience of non-OPEC supply, especially from the United States, but it is coming from other places too. You still have new volumes from Guyana, you have some from Canada, some from Norway and other places. It's interesting, industry conferences always have a theme. One of the themes that the last year seemed to be about peak shale production and everyone's talking about the decline of shale resources and whether or not the good resources have been tapped out, but as you said, we're still seeing this slow, gradual but continued growth from the shale patch.

Adi Imsirovic: Yes, I used to teach resource economics and I always question every time somebody mentions peak supply or something, I kind of shiver because I don't think resources work like that. They're very much a function of technology and price, not so much geology because let's face it, for decades we can only be exploiting a very small proportion of that oil in the ground and leaving everything else in the ground. The reason being that it was too expensive or we didn't have sufficient technology, and as technology improves we can actually get more and more out of the ground.

So I think these are the factors to look at. And oil prices have been sufficiently high to justify production at these high levels. And obviously OPEX very much helped everyone else in non-OPEC by attempting to support these prices.

Ben Cahill: Yeah, I tend to agree with that. I think we've seen in recent years that the oil industry in the United States has gotten a lot better at squeezing efficient production out of more limited upstream spending. But still it seemed like there was this skepticism that that could continue and obviously it's slowed, but that does seem to be a continued aspect of U.S. shale.

Adi Imsirovic: I don't disagree. I think actually I have my own theory about the sort of situation with shale. I think what's been happening in the last few years, we've had concentration of market power. We've had big companies like Exxon Mobil, I've had Oxy buying a lot of these small producers out. And one probably metric that would support my argument is that it's private versus public companies. Private companies still continue to be aggressive and produce more, whereas public companies tend to produce less.

Now what is the reason for that? Well, it all falls onto a collective term called discipline. I'm a little bit more cynical about it. I think that was a very long period when senior management in oil companies couldn't get their bonuses. And I think they're trying very, very hard to get money to the shareholders, but actually trying to support their own turf and trying for a change to make some money themselves. Otherwise, it's very hard to explain not investing in fields where production is 50, \$60 a barrel, when the price is 70, \$80 a barrel.

Ben Cahill: Yeah, I think obviously the capital discipline continues, but if you remain disciplined about spending and you have prices at a certain level that are well above your all-in breakeven costs. There's room to grow a little bit at the margins, right?

Adi Imsirovic: Well, for shale in particular, because shale is really, when you invest in shale production, you're talking about the next 12 months and that's very easy to hedge at prevailing prices. So you can actually borrow money, hedge it and produce, and there's no risk, virtually zero risk. It's very different type of production from so-called conventional oil where you're spending months and sometimes years getting the gear into the ground and produce for the next 20 years. And it's very, very hard to manage risk for those.

Ben Cahill: Let's shift outside the U.S. for a minute and return to the macro picture. So the big story of the market last year I think was China and the delayed reopening of the Chinese economy and the fact that Chinese demand didn't rebound. Things are different this year, obviously, and the whole narrative about China's reopening I think was central to a lot of the bullish forecasts and to this idea that the market would tighten. It does feel like the signals have been a little bit mixed from China in the first half of this year. Apparently oil demand was really high, I think it was around the highest levels ever earlier this spring. And oil imports in the first half of the year were up by more than 10 percent year-on-year according to the customs data. But at the same time, you already mentioned this, inventories are pretty high and it does seem like there's been a lot of inventory builds. So what do you make of these signals?

Adi Imsirovic: Well, first let's start with the Chinese economy. My opinion is that China has a big problem. They have virtually subprime situation in terms of real estate and property market that they've been trying very hard to get under control using various measures, typical command and control measures. Now, every time they try and spur the economy, it tends to take a form of lower interest rates and so on that just exacerbate the subprime situation. So I think that's been a big problem in the Chinese economy and I think that's what makes it extremely hard for the government to revive the economy in a way that they normally used to do. Now China is an economy that's obviously centrally planned. The so-called Chinese majors, trading companies, UNIPEC, which is Sinochem's trading arm, and China Oil, and they do buy oil for the strategic petroleum reserve when the oil prices are low. So we've seen a lot of buying. I've spoken to people who are in the know, in Asia who believe that the buying for the strategic petroleum reserves been probably to the extent of maybe seven, 800,000 barrels each day. So that's what they've been doing. And the rest of Asia is not dissimilar. India is quite similar as well, they're very price sensitive. When they see good opportunity to buy cheap barrels, they'll step in and buy.

On the base of that, what makes China very difficult to analyze because it's a bit of a black box. You don't know what's going into strategic petroleum reserves, what's going into commercial reserves because they are sort of intermingled and what's actual real apparent demand because obviously, they export quite a lot of product as well. And the more we go into the future at moment, most of the excess capacity and refining is in China, which is a little bit worrying because they can actually virtually control the refining margin globally by switching on and off. This is sort of the product exports from that excess refining capacity.

Ben Cahill: Yeah, definitely. We saw last year that one of the reasons why the diesel market was so tight, it's because you had this decline in export quotas for Chinese refineries, and those volumes disappeared from the markets in Asia and the whole world tightened as a result. I agree with you that the sources of demand growth in China are changing. I wrote a piece about this with a colleague in our China program a couple months ago. It does seem like China's shifting to a different kind of economic model and it's going to be less dependent on the property sector and construction. So economic activity will be less commodity dependent than it has been in the past. We're not going to have a return to the heady days of huge amounts of year-on-year old demand in China, which is a big engine of the oil market for a long time.

Adi Imsirovic: Absolutely. And there are many other reasons that we can mention here since we're at it. The more longer term you've got demographics, it will naturally slow down growth of the Chinese economy. Also, it's a mature economy now. Mature economies don't grow at six, seven, eight percent per annum, and China's got there. I think one point that we haven't mentioned, Ben, which is very important in the case of China, is energy security. And I think Chinese leadership have realized that they can't just go on increasing their imports by a million, 2 million barrels each year. It has to stop somewhere because otherwise they would be hugely exposed to the oil markets, the vagaries of the oil markets, particularly coming from the Middle East. So one of the strategies that they've employed is for not for that reason only, but other reasons as well of the reasons of industrial policy has been the shift towards EVs.

So EVs have played a very important role in China. I think some numbers this year, I think that there was about 2 million EVs bought in China this year. Should double in the next two years, at least a third of all new vehicles in China are EVs. And it's also part of industrial policy because policy when it comes to internal combustion engine, European and American or as well as Japanese producers obviously are leading that technology. And this is a new technology with no barriers to entry. So they've really put a lot of emphasis, subsidies and everything else. And now they'll lead us. I read this from the IEA report, I think recent report, it was in April I think or May, on EVs. In China, small EVs sell for less than \$10,000. What bank... If I could buy an EV for less than \$10,000 in the UK, I'll just buy one for fun.

Ben Cahill: Right.

Adi Imsirovic: Exactly. And it's no surprise that EVs are taking off. And I think that's the technology that the IEA is very, very bullish on. And I think it's going to have huge consequences for the oil markets, which is an opening for another whole discussion here, because for decades, the oil industry has this monopoly of transportation. So what happens is that you can't substitute kerosene on an airplane. Most cases we couldn't substitute fuel in the car. So when the prices go up, we keep flying and flying probably a little bit less, but driving for certain, especially in the United States where there's less public transport available. So it has this monopoly, so you have very inelastic demand. When supply falls, you have huge increases in price. The old economics curves.

So now with EVs, I think what is going to happen are these elasticities are going to change. I think market is going to change because if you think that oil prices are going to be high in the next two or three years, well you may as well invest a little bit of extra money and buy an EV, which basically makes a big difference in terms of how the market is

going to behave. And this will have implications for the structure of the market, for OPEC, and I'm sure we can talk about this a little bit more, but as a result of these EVs in the next few years by holding oil prices high OPEC is just shooting itself in the foot. People will just say, "Okay, fine, I'm just going to buy a cheaper EV, Chinese or non-Chinese."

Ben Cahill: Yeah, we are kind of moving into the period now where the rapid rate of EV adoption is not far off in the future. It's kind of unfolding. Of course, it's happening in China much faster than anywhere else, but it's happening in the EU and the United States too. And you see trajectories just climbing really fast for EV adoption everywhere. So it is an issue the market will have to grapple with more and more.

Adi Imsirovic: I think I saw some number. I agree with you. I think in the U.S. I think there was a last year you had 60 percent increase. OI know it's from very small base, but it's about almost 10 percent of all vehicles in the U.S. are EVs.

Ben Cahill: Yeah. So you mentioned OPEC and OPEC trying to manage the market. We've seen in recent months that there's been some frustration on the part of OPEC+. I think it's fair to say that they were making cuts and trying to shift the fundamentals, and yet the market wasn't responding. It only seemed to be listening to bearish signals. No matter what OPEC did, prices either were flat or declined. And the Saudi energy minister has repeatedly talked about how speculators are driving the market and ignoring the fundamentals. You've written some good short pieces on this recently saying that this term speculators is actually a little bit misleading. It's been misapplied. These are not irrational people in the market. Can you talk about that a little bit and explain what you meant?

Adi Imsirovic: Sure. If we use the very basic model of oil prices is at the front end, people who are involved at the front end of the market are the physical players. And the physical players tend to impact the market, but primarily the shape of the curve, so-called and contango. So if they're buying more, the market will pick up at the front end. If they don't, it'll fall. Maybe you'll have that backwardation and contango moves. But really the backend of the market is primarily controlled and traded in terms of volumes by financial traders.

Now, those financial traders are not speculators necessarily speculators, I'm sure that there are speculators, but from my discussions with people who are involved in the companies and funds, in various swap dealerships and so on. It's obvious that they are also fundamentally driven. They're only driven by future fundamentals. So they're looking down the road six, 12 months, what is going to happen? And they will trade the market flat price accordingly. Now, a

lot of these financial players as well are actually do hedge. They have large portfolios of financial assets and oil is just a small part of that portfolio. Now they're so big that even that small part carries probably millions of barrels of oil, but they don't necessarily... They're not speculators. They basically do follow fundamentals of the market. So calling them speculators, trying to discourage them is not quite correct, I think.

And I think the Saudi oil minister, I still think that it was more his spin on the market to justify the fact that the market has not been recovering as quickly as he was hoping it would happen. But there is in some quarters, at least, there is some lack of understanding how markets work. And that there is this perception that people who lift physical barrels determine the market prices and they don't, they simply don't. They usually, the Vitos and Glencores of this world, would hedge most of their positions and a very, very small portion of that market would be speculative.

Probably the last point I would mention is also very hard to say who is speculative, who is not, because the CFTC data that's published on a weekly basis, which is backward-looking, and of course it is correlated with the prices of oil is it also includes a lot of IRM. I worked in several trading companies myself where we did some speculation, not much but some, but we were always going under the term commercial. So whose commercial is non-commercial is a very debatable issue. So these definitions are not always precise.

In any case the bottom line is that, in my opinion, the markets have been driven and are driven by fundamentals, whether the fundamentals now or expected fundamentals in 3, to 6, whatever, months' time. But speculators as such, doing something without understanding what they're doing is just a bit of a hollow story that just doesn't bring truth.

Ben Cahill: Yeah, I think the key point there is that people are reacting to fundamentals and to expected fundamentals in the future, and that's shaping their decisions today. It's not like a desire to short the market, it's that you set your position based on where you think the market's going to be in 3, 6, 9 months.

Adi Imsirovic: Exactly. Why would anyone aimlessly short the market, especially when the Fed of the oil industry, i.e., the Saudis, are saying we are going to cut that. That would be insane. What these people who trade financial markets, who trade oil markets forward is they look at the fundamentals. They say, "Okay, well maybe Saudis will cut a million barrels, but you know what? China is not performing. The rest of the

world may be going well into recession, and we don't believe that oil demand is going to continue growing." And they act accordingly.

Ben Cahill: So this brings us back to what we were discussing earlier, which is the impact of these unilateral cuts that have been announced. And they're big numbers that we're talking about. Saudi announcing a million barrel-a-day cut for July and August is pretty big. Whether or not Russia will comply with its pledge to cut exports by 500,000 barrels a day next month we'll see. I remain skeptical, but things could always change. What strikes me about this though is that it's a shift in approach. For many years now, Saudi energy ministers have really emphasized cohesion, collective action, discipline. If OPEC+ and before that OPEC can really stay unified and stay disciplined, everyone will benefit. And it does seem to me like a pretty big departure for Saudi Arabia to take on more of the burden itself to cut those barrels from the market and clean up the fundamentals. How do you interpret this?

Adi Imsirovic: Well, it's a massive departure, which I found very difficult to interpret because, well, I would just extend it to saying that, I've been in the oil industry for a very long time. Saudi policy always used to be based on very steady, long-term views. And what seems to have changed in the last couple of years at least has been a shift towards more short-term revenue maximization, whatever the long-term cost. And this came to me as a surprise because Saudi Arabia never wants to be a spring swing producer. And I'm sure that if you ask the Saudi minister now, he would say that they're not going to be or not planning to be, but effectively they've put themselves in a very difficult position where they are. And a big, big question is now what happens, and this is absolutely crucial for the next six months of the old market, is what happens if Russia does not cut?

Now this, in my opinion, will take a while to develop simply because it's very hard for Russia to actually see whether they're cutting or not. They admitted they're not going to talk about production, they want to talk about export, given that the cuts are effectively crude oil cuts. Well for Russia is meaningless because Russia exports almost as much product as exports crude. So they can just cut crude oil exports, increase product exports for the on market as a whole, it doesn't make any difference.

So I think it will take some time to ascertain. I was jokingly saying to a friend of mine yesterday, I said, "It's a shame this whole announcement by Russia hasn't come out in October, November where they normally have weather problems loading in Novorossiysk. So the cut will probably come automatically anyway," but it's not the case.

So we'll just have to wait and see. I totally agree with you. I think Russia is in a very difficult situation as well. They need money desperately. They need hard currency, desperately. They're fighting a war. They are not winning it. And then I think it's an unwinnable war and they need the funds desperately, the economies on the ropes. So to expect Russia to comply with something in order to support prices, I think is probably a little bit a step too far.

Ben Cahill: Yeah, since OPEC+ was formed, the Declaration of Cooperation was signed at the end of 2016, Russian compliance has been pretty poor. It did improve after 2020 in the depths of COVID, then the discipline really ramped up for them and everyone else. But month by month, Russia tends to overproduce all the time, and yet it seems like it's getting a free pass from OPEC+. I think if it were another producer, maybe not at that scale, it wouldn't be quite the same tolerance. But I have to admit, I'm a little surprised at the fact that it's continued at a time when the rest of the group is clearly trying so hard to tighten up the fundamentals and Saudi Arabia is even making these big unilateral cuts. Something is different about, I think, decision making within the organization now, right?

Adi Imsirovic: Well, we'll have to see. We'll see how the situation develops and how much patience Saudis have. I do understand why the Saudis are tolerating this to an extent because it's taken Saudis decades to get Russia on board. The two biggest producers in the world producing more than a third of global oil are the United States, Russia, and Saudi Arabia.

Now obviously for obvious reasons, the United States is not going to be part of that club, but having Russia there, it is a big deal for Saudis and it has been a big deal primarily because it was seen that through OPEC+, Saudis would not have to act unilaterally. Now we have to see whether they will have to, because my guess is that the Saudis made this unilateral cut as a show of goodwill to Russia saying, "Look, we are doing it. Can you please now join as well?" The only thing is that they have to understand that it's going to be extremely hard for Russia to accept that.

There are other issues as well with Russia. I worked as a global head of trading for Gazprom from marketing and trading for a number of years. I'm aware that you have a multitude, almost similar to the United States multitude of oil players out there. They're all in a way united through Transect. So the only way for Russia to actually control those export is by telling Transect, "Well, you've got to cut the volumes to certain people so they can't export." But in terms of ordering companies to not produce or to stockpile it's going to be very, very hard.

Of course, there are a couple of big players such as Rosneft, but still, overall, it's a complex industry that's not based on one national oil company.

Ben Cahill: Yeah, that's a good point. It's not monolithic. And I remember a couple of years ago we were coming off a period where lots of upstream companies had spent billions of dollars on new field development and they wanted to produce this stuff. They didn't want to keep it in the ground. And it is hard to keep private producers in line, including some of the big ones.

Adi Imsirovic: Absolutely.

Ben Cahill: I totally agree that from the OPEC+ perspective, this partnership with Russia has been a boon to them. It's delivered the goods. I think from their perspective, they had shale, which is unpredictable hard to track, and hard to anticipate, and introduced a huge new element of uncertainty in the marketplace. They have all this uncertainty about long-term demand and how much it's going to be eroded by EV adoption and everything else.

Bringing a lot of big producers in under the tent, clearly, we've seen as important, and I think they still see it as something that's quite successful, and all the public comments suggest that they still believe that's true.

Where I think things get more complicated is if this continues, this bifurcation of the market where Russia's been cut off from its traditional export market and it has to ship more to Asia, kind of seems like they're in direct competition with the Gulf producers in OPEC+. And for the first year, maybe that's okay. Longer term, that seems to me like a big challenge. You're competing for the premium growth markets directly with each other.

Adi Imsirovic: Absolutely. When I teach, I always say Asia, it's the future when it comes to oil markets and gas markets as well. Asia is the future. So this is the market where you want to nurture and grow and protect your market share and what's actually been happening, two things. First of all, you have the second-largest producer in the world taking your market share. But not only that, not only is OPEC and Saudi cuts.

Well, it's kind of interesting. Saudi cuts haven't been working very well in terms of absolute price level, even though expectations should have worked that way. But actually, the way they've worked was by impacting the front end of the curve impacting the differentials. So Euro's differentials. Now, euros, which is Russian crude, has in the past

year increased, but I think about at least \$20 a barrel, just the differential versus Brent.

So they benefited that way as well as having a higher absolute price level. We have massive, even though OPEC is saying that they're trying to balance the market, well, economics one-on-one, competitive markets are always balanced at a price. They don't need a monopoly or some monopoly to come in and balance them. They don't need a cartel to come in and balance it. Competitive markets are always balanced. What has actually happened was that we have imbalance in the market. So OPEC has been a source of imbalance in the market. We have extremely heavier and high self-accrued prices and actually weaker low self-accrued prices. So in the North Sea for example, you have Norwegian crude called Johan Sverdrup, which normally trades at big discounts to Brent now trading at a massive premium of close to \$4 a barrel. And that's the case with Brent Dubai differential that went negative at one stage and is the case with West Canada select crude, which rallied in a few months by \$15 a barrel.

So we have this big imbalance in terms of sweet sour or lighter, heavy crudes as we speak.

Ben Cahill: And how's that shaping up in Asia in terms of availability and price of the heavier stuff?

Adi Imsirovic: Well, you can actually see premium going out. So for example, Angolan crudes are now in a fair bit of demand, even though they're sweet rather than sour crudes. You see the differentials, for example, Urals compared to all the other grades has gone up, and now you've got Urals trading above the price cap as well as a result.

Ben Cahill: Yeah, we do have to talk about the price cap. What is your assessment of the impact of the EU embargoes on Russian seaborne crude oil and products in the EU-G7 price caps at this point?

Adi Imsirovic: Well, two different things. So let's put it in chronological order. First came the EU sanction, which was extremely harsh. It was extremely bullish, and I think most of my colleagues would agree that that was probably the most bullish thing we saw in the market in the last whatever, 24 months, including the invasion of Ukraine. Simply what that would've meant was that no Russian crude or product would've been lifted using Western vessels, using Western insurance, and so on and so forth.

Now, the price cap was actually, for those uninitiated is seen as sort of some kind of additional sanction, and it is not, it's just the opposite. The

price cap was introduced primarily by G7, but primarily with the leadership of the United States government in order to allow for Russian crude to flow. So we said, "No, no, no, we don't want that because what will happen, is oil prices will go through the roof, which they were going to.

What we are going to do is we are only just trying to limit the revenues for the Russian government by imposing a price cap, they'll get less revenues, oil will flow out and everyone's happy."

Now, it didn't really work that way because the price cap was set at a very high level, well above the price of which Euros was trading. So it actually never got applied. I don't know if you know of any case of anyone being prosecuted for trading above price cap, but I don't. And in Asia, of course, where ESPO crude, which is Russian crude, has been trading way above the price cap for quite some time. It kind of doesn't apply because China really doesn't care and so on.

Ben Cahill: Well, yeah, it seems much easier to send oil throughout the system without relying on Western-listed services, right?

Adi Imsirovic: Absolutely. So to me, price cap, the only thing that price cap did, it did a job, very important job. What the Biden administration wanted it to do was to allow the flow of Russian crude, and that's what it did. It did a great job but actually didn't penalize Russia in any way, shape, or form. It was the European sanctions that actually made it very difficult so that Russia had to ship the oil into different markets and ship that oil in a way that unfortunately... Well, it's going to increase obviously the costs and shipping costs and everything else.

But the problem is also that now a lot of legitimate regular traders of Russian crude oil have either reduced their oil substantially or got out of that business altogether for sanction reasons. So now, and this is what happens every time when you ignore markets and you try to ignore the market, try to sort of stop markets functioning, you get a black market.

So you've got a bunch of very unpalatable characters out there trading this oil and actually siphoning vast amounts of money to places that nobody really understands who's behind it, who's getting this money. So if you think that the oil for food program was bad, we talked about cents a barrel, what we have right now, a program where people are siphoning dollars and maybe tens of dollars a barrel, we don't know. I was joking last year, well, it's not particularly a clever joke, but I was saying, "Well, for all you know the money could be going to Wagner." You don't know where the money's going. So a huge amount of money is being siphoned by very small entities that nobody's ever heard of.

Most of them are Russian or offshoots of big Russian companies such as Rosneft, Gazprom, and so on. And we have this sort of gray area, including our gray fleet that's doing all this business.

And that's another issue as well that really worries me because we have this whole fleet of gray vessels or gray fleet that are very, very old vessels. They're not properly insured, and they're doing a lot of ship-to-ship transfers. As a result, if there is an oil spill, first of all, nobody is going to pay for it because they're not properly insured. Secondly, the risk is much higher because they're doing all these ship-to-ship transfers, which are off their AIS (automatic identification system), and so on that they're making it more likely.

So it's not a great picture, but the oil is flowing. Oil prices have been relatively low because Iran obviously kicked in their output, and production and exports over 3 million barrels. So certainly the sanctions not working properly has been good for the consumer, I guess.

Ben Cahill: And of course, the Treasury would argue that even if some money is moving off the books from the Russian government, it's not flowing to the government, it's not flowing to the treasury. So it is depriving the government of revenue. But I certainly agree it's introduced a lot of distortions in the market and those issues that you raise around tankers and safety and lack of insurance or dodgy insurance, are actually quite important.

Adi Imsirovic: But Ben, if the money is not going to the government, if it's going to Putin and his friends, it might be even worse.

Ben Cahill: Yeah, there's definitely a black box effect happening. Revenue flows, no doubt about that. So I wanted to touch a little bit on some of your personal experience and history over the time with the markets and just talk about how the trading market has changed. So you've written a couple books on the evolution of trading and the creation of the Brent benchmark, which of course is the world's most famous crude oil benchmark. Kind of started that all.

There have been some pretty significant changes with the Brent Benchmark this year. I think it was back in April, the WTI Midland crude was included in the kind of basket of crudes underpinning Brent for the first time. This is very wonky technical stuff, but I wonder if you can just explain for a non-market participant, why is this significant and why was it a big departure from the way that Brent has functioned? What's the impact on the market?

Adi Imsirovic: Sure. I'll try and make it as simple as possible. Well, let's start with the problem. The problem was that the so-called Brent crude, which consists of Brent assessment, is done on the base of a basket of crudes. A lot of most of them were up until now, North Sea crudes, five of them, BFOET. The basket of these crudes has been falling in terms of volume of production. So whenever you have a big fall, and it comes down to just about 700,000 barrels a day, which is really not enough for proper price assessment, and that opens up a Pandora's box of people literally, let's me use the S word, squeezing the market. It doesn't have to be proper old-fashioned squeeze, but can actually manipulate the market with smaller volumes.

Being the most important benchmark, international benchmark in the world that was a very serious problem. So the various options were looked at, and one of the options, I guess, that couple of colleagues of mine had put forward was just scrapping it all together and doing something completely new.

The problem then with this was that you've got tens of millions, and nobody really knows, tens of millions of barrels of various paper and physical contracts that go out maybe 10 years from now. I know in my last job, I was actually hedging LNG, 10 to 15 years forward. Now, not even Brent had that liquidity. So we would hedge, let's say five years forward and then roll those hedges slowly every year because the backend of the curve normally is not changing that much. So you have this massive volume of contracts that's based on Brent. And if you get rid of Brent, if you say, "Well, it doesn't work very well," you would have to renegotiate all of that, which is just nobody wanted to even think about that.

So it was this whole idea of the industry discussing the problem was done with a lot of constraints, as you can see. So then the other two options left for Johan Sverdrup, which has a big volumes, but in terms of quality, it really sticks out like sore thumb in that North Sea. It's a very heavy, high self accrued. It's very different from Brent, other Brent Crudes. It loads on VCCs. It used to go primarily to Asia prior to the war. So that wasn't a particularly good option. Well, at least the industry thought it wasn't. So the only option left was really to use WTI, which is a very similar crude to North Sea grades. It's actually competing directly with Ekofisk. Over time, it became hugely popular, WTI Midland of course, to be specific, it's very popular with both Mediterranean and Northwest European refiners.

So it just made a lot of sense. Now, obviously, the fear was that WTI would overwhelm Brent because the volumes of WTI coming to Europe can be actually greater sometimes than the volumes of the BFOET or Brent basket of crudes. I was involved with the industry in that process, and my argument was going back to my books and all the research that I did, and of course my own experience. I remember in the early nineties, me with a couple of friends were working on a deal where we put a Bonny Light into Cushing.

So that was the time after, obviously this is after the mid-eighties when NYMEX then, now CME, introduced other alternative delivery crudes where even Brent was deliverable and some other sweet crudes, including West African, into the WT contract.

And it worked like a dream. It really helped the contract. They were struggling at the time, and it actually made it work, and the open interest picked up very quickly and worked really well. So the logic was, well, if it worked well for WTI, having Brent and other grades in it, why not have WTI in Brent, why wouldn't it work? And of course there will be bumps.

There's a lot of technicalities, which I don't want to go into to be sorted out. But if it's done properly and over time, I think it should double the volume of Brent crude, increase the liquidity and bring the two benchmarks closer together.

Which I think is only a good thing because WTI will continue to be very, very important regional benchmark, and maybe in future WTI takes over and becomes on FOB basis in the U.S. Gulf. May become a benchmark in its own right, IE global benchmark.

Ben Cahill: Yeah, it's so interesting that these terms that are just part of the global vocabulary now, Brent and WTI, if you look at under the hood. What's actually contained there, it's not constant, it's not fixed. It changes over time depending on the life of those fields and available flows, et cetera.

Adi Imsirovic: But that complication sometimes is not that bad. Brent is easily the most complicated commodity contract that I've ever heard of, but that's complex because it evolved over time and evolved naturally. So when we had the 2020 pandemic and the crisis, obviously when WTI went negative, Brent performed perfectly well, didn't have any problems. Melbourne had problems, Dubai had some problems. Brent worked just fine.

And that's because there's so many levels of this complexity that when the market got really weak, first it was the differentials got hit versus

dated Brent, then dated Brent to forward Brent got weak, then Brent spreads got weaker, and then the flat price, what we called flat or absolute price level came under pressure. So there were so many buffers in the system to take that on.

Ben Cahill: Yeah, that's really interesting. Last question for me. You've written some recent material, I think about the evolution of the Brent Benchmark, but also just how trading has changed over time. And I believe you worked with some authors who were present at the creation of the benchmark and have talked about how the paper market developed.

So you said you spent 35 years in the trading world I think, what's changed the most since you were in the industry? What have you seen in the last couple years that really strikes you as different from the way things used to operate?

Adi Imsirovic: Well, lots of things change. What I would probably single out is technology. I think the exchanges have taken on a really big role. When I started trading in the late 80s, basically, yes, there was then NYMEX contract, there was the IP, so at the time it was called International Petroleum Exchange, but a lot of trade was done through what we call OTC, over the counter. It was done on bilateral basis. A lot of things were kept quiet, what we call PNC. I think the relationships were far more important. I think what's happened.

The relationships are still important in oil, but I think the markets started moving a lot faster with the exchanges, with financialization of the market as well. But that came, I would say, in sort of late 80s, early 90s, when the financial players came into the market and started hedging their positions or overall books, because oil was seen very much and still seen by many funds as a hedge against deflation. So if you have a massive portfolio of equities, bonds and whatnot, you may want to have even a small portion of that in terms of oil. And that probably for a large fund is not very much, but it could be millions of barrels. So that has changed a lot.

And I think last but probably not least, is the involvement of the national oil companies in trading. So now you see most of the national oil companies having some sort of a trading arm. And it's not surprising because when you see the profits made by trading companies in the last two or three years, they've been almost ridiculous. And even oil producers like Saudi Arabia now, they have Aramco trading and Omani's have Omani trading company and the UAE, ADNOC trading and so on and so forth. All these guys have their own trading arms, usually men by old London Geneva traders teaching everyone else how to trade

and get involved in the sort of plays window and get involved with the exchanges. So I think that that's changed a lot. So we have a lot more players as well involved.

Ben Cahill: Yeah. It's a desire to take those margins away from others and capture some for themselves.

Adi Imsirovic: If possible, yes.

Ben Cahill: Adi, I think we need to draw to a close here. This has been great, learned a lot from this conversation. Really grateful to you for joining us today and talking through oil markets. Great to speak with you.

Adi Imsirovic: Thank you, Ben. It's been a pleasure.

Lisa Hyland Thanks to Adi for joining us this week. I've included links to his publications in our show description and encourage you to follow his work. You can find more episodes of Energy 360° wherever you listen to podcasts and at [csis.org](https://www.csis.org). For updates you can follow us on Twitter [@CSISEnergy](https://twitter.com/CSISEnergy). And as always, thanks for listening.