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POTEN TANKER OPINION

Russia Attacks Ukraine

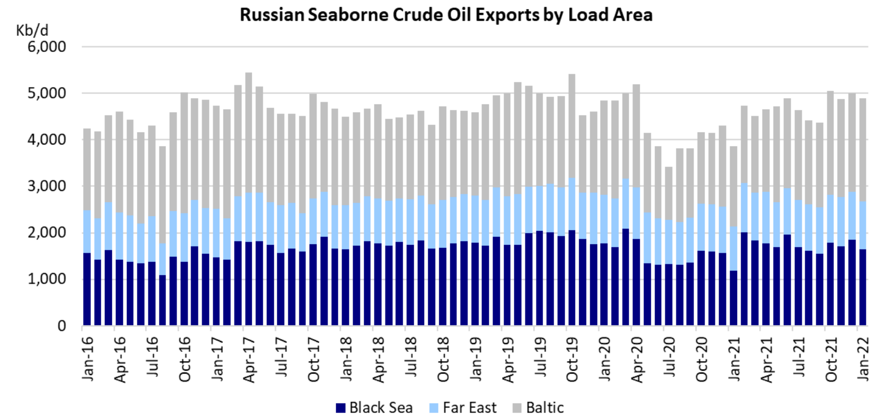
What has been the impact on the tanker market so far?

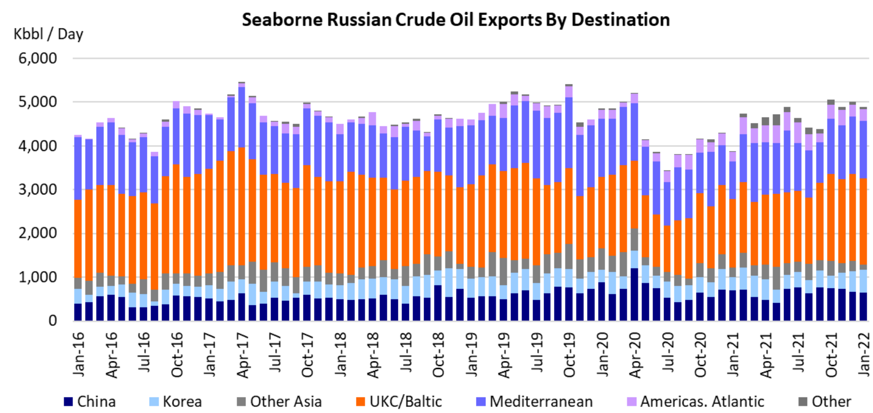
A little more than a month ago, we wrote a Tanker Opinion discussion the possible implications of a potential conflict between Russia and the Ukraine. This potential conflict has turned into an actual war and the implications are felt throughout the shipping markets. In our previous opinion, entitled "Russian Roulette", we highlighted the major role that Russia plays in the global oil and gas markets. Russian seaborne crude oil exports reached about 5 million barrels per day (Mb/d) by the end of 2021, with Europe as the main destination. Pipeline exports make up another 1.5 Mb/d, split between Europe (Druzhba) and Asia (ESPO). In terms of export locations, the ports in the Baltic and the Black Sea make up the majority of the volumes. After the conflict escalated and Russia invaded Ukraine, countries around the world have condemned Russia's actions and announced a variety of sanctions. None of these sanctions directly targets the Russian oil and gas industry, but the oil and tanker markets have been significantly affected nevertheless.

In the oil markets, the main Russian grades have seen their prices weaken dramatically versus the international benchmarks like Brent and WTI. Prices of Ural crudes are under pressure as some buyers are reluctant to buy Russian crude in fear of future sanctions. The discount of Urals to Dated Brent increased from around $2/barrel prior to the crisis to $11/barrel after the fighting started. Potential buyers are also having difficulty obtaining letters of credit from Western banks to finance the purchase of Russian crudes. Even without explicit sanctions, this will have a significant impact on Russian crude oil exports and revenues.

Shipowners, facing a fluid and uncertain situation are reluctant to charter vessels to buyers of Russian crude. Partly as a result, tanker rates have spiked on various export routes from the Baltic and the Black Sea, although very few transactions are done. Since the conflict started, at least three commercial vessels (two bulk carriers and a bunker tanker) have been hit in the Black Sea. Until hostilities are reduced, many shipowners will likely avoid this area, through which Russia exported on average 1.7 Mb/d of crude oil in 2021. On the other hand, high enough tanker rates and discounted prices for Russian crude will create a powerful motivation for some brave charterer and owner to take a chance and pick up a cargo. Russian exports flow mostly from Aframax and Suezmax ports, so the rates for these segments have been impacted the most. There will be a knock-on effect on VLCCs, but so far, the impact has been limited.

The longer-term implications of the conflict for the oil and tanker markets are unclear at this point. Sanctions are still





Source: Lloyd's List Intelligence

being implemented and further penalties could be announced down the road. The oil market was already tight and reduced export flows from Russia cannot easily be compensated for by other exporters. Short-term solutions, such as releases from the Strategic Petroleum Reserves, will only have a limited (and mostly psychological) impact. U.S. shale production can ramp up, but that will take time. Furthermore, these are private companies, so we cannot expect a "coordinated" approach. The only short-term sources of additional crude oil are the Middle East OPEC producers with spare capacity, like Saudi Arabia, Iraq, UAE and (if a deal can be struck) Iran. However, the OPEC+ group includes Russia and they will not appreciate OPEC helping their Western adversaries.

The next few weeks will continue to be marred by uncertainty and rates will likely remain elevated and volatile, especially in the Baltic and Black Sea regions. However, once the impact of the sanctions is clearer, the market will settle down. Trade flows will adjust, and tanker rates will likely come back down, since the overall market fundamentals have not changed, and the tanker market continues to be oversupplied.

If the situation escalates and more severe sanctions are implemented that include restrictions on Russian exports, things could change. We would see more dislocations and inefficiencies in the market, with more long-haul movement replacing the current short-haul trades. This could boost tanker rates more durably.