

Russian Domestic Market Developments: Understanding The Stagnation Of Domestic Supply & Determining The Impact Of A Potential Move Towards Stronger Competition

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RUSSIAN POST-CRISES GAS BUBBLE

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RUSSIAN MACROECONOMIC PERFORMANCE AND DOMESTIC GAS DEMAND

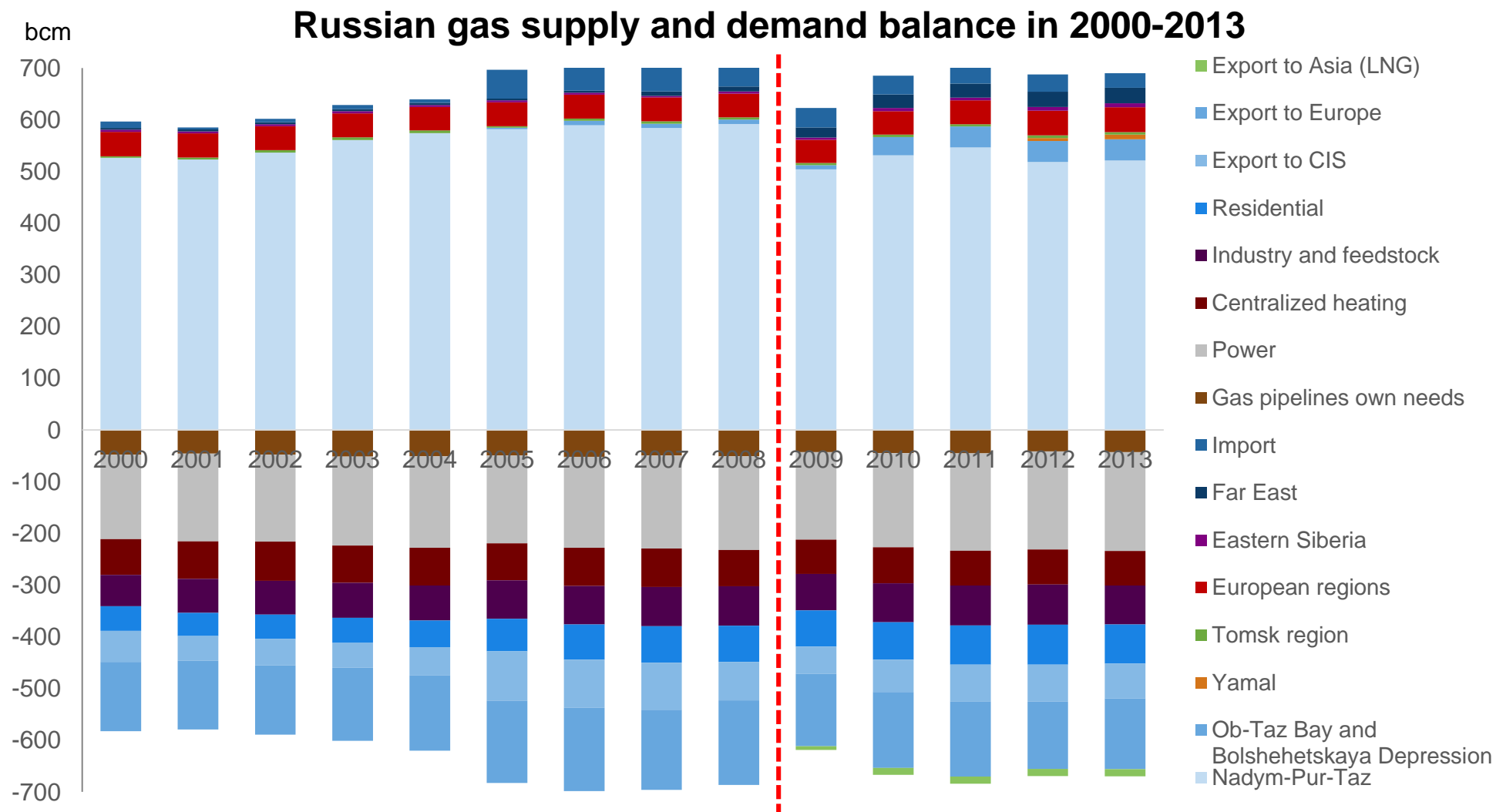
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INCREASING COMPETITION OR NEW OLIGOPOLY?

4

FUTURE TRANSFORMATIONS OF THE RUSSIAN GAS BALANCE

Russia enjoyed the “Golden Age of Gas” until the crises in 2008



Sources: Rosstat, ERI RAS

Major post-crises transformational changes in the Russian gas balance

- **Start of Bovanenkovo** by Gazprom **and fast growth of IGPs** production resulted in gas oversupply
- Main **transportation bottlenecks were expanded** (SRTO-Torjok, Urengoi hub, Bovanenkovo-Ukhta)
- Slower economic performance resulted in **domestic gas demand stagnation** in all sectors, with the main consumers being strongly affected by the crises and higher prices
- There is very **limited gas export alternative** for the Russian gas now:
 - Gas demand in **Europe** was strongly affected by the crises and it is unlikely to return to pre-crisis levels prior to 2020, there is nearly no room for exports growth
 - Russian gas exports to **CIS** were gradually falling due to falling gas consumption and inability of the consumers to pay
 - Start of the Sakhalin-2 **LNG** export could not compensate for the decline of exports to the West, other LNG projects cannot be commissioned before 2018-2019
 - Exports **to China** are still in limbo
 - Imports of **Central Asian** gas fallen dramatically after 2009 explosion on Turkmen pipeline, China emerged as a key gas consumer to replace Russia

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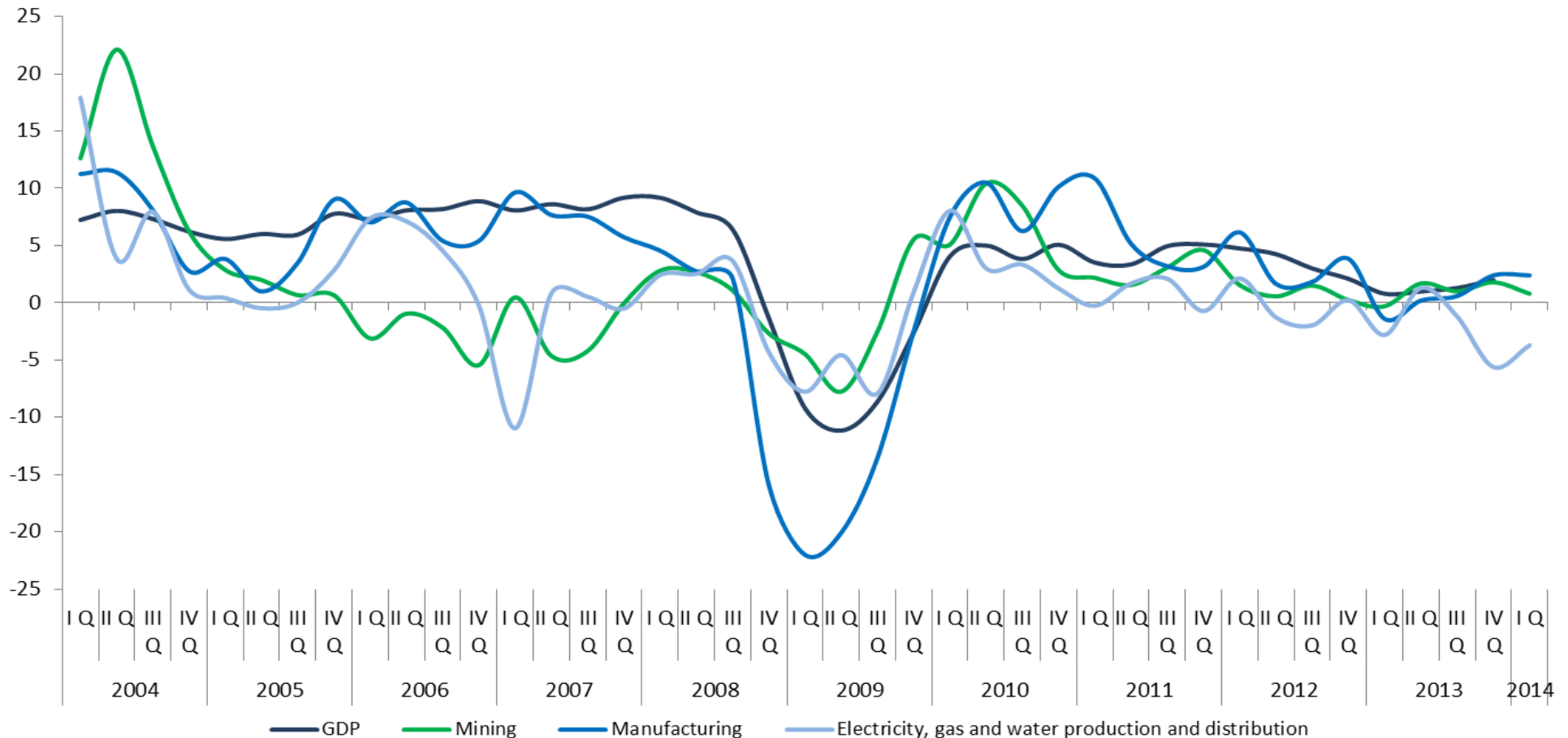
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FUTURE TRANSFORMATIONS OF THE RUSSIAN GAS BALANCE

Russian economy is now facing recession

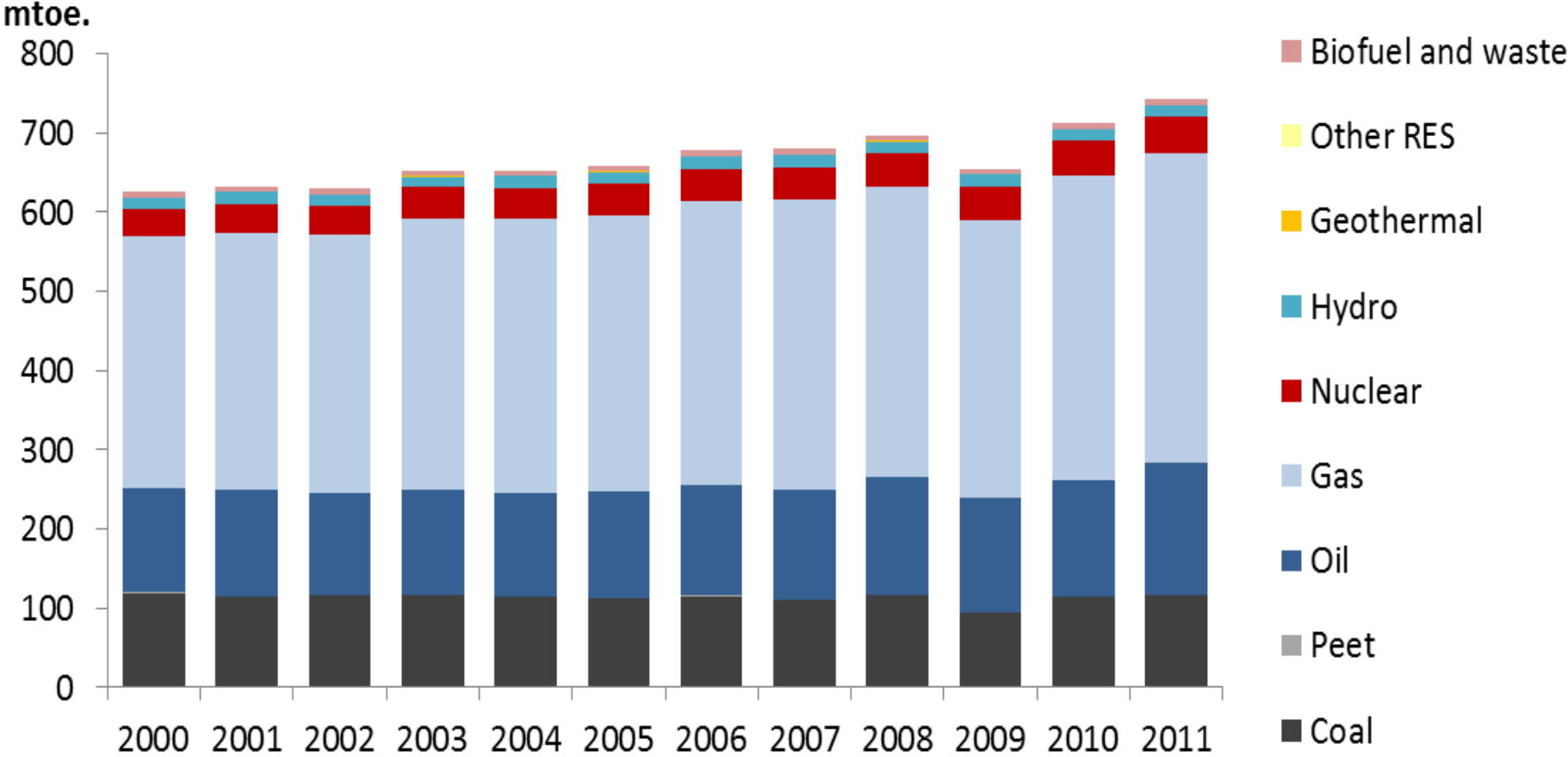
GDP and industrial output (% to the corresponding quarter of the previous year)



Source: Rosstat

Gas remains the main fuel in the Russian energy mix with 53% of the TPEC

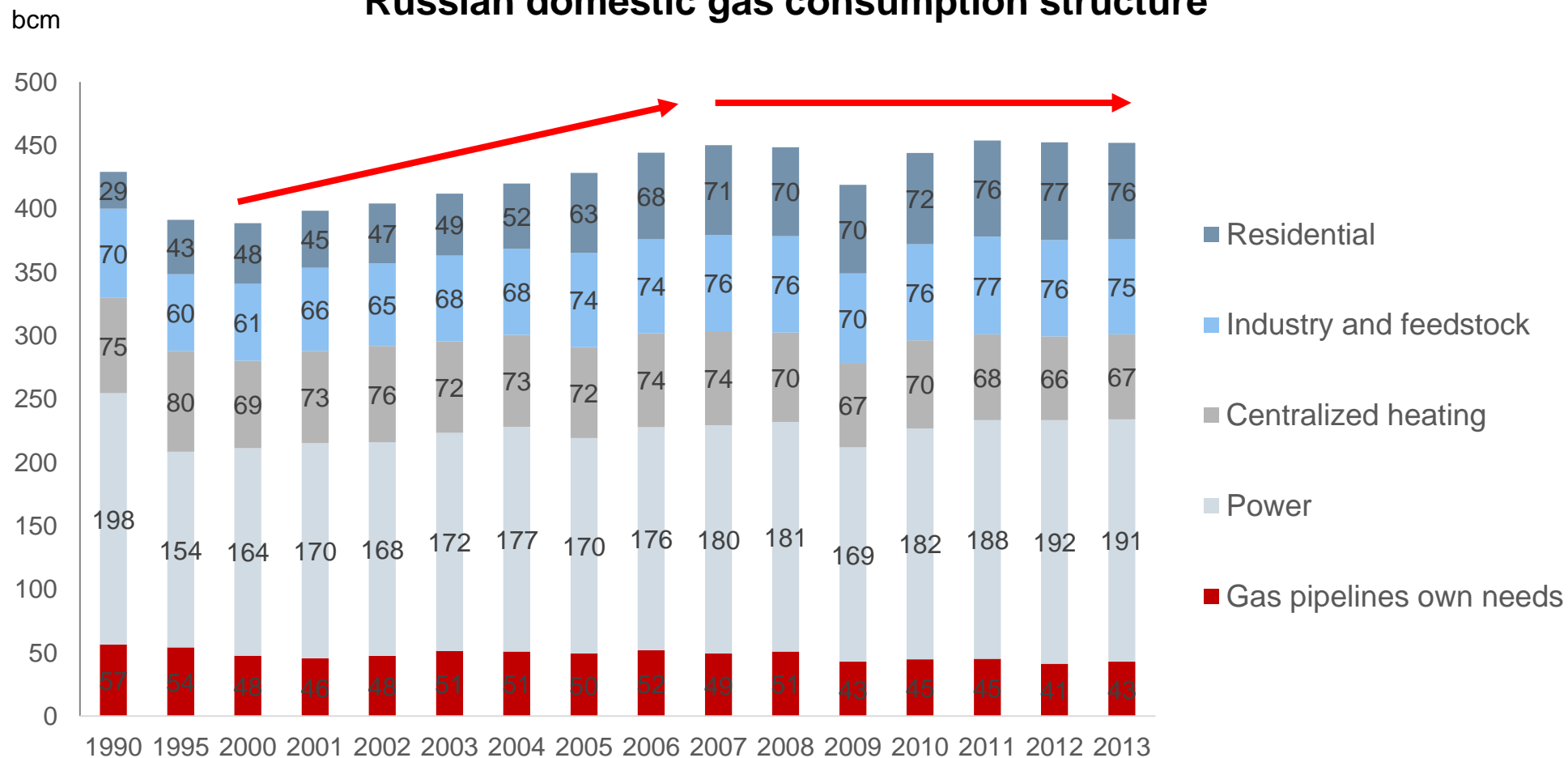
Russian primary energy consumption in 2000-2011



Source: ERI RAS

Russian domestic gas consumption stagnates on the back of weak economic growth: economic slowdown and higher gas prices limit gas demand growth in all sectors

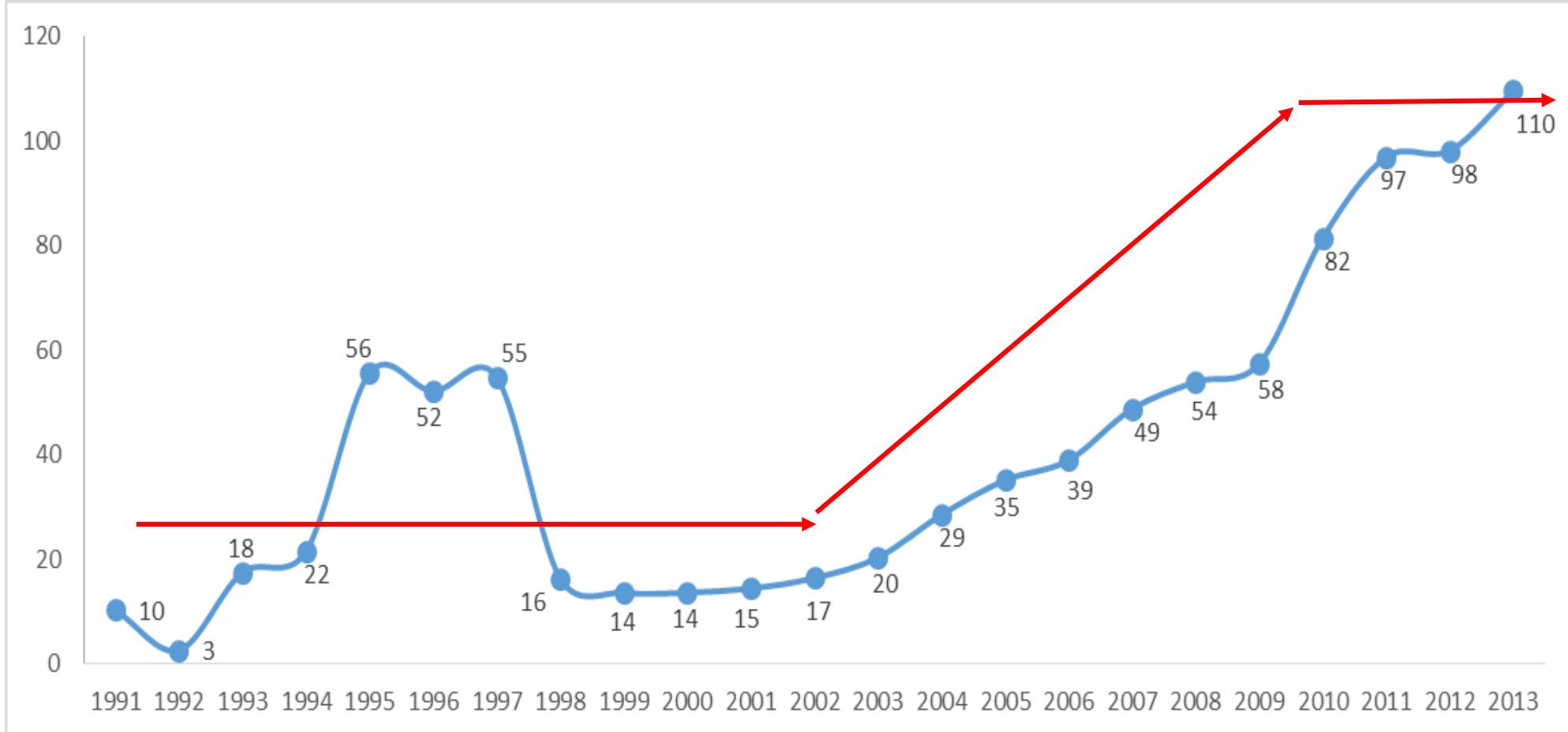
Russian domestic gas consumption structure



Sources: Rosstat, ERI RAS

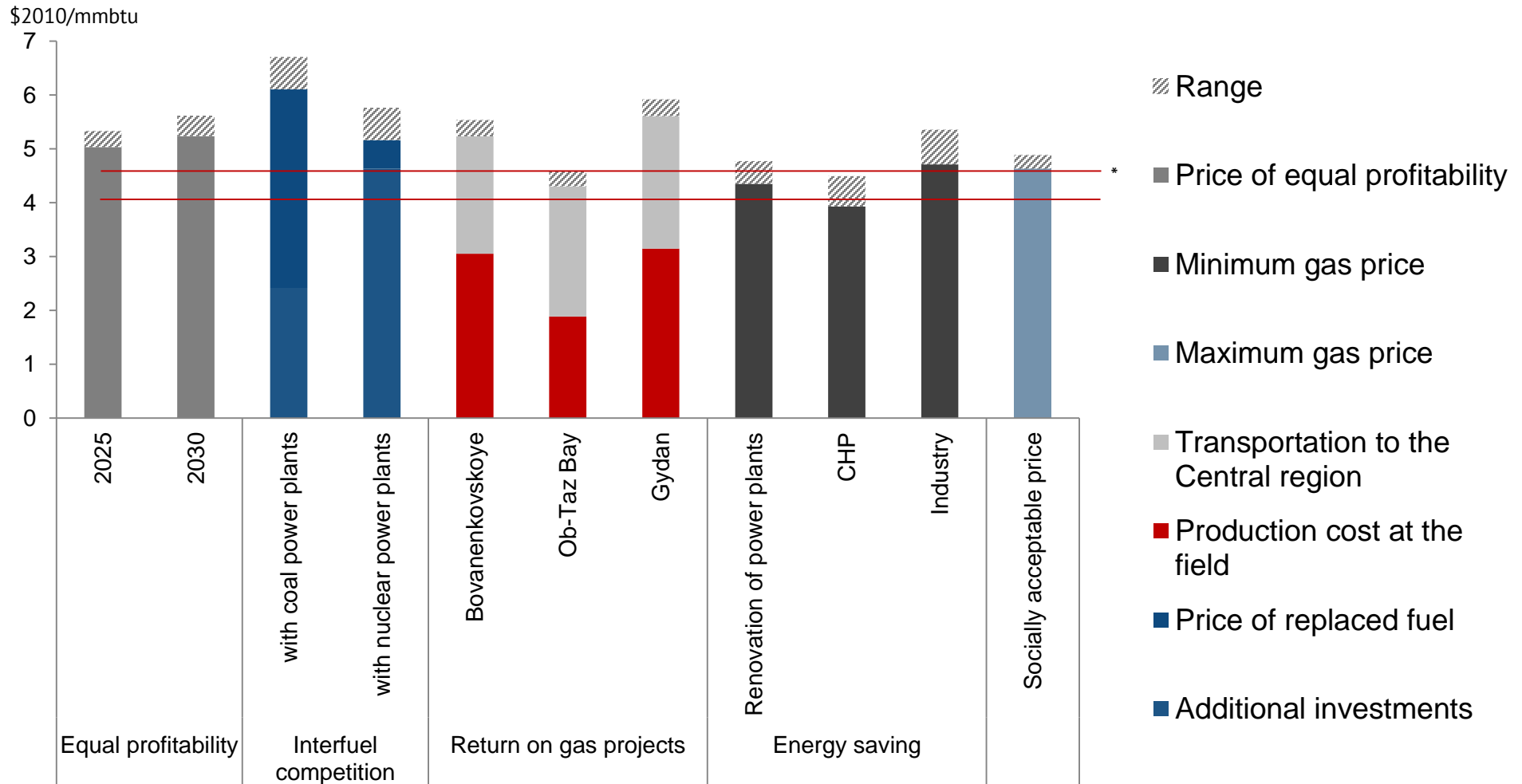
Russian gas prices were frozen in 1991-2002, then they were growing by 15-25% pa to reach netback parity, and now they are frozen again...

Average weighted wholesale gas prices for industrial consumers in 1991-2013, \$/mcm



Sources: ERI RAS, Gazprom

Comparison of the different prices defines the price range, acceptable for the main stakeholders: 4-4,5 \$/MBtu



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THE ROLE OF GAS IN THE RUSSIAN ECONOMY

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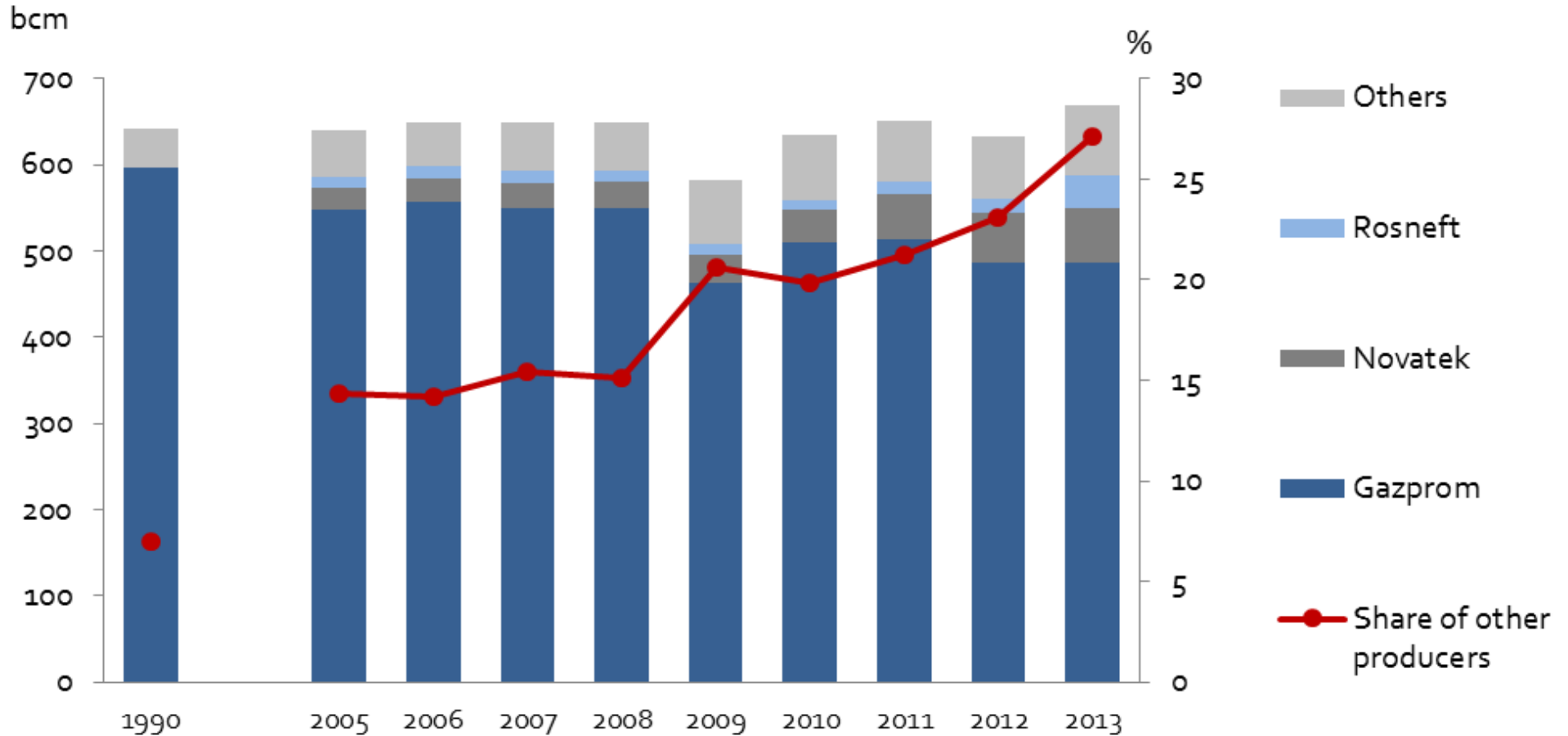
FUTURE TRANSFORMATIONS OF THE RUSSIAN GAS BALANCE

Major shifts: adapting to the new environment

- Russian gas production tries to adjust to the weak internal and export gas consumption growth rates
- IGPs production is booming against stagnation at Gazprom, there is increasing output by all producers of more profitable wet gas (instead of traditional dry gas)
- Gazprom has to sell gas at the regulated FTS price while IGPs have an opportunity to provide price discounts
- As a result Gazprom has to constrain its own supplies, while independents actively expanded into end users market
- In order to ease pressure on the domestic market, partial breakup of the gas export monopoly was approved (for LNG).

Increasing role of the IGPs at the expense of Gazprom

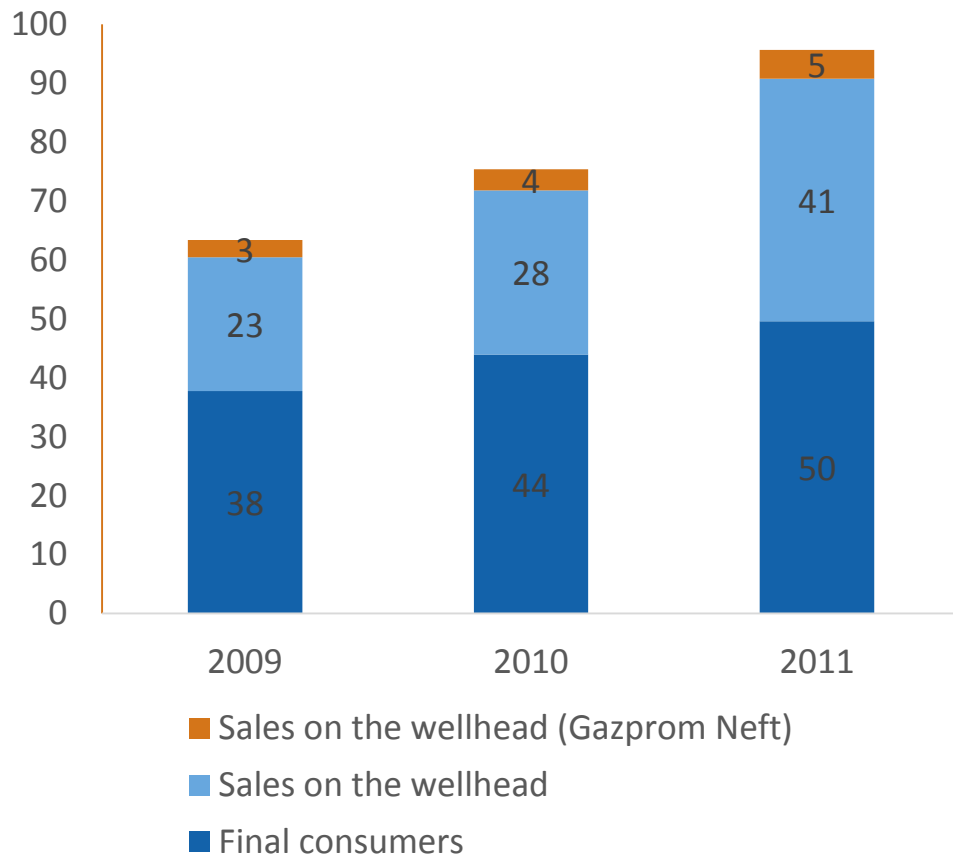
Russian gas production structure by company



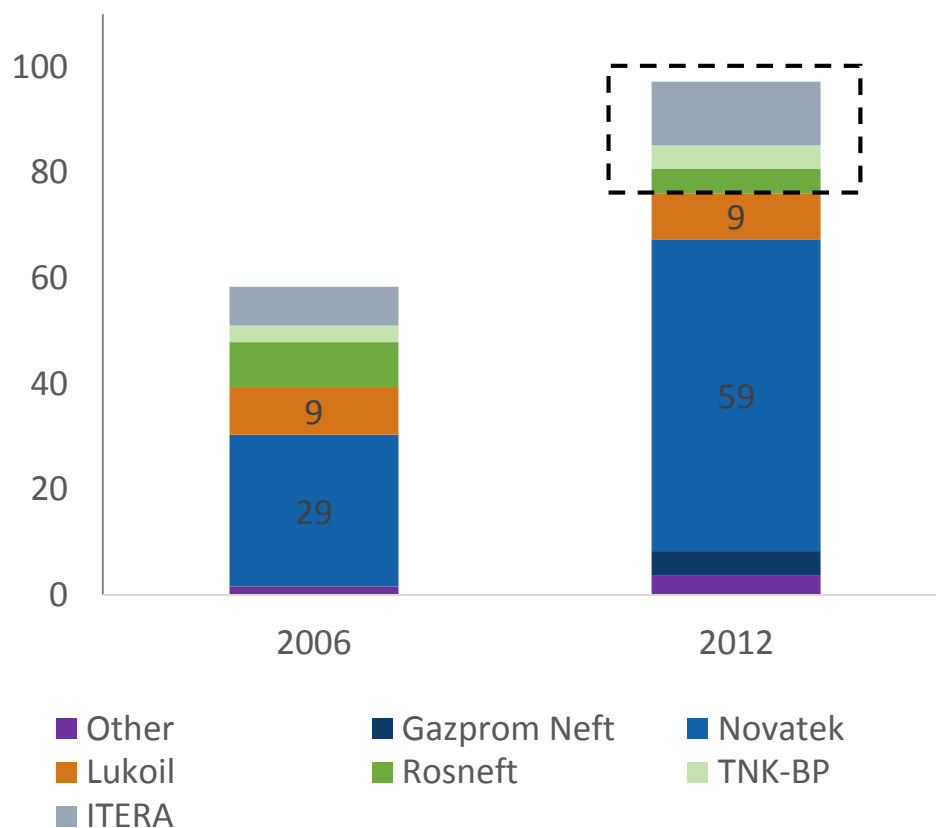
Sources: Rosstat, ERI RAS

Growing role of IGPs on the final markets and their consolidation increase pressure on Gazprom

Sales by the major independents, bcm



Major independents gas production, bcm



Sources: Rosstat, ERI RAS, CDU TEK

LNG export liberalization – just a part of a power game



Igor Sechin



Alexey Miller



Gennady Timchenko

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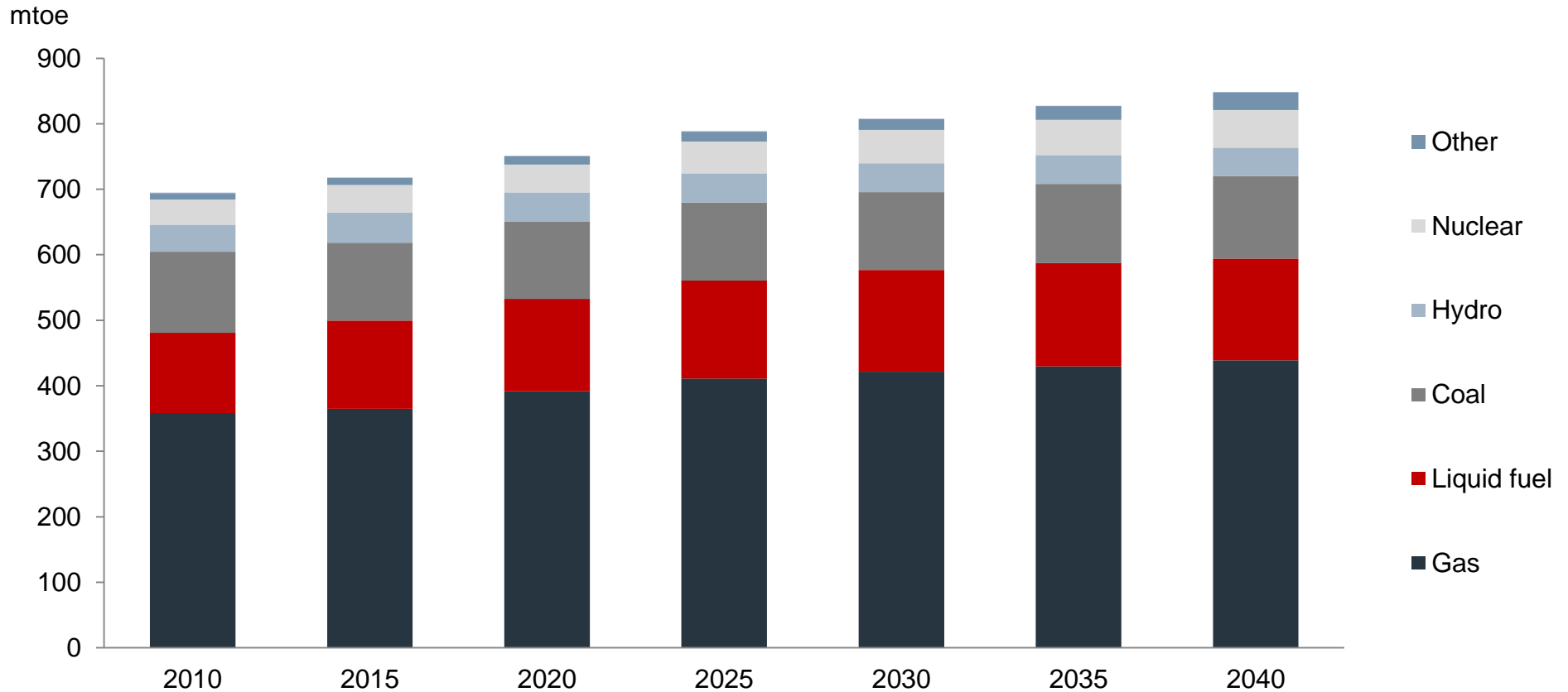
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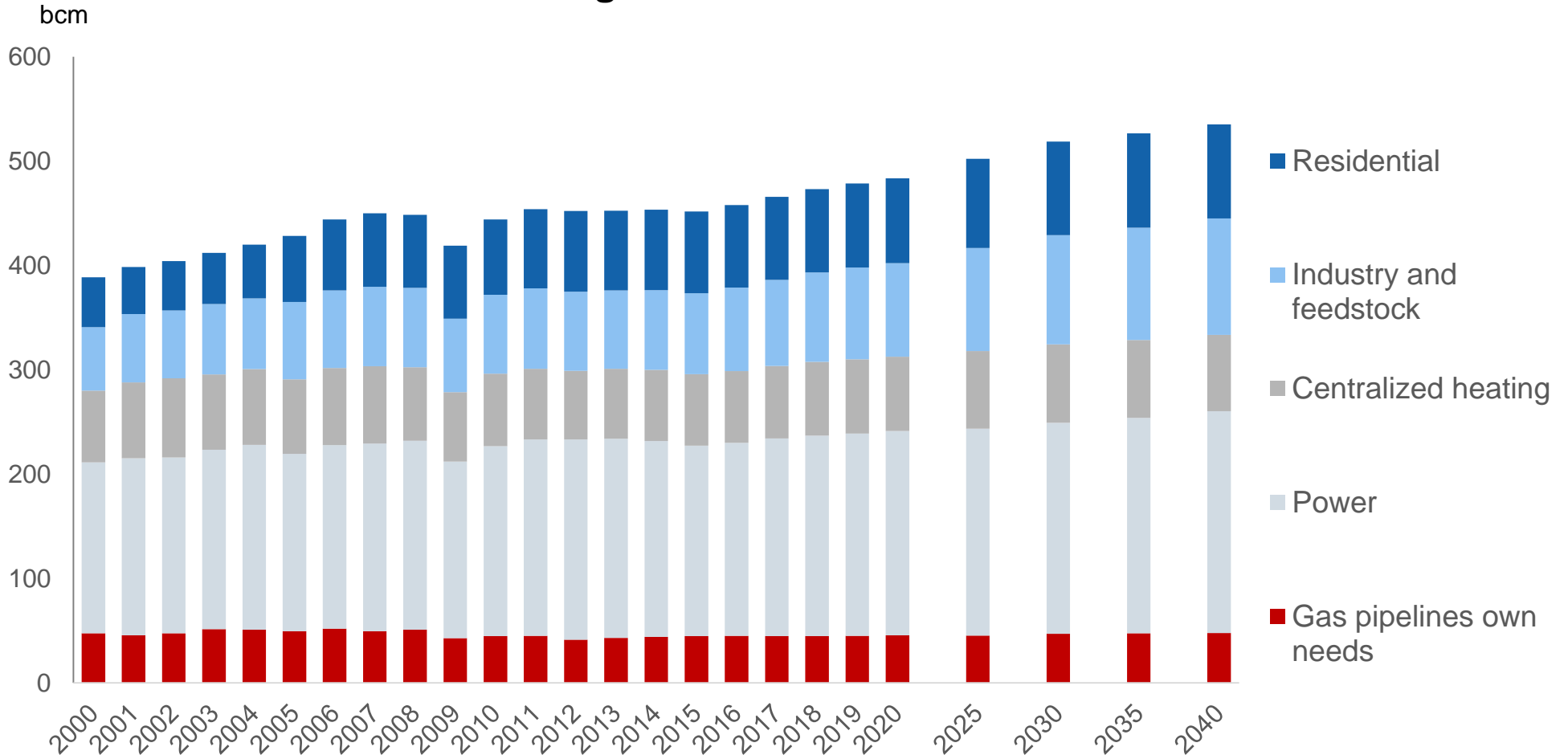
Natural gas will dominate in the Russian fuel mix with still 52% of total primary energy consumption by 2040

Russian primary energy consumption by fuel



Russian domestic gas demand will grow just 0,6% per annum mainly due to the increase of gas use in the industry and power generation

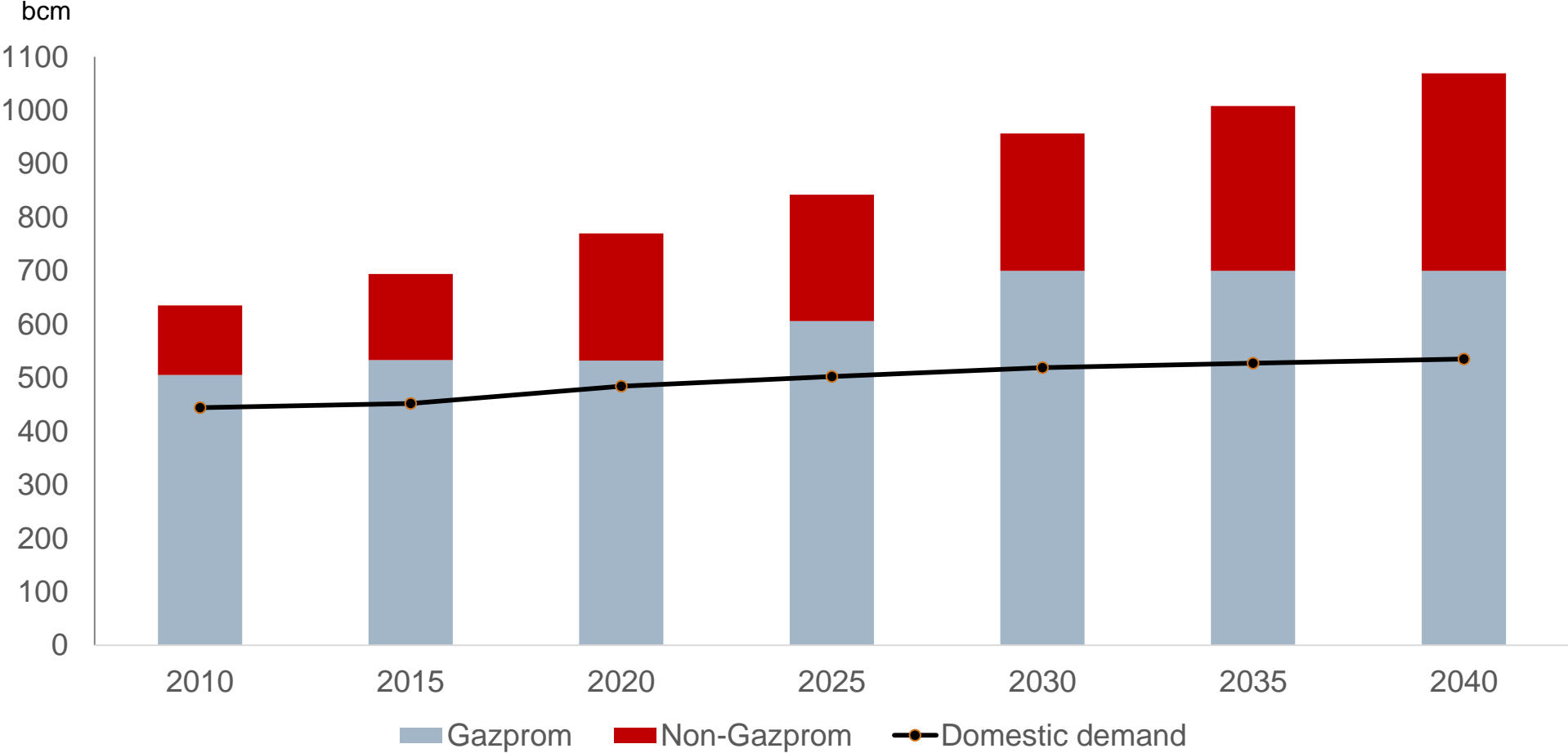
Russian gas demand structure forecast



Source: ERI RAS

Russian gas production potential is huge, significantly exceeding domestic demand

Russian gas production potential



Sources: ERI RAS

Future transformations of the Russian gas balance

- Russian gas production will remain essentially demand constrained
- Domestic gas demand growth will be constrained by the modest GDP and industrial output growth rates
- With slowly growing domestic gas market, Russia has huge export potential
- Oversupplied domestic market will lead to increased competition
- Russian exports in the coming years will stay under pressure, though tight gas market in Europe will allow Gazprom to restore its position for several years (until new massive LNG supplies come).
- The role of the Asia-Pacific market in the medium term will remain low until new pipeline supplies to China will start

Contacts

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