Russian Gas Supplies to Europe

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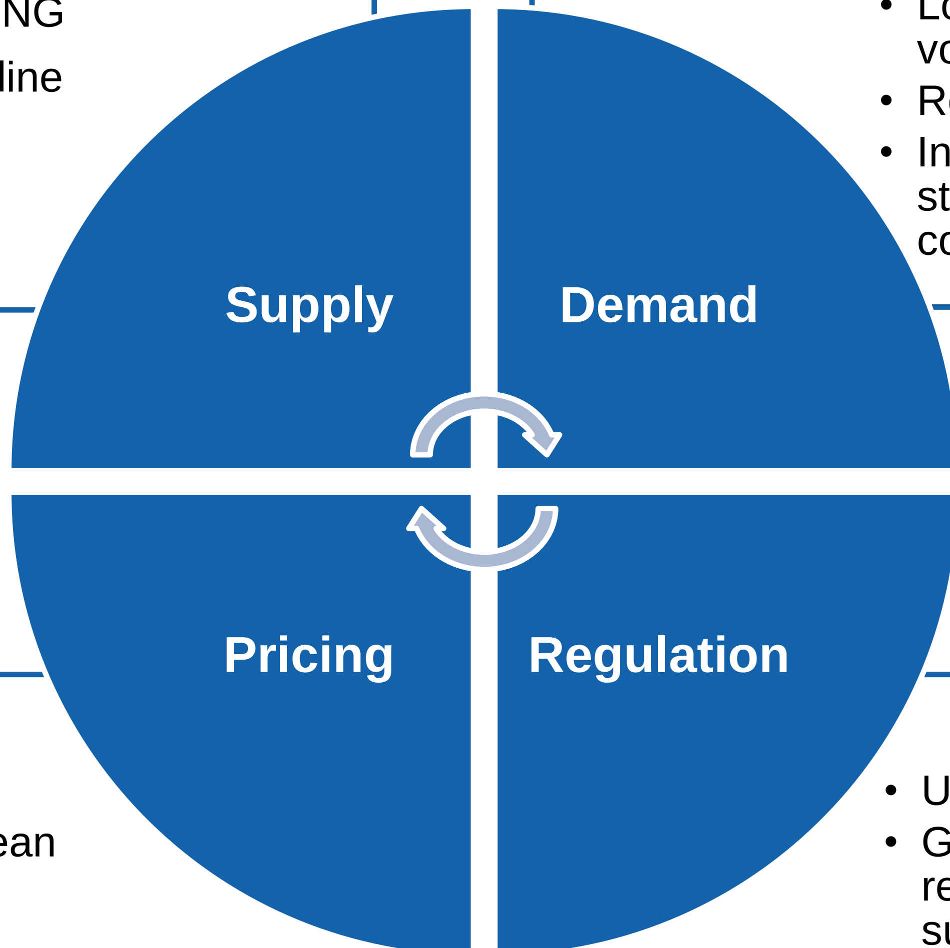
Oslo
June 5, 2013

Situation on the European gas market does not favor Russian exports

- Growing supplies of LNG
- Diversification of pipeline supply sources

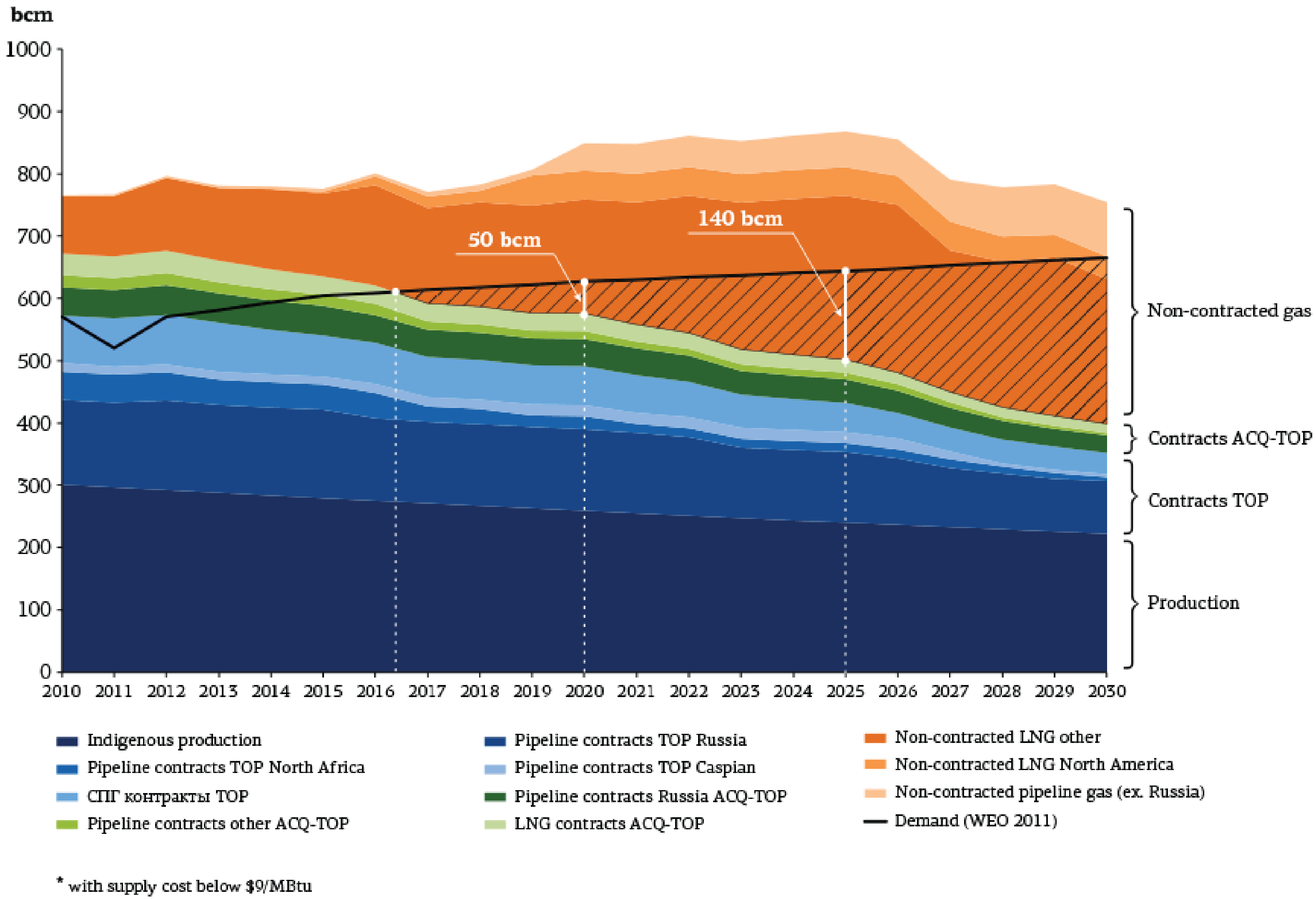
- Lower than contracted volumes
- Recovers very slowly
- In the power sector gas is strongly competing with coal



- Spot volumes are increasing very fast (30-40% p.a.)
- Majority of the European stakeholders support transition to the spot pricing

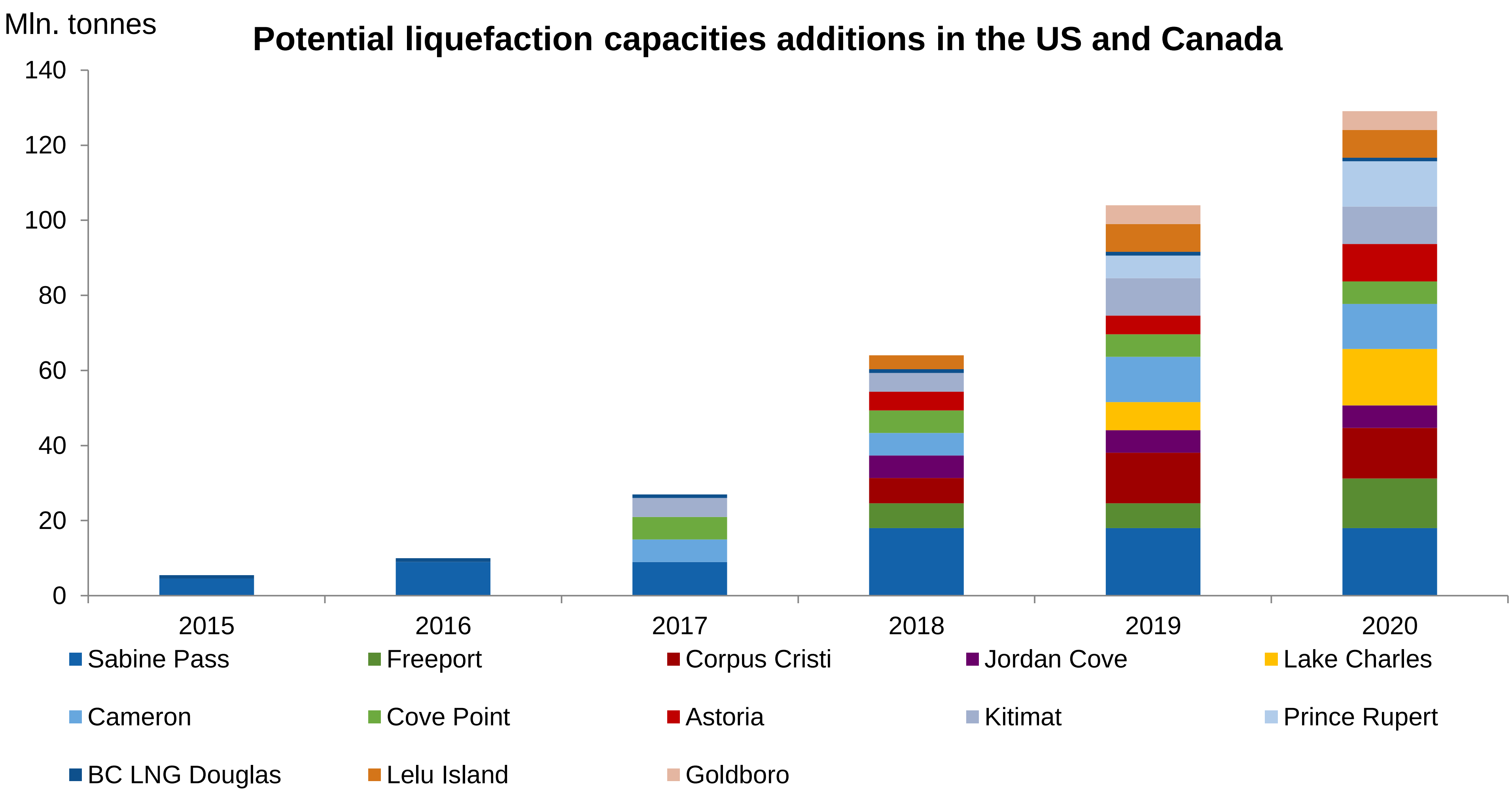
- Unbundling
- Gas Target Model requires all gas to be supplied at the virtual hubs

Market niche in Europe: strong competition in the future



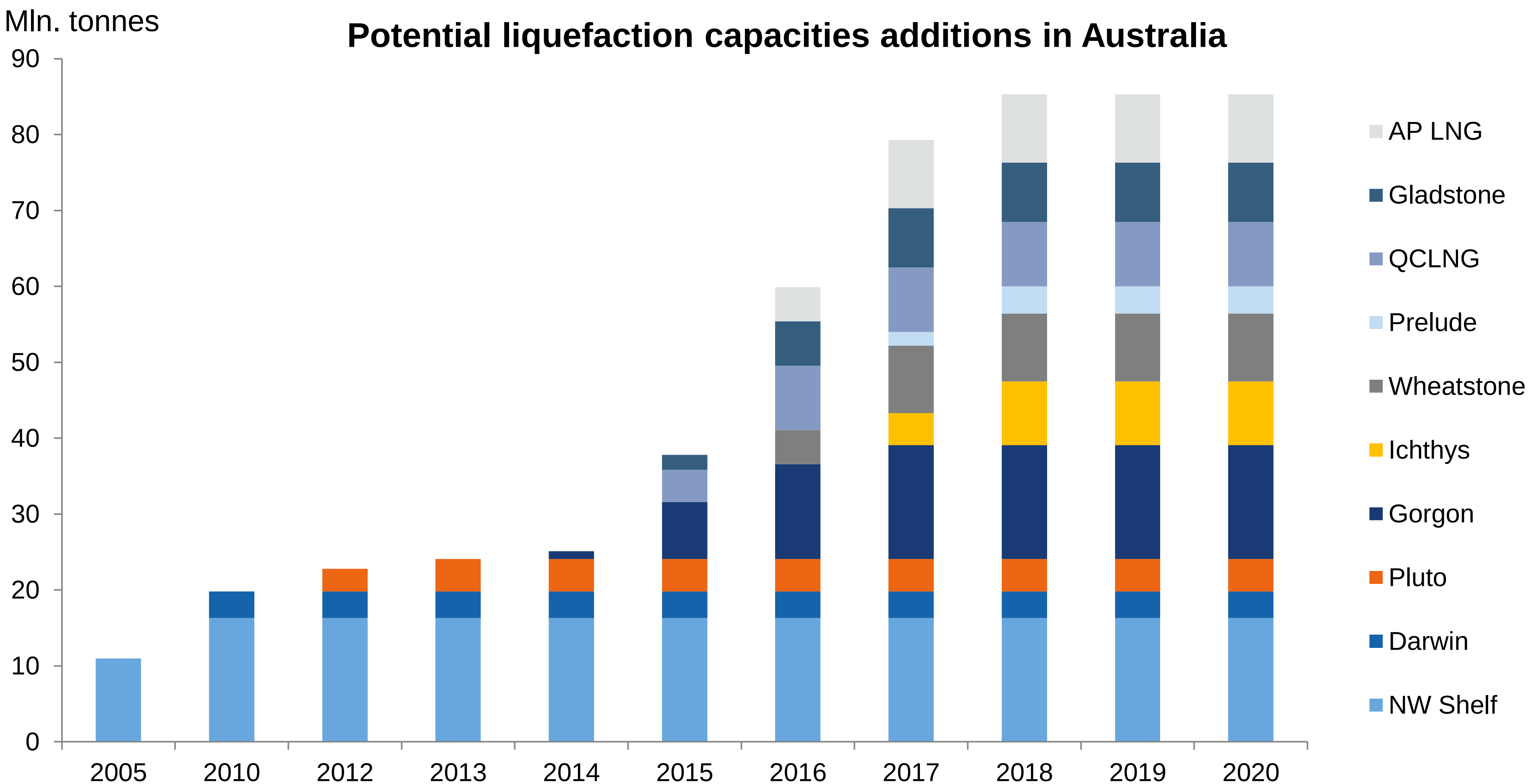
Source: WEO2011, IEA; Cedigaz; SKOLKOVO Business school Energy Centre.

We don`t know the future US (and Canadian) LNG export volumes



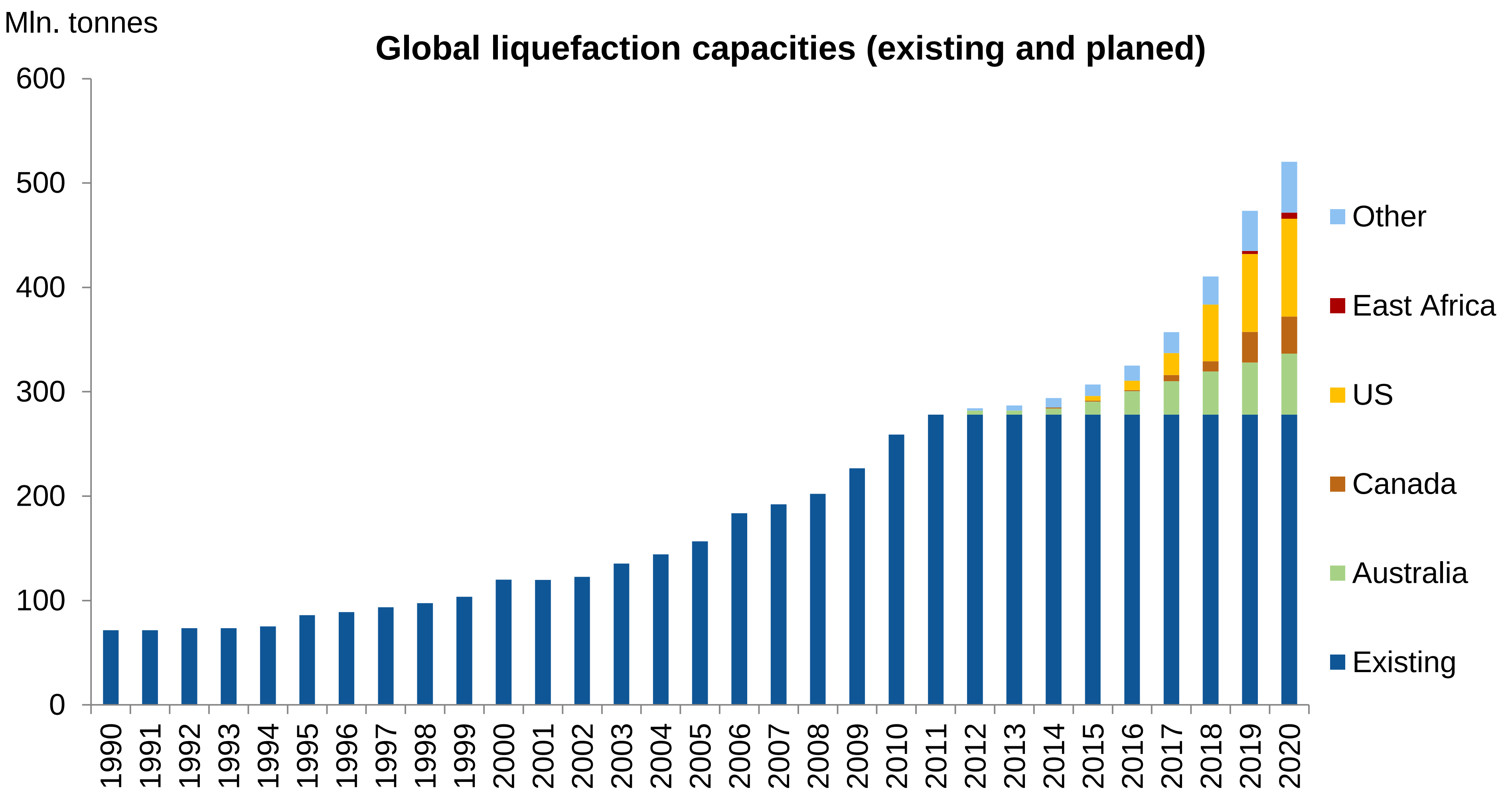
Source: ERI RAS

New projects will make Australia LNG producer #1 by 2018



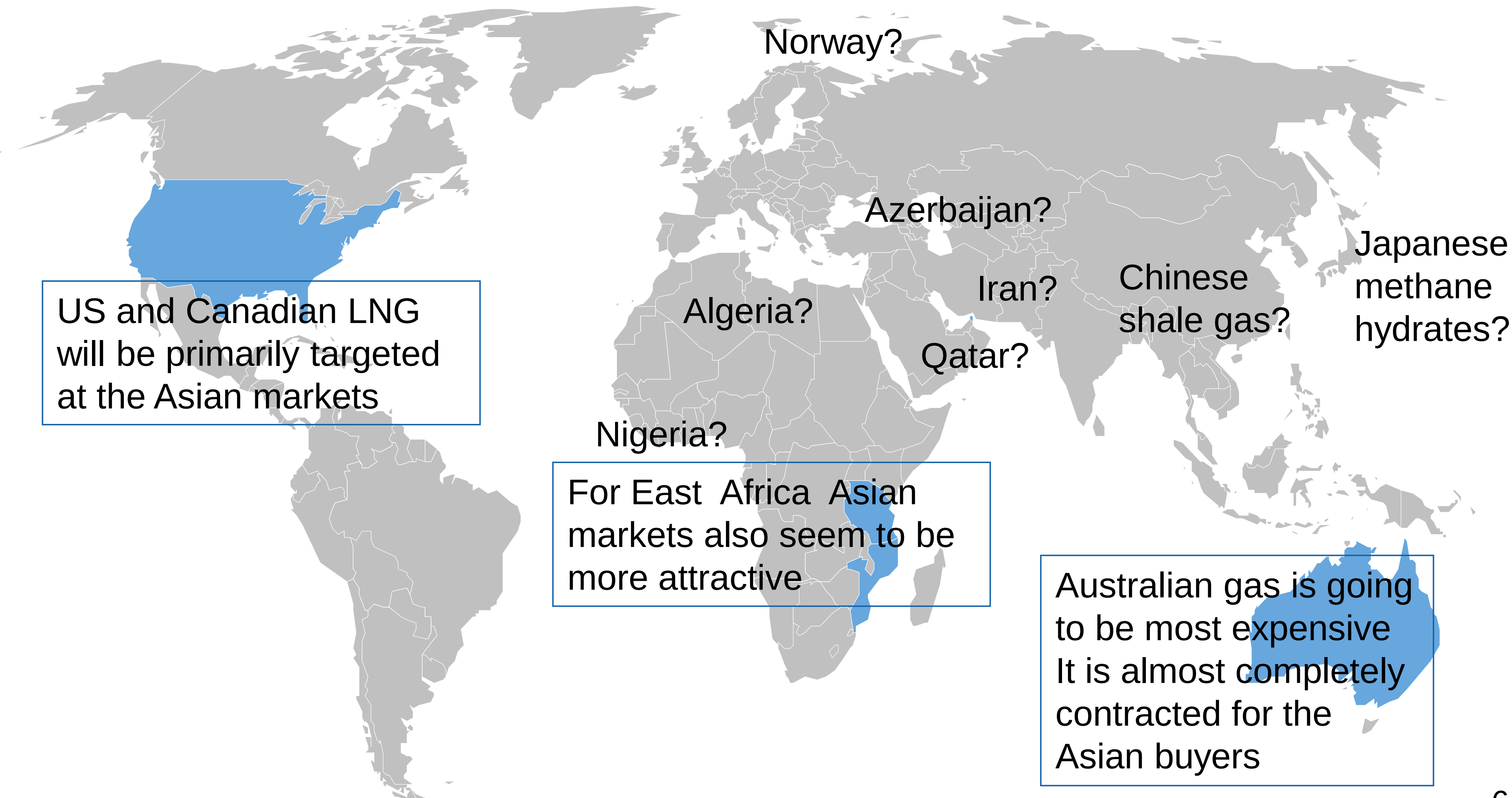
Source: ERI RAS

Global LNG supply is expected to boom during the next decade

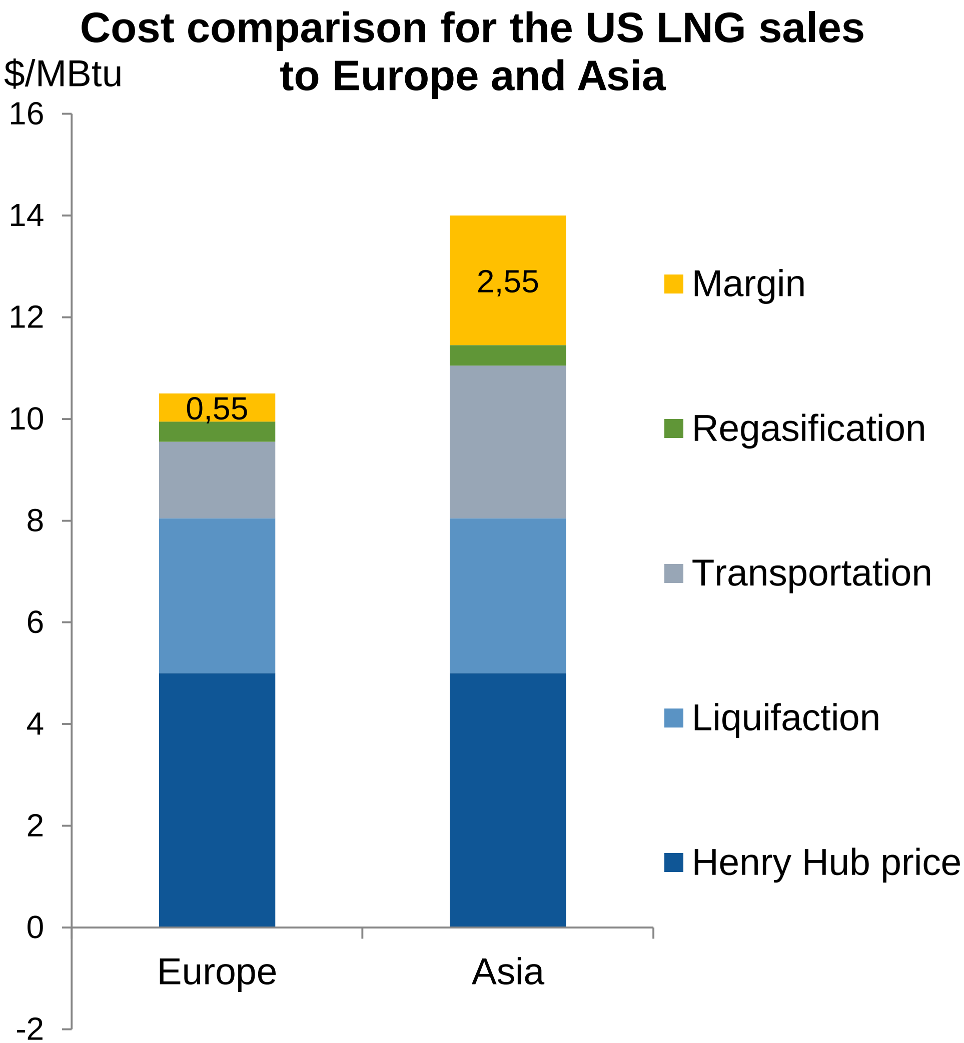


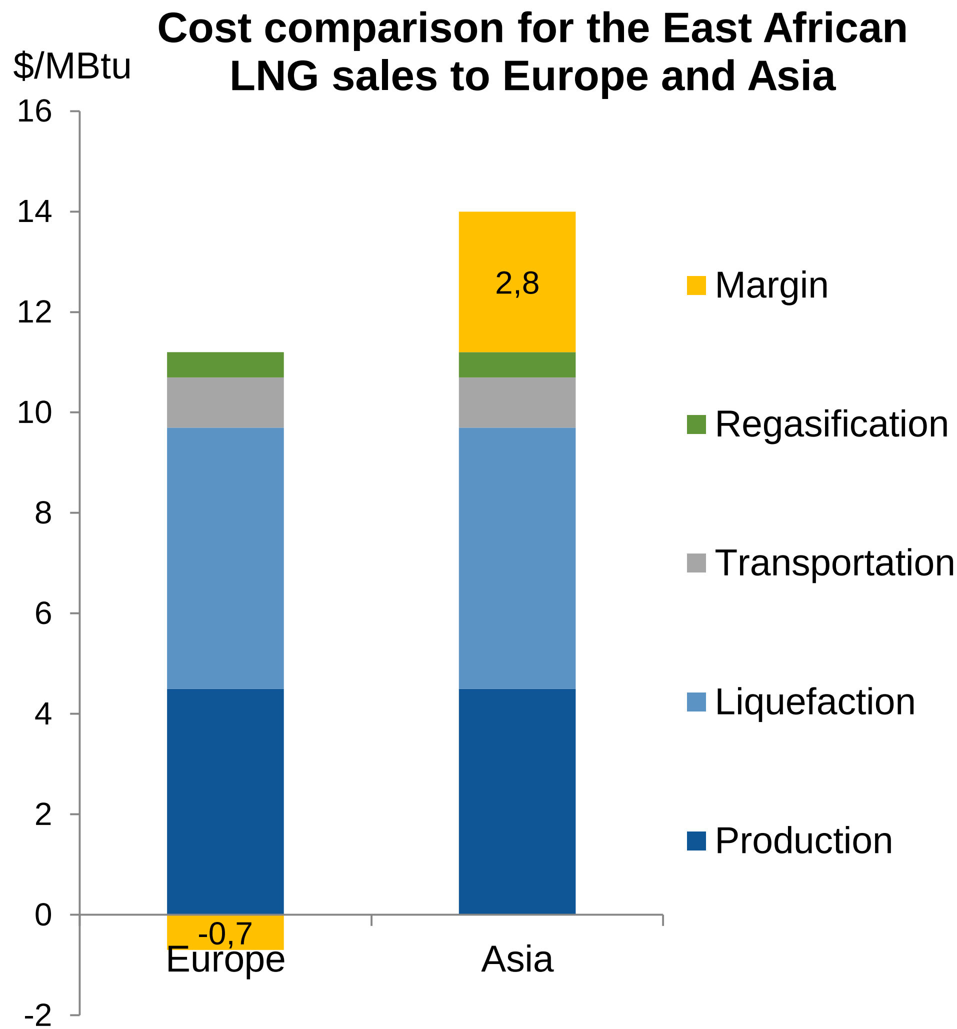
Source: ERI RAS

Devil is in the details:
new additional gas to Europe - where will it come from?



Both for the North American and for East African LNG Asia seems to be much more attractive market



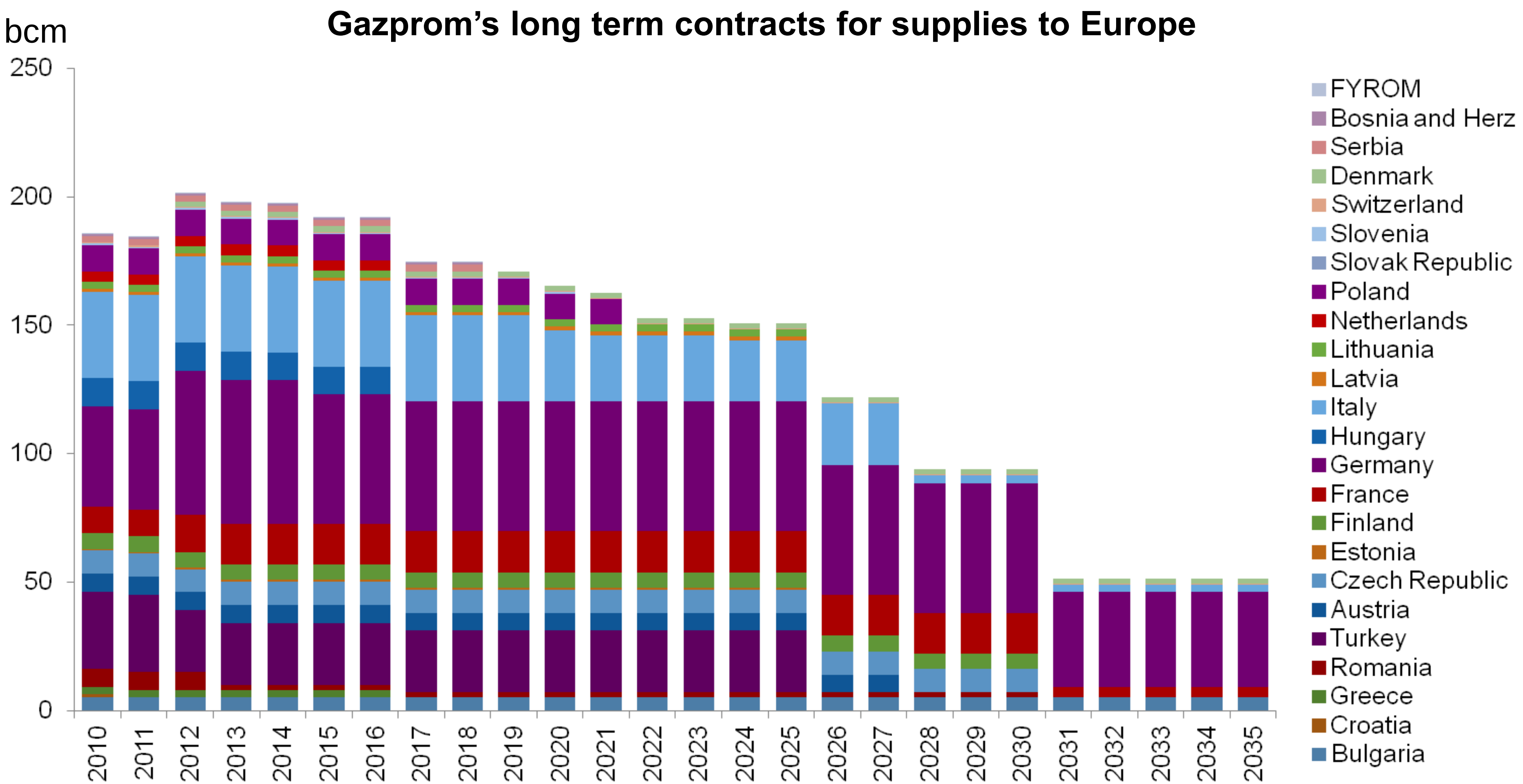


Source: ERI RAS

Evolution of the Russian gas export strategy: what will be the Russian response?

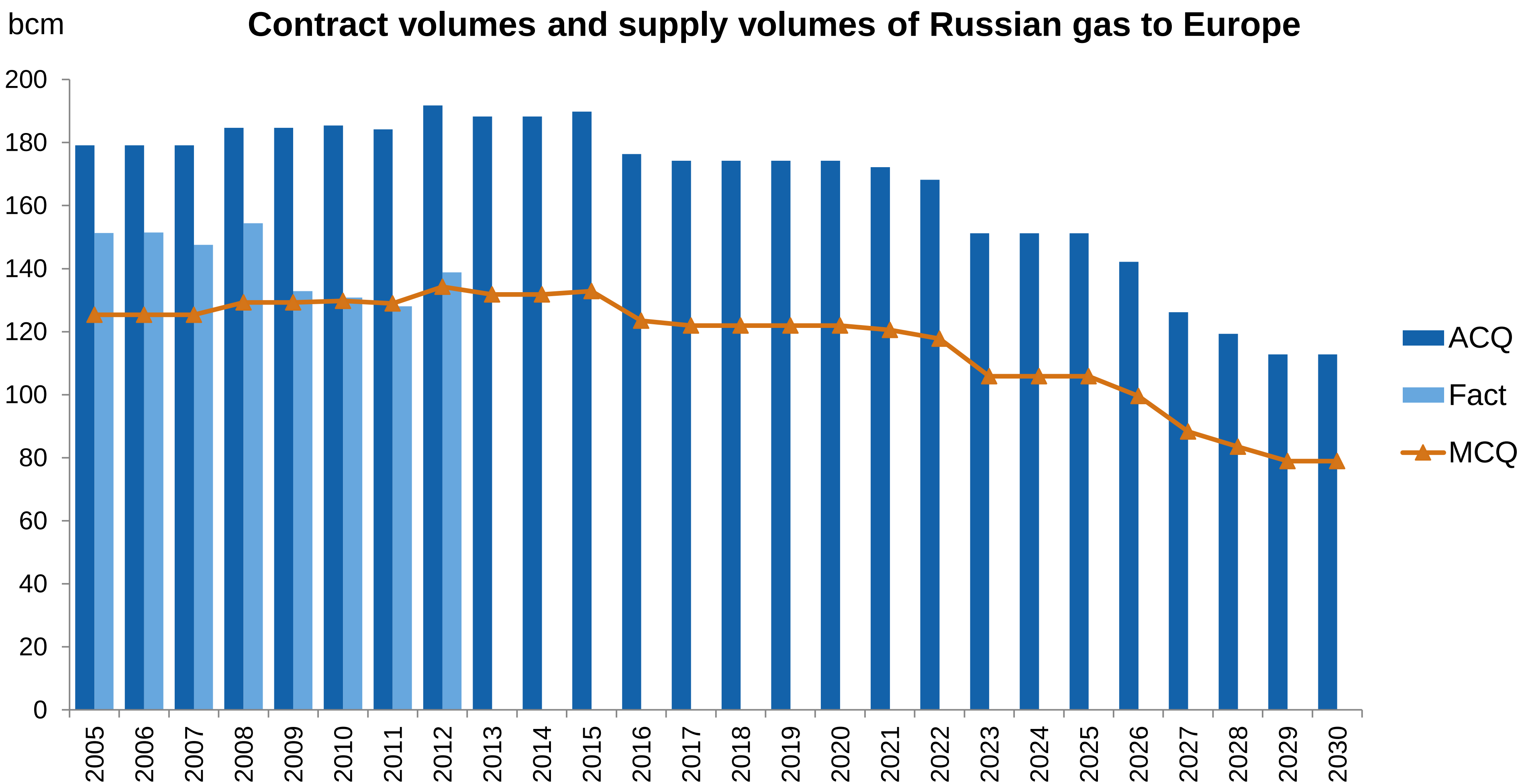
Traditional strategy 1990-2002	Miller`s team strategy 2002-2008	Anti-crises strategy 2009-2013	??? 2013-2020
Volume maximization, Price damping	Price maximization and volume growth	Minimal price adjustments acceptable for the consumers (price maximization in the new conditions), stagnating volumes	Most probably price maximization
One target market – Europe Only pipeline gas	One target market – Europe Only pipeline gas	Attempts to diversify markets (Asia) Strong desire to develop LNG	

Gazprom has a huge portfolio of oil-linked long term contracts for supplies to Europe for the next 25 years and longer



Source: Enerdata, ERI RAS..

Existing long-term contracts guarantee stable sales volumes for Russia until at least 2022



Sources: Cedigaz, Gazprom, ERI RAS.

Arguments: oil indexation vs. gas indexation

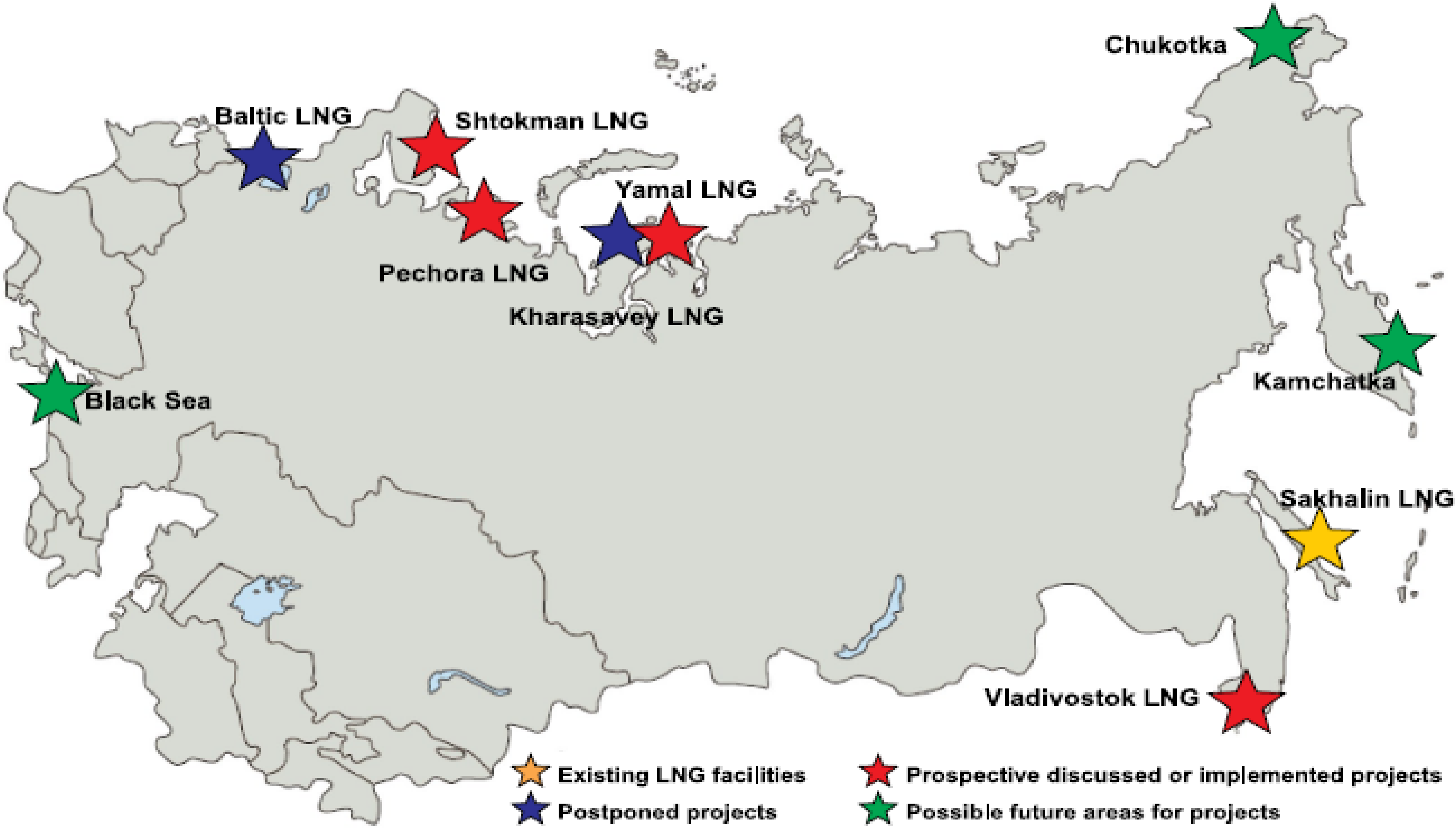
Oil indexation	Spot indexation
▪ Disappearing gas glut on the European gas market in the medium term – gap between oil-indexed and spot prices will narrow ▪ Arbitration lasts for several years ▪ Gazprom will face price reopening and contract expiration only after 2015 ▪ With high oil prices even lower sales volumes are providing high revenue ▪ New projects need high prices ▪ Oil indexation is needed for the project financing	▪ Strong pressure from the customer side ▪ Gazprom could demand financial compensation for contract review + 3rd Package exemption for the South Stream and NEL + transitional period for price adjustments + European-level financial support for its mega-projects (like EBRD and other European financial institutions) ▪ Gazprom could become a dominant player dictating prices at the spot market by changing its supply volumes

There are strong commercial reasons for Gazprom to protect the oil indexation at least during the next 3 years

Eastern Gas Program: from discussion to the real investments

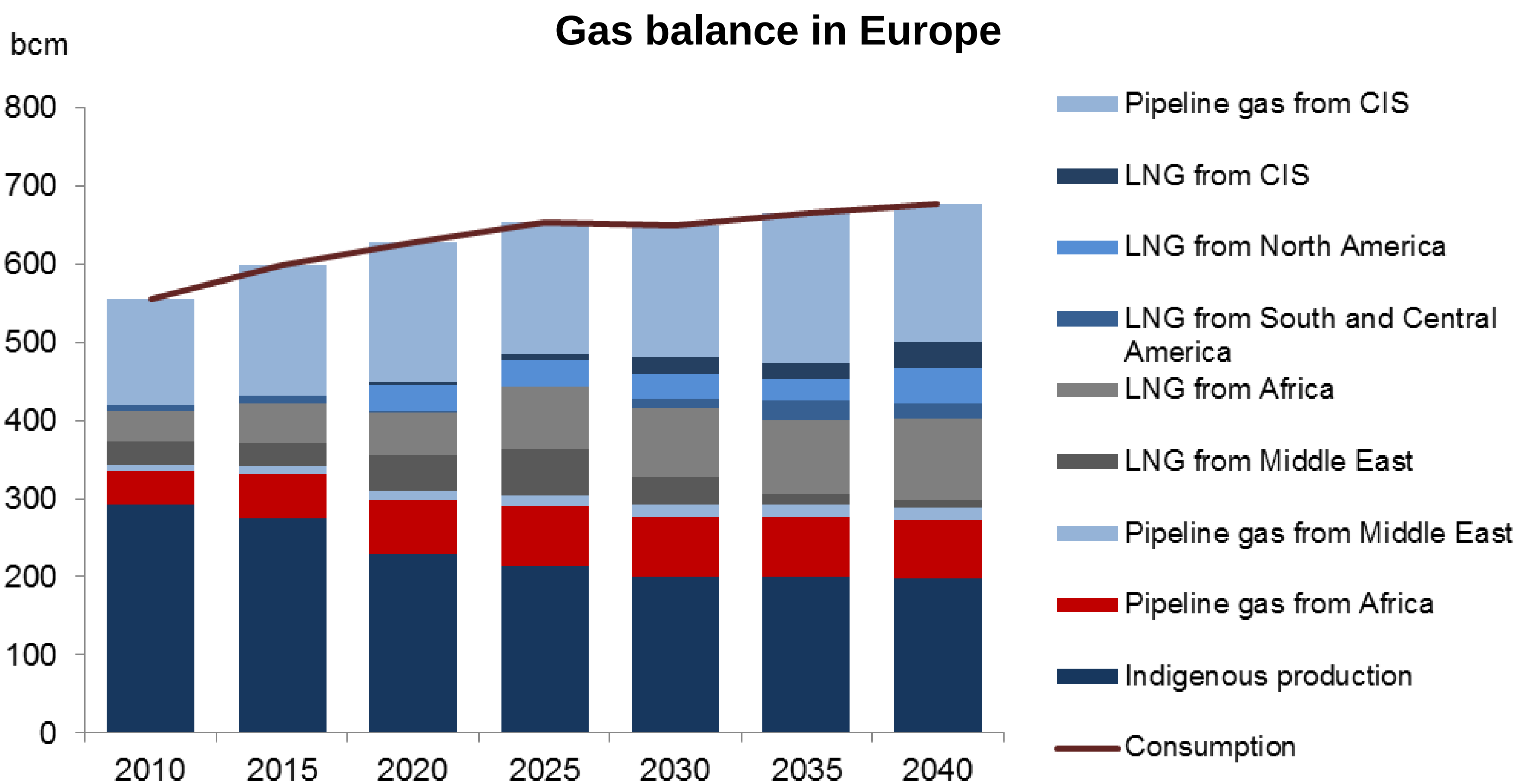
Sources: Gazprom

Russian LNG projects: challenges and increasing competition



Source: ERI RAS

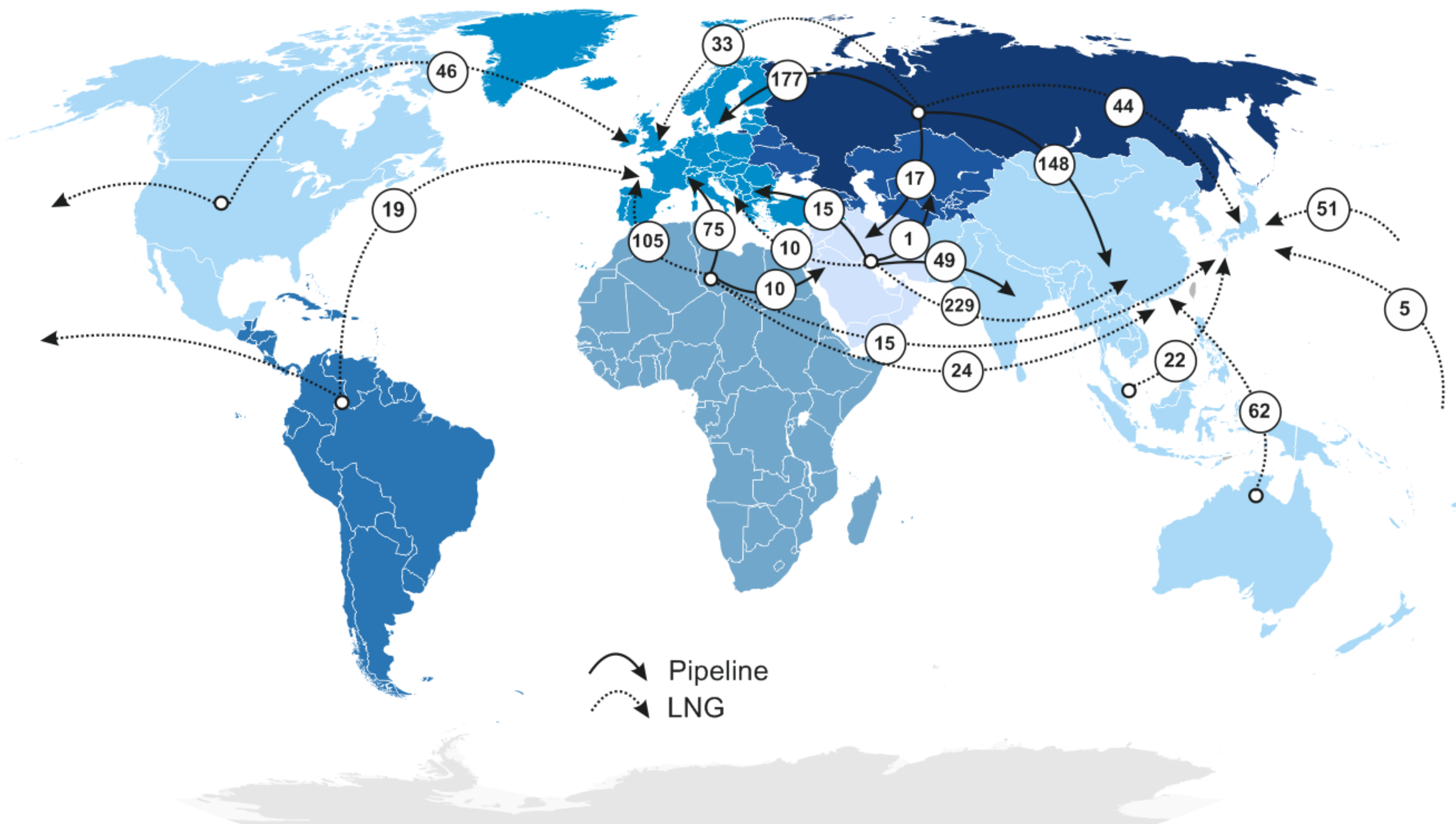
European gas market: in the long term all suppliers will be needed to feel the gap



Source: Global and Russian Energy Outlook up to 2040. ERI RAS-AC. 2013.

In the long term Europe will have to compete with Asia for gas supplies

Inter-regional gas trade in 2040, bcm



Source: Global and Russian Energy Outlook up to 2040. ERI RAS-AC. 2013.

Conclusion: Russian response

» Russia is for the first time facing demand constraints on its export markets

» European policy and market situation create no incentives to invest in additional gas supplies to Europe

» There are strong commercial reasons for Gazprom to protect the oil indexation at least during the next 3 years, and there is strong political will to protect oil linkage

» Russia will have to market more expensive gas from the new projects, revenue maximization seems to be more attractive

» Russian gas export policy response so far includes three pillars:

- Price reviews with minor adjustments (remaining oil indexation as a basis)
- Eastern development
- LNG

» Discussion on gas exports liberalization might be only for special cases and only under very strict control of the State

Contacts

Energy Research Institute of the Russian Academy of Sciences

"Global and Russian Energy Outlook up to 2040"

http://www.eriras.ru/files/Global_and_Russian_energy_outlook_up_to_2040.pdf

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