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

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

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

- 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

Potential liquefaction capacities additions in the US and Canada

Source: ERI RAS
New projects will make Australia LNG producer #1 by 2018

Potential liquefaction capacities additions in Australia

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?

US and Canadian LNG will be primarily targeted at the Asian markets.

Australian gas is going to be most expensive. It is almost completely contracted for the Asian buyers.

For East Africa, Asian markets also seem to be more attractive.

Norway?

Qatar?

Chinese shale gas?

Japanese methane hydrates?

Azerbaijan?

Iran?

Nigeria?

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

**Cost comparison for the US LNG sales to Europe and Asia**

- Europe: 0.55
- Asia: 2.55

**Cost comparison for the East African LNG sales to Europe and Asia**

- Europe: -0.7
- Asia: 2.8

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

- **Traditional strategy**
  - 1990-2002
  - Volume maximization, Price damping
  - One target market – Europe
  - Only pipeline gas

- **Miller`s team strategy**
  - 2002-2008
  - Price maximization and volume growth
  - One target market – Europe
  - Only pipeline gas

- **Anti-crisis strategy**
  - 2009-2013
  - Minimal price adjustments acceptable for the consumers (price maximization in the new conditions), stagnating volumes
  - Attempts to diversify markets (Asia)
  - Strong desire to develop LNG

- **??**
  - 2013-2020
  - Most probably price maximization
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

<table>
<thead>
<tr>
<th>Oil indexation</th>
<th>Spot indexation</th>
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<tbody>
<tr>
<td>Disappearing gas glut on the European gas market in the medium term – gap between oil-indexed and spot prices will narrow</td>
<td>Strong pressure from the customer side</td>
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<td>Arbitration lasts for several years</td>
<td>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)</td>
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<tr>
<td>Gazprom will face price reopening and contract expiration only after 2015</td>
<td>Gazprom could become a dominant player dictating prices at the spot market by changing its supply volumes</td>
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<td>With high oil prices even lower sales volumes are providing high revenue</td>
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<td>New projects need high prices</td>
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<td>Oil indexation is needed for the project financing</td>
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</table>

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

Gas balance in Europe

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

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
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