

How Is Russia Responding To increased Global Competition From New Suppliers & How Will Russia Develop Its Export Strategy?

Dr. Tatiana Mitrova
Head of Oil and Gas Department
Energy Research Institute of the Russian Academy of Sciences



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EVERYTHING IS BAD ☹️

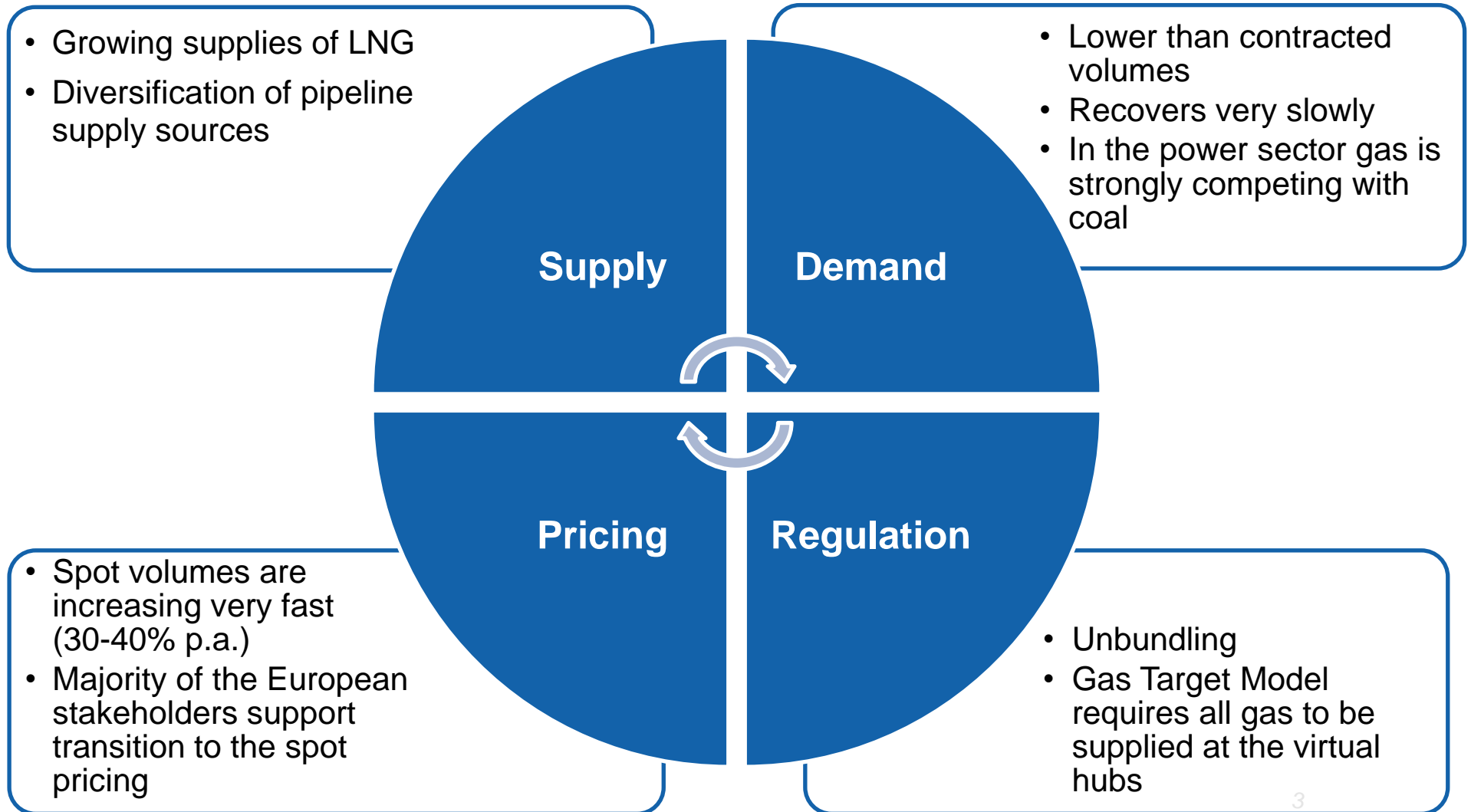
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IS IT THAT BAD?

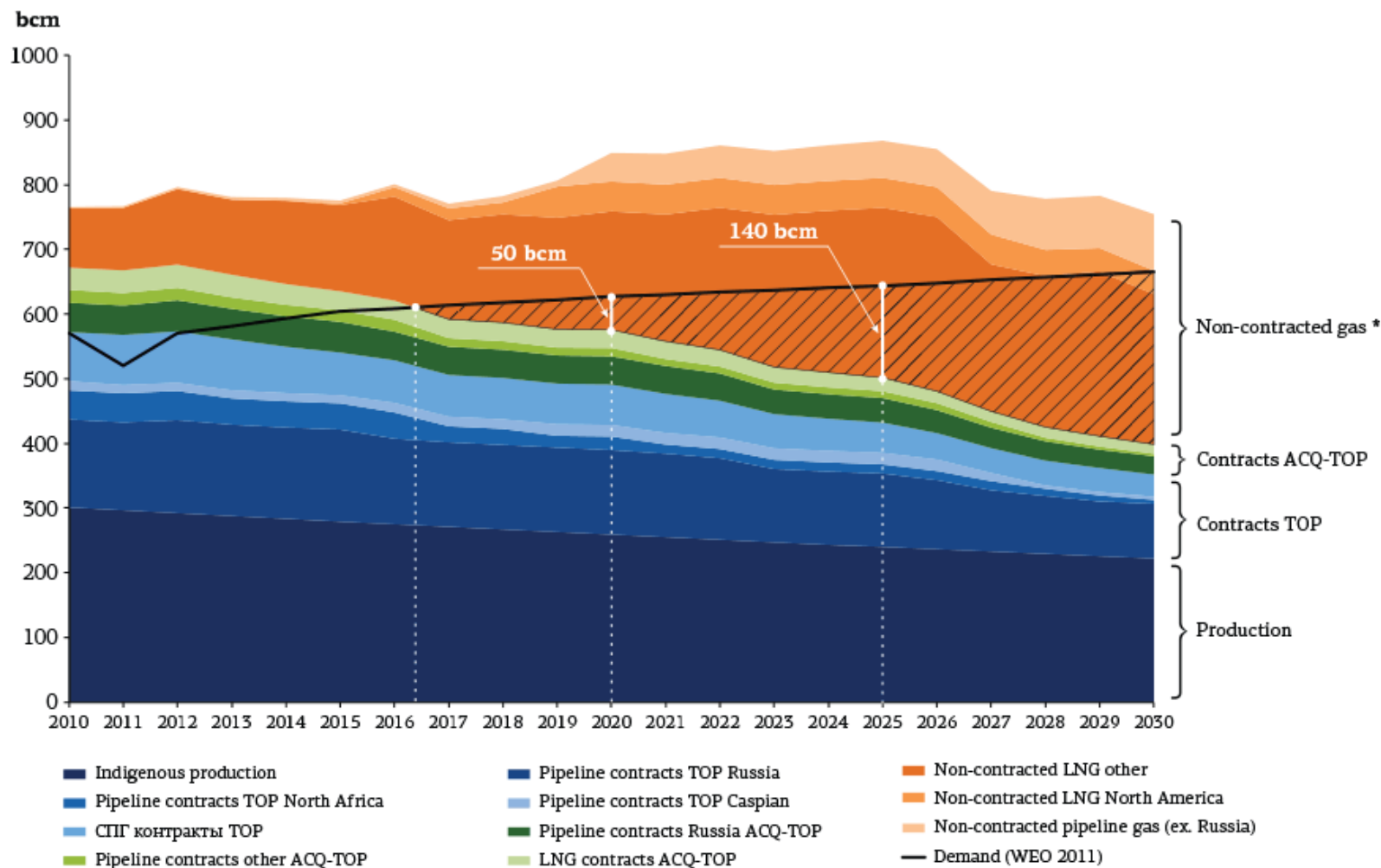
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SO WHAT IS THE RUSSIAN`S RESPONSE?

Situation on the European gas market does not favor Russian exports



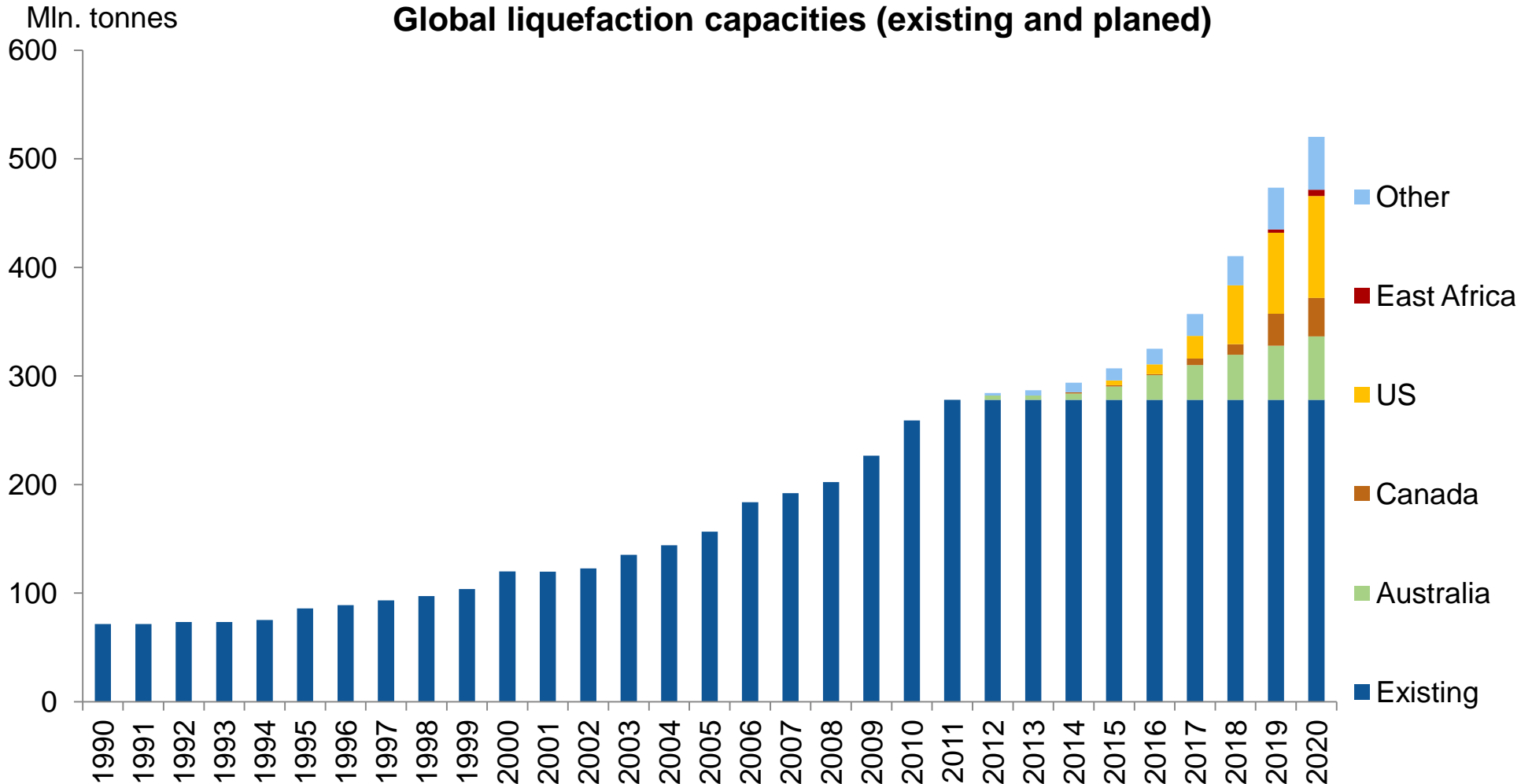
Market niche in Europe: strong competition in the future



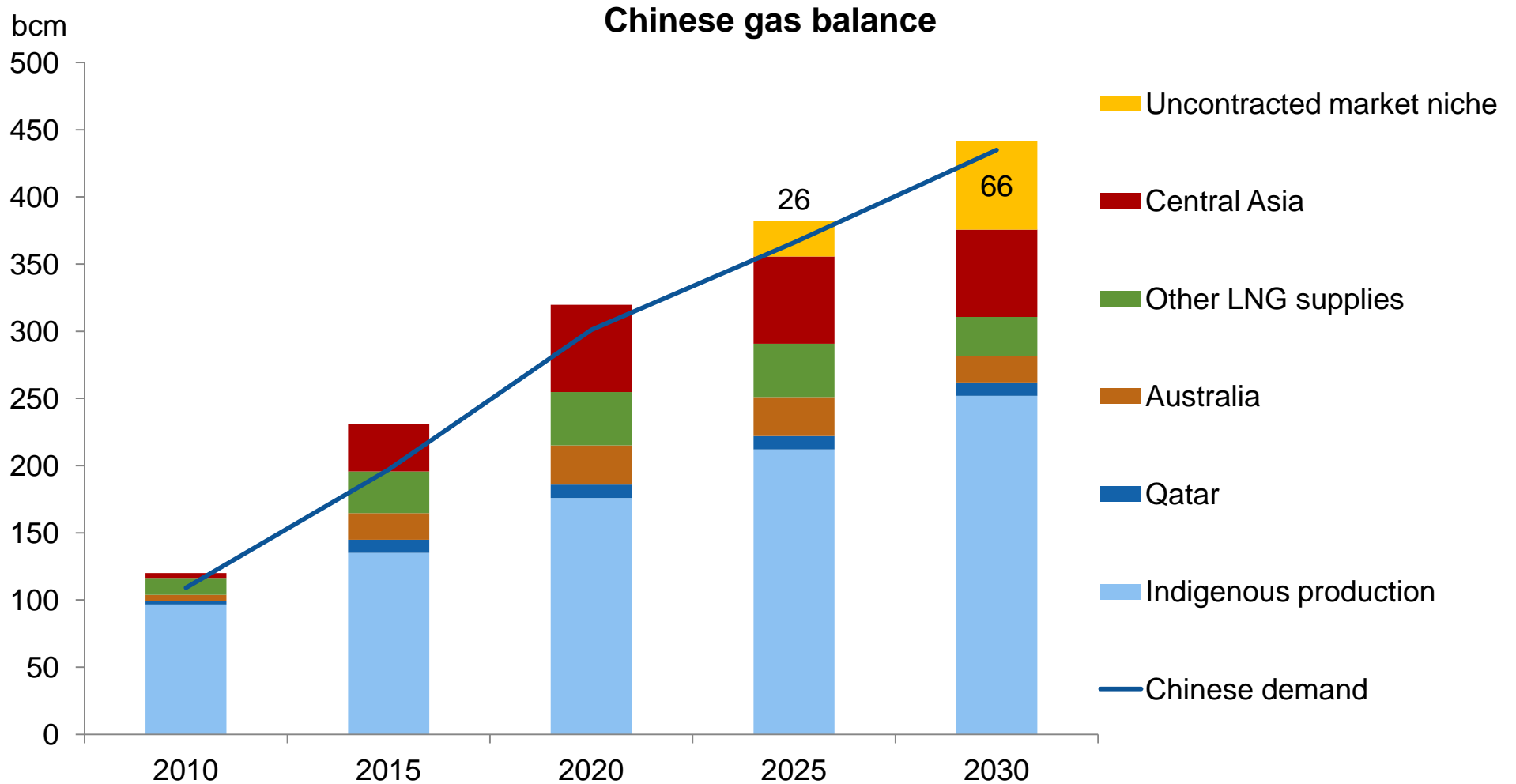
* with supply cost below \$9/MBtu

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

Global LNG supply is expected to boom during the next decade: it seems to be a buyers market

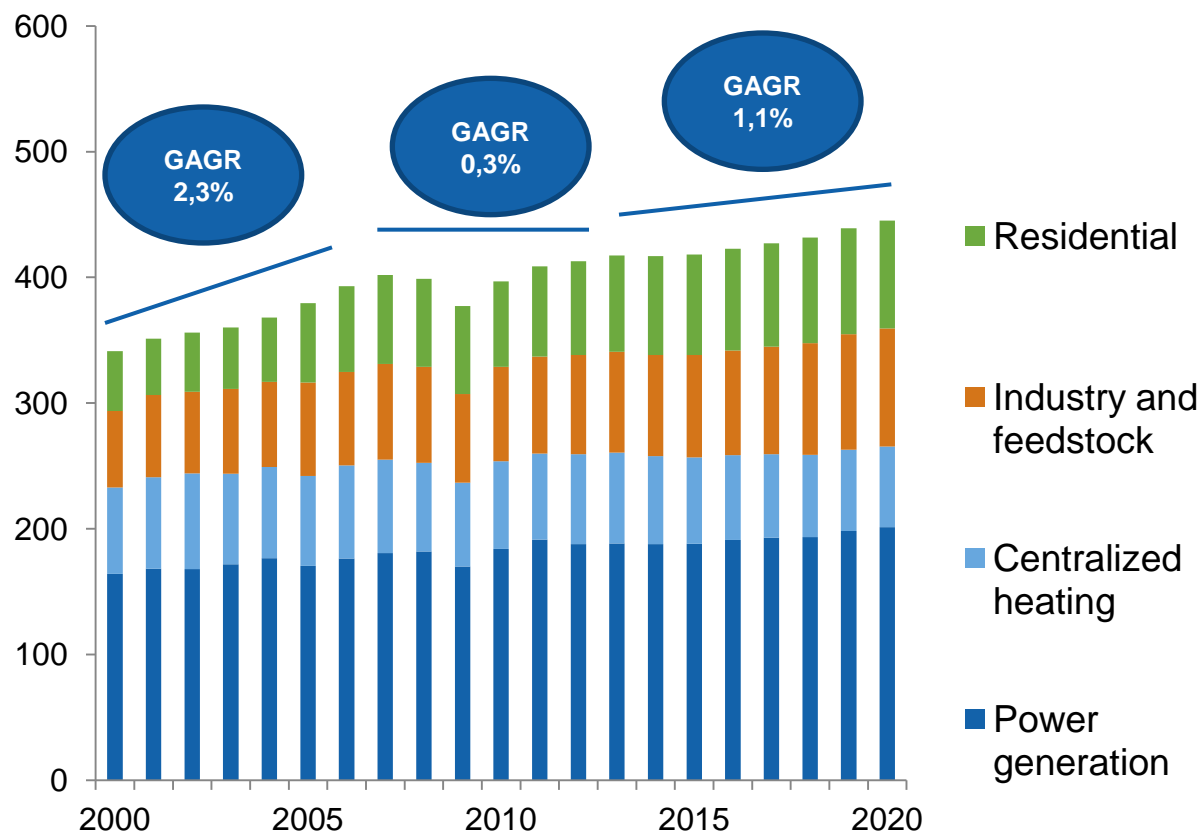


By 2020 there is no market niche in China, by 2030 the niche might reach 66 bcm



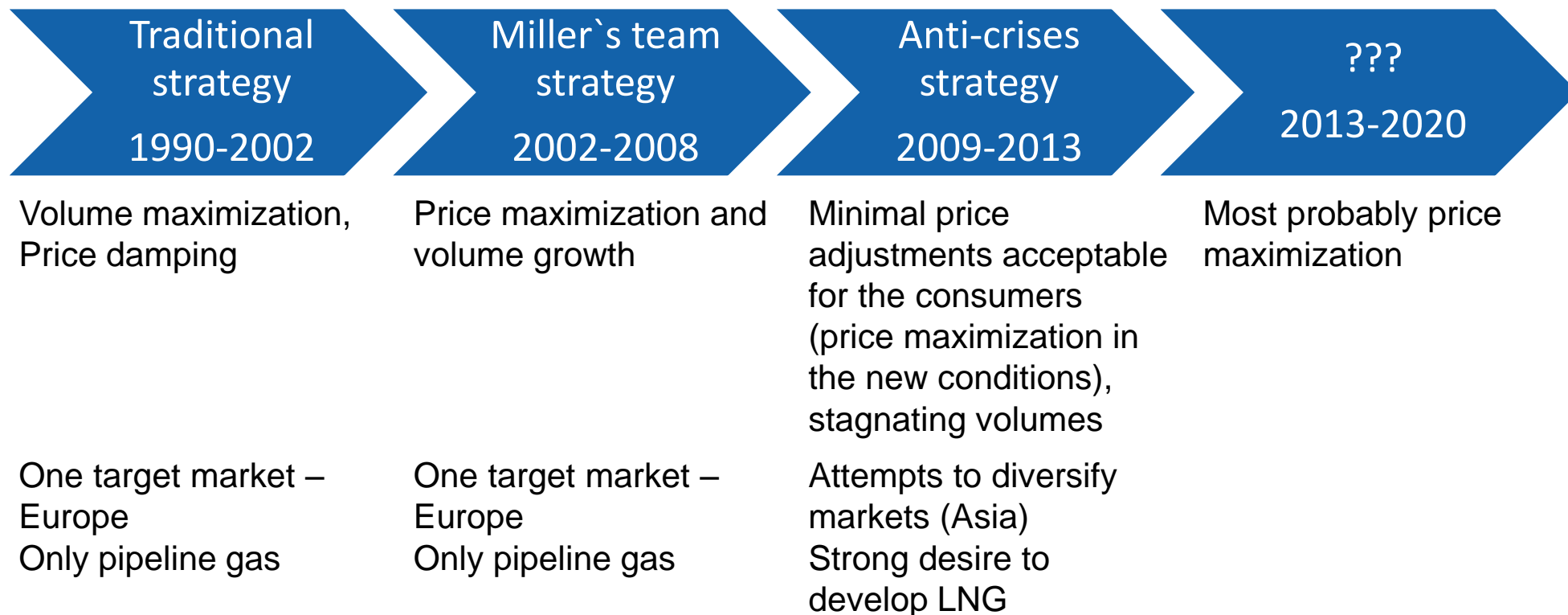
Limited demand on all markets, including domestic

Russian gas demand by sector until 2020 (optimistic scenario)



| | 2012 | 2020 | Δ | AGR 2012- 2020 |
|------------------------|------|------|----|----------------------|
| Total consumption | 428 | 468 | 40 | 1,12% |
| Power generation | 188 | 201 | 14 | 0,88% |
| Centralized heating | 72 | 64 | -7 | -1,36% |
| Industry and feedstock | 79 | 94 | 15 | 2,17% |
| Residential | 75 | 86 | 11 | 1,78% |

Evolution of the Russian gas export strategy



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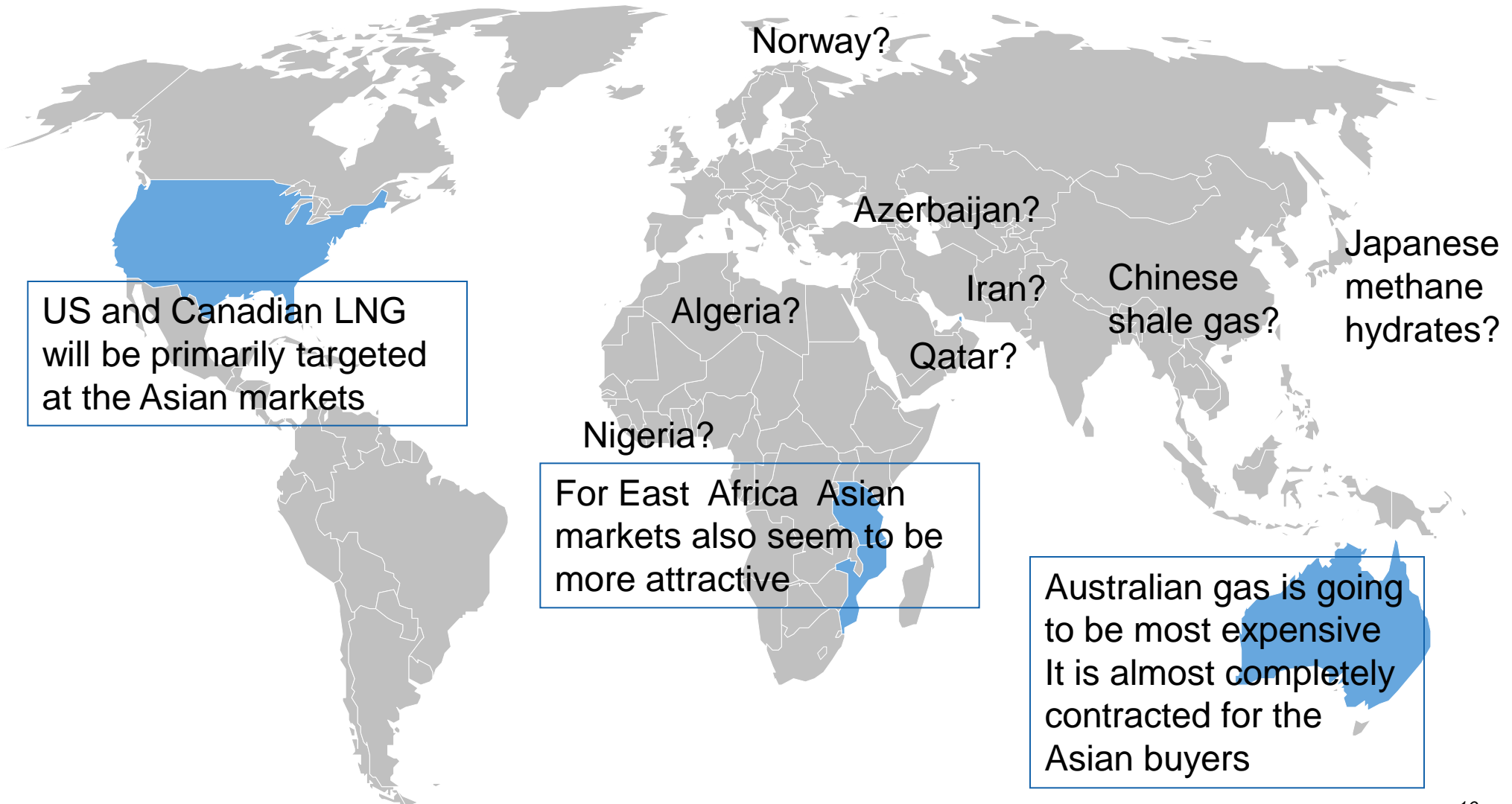
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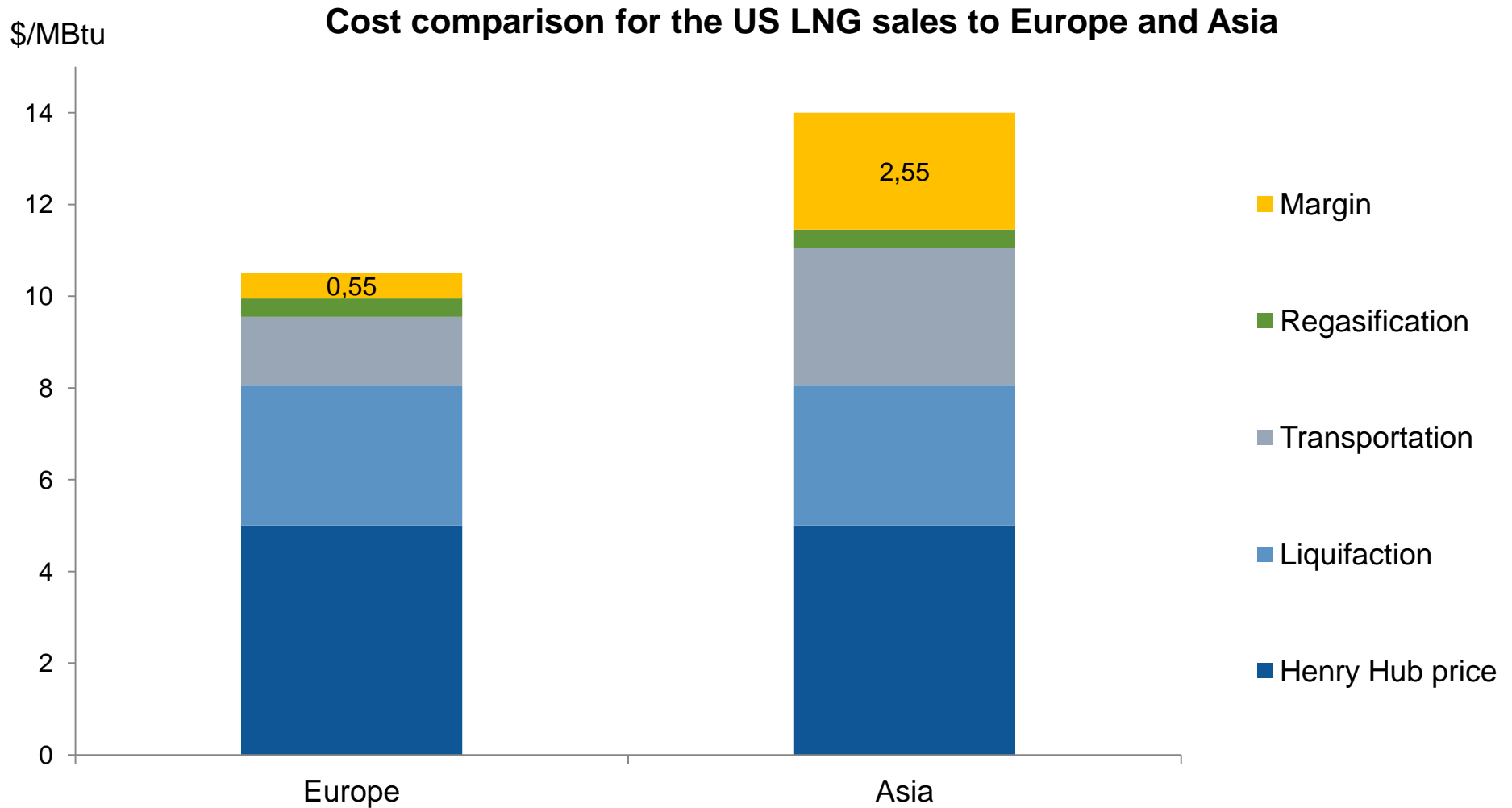
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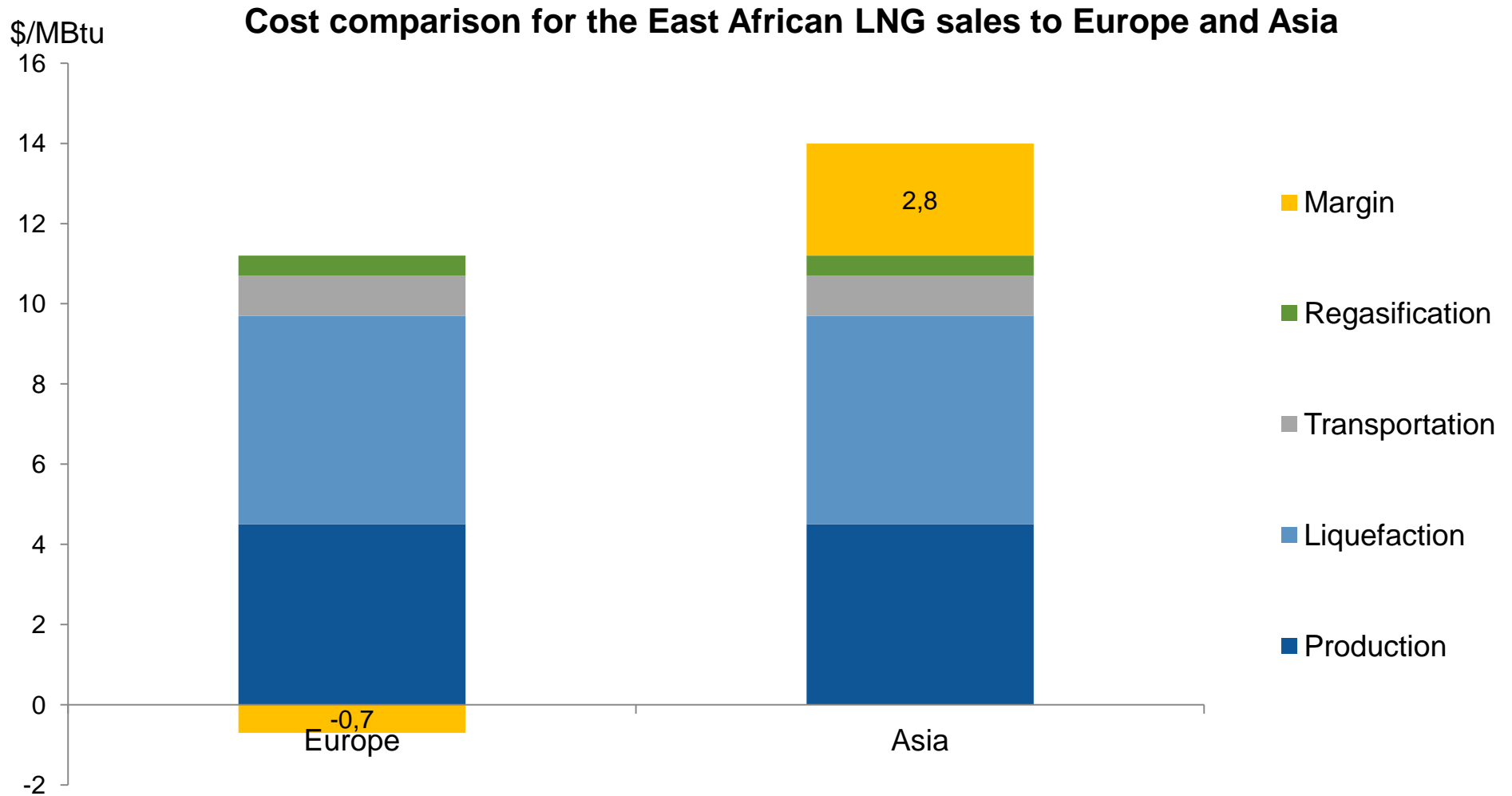
Devil is in detail: new additional gas to Europe - where will it come from?



US LNG seems to be competitive in Europe, but Asia is a much more attractive market for it



The same situation with East African LNG



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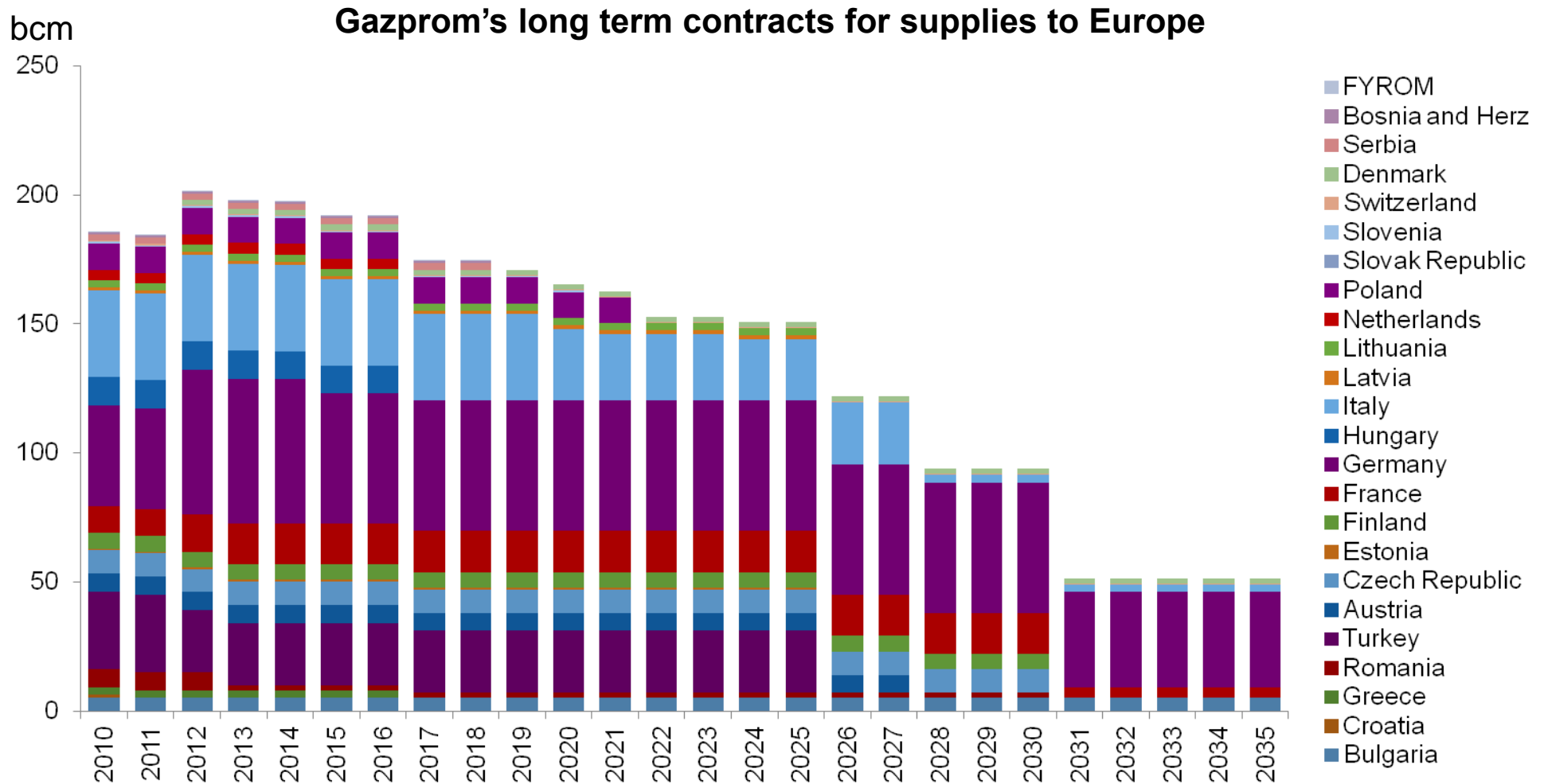
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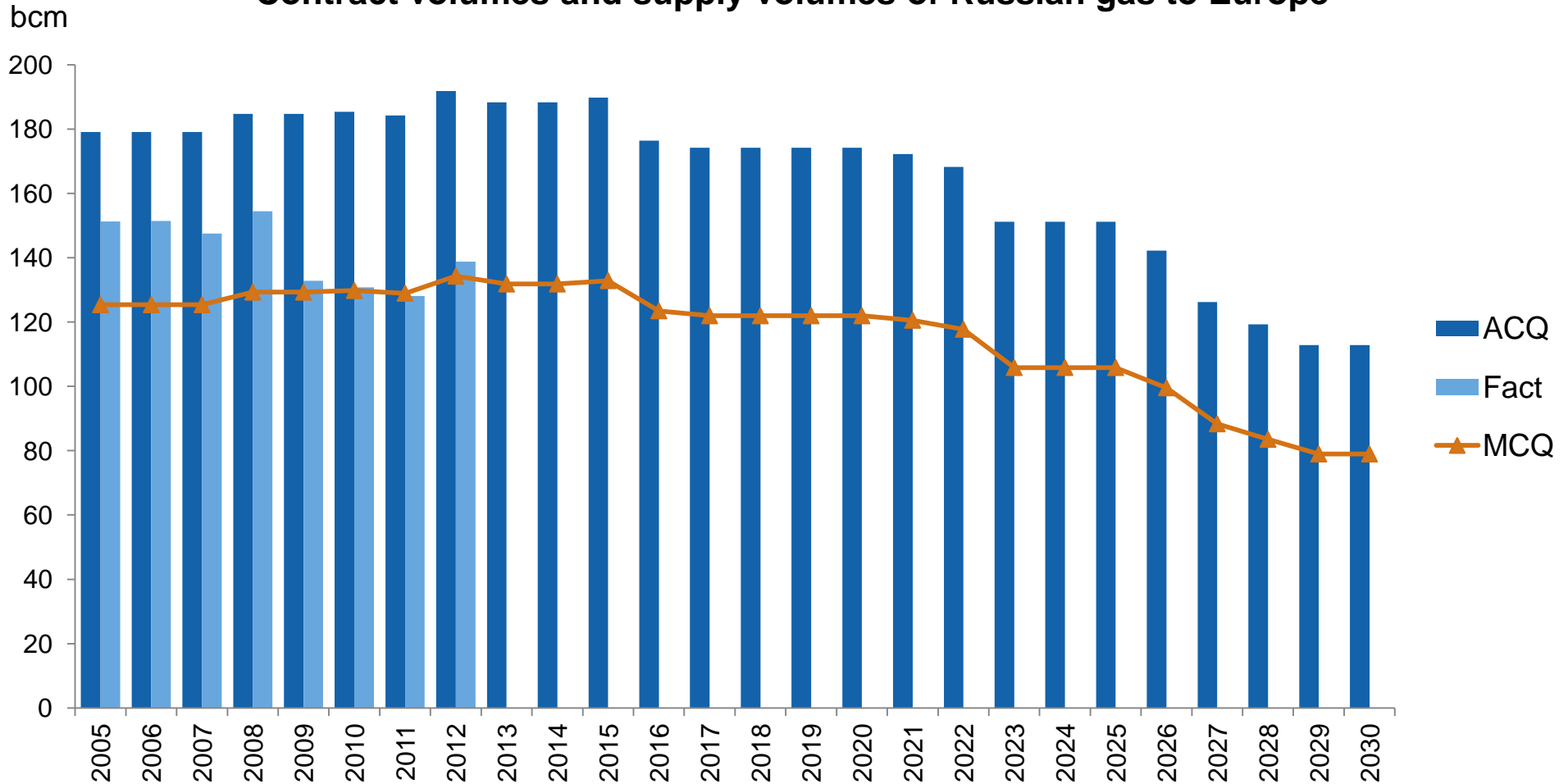
Gazprom has a huge portfolio of oil-linked long term contracts for supplies to Europe for the next 25 years and longer



Source: Enerdata.

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

Contract volumes and supply volumes of Russian gas to Europe



Sources: Cedigaz, Gazprom

Arguments: oil indexation vs. gas indexation

Oil 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

Spot indexation

- 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

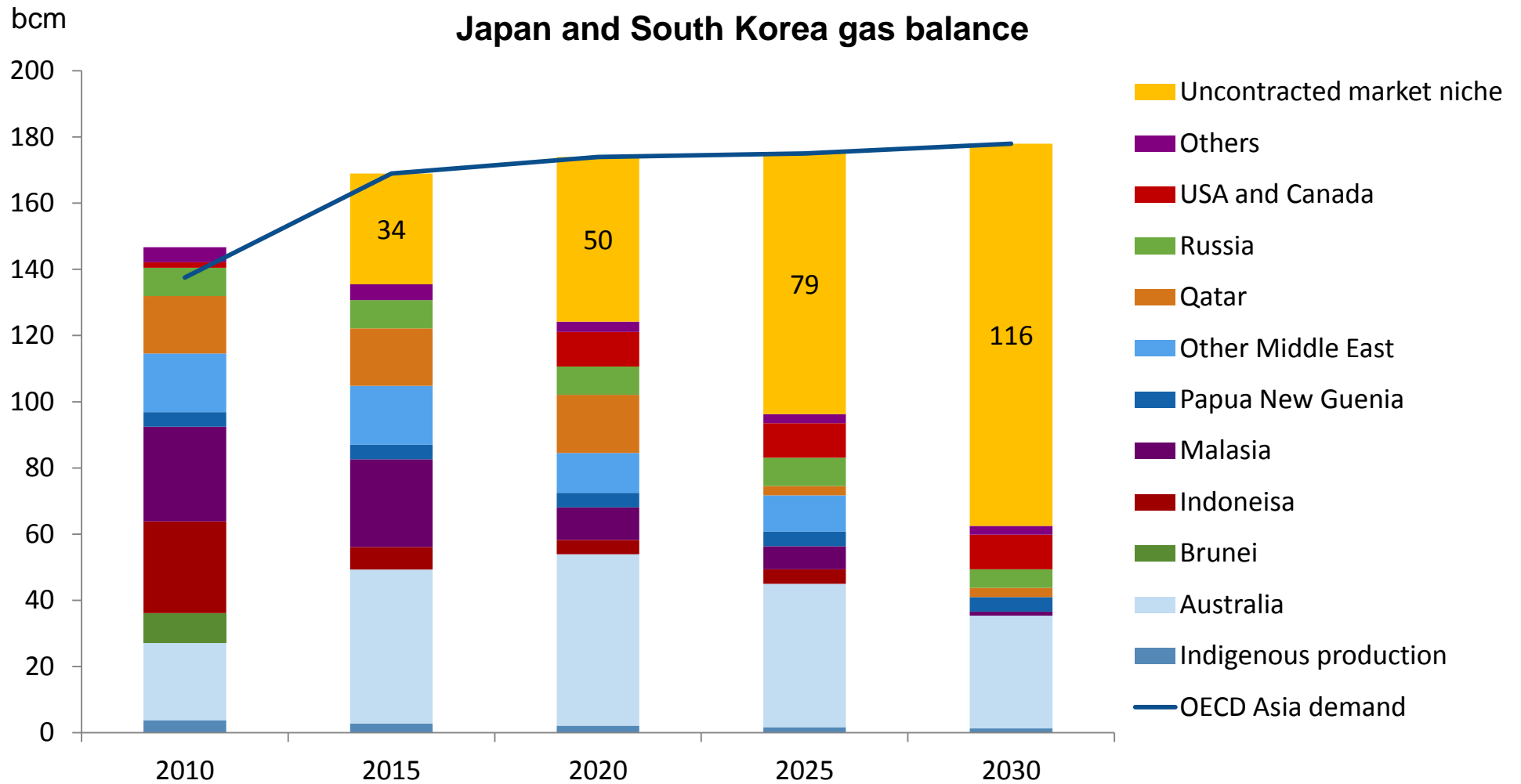
There are strong commercial reasons for Gazprom to protect the oil indexation at least during the next 3 years

Eastern Gas Program

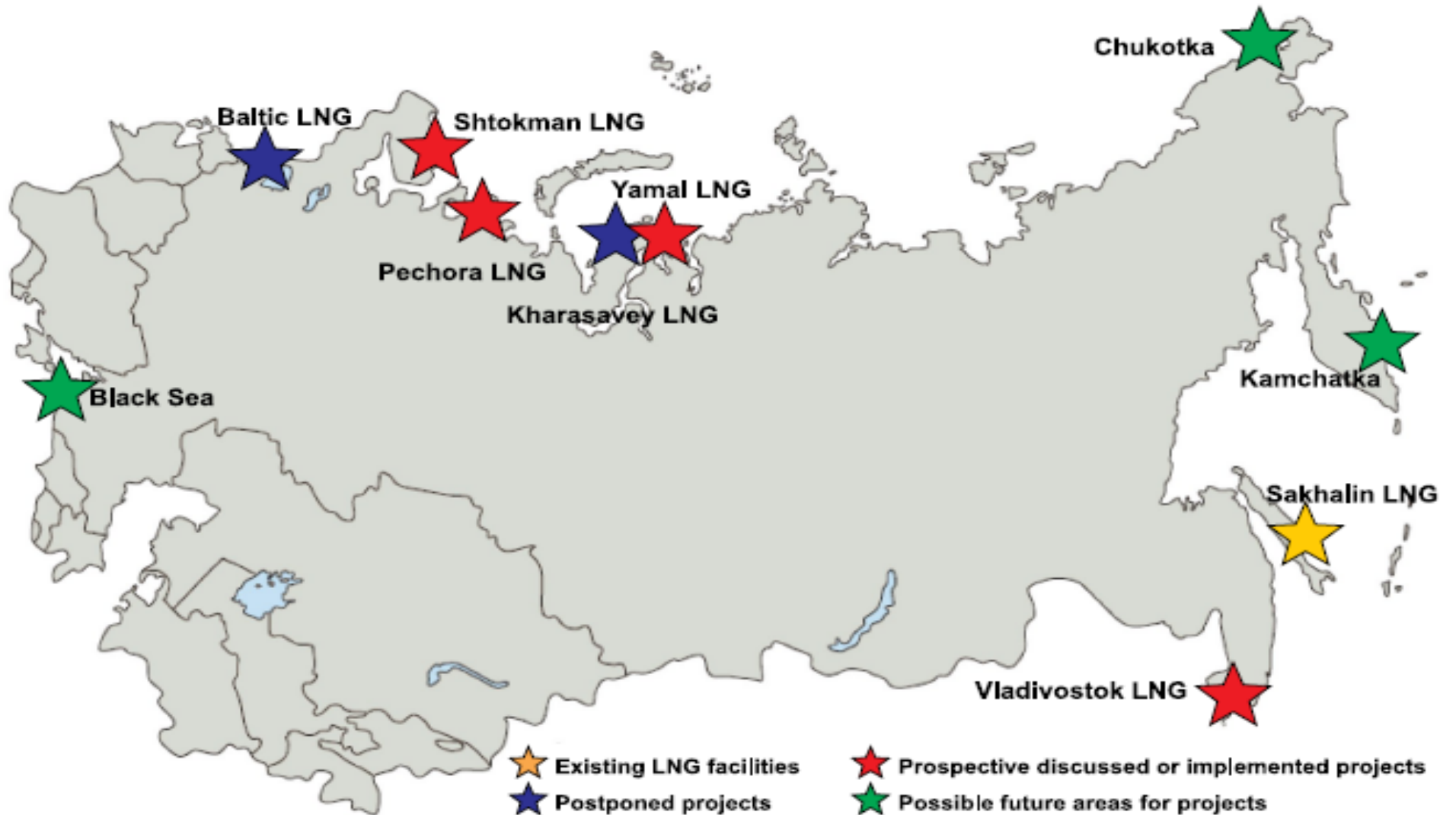


Sources: Gazprom

By 2020 market niche in OECD Asia might reach 50 bcm, by 2030 - 116 bcm



Russian LNG Projects



Conclusion: Russian response

- » Russia is for the first time facing demand constraints on all its 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
- » Asian markets are becoming more attractive than European market with weak demand, unpredictable and unfavorable regulation and stronger competition
- » 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

Nagornaya st., 31, k.2, 117186, Moscow,
Russian Federation

phone: +7 985 368 39 75

fax: +7 499 135 88 70

web: www.eriras.ru

e-mail: mitrovat@rambler.ru