

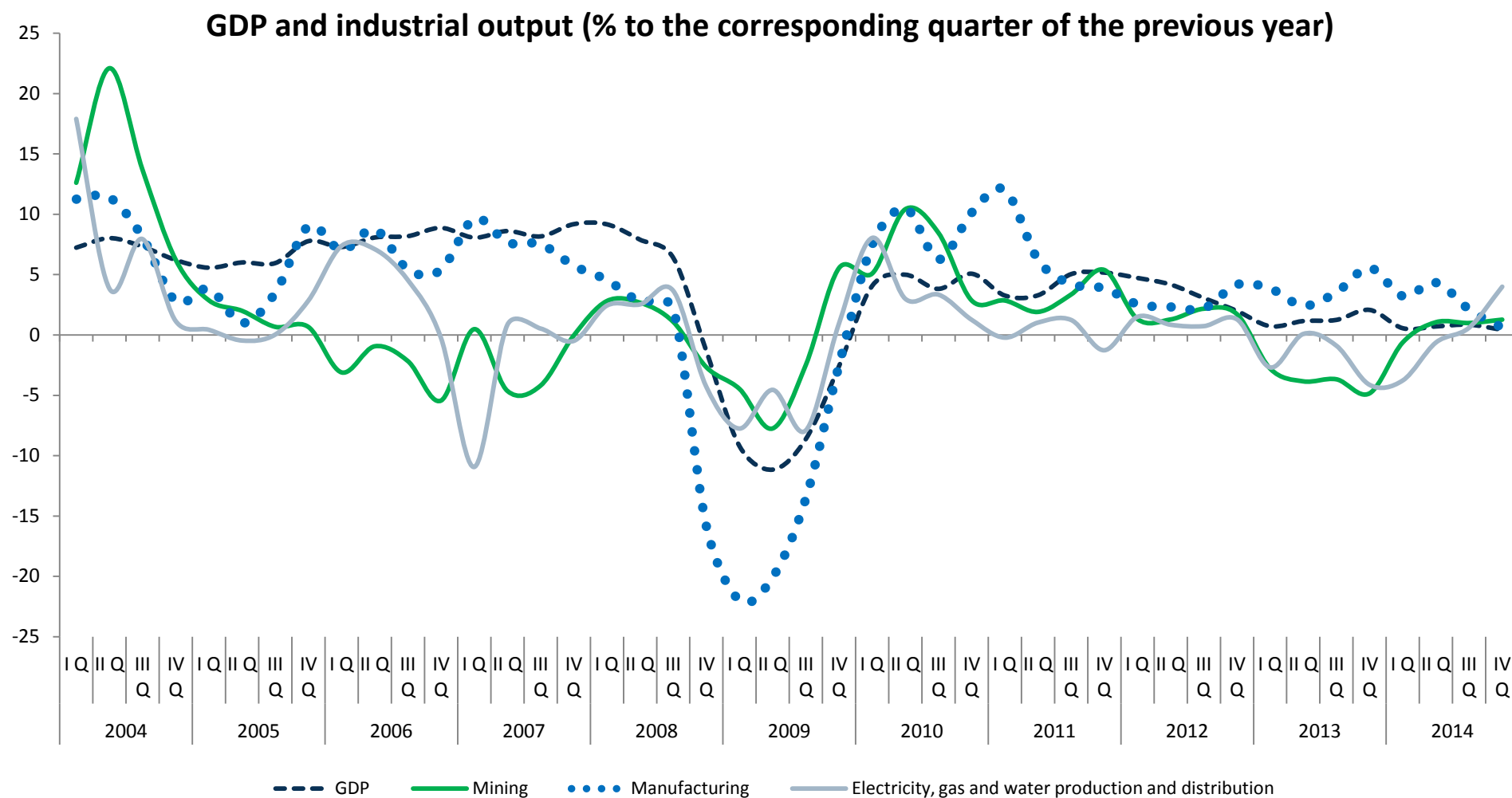
The outlook for oil prices and the economic impacts in oil producing countries: Russia`s case

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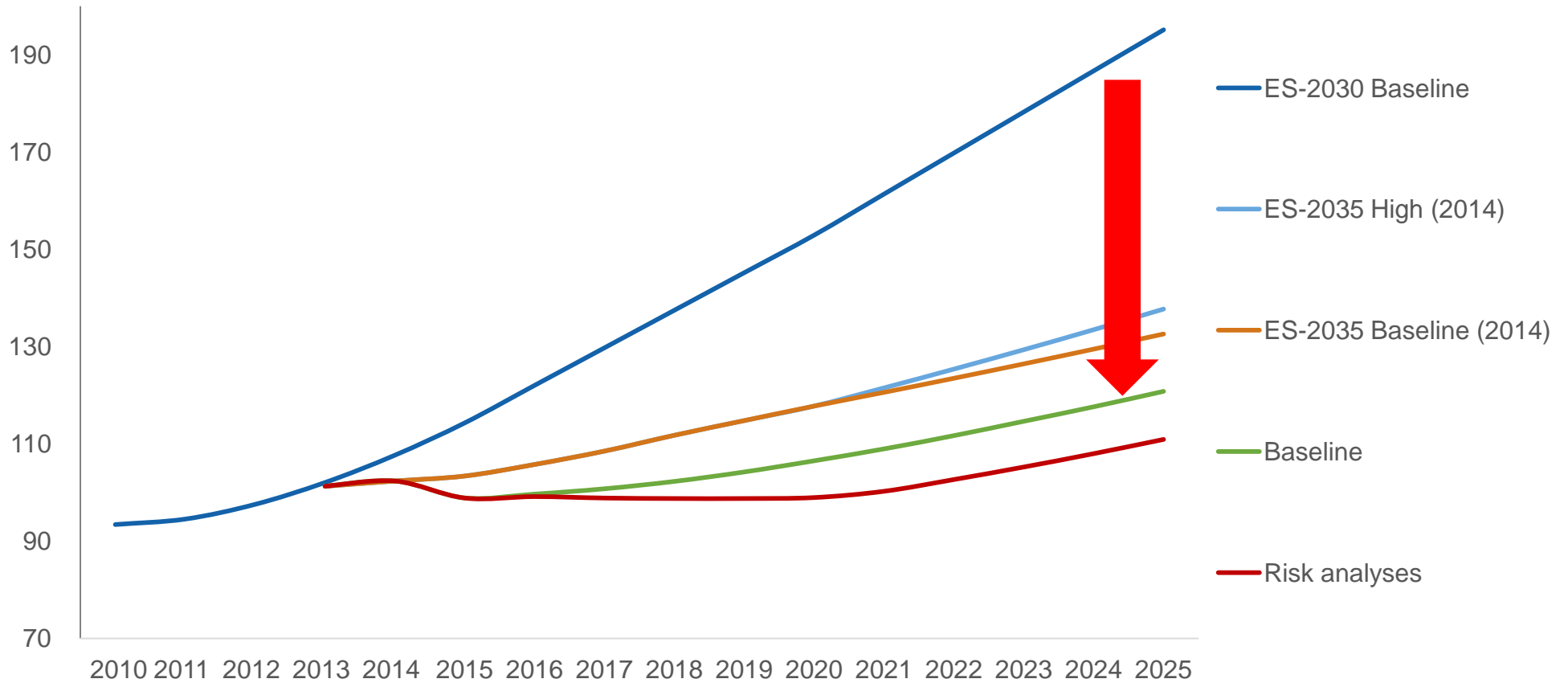
Russian economy started to slow down already in 2012, before the geopolitical crises, sanctions and oil price drop



Source: Rosstat.

Evolution of the GDP expectations: revised to nearly flat

Russian GDP dynamics, % to 2012



Major new challenges for the Russian energy sector

Domestic challenges:

- Stagnation of the Russian economy slows down domestic energy demand. Lower investment availability and frozen energy prices cut investment programmes in the energy sector slowing down its renovation
- Institutional framework in the energy sector has reached critical level of inefficiency

Global challenges:

- Potential export revenues expectations are declining :
 - ❑ Stagnant oil and gas demand, changing rules in the European energy sector (main market for Russia)
 - ❑ Main demand growth moves to Asia, where Russian presence is very limited for the next 5-7 years
 - ❑ New hydrocarbon suppliers (shale from the U.S., Iran, Iraq, Brazil, Australia, East Africa, etc.)
 - ❑ Oil and gas prices declining trend until 2022-2025
- Geopolitical threats: sanctions

Is there life under sanctions?

- ❑ **Financial sanctions.** Russia is now facing unprecedented challenges related to the finance availability and access to the international loans. Chinese seem to become the major source of investments (but demand equity shares in return – see Vankor case).
- ❑ **Technological sanctions.** Sanctions create serious problems with access to the modern technologies. So far the sanction lists, adopted by the U.S. and EU, are not limiting significantly current operations, but they are seriously undermining long-term development (Arctic, shale oil).
- ❑ New sanction could be introduced as an answer to further deterioration of the Ukrainian situation.
- ❑ Increasing “patriotic mood” promotes and supports total import replacement, which is achievable for Russia, but it will take 5-7-10 years.
- ❑ Russian companies engagement in the European market is regarded as risky and thus reduced (see Lukoil and Gazprom announcements).
- ❑ Sanctions introduce additional pressure on the industry and population thus reducing their demand and purchasing ability (in addition to recession).

Implications of low oil prices and sanctions on Russia's macroeconomic parameters

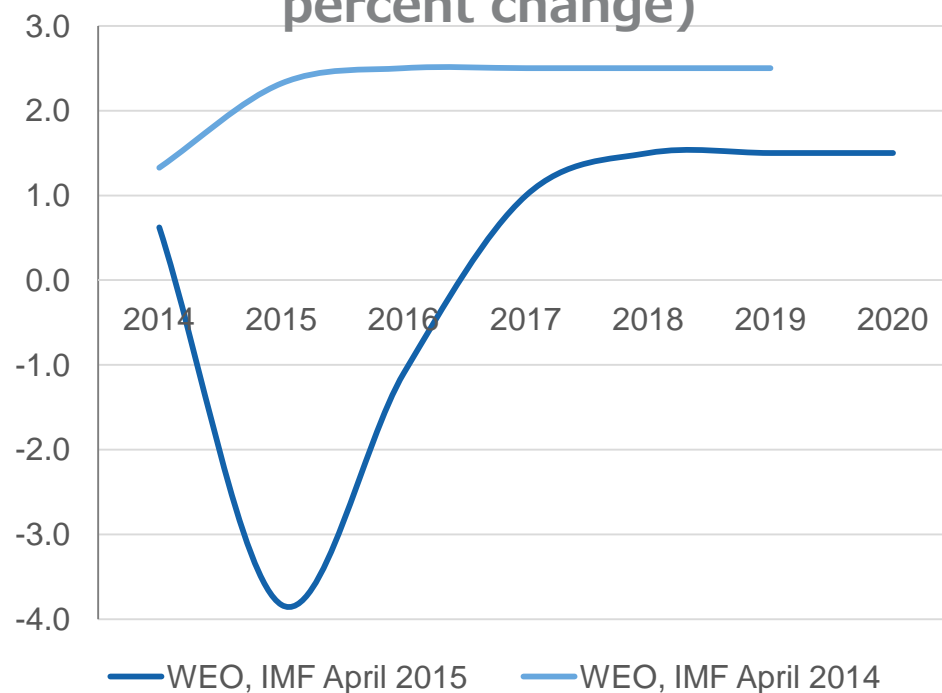
“Our estimate is that last year the Russian economy experienced two kinds of external shocks - one is from oil prices and another from sanctions.

The cumulative effect of those shocks is around 200 billion US dollars - maybe a little more, but the main, major influence was the fall in oil prices.

Our estimate on the sanctions is a roughly 40-50 billion US dollars shortage of capital, but again the main driver of this slowdown is the oil price”.

Anton Siluanov,
Russian Minister of Finance

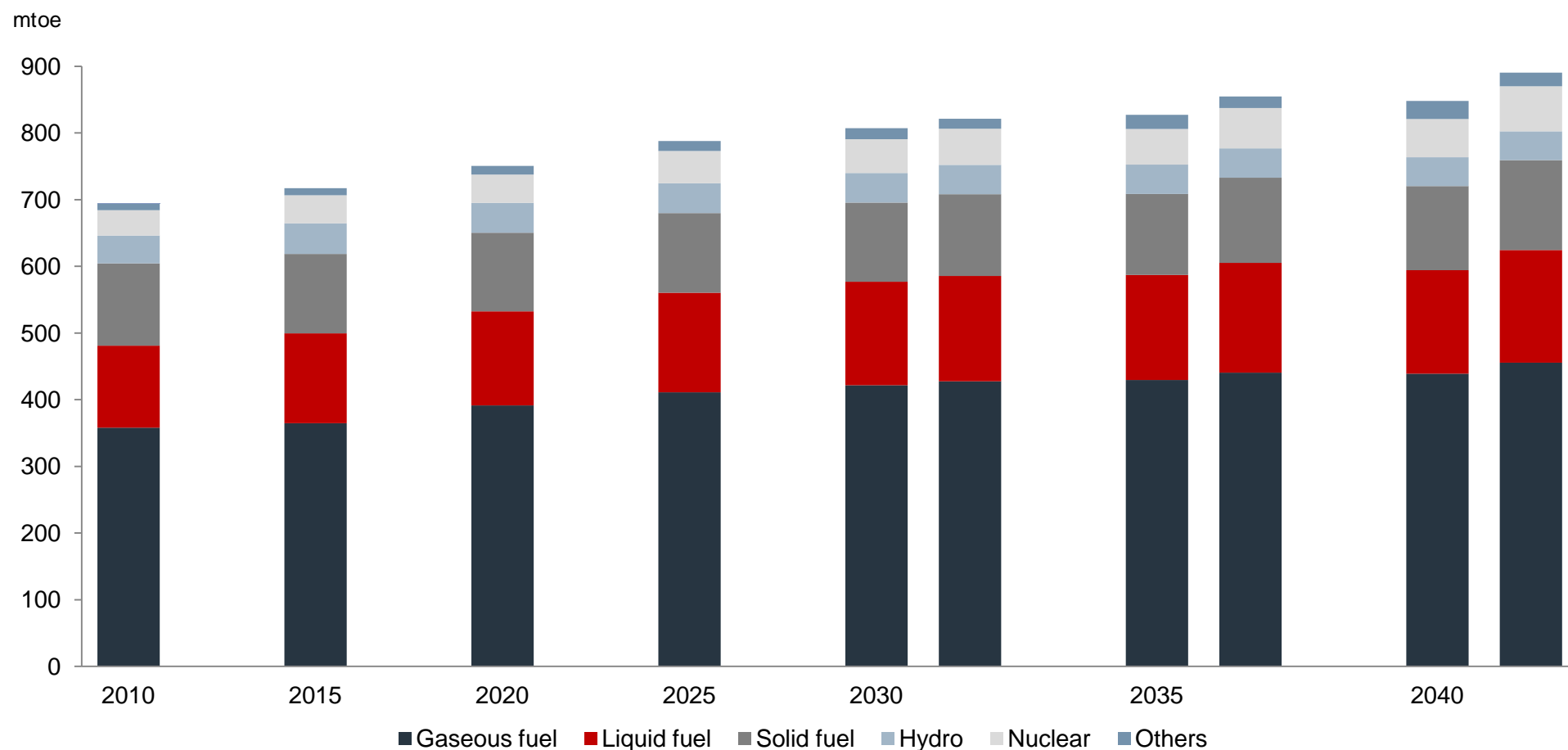
Evolution of the Russian GDP forecasts by IMF (constant prices, percent change)



Source: IMF

Weaker economy results also in lower domestic primary energy demand

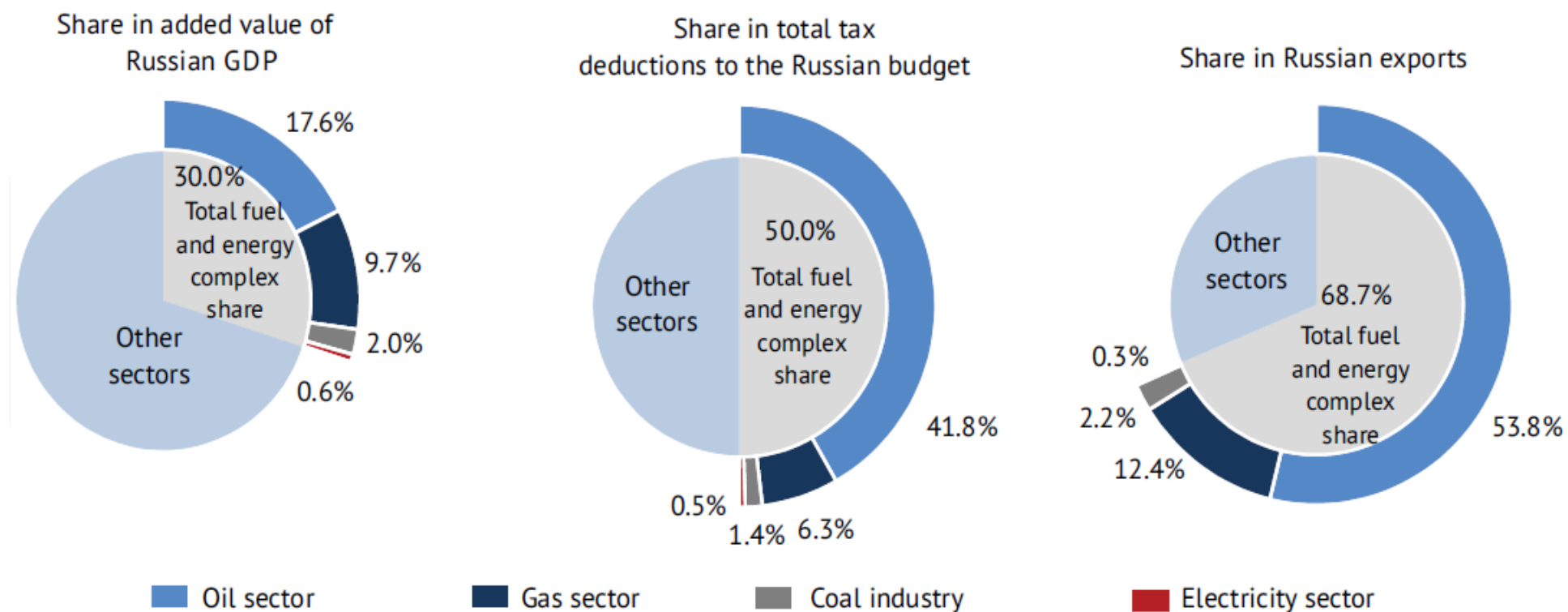
Russian primary energy consumption



Source: Global and Russian Energy Outlook up to 2040. ERI RAS-AC. 2014.

By 2013 the role of oil&gas sector for the national economy has reached its maximum

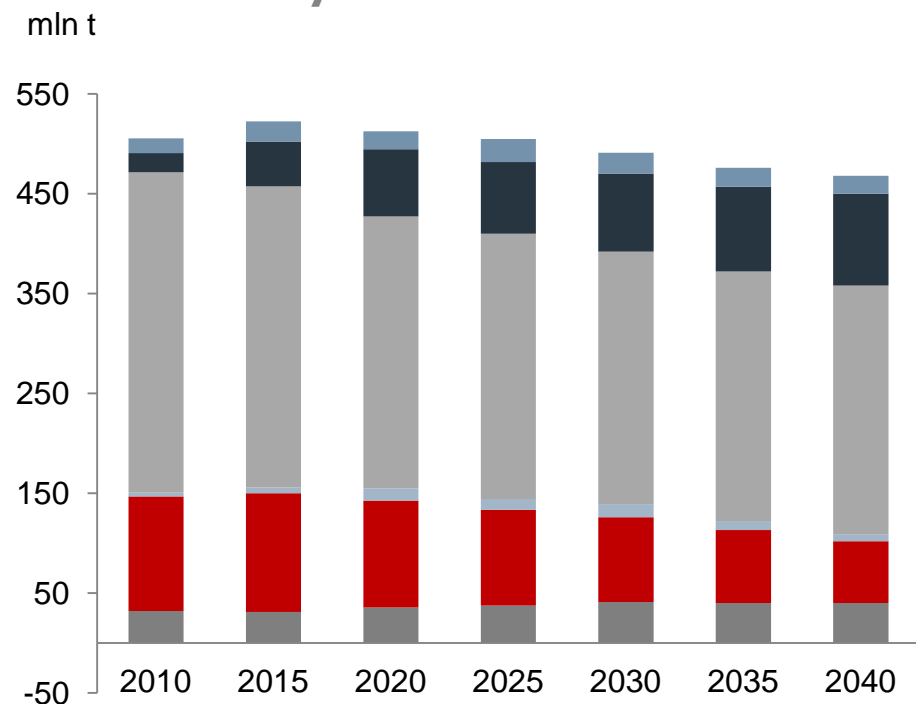
Shares of energy sector in Russian GDP, exports and budget



Source: Global and Russian Energy Outlook up to 2040. ERI RAS-AC. 2014.

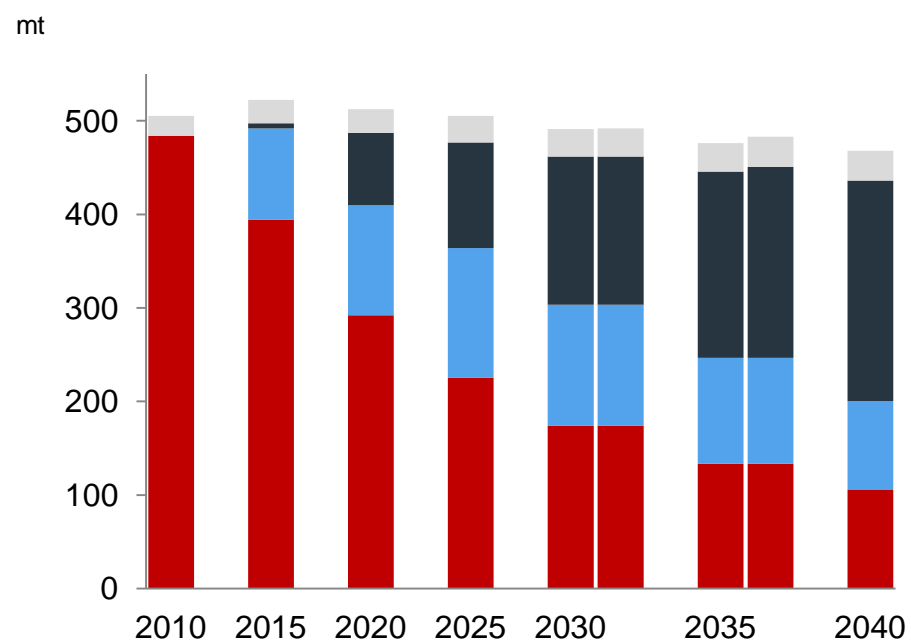
But oil production is now at peak, the country is struggling to sustain production volumes, and in order to do that, Russia needs to develop new fields...

Russian oil production by Federal District



- North-West
- Southern regions and offshore
- East Siberia
- Volga-Ural
- West Siberia
- Far East

Oil and NGL production in Russia by reserve type

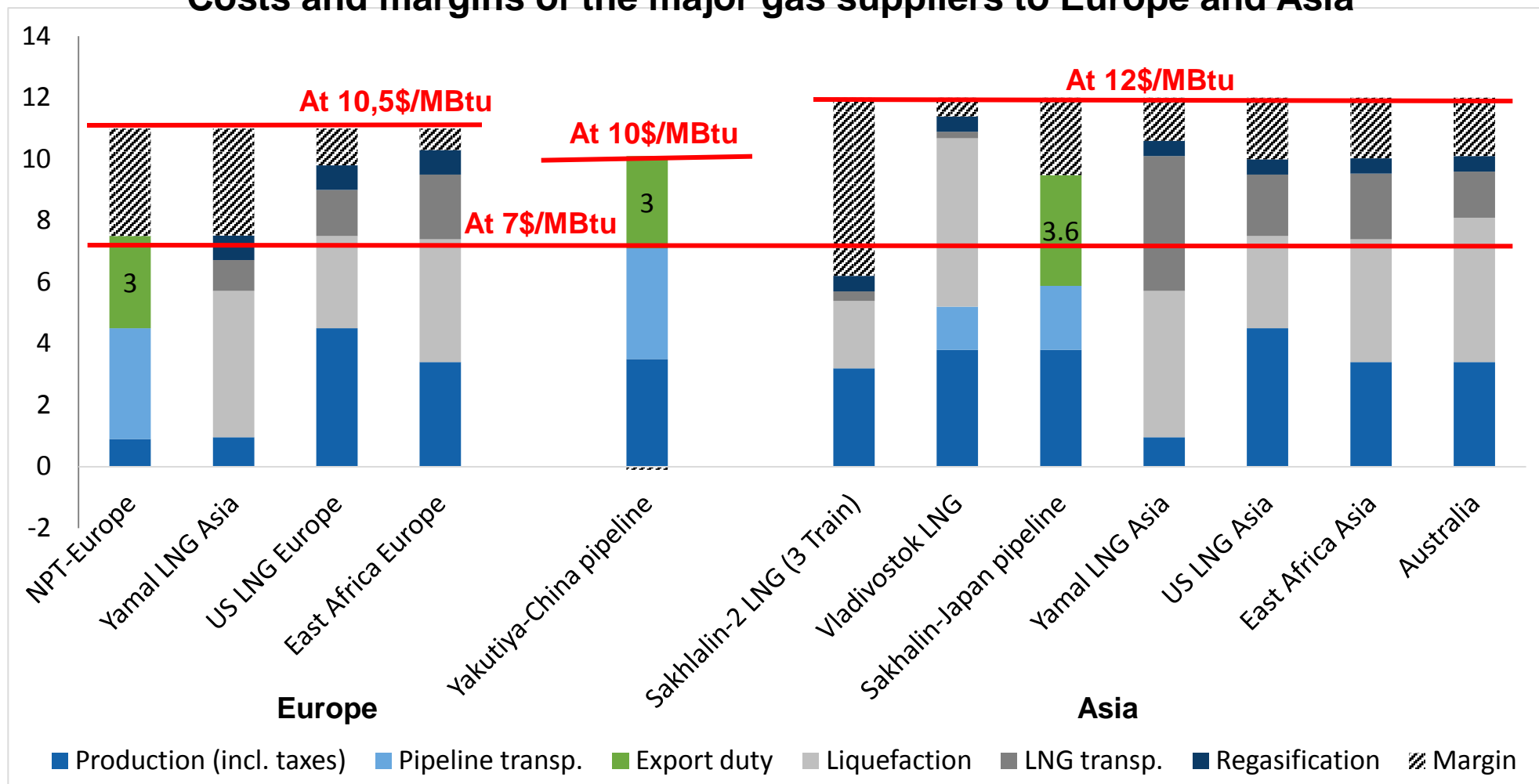


- From old
- From reserves growth
- From new discovered
- Gas condensate production

Source: Global and Russian Energy Outlook up to 2040. ERI RAS-AC. 2014.

Pipeline gas shows the best economics in this difficult time: 30% export duty reduces with the lower gas prices (to 2,1 \$/Mbtu with 7\$/Mbtu final gas price)

Costs and margins of the major gas suppliers to Europe and Asia



Sources: NEXANT, IEEJ, ERI, RAS

Conclusions

- ❑ Low oil prices have very strong negative effect on the Russian GDP growth, industrial output and budget revenues
- ❑ Weaker economy results in lower domestic energy demand growth and frozen energy efficiency parameters
- ❑ The role of hydrocarbon revenues for the state budget is very high
- ❑ Oil production is now at peak, the country is struggling to sustain or even increase production volumes (in order to protect budget revenues), but to achieve that, Russia needs to develop new fields...
- ❑ Pipeline gas shows the best economics in the time of lower oil prices, there is potential upside for the expectations of Russia`s exports, if oil prices remain low for a long term.

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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