Gazprom and Russian Supplies to Europe: Can Major Gas Resource Holders Continue to Sell If They See Long-Term Gas Demand Reducing?

Speech by Elena Burmistrova
FLAME Conference, Amsterdam 3rd November 2021

[Screen 1]

Dear colleagues!

I am delighted to have this opportunity to address you at this year's Flame conference. Flame has become a fine tradition for our industry and it is no coincidence that it takes place as we head into the winter season. The gas sector tends to attract most attention as the days become colder.

However, this year is by no means comparable with others. I have worked in the sector for a while, but I cannot remember a time when the industry was under such a spotlight. It would be no exaggeration to say that we are witnessing a unique time in the history of energy markets. The current developments require detailed, expert analysis and interpretation, and I believe that only professionals such as yourselves, present here at our conference, have the skills to do this.

Unfortunately, the Internet and media today are awash with fanciful assumptions and theories, suggested by people who are, at best, very loosely connected to our industry. Within this, there has been some inaccurate reporting and speculation about Gazprom's actions. Thus, today, I feel the need to set the record straight and outline our position on certain issues.

[Screen 2]

Let us start with the production stage. Gazprom has the largest natural gas reserves in the world, estimated to be about 33 trillion cubic meters, or 16% of the world's reserves. Moreover, we are constantly conducting exploration works in Russia and abroad to replenish and increase our resource base, as well as assessing the potential projects and assets.

We often get asked if we plan to increase our production in anticipation of the limited life cycle of the natural gas. I want to make this point very clear: we do not consider natural gas a stranded asset and we do not perceive any pressure to sell as much as we can in a short time. It would undermine the market's predictability, both for us and for our customers.

Our long-term business strategy, which implies output growth, is based on the assessments of effective prospective demand in Russia and our key export markets. This is all about the balanced business development in view of the demands of our clients and partners, and not about short-term gains.

This ambition is reflected in our contractual and price policy as well. We have always stood for long-term contracts with take-or-pay conditions, and will continue to do so. Our industry is capital-intensive and has a long investment cycle, and only such long-term contracts can provide confidence along the whole production chain – from exploration and production to transportation and consumption. These contracts make the market balanced and predictable, therefore profitable for investors.

Similarly, we have long warned against a heavy shift to hub indexation and short-term trade model, as is being advocated by EU officials. They want to create transparent gas market models akin to those for other commodities. Whilst this is understandable, it is not easy for us to support. This idea works well in theory, but the reality is much more complicated.

The last two years have given many demonstrations of the drawbacks of the hub indexation. On the TTF, which has the highest liquidity in Europe, spot prices have been extremely volatile. Very often, these price movements were explosive. The 'day-ahead' price in May 2020 was 5 times lower than in May 2019. In May 2021, it was 10 times higher than one year before. And by today, it has grown even further. Obviously, such a market is neither attractive to the investors, nor more predictable to the participants.

In order to understand the advantages of long-term contracts versus spot ones, we should ask large players on the European market. They will attest that oil-indexed contracts are more profitable than spot ones; and that gas supplied with Gazprom's long-term contracts is many times cheaper than gas from short-term supply deals.

Long-term contracts with the take-or-pay obligation not only provide predictability along the whole value chain, but also protect from current price volatility demonstrated by the spot market recently.

[Screen 3]

Misunderstanding of Gazprom long-term strategy often leads to the wrong perception of company's actions and interests. In recent days, I have been very disappointed to see statements in the media alleging ill-intentioned actions from Gazprom, such as looking to capitalize on record high gas prices in Europe.

I will say again: we are not interested either in record low, or in record high gas prices. The latter leads to gas demand degradation in Europe, which is clearly against our interests as a gas producer and supplier. We want to see a balanced and predictable market, where we and our customers can successfully develop our business.

Let me remind you of the previous year, when prices were very low because of the weak demand and extensive supply, and when Gazprom was criticized for not cutting deliveries to Europe. Now, the situation has changed 180 degrees and correspondingly the complaints against Gazprom from some politicians, media and even a number of experts have also turned around.

At the same time, our business partners and clients make no such allegations.

[Screen 4]

The reality is that in recent months, Gazprom has been increasing gas production and supplies to major markets, including Europe. From January to mid-October, we produced 56.7 billion cubic meters more gas than in the same period last year. Approximately half of these additional volumes were supplied to the domestic Russian market, some part to the CIS countries and China. Significant volumes have reached Europe as well. Supplies to our European partners increased by more than 15 billion cubic meters or 13%. Exports to Germany increased by 30%, exports to Turkey more than doubled, exports to Romania increased four times.

Why is the European market so feverish? Why don't additional supplies bring prices back to normal? To answer this question, we must consider the situation holistically.

Let's look at demand. Gas consumption is steadily recovering in Europe. In the first three quarters, it grew by 33 billion cubic meters, or 9%, year on year. The demand side was influenced not only by the economic recovery, but also by the weather.

It is not so straightforward on the supply side. Although a number of suppliers, mainly of pipeline gas, are increasing deliveries, the gas flows from other sources are decreasing. Since the beginning of the year, domestic production in European countries has decreased by 10 billion cubic meters, or 6%. LNG inflow has also reduced drastically: in three quarters of 2021, it fell by 13 bcm, or 14.5 %, compared to the same period of last year. LNG suppliers have redirected exports to the premium markets, mainly in Asia. For example, the United States has increased gas exports by as much as 35% since the beginning of the year. But US LNG supplies to Europe remained at the same level as in 2020. That means, that all additional volumes of LNG from the United States went not to Europe, but to other markets.

Against this background, it is confusing to hear accusations that Gazprom's actions led to the rise of gas prices in Europe. Let me remind you that, unlike flexible LNG suppliers, it is us who are rigidly tied to Europe by the gas pipeline system. We physically cannot leave the European market, we are closely connected with it, and that’s why we treat it with great responsibility. Therefore, we must reject these unfounded claims, allow our actions to prove our case and continue to develop on the basis of our own long-term business model.

[Screen 5]

What makes us so confident? Why do we believe in the future of natural gas, despite some analysts predicting a gradual stagnation and then even a reduction of gas demand in Europe?

First and foremost is Gazprom's diversified development model. Europe is our main market, but not the only one. About a half of the gas we produce is supplied to the domestic Russian market. The current share of gas in the Russian energy mix is over 50%. It makes our energy system one of the cleanest in the world. According to government forecasts, the share of gas in the domestic market will not change in the next 15 years. In absolute figures, gas consumption in Russia will only grow. So, finding an alternative to gas is not the case here.

Secondly, in recent years, Gazprom has been actively entering the emerging Asian markets. According to current forecasts, by 2050, gas consumption in the Asia-Pacific region will exceed 1.4 trillion cubic meters of gas. About a half of this volume will be imported. That is why we see great long-term prospects in the Asian gas markets, primarily in China. Already today, we are increasing supplies to China via the new Power of Siberia gas pipeline. In a few years, it will reach its full annual capacity of 38 billion cubic meters. The second export route via Mongolia is also being discussed with China. The annual capacity of this pipeline can reach 50 billion cubic meters. Again, finding an alternative to gas is not the case here either.

Thirdly, if we go back to Europe, the situation there is not so definitive. As I have already said, the gas demand in Europe is growing steadily this year. Record European gas prices themselves are the best evidence that gas is still in demand there. The statistics of each country shows the same. In the first half of this year, gas became the main source of energy in Germany, our largest market, for the first time ever. From January to June, the share of gas in the German energy mix exceeded 30%.

[Screen 6]

Gazprom is optimistic about the future of the gas demand, including in Europe, not only because of its growth prospects. We also foresee a qualitative change in gas consumption.

The European Union has proclaimed a gradual shift away from hydrocarbon fuels, including natural gas, as primary energy sources. However, does that mean the end of gas use? Not at all actually.

We believe that only the focus of gas consumption will shift from direct combustion by industrial end-users to hydrogen and electricity production. They will be used in the same industries as natural gas before.

According to the research by Hydrogen for EU project, even if Europe is completely carbon neutral by 2050, gas demand will remain unchanged. The latest study shows that if the energy transition results in a wide range of decarbonisation technologies, the share of gas in energy demand will grow to 32% by 2050. Today it is around 25%. If only renewables are developed, the European gas demand will still remain around 26% by 2050. In this scenario, gas provides flexibility as a complement to renewables.

We also expect the gas demand to increase in new sectors, such as transport, including shipping, hydrogen production, as well as petrochemicals. Gazprom is already actively working in all these areas.

[Screen 7]

Dear friends!

In recent times, the terms '*energy transition*' and '*carbon neutrality*' have become ubiquitous in European discourse. Very often, they are mentioned without understanding of their real meaning and a broader context.

Gazprom is very much alert to fair concern over climate change problems. We are pleased that right now these issues are being discussed at the UN Climate Change Conference in Glasgow. I hope that the discussion will be wide-ranging and fruitful.

Gazprom is ready to make a significant contribution to reducing emissions. However, we call for examination of these problems with less populism and a more pragmatic approach. We are convinced that the most effective way to solve environmental problems right here and right now involves natural gas. I am sure that gas will be in demand for many years to come. Gazprom is ready to ensure its stable and reliable supply.

Thank you for your attention!

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Elena Burmistrova

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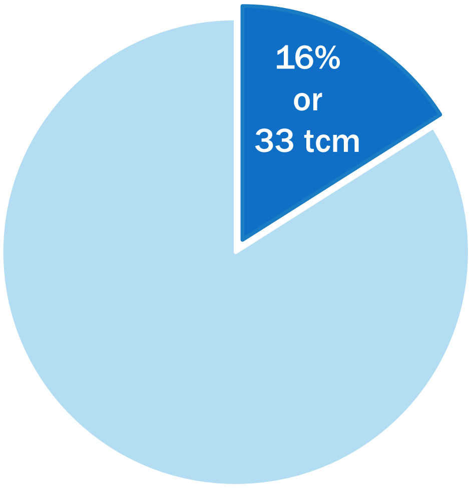
Director General of Gazprom Export

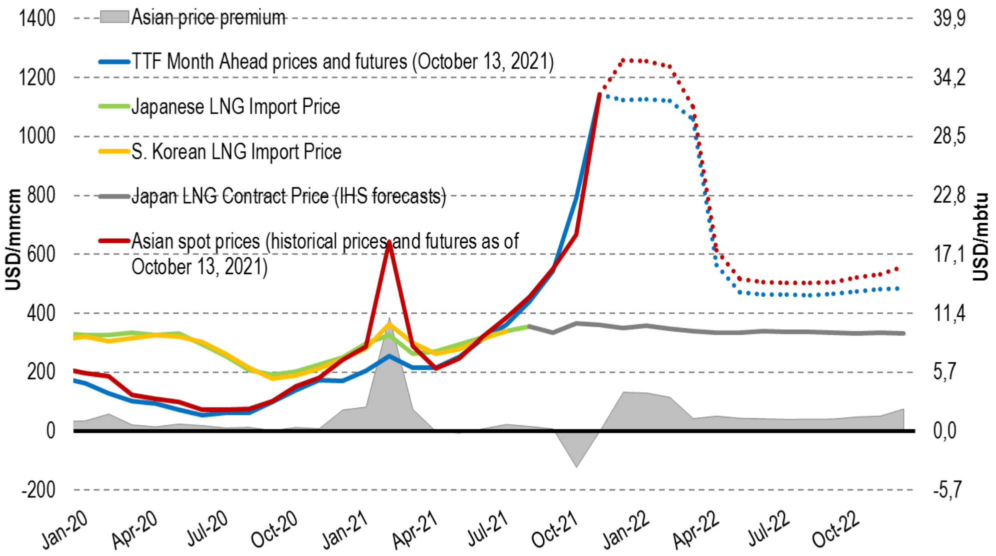
November 3, 2021

Gazprom Share in Global Gas Reserves



Source: PJSC Gazprom

European Gas Prompt Prices Volatility



Sources: IEA, EIA, Bloomberg, Russian custom, EU statistics

Misunderstanding of Gazprom Market Behavior

June 2020

- Gazprom export to Europe: 12.9 bcm
- Headlines:

Industry Focus: Russia Accelerates Fight For Global Gas Export Market Share

Russia aims to ramp up its efforts to gain more gas export market share this year, despite an unfavorable business environment and growing pressure from major competitors.

The beginning of 2020 was a tough time for Russian gas export monopoly Gazprom, which saw its revenue for January exports fall by 41.1% on a year-on-year basis, barely exceeding US$3 B. The drop in export revenue, which was largely due to a decline in global gas prices, marked a significant decline for the company after several years of consecutive growth in exports.

Source: gasprocessingnews.com/columns/202006/industry-focus-russia-accelerates-fight-for-global-gas-export-market-share.aspx

July 2021

- Gazprom export to Europe: 14.5 bcm
- Headlines:

Oilprice.com

Why Russia Is Refusing To Send Europe More Natural Gas

Editor OilPrice.com
July 16, 2021 · 3 min read

In this article:

NG=F -1.81% CL=F +0.53% OGZPY +0.69%

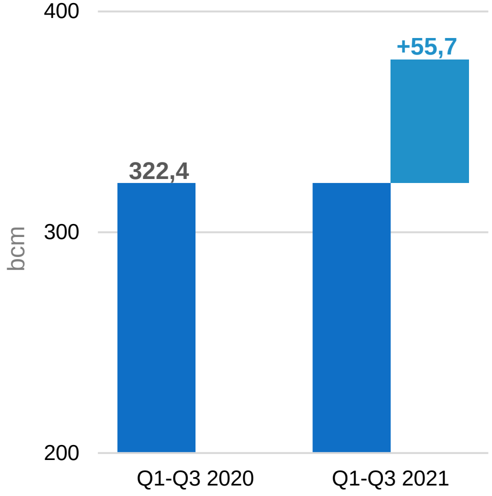
Rising commodity prices have strengthened the economic outlook of resource-rich countries. Russia is taking advantage of this in a major way, with a particular focus on crude oil and natural gas. As Europe's most important supplier of gas, Gazprom is well-positioned to reap major dividends. However, the state-controlled energy behemoth's lukewarm response to sending additional volumes to Europe could be a sign that the company's strategy has changed.

Source: finance.yahoo.com/news/why-russia-refusing-send-europe-220000572.html

Gazprom Contributes to European Gas Market Security

Gazprom Production and Global Gas Demand

Gazprom Gas Production

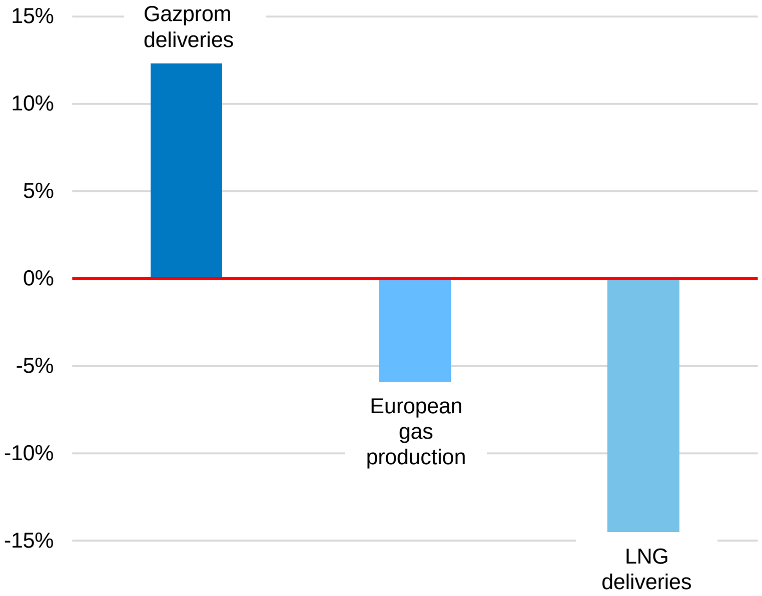


Global Gas Demand Increase Q1-Q3 2020 vs Q1-Q3 2021

Russia and CIS	**+58 bcm**
Asia-Pacific	**+56 bcm**
Europe	**+33 bcm**

Source: Gazprom, Bloomberg, EU statistics

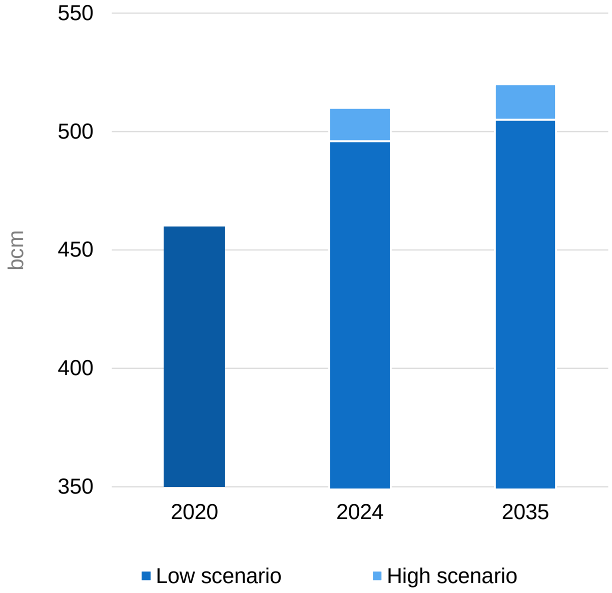
Dynamic of European Gas Market, Q1-Q3 2020 vs Q1-Q3 2021



Source: Gazprom, Bloomberg, EU statistics

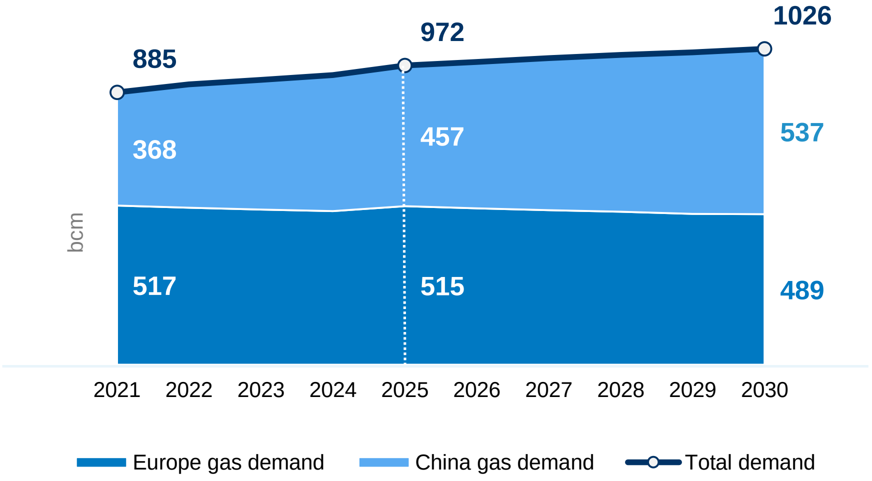
Prospects of Gas Demand Growth

Russia Natural Gas Demand Outlook



Source: Energy Strategy of the Russian Federation

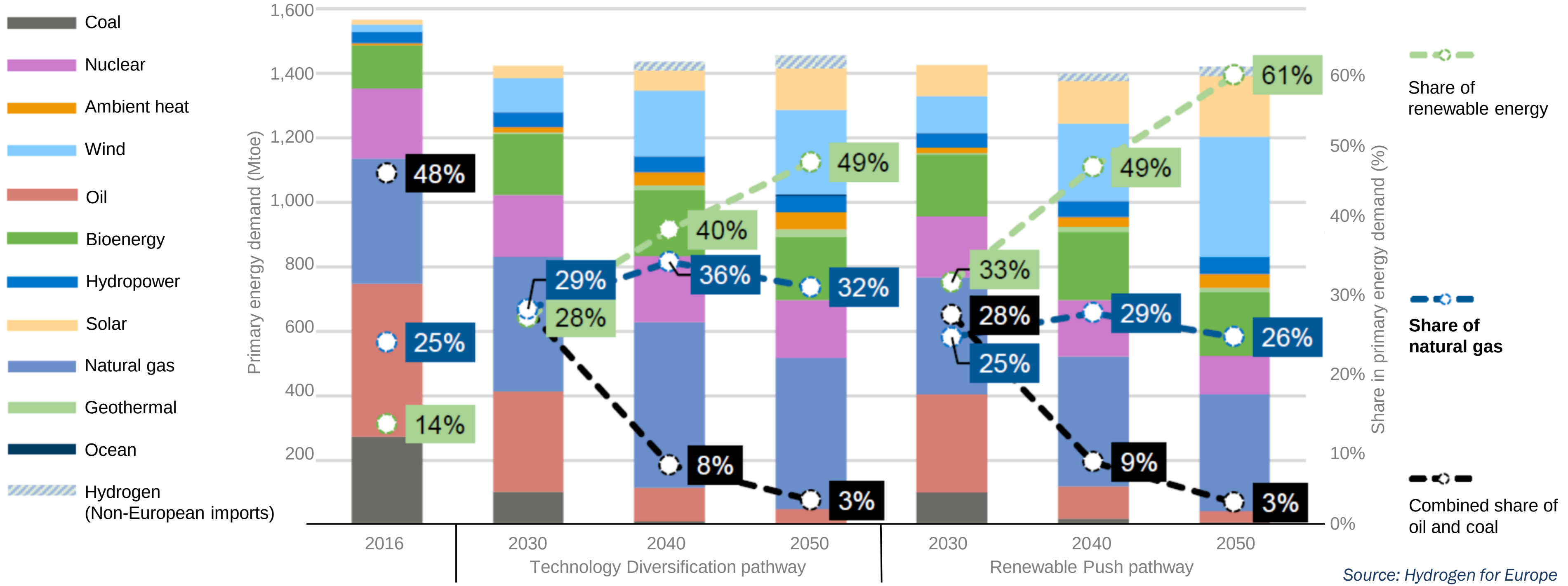
Europe & China Natural Gas Demand Outlook



Source: IHS, SIA Energy

Gas Demand Expansion in New Segments

Evolution of Total Primary Energy Demand to 2050



Source: Hydrogen for Europe

Thank you for your attention!