Pipeline gas from Russia: Impact on European markets

Speech by Elena Burmistrova,
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Good afternoon, colleagues.

I am delighted to speak to you after such a long pause caused by the coronavirus. Even the format of today's meeting shows how the world has changed in just six months. It would not be an exaggeration to say that we have never faced a crisis like this. It has challenged our usual way of life and threatened the lives of millions.

At first sight, due to the coronavirus, we have become more divided. State borders are closed, and we have to remain in our countries and cities. But on the other hand, we are now even more united, as we pursue a common goal to restore the balance of the European gas market. We represent different countries and companies, but I am sure that stabilizing the market is in everyone's interests.

This goal is directly related to the topic of my speech – the influence of Russian pipeline gas on European markets. Before discussing its role, let us specify the sources of the current turbulence.

I have been working with the gas market for a long time, but I cannot remember such a violent crisis. It would be easiest to blame everything on the coronavirus. However, the current turmoil has many other aspects. Already before the pandemic, we were facing an unprecedented combination of negative factors. Among them were a second unusually warm winter in a row, excess gas volumes in storage, and a general oversupply. The coronavirus has added a dramatic drop in gas demand.

Last but not least, another factor was record LNG supplies. Especially in the first quarter, this become a source of instability for the entire market.

The current crisis has clearly highlighted the difference between pipeline gas and LNG. A number of negative factors depressed prices at the beginning of the year. Reasonable suppliers had to cut their flows to save prices. Major pipeline gas exporters to Europe gave up on the idea of increasing exports and compensating declining revenues. In contrast, LNG deliveries to Europe continued to grow. We witnessed record LNG exports not only in March, but even in April and May. At that time, the coronavirus had already painfully hit Europe, industry was almost at a standstill, and demand was close to 10-year lows. Overall, from January to June, LNG supplies to Europe increased by almost 10 bcm, or 17% year-on-year. LNG supplies made a particular contribution to the market imbalance.

The consequences were not long in coming. Along with other negative factors, this oversupply brought gas prices down to historic lows. This benefitted neither the European gas market, nor LNG suppliers themselves. Since April, the average TTF month-ahead price has been below the operational costs of American LNG deliveries aimed for Europe. However, shipments kept arriving, even at that low price, due to the lack of arbitration opportunities.

I don't blame LNG suppliers and partly understand their motives. But one way or another, the reality is clear: LNG became a kind of market spoiler and destabilizing factor, which has increased market turmoil dramatically.

All of us had to deal with this major instability, but everyone acted differently. While LNG came and went from the market, our pipeline gas remained, proving its reliability and affordability. LNG suppliers overloaded the market with cheap spot gas, killing the price. At the same time, we have maintained supply in a consistent and intelligent manner. This is what allows me to call Gazprom's pipeline gas a market-balancing factor. But what exactly does this mean?

First of all, we have ensured uninterrupted supplies to each international partner, despite any difficulties. The governments of European countries, as well as of Russia, imposed unprecedented restrictions to control the spread of the virus. Borders were closed and people were forced to stay home, but Russian gas continued to flow. No gas rigs or compressor stations were shut. Gazprom has proved its reliability once again, and has retained leadership of the market even in the most unfavourable conditions. Our flows remain the keystone of the market. We are still the major gas supplier to Europe, and we satisfy about a third of the European Union's gas import demand.

Being a responsible and self-confident player, we have not tried to compensate falling sales at any cost while the market goes through extreme turbulence. We have adjusted our Electronic Sales Platform. To minimize the negative impact on prices, we focused on selling forward gas with longer delivery periods. Since mid-May, to reduce the pressure on spot prices, we have not offered contracts such as Within-day, Day-ahead, Weekend or Balance-of-Month. And the reality has proved that buyers share our view. In June, the ESP set a new record. The overall volume of deals concluded within the month reached almost 5 bcm. All these volumes were sold under longer-term forward contracts.

Another way to support the price by balancing supply and demand was the withdrawal of gas from storage during the summer maintenance of export pipelines. We did not supply extra volumes through alternative routes, but used the volumes we already had on the market. This has contributed to a decrease in excess gas volumes in storage, which was one of the causes of the crisis. In April, stored volumes exceeded the 5-year average by 29 bcm. By early September, this difference had halved to 14 bcm.

Yes, in general, our flows have decreased, following a drop in demand. As the largest supplier, Gazprom has taken a hit to balance the market. This is the feature of a responsible market leader which is concerned about broader stability. We do not try to defend our sales volumes at any cost.

As a result of our diversified contract model, which includes different indexations, our prices are much less volatile than those on the European hubs. While spot prices collapsed to historic lows of around 60 dollars per thousand cubic meters, our average price under long-term contracts has never fallen below 100 dollars.

We are sure that our strategy will help stabilize the market. In fact, this is already happening. Spot prices are recovering as demand grows, and winter is on the way. Russian gas flows are growing, too. Since the end of August, they have been steady at the level of 500 mmcm per day.

So what comes next? I would like to warn anyone who is over-optimistic about a market recovery. The majority of challenges and threats are still here. One of them is general oversupply, which we are likely to see in 2021 as well. LNG supplies to Europe cannot be expected to decrease either. The TTF forward curve indicates that prices will exceed the lower limit of the LNG operational cost range by November. As for demand, we all hope that a second wave of coronavirus will not lead to the tough restrictive measures which we saw in the spring. Still, no one can predict this for sure. Demand dynamics will also depend on winter weather, which cannot yet be forecasted.

Unfortunately, there is an additional threat which is increasingly affecting our cooperation. This is the political standoff in general, and in particular the threat of US sanctions against Nord Stream 2. US LNG suppliers have unbalanced the European market and failed to stabilize it. Now the United States is trying to oust Russia by using non-market instruments. In the face of these threats, I am pleased to see the united opposition from governments in key countries which buy our gas in the EU.

We are well aware of all the risks and are ready to deal with them. Despite all the challenges, we continue to develop our business successfully and systematically. As the largest gas producer and supplier in the world, Gazprom has a safety margin, a stability reserve which Alexey Miller, Chairman of the Gazprom Management Committee, mentioned recently. I am sure that with our international partners, we can improve the stability of the entire European gas market. Let us achieve this by working together.

Thank you.

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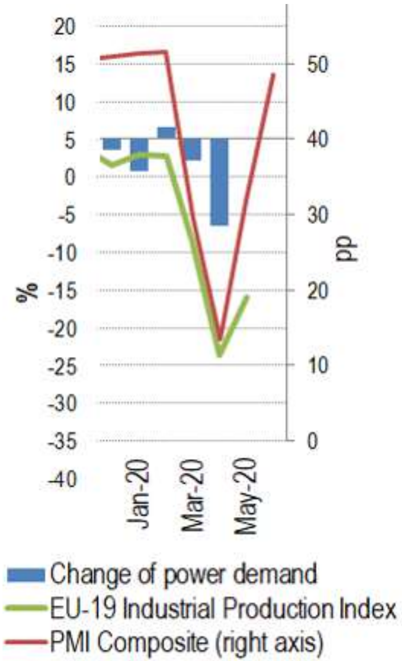
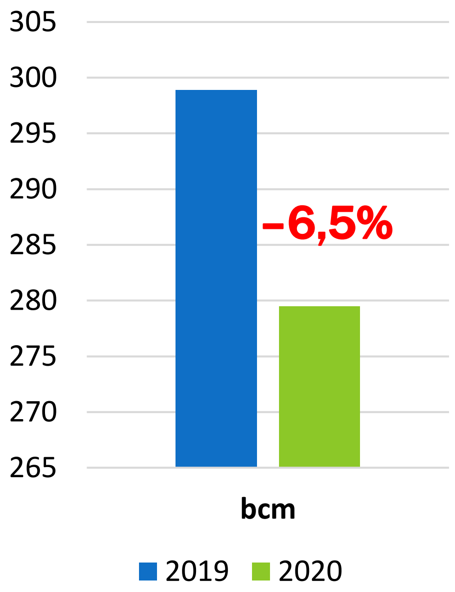
Sources of Market Turbulence

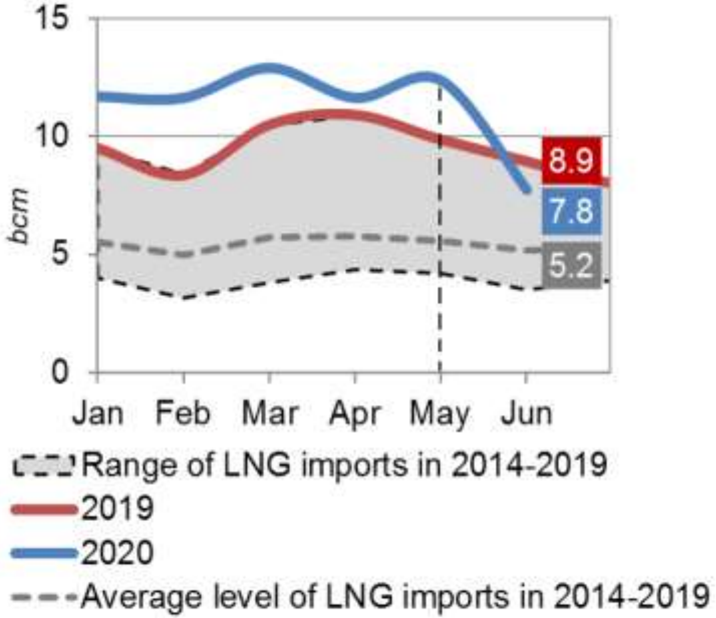
Business activity in Europe in H1



Gas consumption in Europe in H1

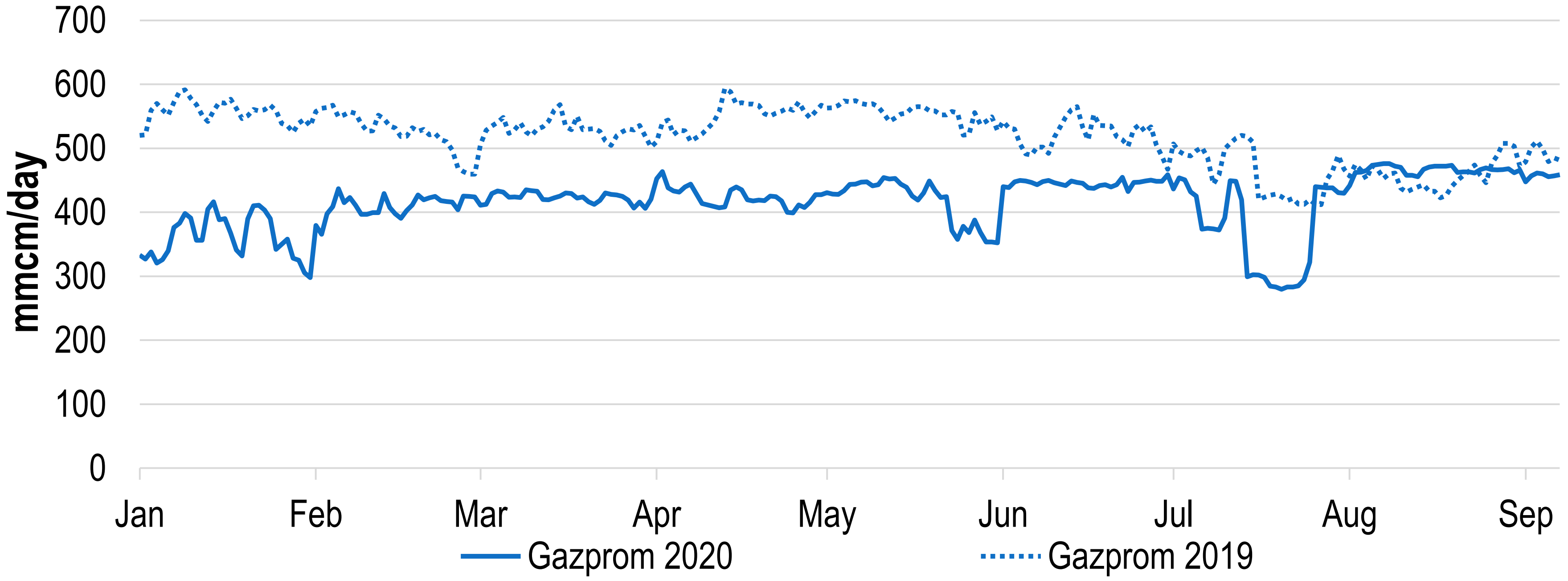


LNG deliveries to Europe in H1

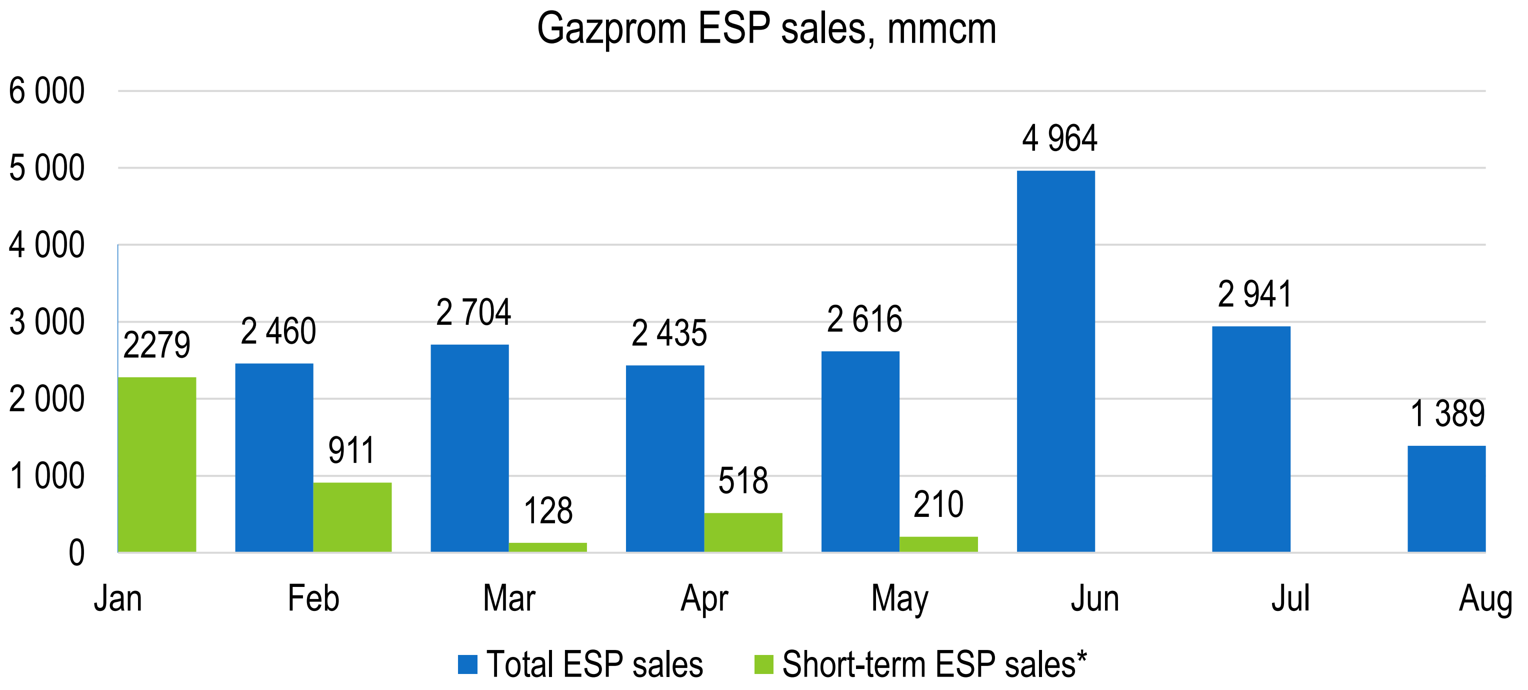


Sources: Bloomberg, IEA, Eurostat, ENTSO-G, IHS, national statistics agencies

Gazprom deliveries to Europe



Source: Gazprom Remit



** Contracts with less than a month maturity*

Thank you for your attention