The Moscow Times
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INDEPENDENT NEWS FROM RUSSIA

Risks Seen in Gazprom Price Inflexibility

By The Moscow Times

July 10, 2011



Gazprom may lose sales in Europe as its insistence on pricing policies creates "a big problem" with buyers, said Jonathan Stern of the Oxford Institute for Energy Studies.

"If Gazprom continues its current gas pricing strategy, I don't see it selling more gas this year than it sold last year or the year before," Stern, director of gas research at the Oxford Institute, said in Moscow. "It's a very simple choice between higher prices and lower demand, or lower prices and higher demand."

Gazprom has said it is willing to take talks to arbitration as its European customers, including E.On and GDF Suez, push to change their long-term contracts. Exports to Europe, Gazprom's biggest market by revenue, are recovering after a two-year slump during which buyers turned to the spot market for cheaper supplies.

Gazprom doesn't plan to make "radical changes" in its contract system, chief executive Alexei Miller said June 30. The company ties prices to oil products with a time lag of about six to nine months and sets minimum volumes that importers must take or pay for unused gas.

Europe's price may reach $500 per 1,000 cubic meters in the fourth quarter and exceed that level in the following three months, Miller has said. The company forecasts the average price this year to rise to $400 from about $306 last year.

"We'll see a big problem between Russia and the main buyers, which may be a legal problem or a negotiation problem," Stern said. "This cannot continue for very much longer. Russia will earn more money for as long as these contracts continue, but the outlook for sales is poor."

Gazprom, Europe's biggest single gas supplier, expects to ship as much as 158 billion cubic meters of gas to Europe with record earnings after deliveries jumped 26 percent in the first half of the year, Miller said last month. That compares with 139 billion cubic meters last year and 160 billion in 2008.

Gazprom's production growth and exports probably aren't sustainable, said Oleg Maximov, Alex Fak and Valery Nesterov, energy analysts at Troika Dialog. An "unprecedented rise" in storage in Europe since April may mean that customers "are simply anticipating higher gas prices during the third and fourth quarters on the back of the oil price move," the analysts said in a research note last week.

Demand recovered only in Northwestern Europe, while Southern Europe hasn't rebounded "at all," Stern said. Current pricing from Russia may hinder demand growth, he said.

Gazprom supplied 23 percent of Europe's gas at the end of last year and targets 32 percent in 2020.

"The Europeans have given a very clear message to Gazprom: 'If this is the pricing structure you want, this is the volume you are going to get,'" Stern said. "I don't expect that to change because nobody in Europe can afford to pay these prices, let alone buy any more gas at these prices."

The priority for Gazprom is revenue, not export volumes, deputy chief executive Alexander Medvedev said June 20.

The exporter is holding a new round of talks with some of its largest partners on gas supply contracts. Gazprom reached "very balanced" conditions with partners including GasTerra and Edison, preserving the link to oil prices, he said.

E.On, one of Gazprom's biggest European buyers, failed to reach an agreement on prices in the new round of talks and may bring the conflict before an arbitrator, Handelsblatt reported on July 4.

Miller and E.On chief executive Johannes Teyssen met last week in Moscow to discuss gas supplies and possible electricity projects, Gazprom said in a statement.

"What is extremely clear is that buyers are losing money with these prices and many of them are losing a lot of money," Stern said. "I don't think that legal cases will solve this problem, but we may have to go through legal cases before we find a solution."

Gazprom expects to agree with the European Commission on a deal to buy a stake in Central

European Gas Hub in Austria, deputy chief executive Medvedev said. "The possibility for the entry in this project still exists," Medvedev said Friday on Rossia 24 television, Bloomberg reported. "I hope a compromise will be found to let us enter this project and remove concerns that Europeans have."

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