

# Sanctions or No, Price of Oil Spells Future of Russia's Economy

By [The Moscow Times](#)

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A general view shows the Achinsk oil refining factory, owned by the Rosneft company, outside the town of Achinsk, some 188 km (117 miles) west of Krasnoyarsk, Russia.

For all the sanctions Western leaders can throw at Russia, the biggest threat to President Vladimir Putin's ability to back separatists in east Ukraine is something beyond his or their control: the price of oil.

With Russia's \$2 trillion economy heavily dependent on crude exports, oil prices are always closely monitored by the Kremlin, but the government is particularly wary now as tensions with the West mount and sanctions ratchet up.

Such conflicts often push up crude prices, but as long as oil, which accounts for 40 percent of state revenues, remains above the average \$104 per barrel written into the 2014 budget, Moscow has little immediate need to worry.

The alarm bells will start ringing if it falls significantly below \$100, forcing the government to pay more attention to propping up an economy already close to recession.

The International Monetary Fund warned in May that Moscow had no contingency plan for such a scenario, so a sustained tumble in the price of crude could even undermine Putin's grip on power.

"If the oil price goes down to \$75 and stays there for a few years, Russia will have a regime change," said a prominent Russian economist who asked not to be named. "Two years ago I would have said \$60, but now, given the lack of growth, the increase in corruption and sanctions, \$75 would be enough."

## **Price Under Pressure**

Such a scenario is not merely idle speculation; most analysts expect oil prices to fall in the coming years as new production, including from unconventional sources in North America, applies downward pressure to markets, with some forecasts going as low as \$70 per barrel for Brent crude oil in 2020, down from over \$105 currently.

A long-term decline in prices may be unlikely given the unrest in Iraq and the limited scope for Iran to increase output due to sanctions, but any substantial fall could derail the Russian economy.

Sergei Aleksashenko, a former deputy Central Bank head and now a scholar at the Higher School of Economics in Moscow, said a \$10 drop in oil prices would strip 700 billion rubles (\$20 billion), or 5 percent, from Russian budget revenues a year.

That translates to about 1 percent of GDP. Local economists estimate that a \$10 price drop could rob Russia of 3 to 4 percent in GDP growth.

"The most evident outcomes of any decline in oil price are destabilizing of the balance of payments, devaluation of the ruble, rise in inflation and decline in budget revenues, decelerating of the growth," Aleksashenko said.

"It is evident that the longer the period of reduced oil prices, the more significant the impact on the Russian economy," he said.

A drop to \$38 per barrel in the aftermath of the 2008 financial crisis sent Russian GDP falling 7.8 percent, and it shed \$200 billion of reserves within a few short months trying to defend the ruble, which still lost a third of its value.

Its reserves, though still the world's fifth largest at nearly \$500 billion, are more than \$130 billion below their level at the beginning of the 2008 crisis.

The crisis passed when prices promptly climbed, but if Moscow learned any lessons, it is not clear in its economic pronouncements.

"The government only publishes a basic level of macroeconomic risk analysis to support fiscal policymaking," the IMF said in its May report. "There is no analysis of the implications of [changes, such as in oil] for the government finances."

The Finance Ministry manages two oil windfall revenue funds. One, the \$87 billion Reserve Fund, has a clear goal to patch budget holes if the need arises.

Former Finance Minister Alexei Kudrin said in a recent interview with ITAR-Tass news agency that if oil were to fall to \$80 per barrel, the fund could last for two years.

"That [reserve] is rather small," said Anders Aslund, a senior fellow at the Peterson Institute for International Economics in Washington.

If oil hits \$75-80, Aslund said, "Russia would have to cut its imports, which would hit the standard of living, investment and economic growth. A decline in GDP and standard of living would be inevitable."

Besides oil and the oil wealth stash, Russia has precious little.

"The policy of recent years has led us to a point when in the current stagnation all [other] reserves have been exhausted," said Kudrin, who helped to amass the sovereign funds during a decade of economic boom.

"Structural reforms or a [policy] maneuver in favor of growth are not being considered," he said.

## **Output Under Threat**

Keeping oil output at the current 10.5 million barrels a day is also essential for the budget. But the vast West Siberian deposits, which amount to about 80 percent of the country's total oil output, are in decline.

Some firms have already cut investment and others may follow suit as a result of the stand-off between Moscow and the West over Ukraine. Many cut investment after the 2008 crisis.

"The situation is difficult and most likely will lead to the need to revise the investment program," a source close to one of Russia's largest oil producers said. "Everyone is pretending that nothing horrible is happening. It is very difficult to predict how the situation will develop."

The annexation of Crimea from Ukraine in March boosted Putin's popularity at home to all-time highs, but the Kremlin's ongoing involvement in Ukraine and the economic price the country is paying is making business owners uneasy.

Yet, in a country where criticism is rare and can result in exile or prison, most remain silent.

"Business always adapts to the situation in which it finds itself," Trade Minister Denis Manturov said last week, adding that the punishment on Moscow by the West is "peanuts" compared with the isolation Russia suffered in Soviet times.

Four of Russia's leading oil producers — Rosneft, LUKoil, Surgutneftegaz and Gazprom Neft — plan to invest a total of about \$50 billion this year.

Russia plans to spend around \$150 billion a year over the next 10 years to bring onstream new

fields in east Siberia, the Far East and the Arctic, as well as improve oil output at mature fields, according to Energy Minister Alexander Novak.

But that requires financing, which may be tricky, given the recent sanctions, which closed U.S. financing of longer than 90 days for Russia's top oil producer Rosneft and leading independent gas company Novatek.

Rosneft, which paid 2.7 trillion rubles (\$75 billion) in taxes to state coffers last year, used North American banks to arrange most of its over \$38 billion in loans raised since the end of 2011.

Asian banks are unlikely to be able to fill the gap. Domestic funding capacity is limited as the Central Bank keeps a cap on liquidity, to avert inflation, and Western sanctions aim to restrict capital markets for Russia's state-owned banks.

Rosneft, which is preparing to start drilling in Arctic Kara Sea with ExxonMobil, declined to comment. Its capital expenditure was around 700 billion rubles (\$19.6 billion) for this year under an oil price of below \$100 per barrel.

"The sanctions will significantly limit [Rosneft and Novatek's] financing options and could put pressure on development projects," Moody's ratings agency said in a recent report.

Gazprom Neft, Russia's fourth largest oil producer, which is exploring for shale oil with Royal Dutch Shell, declined to comment, as did LUKoil.

But based on their documents and earlier comments, they all envisage oil prices at between \$90 and \$100 in the medium term.

Kudrin has for years warned that oil prices will fall. Some analysts say it was falling oil prices and the passing of peak production that led to the rapid meltdown of the Soviet Union a quarter century ago.

Aslund, of the Peterson Institute, said a long-term oil price drop was unlikely, but not impossible, given the geopolitical volatility, and that scenario could be catastrophic for Putin, who is facing re-election in 2018.

"Putin would look weak and incompetent," Aslund said.

**See also:**

[EU Energy Sanctions Only Painful on Paper](#)

[LUKoil Considers Cutting Investment Over Sanctions](#)

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