

Gazprom Sees Production Tumble as Ukraine Crisis Bites

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Gazprom's natural gas production fell 19.6 percent last month compared with the same period last year, as the state-owned behemoth struggles in the face of increasing competition at home and declining exports that are due in part to a breakdown in the political relationship between Moscow and Kiev.

Natural gas output at Gazprom declined to 26.3 billion cubic meters, or bcm, in August and could come in at under 450 bcm for the year, analysts at Sberbank CIB said in a note to investors Wednesday, citing monthly numbers released by monitoring body CDU TEK.

Gazprom produced 487.4bcm of gas in 2013, according to company figures, but this year it is finding it harder to sell its wares.

While Gazprom has not been targeted by sanctions from the U.S. or the European Union, the gas export monopoly stopped supplying Ukraine with gas in June after Russia annexed the southern Ukrainian region of Crimea, relations between the two countries tanked and Kiev refused to pay when Gazprom almost doubled the price of its gas.

Ukraine has said it will be obliged to import 5 bcm of Russian gas over the winter period to meet domestic demand, but no agreement over terms looks likely to be achieved in the near future.

"Should Gazprom prove able to pick up the pace [of production] to match the monthly figures seen in 2013, the full-year score could reach 454 bcm," the Sberbank CIB analysts wrote.

"This would be below Gazprom's recently revised forecast of 460 bcm for 2014, down a hefty 36.4 bcm, or 7.4 percent, from the company's forecast earlier this year."

In December 2013, Gazprom predicted that it would produce more than 490 bcm of gas.

Gazprom's revenue in 2013 was 5.25 trillion rubles (\$140 billion) — 7.4 percent of that figure is just over \$10 billion.

Gazprom has not only been facing problems selling its gas because of the crisis in Ukraine, but has been hit by reduced demand at home: Slowing economic growth has weakened industrial demand while competition from independent producers has been intensifying.

Privately owned Novatek, which has expanded rapidly in recent years, increased its gas production by 19.2 percent in August compared with a year earlier, according to Sberbank CIB.

While Gazprom's production slumps, its oil sector counterpart, state-owned Rosneft, also recorded falling production. Rosneft's production in August reached its lowest level since March 2013, according to CDU TEK data cited by Bloomberg on Tuesday. The decline is due to falling output from mature Siberian fields and reduced drilling, analysts said.

If falling production for Gazprom and Rosneft translates into reduced revenue, it could have serious consequences for Russia's budget, which is heavily dependent on cash from the two energy giants.

The success of Gazprom's efforts to reverse production decline are closely linked to three-way gas supply talks between Russia, Ukraine and the EU that are expected to determine on what basis Russia could resume supplying Ukraine. Russian Energy Minister Alexander Novak said earlier this week that these negotiations will resume on Sept. 6.

Gazprom has said it is prepared to offer Kiev a price of \$385 per 1,000 cubic meters while litigation with Ukrainian state energy company Naftogaz is pending in a Stockholm arbitration court. Ukrainian Prime Minister Aseniy Yatsenyuk said Wednesday that Kiev would be willing to pay an average price of \$340 per 1,000 cubic meters, RIA Novosti reported.

Against the background of the worsening relationship between Russia and the EU amid the crisis over Ukraine, European countries have gone to great pains to build up their gas reserves ahead of the winter period.

Yatsenyuk opened a gas pipeline on Tuesday from Slovakia that could supply up to 10 bcm of natural gas to Ukraine per year. Other European countries that could take part in so-called reverse gas flows eastward to Ukraine include Germany, Poland, Hungary and Austria.

Gazprom head Alexei Miller said in June that the company was looking very closely at the legality of reverse gas flows and warned that gas exports to companies participating in such operations could be cut as a result.

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