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INDEPENDENT NEWS FROM RUSSIA

Cheap Oil Threatens Russia With Recession, Deficits and Oil Output Falls

By Howard Amos

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Russia was expecting an oil price of $100 a barrel next year, an estimate that now looks hopelessly optimistic.

President Vladimir Putin said on Oct. 17 that if the oil price stayed at $80 a barrel for any substantial length of time the world's economy would "collapse."

Six weeks of sliding oil later, many Russian officials see $80 a barrel as an optimistic long-term forecast.

Igor Sechin, the most powerful figure in Russia's energy industry, told reporters Friday that the average price for oil next year would be between $70 and $75 a barrel, the Reuters news agency reported.

Meanwhile, Putin said Friday that turbulence in the oil market has months to run and will only find a "balance" next year, according to a transcript on the Kremlin website.

While Russia is cushioned from the immediate effects of falling oil by a weaker ruble and rainy-day reserve funds, experts said an extended period of low oil prices could lead to recession, government spending cuts, a ballooning budget deficit and faltering production in the oil industry.

New Reality

The decision by the Organization of Petroleum Exporting Countries (OPEC) on Thursday not to prop up prices by cutting production caused fears of a price war as Middle Eastern oil states flex their muscles in a bid to retain market share.

Oil dropped $8 after the news of OPEC's decision. By Friday evening, the Brent crude international benchmark was trading at just over $70 a barrel, down from almost $115 in June.

Russian officials immediately began to respond to the new oil price environment.

Economic Development Minister Alexei Ulyukayev said Friday that the oil price was likely to be closer to $80 a barrel in the long term and that his ministry would be revising down its price predictions.

“We won't collapse,” Ulyukayev told reporters, the RIA Novosti news agency reported.

A price of $80 a barrel looks “moderately optimistic,” Maxim Oreshkin, head of the Finance Ministry's strategic planning department, said Thursday, according to the Interfax news agency.

Dependence

Russia's dependence on oil revenues has risen in recent years, and the 2015 budget only balances if oil averages $100 a barrel.

About $2 billion is shaved off Russia's revenues every year for every $1 decline in the oil price.

Finance Minister Anton Siluanov said earlier this week that the Western sanctions on Moscow for its role in the Ukraine crisis and oil price falls will cost the Russian economy $130-140 billion a year.

Russia’s dependence on oil grew “sharply” in 2013, Deputy Finance Minister Tatyana Nesterenko said Sept. 12 on Facebook, according to the Bloomberg news agency.

While Russia is one of the world's biggest exporters of natural gas, it is crude oil that provides the lion's share of money for the state coffers. Russia earned $194 billion from oil exports last year, and just $28 billion from natural gas exports, Putin said in April.

Oil Industry Pain

The accelerating fall of the oil price has also raised fears about the ability of Russia's oil industry to maintain current record levels of post-Soviet production.

Russia pumped 523 million tons of oil in 2013. The country will produce 525.3 million tons in

2014, rising to 526 million tons in 2017, according to official Energy Ministry forecasts.

But experts have suggested that Russia could be facing a fall in output.

Leonid Fedun, the vice president of LUKoil, Russia's second largest oil company, said Thursday that annual oil production could fall to 490 million tons within four years, The Financial Times reported.

Sliding prices mean that Arctic drilling and tight oil projects — essential if Russia is to offset a loss of production from its declining oil fields in western Siberia — will become prohibitively expensive for cash-strapped Russian companies.

Equipment for Arctic offshore and tight oil developments were targeted by a sale ban imposed as a part of Western sanctions imposed in September.

Rosneft, which has lost 30 percent of its value in dollar terms, is already in a precarious position. The state-owned oil giant's debt — about $60 billion — is now $10 billion more than its market capitalization, Bloomberg reported.

Recession?

Battered by Western sanctions, levels of capital flight not seen since the financial crisis of 2008 and a currency that has lost over 30 percent of its value against the U.S. dollar since January, the Russian economy is expected to narrowly avoid slipping into recession this year.

Lower oil prices could make recession in 2015 a certainty.

If the Russian oil benchmark, Urals crude — which trades about $2 under the Brent price — averages $80 next year then 75 percent of 32 economists surveyed by Bloomberg on Friday predicted that a recession was on the cards.

State Finances

An average oil price of $80 in 2015 will mean a budget deficit of just below 2 percent of gross domestic product, said Oleg Kouzmin, chief economist at Renaissance Capital in Moscow. The budget for 2015-17 passed by Russia's State Duma earlier this month allows for a budget deficit of 0.6 percent.

Instead of allowing the deficit to rise, other options available to the government include moving to cut social or military spending, or seeking to raise extra capital in Asia, according to experts.

Russia's state finances are to a certain extent cushioned by a weaker currency and cash reserves.

A one-ruble increase in the dollar's exchange rate boosts income by about 200 billion rubles ($4 billion) and the National Welfare Fund, one of Russia's oil-funded sovereign wealth funds, contains about $85 billion that the government can access.

Lower oil prices are “no catastrophe,” said Valery Mironov, deputy director of the Higher

School of Economics' Development Center. “But all modernization plans will be wrecked.”

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