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Think Tank Warned Russia's Energy Ministry Against Production Cut, Despite Oil Price Dive

By The Moscow Times

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MOSCOW / LONDON — As Russia prepares to meet OPEC next week, a briefing paper from a Moscow think tank has shed light on how the government was warned against cutting oil output late last year even though global prices were plummeting.

Speculation was rife that Russia and the oil exporters' cartel might strike a production deal to arrest the slide when Energy Minister Alexander Novak met his Saudi Arabian counterpart last November.

However, the think tank had already advised Novak that OPEC would not cooperate and unilateral action would be costly at a time when Russian state finances were in a dire state.

"If Russia cuts output, OPEC will take our market share in Europe," a team led by energy expert Grigory Vygon said in the previously unpublished paper, commissioned by the Energy Ministry before the Nov. 25 meeting in Vienna.

The paper was prepared by the Skolkovo Institute's energy team, which has subsequently set up the independent Vygon Consulting group.

In the event, Novak opted against lowering Russia's output and two days later Saudi Oil Minister Ali al-Naimi also blocked calls at an OPEC conference for production cuts, sending crude prices to a fresh four-year low and declaring a global battle for market share.

Six months on, the agenda at least will repeat itself next week: non-OPEC producers led by Russia are scheduled to meet the cartel in the Austrian capital on Wednesday and Thursday, before an OPEC conference on Friday.

Benchmark crude at around $63 a barrel remains well below where it was before last November's OPEC meeting. However, it has recovered from a low of $46 hit in January, easing the pressure for radical action.

Therefore OPEC, which controls a third of the global oil market, and Russia, which produces another 12 percent, are unlikely to reverse their output strategy.

The confidential briefing paper, seen by Reuters, said that should Moscow decide to cut output or exports, similar quality OPEC crude — mainly from Saudi Arabia but also from Iran and Libya — would replace as much as 1 million barrels per day (bpd) of Russian oil. That is equivalent to a tenth of both Russian production and of European consumption.

The Energy Ministry declined comment on the paper, which was written in November but carries no exact date.

Vygon predicted Saudi Arabia would refuse to cut production as it could weather the low oil price. Instead, OPEC's leading member would use the opportunity to win market share at the expense of rival and more costly producers, such as in the United States or Russia, it said.

That has proven true. Far from cutting, OPEC has increased production by 1.4 million bpd over the past year with Saudi output alone jumping by 450,000 bpd year-on-year to 10.15 million in April.

The paper also predicted that U.S. shale oil producers would prove resilient in maintaining output, even with the much lower prices. That has also proved correct, at least so far.

Tensions

In addition to Novak, Russia was represented at the Nov. 25 talks by Igor Sechin, the head of energy giant Rosneft and an ally of President Vladimir Putin. They met Naimi, OPEC Secretary-General Abdulla al Badri, Venezuelan Foreign Minister Rafael Ramirez and Pedro Joaquin Coldwell, energy minister of Mexico, which like Russia does not belong to the cartel.

Market expectations were then the highest in years that Moscow and OPEC could agree a simultaneous cut to support prices. Russia's financial situation was troubled, largely due to Western sanctions imposed over its annexation of Crimea and backing for separatist rebels in eastern Ukraine.

But after several hours of talks, Sechin and Naimi left the Grand Hyatt hotel by different back doors. Russia announced it would not cut output even if prices fell to $40, while Naimi said he had come to the meeting with zero expectations and two days later persuaded fellow OPEC ministers not to cut output.

Russia has pushed its own production up by 200,000 bpd over the past year, hitting an all-time high of more than 10.7 million in April. This is mainly thanks to rising output at state-run Gazprom and freshly nationalized Bashneft.

The Russian firms have achieved the increase despite some predictions of imminent national economic collapse due to the sanctions, which have throttled their access to international financing and Western technology.

"They have always succeeded when a barrier was put in front of them. They need higher production, no doubt it will grow," the head of global trading house Trafigura's Eurasian operations, Jonathan Kollek, said this month.

The paper shows Russia knew a pump war would weaken oil prices and hurt the country's budget, which is running a deficit equal to 4.4 percent of gross domestic product.

However, a source close to the Russian team responsible for talks with OPEC said that much has changed since then. "The oil price has bounced back and Russia is kind of coping. There is also an understanding that the Saudis will not cut as they would lose market share, so nor should Russia," said the source.

Sechin is not due to attend next week's meeting, adding to expectations of no change in Russian strategy. Vygon Consulting has not been invited to produce a briefing paper this time.

Deputy Energy Minister Kirill Molodtsov suggested this month that Russia was much less worried about the oil price these days, signaling that it is even less willing to cooperate with OPEC on production cuts.

"The consultations [with OPEC] are under way," he said. "Look at the forecasts we had produced earlier. In that sense, you will understand that we are within the [pricing] corridor that we had forecast."