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Russia's Gazprom Sees Gas Output Fall to Record Lows as Demand Slumps

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Russian state-owned gas giant Gazprom faces a record drop in gas production amid a decline in domestic and export demand and growing competition from other Russian gas producers.

Gazprom, which generates some 10 percent of Russia's economic output, is battling a slump in demand both from the key export markets of Ukraine and Europe and from consumers in Russia, which is mired in recession. Large planned exports to China will not come online until at least 2017.

The company's output in June fell by 19 percent compared to the same month in 2014, to a record monthly low of 24.7 billion cubic meters (bcm), according to a report by analysts from Sberbank CIB, a Russian investment bank. In the first half of the year Gazprom's gas production dropped by 12.9 percent year-on-year, said the report, which was based on data from Gazprom and Russian monitoring agency CDU TEK.

Exports by Gazprom, which has a monopoly on selling Russian pipeline gas abroad, declined

by 8 percent in the first half of the year compared to the same period in 2014, according to Sberbank.

This is partly due to European buyers delaying purchases of gas, said Yekaterina Rodina, an oil and gas analyst at Investment bank VTB capital. Gas prices move in parallel with oil prices, but with a lag of around nine months, meaning they will likely fall sharply later this year.

Europe is also seeking to diversify away from Russian gas to other suppliers and renewable sources of energy, and Ukraine is fast reducing its dependence imports of Russian gas amid political tensions between the two countries. The share of direct Russian gas exports in Ukraine's consumption, which was 74 percent in 2014, declined to 37 percent in the first half of this year as Kiev switched to European suppliers, Sberbank's report said.

Gazprom on July 1 suspended the delivery of gas to Ukraine after failing to agree on a price with Ukrainian state gas company Naftogaz in a dispute that has dragged on for 18 months.

Lower exports will reduce Gazprom's revenues, which Sberbank said would come in this year at $105.8 billion, down 27 percent from $145.9 billion in 2014. But a weak ruble will offset the effect on profits, the bank said.

Foreign sales account for two-thirds of Gazprom's revenue, said Valery Nesterov, oil and gas analyst at Sberbank CIB. The company sells around a half of its gas inside Russia, but domestic pricing is kept low by regulation.

With domestic consumption of gas also falling as an economic recession curbs industrial activity, Sberbank said Gazprom's total production of gas in 2015 would not exceed 410-420 bcm — the lowest output in the company's 22-year history. In 2014 the company produced 443.9 bcm.

Gazprom said in a May report that it planned to increase gas production to 471 bcm. The company plans to increase its production volumes in the second half of the year, anticipating increased demand in the European market, caused by lower gas prices and purchases to replenish European gas storage facilities before the start of winter.

According to Sberbank, Gazprom has slightly improved its export statistics over the last two months, but analysts said the situation on the domestic market was unlikely to improve.

Though the company maintains a monopoly on gas exports, Gazprom is facing growing competition inside Russia from rival companies such as Rosneft and Novatek, which are steadily increasing their gas production.

These companies can attract clients by offering more favorable prices than Gazprom, whose pricing policy is more rigidly controlled by the state, said Ilya Balakirev, a senior analyst at UFS Investment Company.

Gazprom's falling sales could also lead to consequences for the Russian budget through reduced tax revenue. But Balakirev said the problems would only get serious if the slump continued for 5-10 years.

And, he said, “there is a very little possibility for that as we expect the European market to

expand in the future."

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