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Eurasia Strategic Consulting

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Russia's Energy Maneuvers

FX and Commodity Impact

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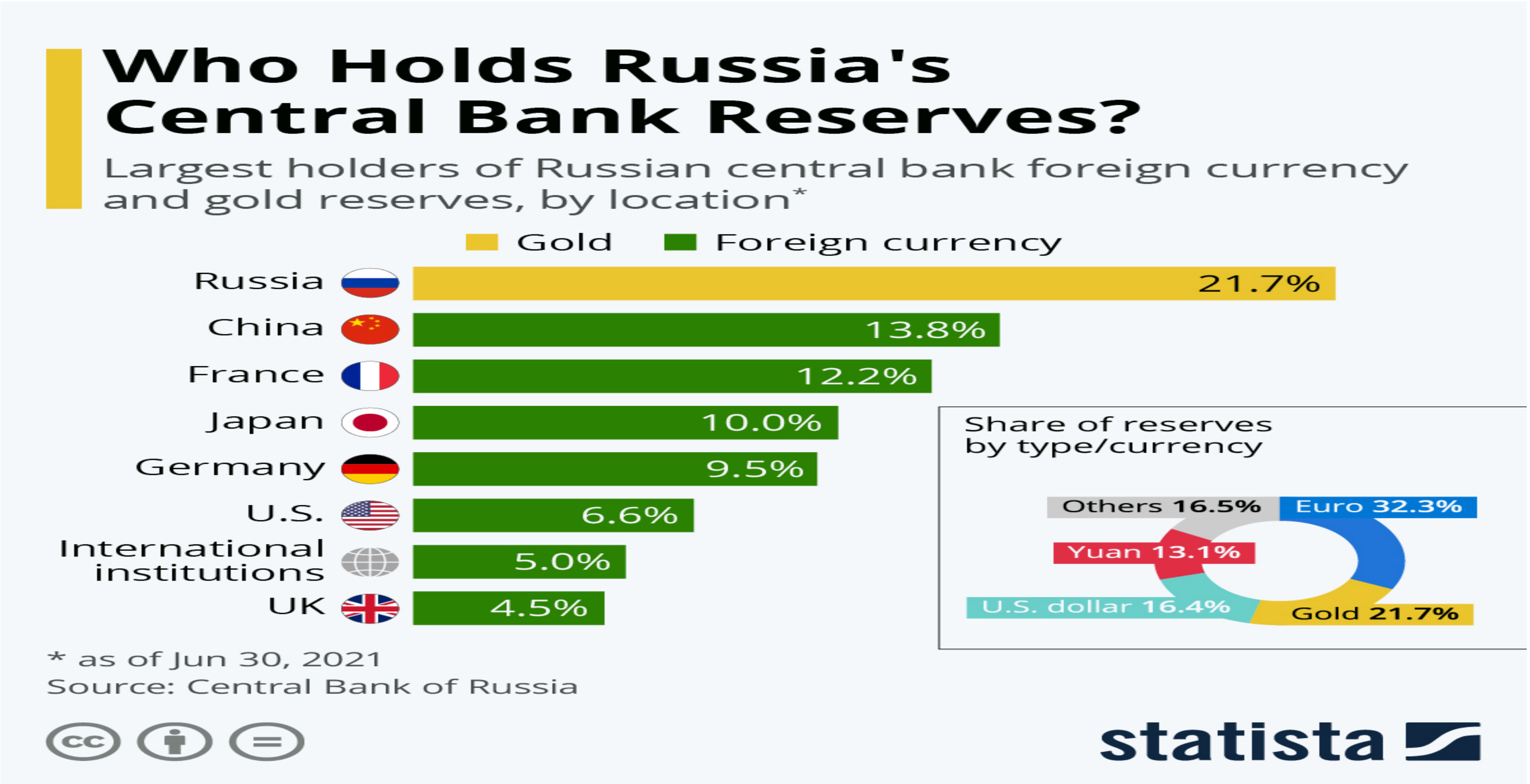
Summary

- President Putin has advocated a move away from US dollar dependency in trade and reserves since 2006
- Part of his view that the US is too dominant in global trade, financial regulation and politics. He has advocated greater use of bi-lateral trade regulations and financial settlements
- The start of the sanctions against Russia in 2014 accelerated his efforts to move away from US dollar dependency/vulnerability
- The Russian Central Bank greatly reduced US dollars from its reserves
- Russia and several EU states concluded oil and gas deals in Euros
- China and Russia have agreed several commodity deals in rubles and yuan

Structure of Reserves & Location



Sanctions Impact

- The so-called "special operation" in Ukraine has clearly not gone to plan
- Russia is under greater sanctions pressure than any other country in history and at a faster pace and broader impact than any reasonable assumption may have expected
- The financial sector has come under the greatest sanctions pressure, including sanctions against the Central Bank and several of the country's largest state and private sector banks
- Russia's key competitive advantage is that it is, in aggregate, the world's largest energy exporter and also the world's largest industrial materials exporter, in aggregate
- Russia is now using this fact to try and block any further major sanctions expansion

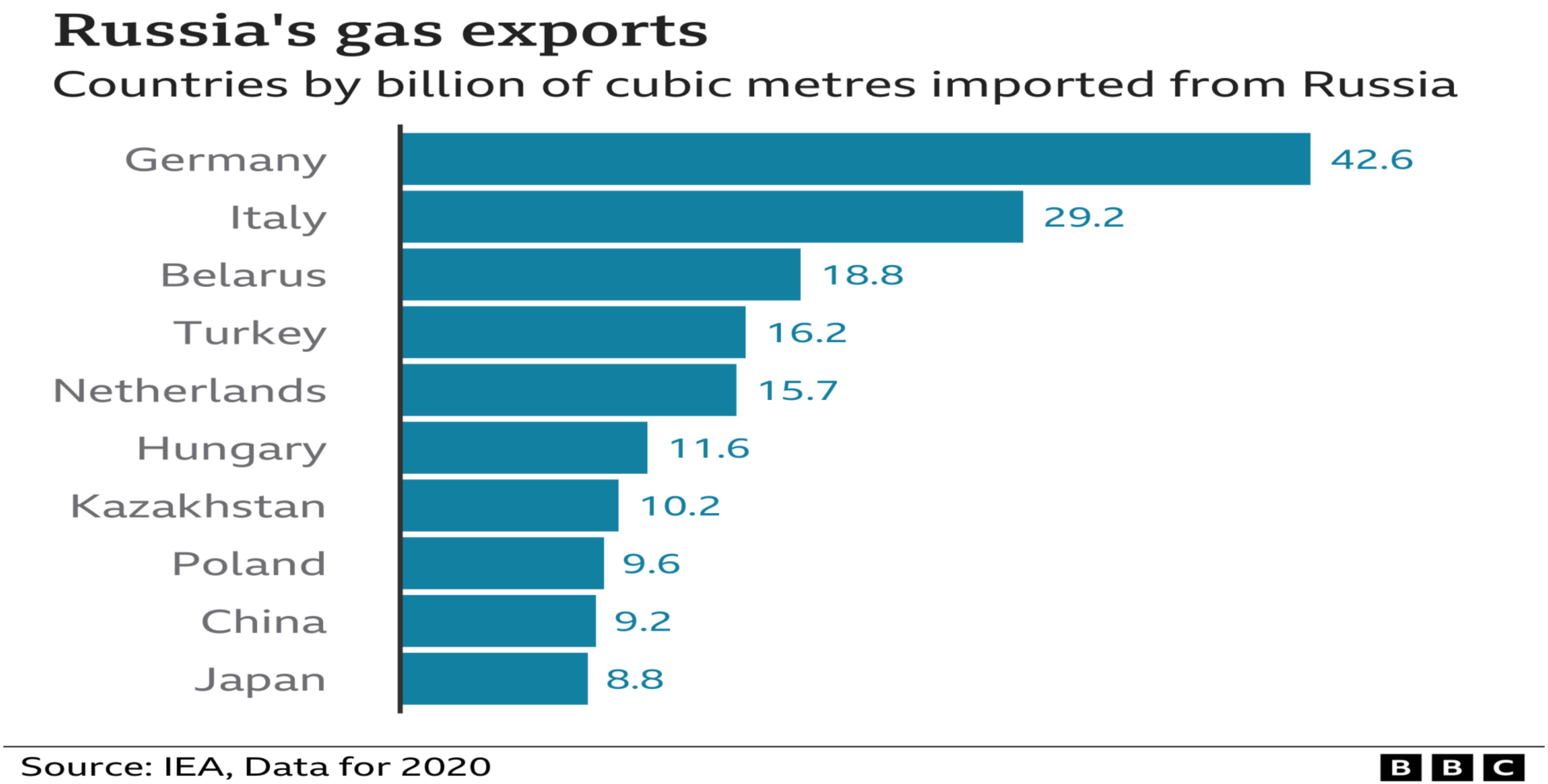
Russian Commodities – In Context

- world's largest natural gas exporter – 236 bcm (approx. 140 bcm to Europe)
- The world's largest oil exporter (crude + products) – 8.4 mln bbl/d – including 2.5 mln bbl/d of refined products
- 4th largest exporter of LNG (40 bcm in 2021) with plans to be the 3rd largest
- 2nd largest producer of nickel and aluminium
- 4th largest in rare earth metals
- 5th largest in steel, coal, timber
- 3rd largest gold producer
- 2nd biggest palladium and platinum producer - #1 producer of diamonds
- Largest supplier of wheat (alternates with Ukraine)

Rubles for Gas

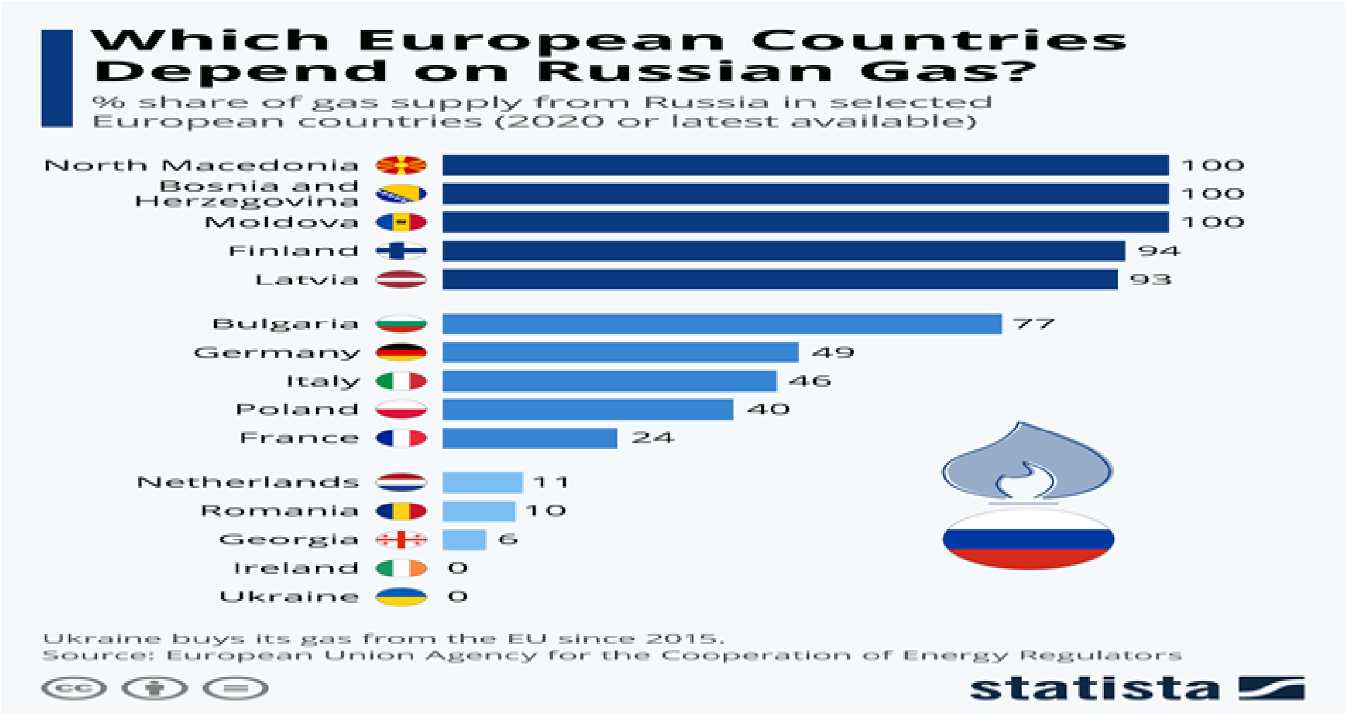
- From April 1st, Russia requires so-called unfriendly states to pay for gas in rubles
- In practice, this means that gas customers pay in dollars or euros (as per the contract) into a special account at GazpromBank – previously they paid direct to Gazprom – and GazpromBank converts to rubles, which it then sends to Gazprom
- This mechanism ensures that GazpromBank cannot be sanctioned (without risking gas export disruption) and it also involves the Central Bank in converting the FX into rubles
- The EU Commission says this is "sanctions busting" and illegal
- Yesterday, Russia suspended gas exports to Poland and Bulgaria (near the top of Russia's list if most unfriendly states) in order to show it is not bluffing

Major Gas Customers



Market Impact

- There will not be a major market impact from the action against Poland and Bulgaria as both have been working on alternatives (from Norway and from the Southern Gas Corridor from Azerbaijan)



What's Next?

- Europe has no choice but to find a way to work with the new payment system as otherwise Russia may cut off more gas export volumes. This would risk a recession in Germany and other EU states

- Europe has no realistic opportunity to replace Russian piped gas "for at least five years"

- Russia would suffer financial loss but mitigated with A) higher average price for continuing export volumes and B) an accelerated effort to boost exports to Asia and other friendly states

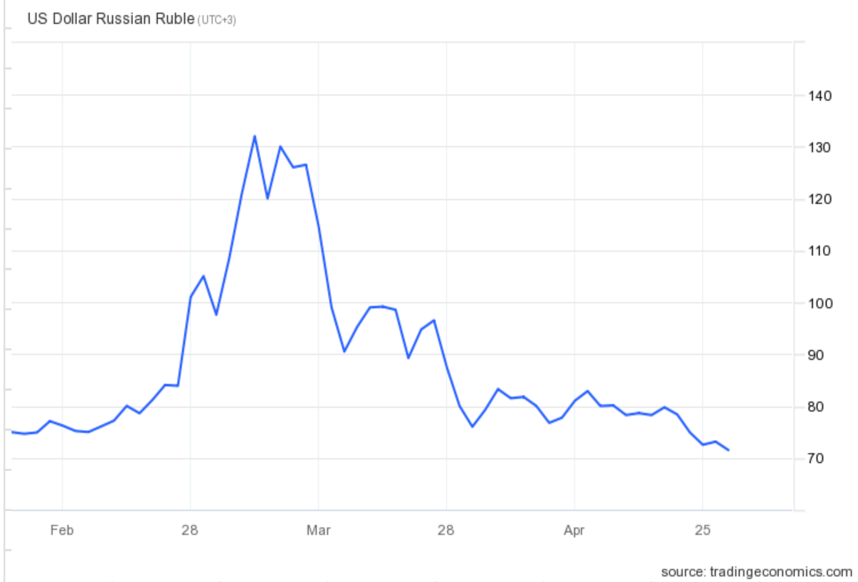
- Moscow will eventually expand the ruble based exports across more bi-lateral deals and with more commodities in the coming years

- Starting with gas exports to Europe is both opportunistic and a defensive move by Russia against the threat of further sanctions

Ruble Impact

- The ruble is currently not free-floating as the Central Bank has imposed a number of restrictions covering currency repatriation and the ability to export foreign currencies
- The government is talking about creating a new exchange mechanism linking the ruble exchange rate with the country's gold holdings
- How this may be achieved is very unclear – it implies a continued managed currency regime and no return to a free float.

Ruble-US Dollar Volatility since February



Source: TradingEconomics

Trade Lifeline Remains

- ❑ Russia is still able to export the most important / valuable products
- ❑ The EU cannot replace Russian gas for 4-5 years. Statements suggesting otherwise are political and do not reflect reality.
- ❑ A reduction in oil product to Europe (2.4 mln bbl/d) will lead to price rises and shortages
- ❑ Globally, products, such as wheat, fertilizers, nickel, are too important to ban (without consequences)
- ❑ Russia is running a Current Account surplus of $25 bln per month – and is able to repatriate the FX. It means that the government has enough money to fund employment subsidies, key industry support, social programs and the military

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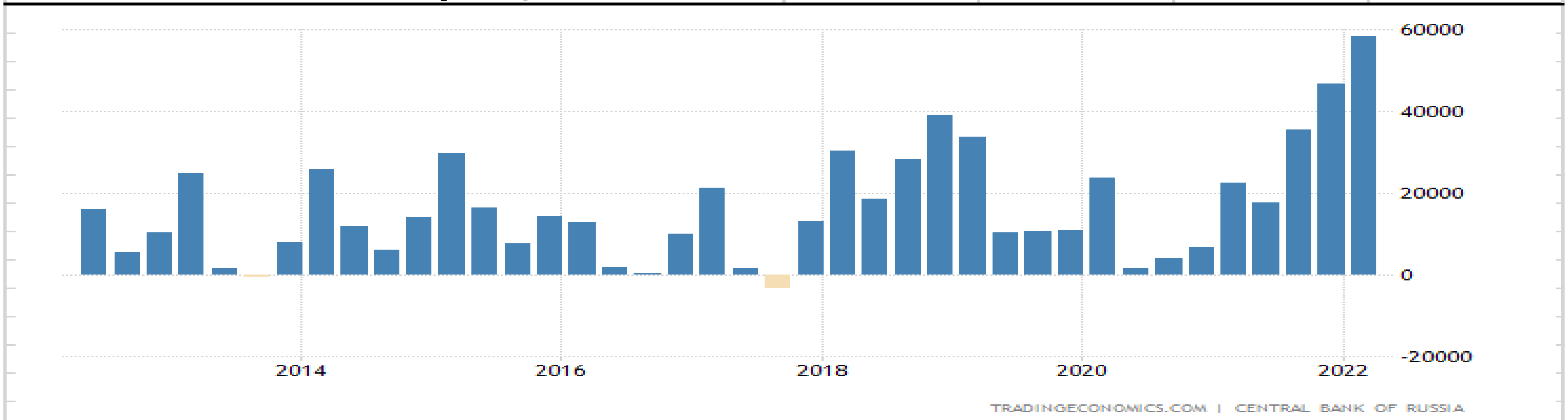
Record Current Account

- The Current Account in 1Q was just short of $60 billion. This compares with $22 billion in 1Q21

- Imports have collapsed while the value of exports is higher

Current Account Surplus, US$Bln



Source: Central Bank of Russia

Broader Implications

- China shares Russia's view that US dollar dominance supports US dominance in global trade, regulation and politics. China is more likely to expand ruble or yuan deals with Russia

- OPEC states (Gulf states) are openly considering breaking the US Dollar currency peg as this is always financially damaging when the oil price slides – selling oil in other currencies will give their budgets greater protection

- The sanctions against Russia shows to others the dangers of being too closely integrated with US dollar and Euro assets

- But, any bi-lateral deals will still have to reference a global price, i.e the US dollar price. There will be a FX conversion cost

- Such bi-lateral deals are more akin to barter deals than a real attempt to create a new global trade settlement system. It will be limited and restrictive

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