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The impact of the EU, USA and other countries' sanctions on the Russian economy

The EU has made a decision to introduce third-tier sanctions against Russia. The sanctions relate to the energy and finance sectors, military and dual-purpose products (Council Regulation (EU) No 833/2014)¹. Sanctions are effective for a period of one year with the possibility of reconsideration after 3 months.

Banking Sector

Financial sanctions include limiting the possibility of financial instruments for the five largest Russian banks to raise funds for more than 90 days. Moreover, state banks are forbidden from issuing Eurobonds and shares on behalf of the European owners.

These sanctions will not cause a liquidity crisis in the Russian banking sector in the short term, since the majority of Russian companies and banks have sufficient funds to ensure current liquidity. Russian companies and banks have substantial foreign currency debts that must be repaid over the next 18 months, but their large monetary holdings and financial instruments cover almost all rollover demands.

However, sanctions will strengthen the tendency of reduction in the potential for the economy growth in Russia, which will lead to a reduction in lending to all sectors of the Russian economy and will have a negative impact in the mid and long term.

Long-term unfavourable market conditions will also have a significant negative impact on the banking system of Russia, causing its increased dependence on CBR funding and a further reduction in profitability of the banking system. However, substantial foreign exchange reserves of the Central Bank of Russia (more than USD450 bln) will allow the smoothing out in the short-term negative trends in the banking sector.

Furthermore, the reduction in investments in the companies' development, including foreign investments and flight capitals, will have a negative impact on production capacity and competitiveness in the mid-term.

Oil and gas sector

Under the sanctions introduced against Russia, companies from the EU countries are prohibited from supplying high-tech equipment for the oil and gas industry **under the new contracts which are to be signed**. The prohibition is effective for 1 year with the possibility of reconsideration after 3 months. This equipment, which is forbidden from being delivered to Russia, is to be used for oil and gas recovery in remote areas of the sea shelf and for the extraction of shale gas.

"Gazprom" and "Rosneft", who require Western technologies for the Arctic shelf exploitation, would be the worst affected by these measures. Projects in remote areas and shale oil projects may become at risk.

It is expected that in three years, these sanctions will result in an oil production **reduction by at least 26mln tonnes per year (5% of annual production)**.

¹ http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.229.01.0001.01.ENG

For the exploitation of oilfields difficult to access in Western Siberia, Russian companies use American technologies which allow the near halving of time of oilfield development. According to the information given by Ministry of Energy and Ministry of Industry and Trade of the Russian Federation, 25% of the equipment used in the oil and gas industry is bought from abroad by Russian companies. European manufacturers and suppliers will not lose more than EUR150mln per year due to the sanctions.

Russia is heavily dependent on the supply of the maintainable equipment since it has no equivalent equipment to operate in the oilfields difficult to access. With no contribution from the international oilfield services companies, problems may appear when operating in not easily accessible oilfields: hard-stocks, high-tech wells (horizontal drilling), extraction of shale oil. In these segments, the share of foreign technologies exceeds 80-90%. It is not only exploitation that will be at risk, but also the exploration of the new fields. These problems will arise after 2018. The hydrocarbon reserves, which Russia will not be able to "unseal" under the next wave of sanctions, are estimated at \$8.2tn. Russia mostly depends on the modern equipment for lateral drilling and Hydraulic fracture technology implementation.

Examples of the effects of such a sanction on the Russian Federation:

1) 28 July, 2014, the Federal Agency for Mineral Resources (the Rosnadra) prematurely terminated the right of subsoil use provided for the British **Shell** subsidiary companies for two hydrocarbon areas. The "Shell Naftogaz Development (III)"» 3 June issued a statement waiving the right of subsoil use for Barun-Yustinsk area in Kalmykia. In addition, "Shell Naftogaz Development (I)"» 5 June addressed the Rosnadra with the same statement concerning the Arkatoyak area in the Yamal-Nenets Autonomous District.

2) The Moscow office of the American company **Halliburton** informed "Gazprom drilling" of a "termination of relations". This was the first time that the Russian oil and service companies were restricted in their access to foreign technology due to sanctions. Halliburton management suspended relations and agreements between the companies because Arkadiy Rotenberg (who owns 100% of "Gazprom drilling" shares) was included in the list of those to be sanctioned by the US Department of the Treasury this May. "The ban applies to any commercial relationship, agreements (sale of goods, services etc.) with any legal entity directly or indirectly related to Rotenberg. On 17 May, 2014, we received instructions from head office demanding compliance, "- says the Halliburton letter. All the major oil and gas structures including "Gazprom", "Gazprom Neft", "Rosneft", Lukoil and others can be found among the customers of the American company, says the Halliburton site.

For example, in August 2013, Halliburton signed an agreement with "Gazprom Neft" for unit operation of hard access fields. Its mission - to increase the production to 100mln tonnes of oil-equivalent by 2020. More than half of the oil should be extracted with the use of innovative technologies. Currently "Gazprom Neft" continues to cooperate with Halliburton. The estimated annual revenue of Halliburton is \$0.5bln. Baker Hughes has similar index. Schlumberger earns about \$3 bln here, Weatherford's part of assets (drilling companies and TKRS) in Russia and Venezuela - about \$1bln. Halliburton's budgets will fall partly to their Russian competitors and will partly be divided between their American competitors.

Some of the US contractors have started to make back-up plans for the work in Russia. Schlumberger opened the Moscow research centre "Schlumberger" this year. The Ministry of Energy intends to support companies in expanding their operations in Russia.

3) Sanctions introduced by the Western countries against Russia will also bring about a negative impact on LUKOIL, the company's head Vagit Alekperov stated on July, 31st . He also stated that there is a possibility that the sanctions may still adversely affect the LUKOIL Investment program. In mid-June LUKOIL postponed their Eurobond placement of \$1.5bln due to "the unfavourable world market

conditions".

4) The **Volga Group** majority owner **Gennady Tymchenko** has announced that he is ready to give to the state or to charity the assets that are part of his investment group. In addition, the imposed sanctions have had an effect on him directly: "for the summer, my family went to the south of France where we traditionally go on vacation every year, and I was cut off from it all. From the family, from my favourite dog ... 11 July, my son turned 19. To celebrate his birthday with me, he came to Russia from Switzerland where he had been studying at university. "Moreover, the Gulfstream company ceased to meet the contractual obligations by stopping the flights of an aircraft purchased from her. My Gulfstream can't be used because the company does not provide the replacement parts; pilots have no right to use the navigation system and built-in maps. Employees of the company are prohibited from communicating with me." He said that although the EU has not put him on the blacklist, he can't go there: "There are reasons to gravely fear provocations from the US intelligence services".

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