**FOREIGN REPORTS INC.**
**818 18TH Street NW, Suite 1050**
**Washington, D.C. 20006**

**Tel: 202-785-4574** **Fax: 202-785-5370**

BULLETIN

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# TESTING PUTIN'S CREDIBILITY

After a meeting yesterday between Russian Energy Minister Alexander Novak and Russian oil companies, the top bosses of most of the companies said they supported the Ministry's plans to cap (or lower) production. Details and schedules still have to be worked out.

Novak has proposed that Russian production be gradually cut back by 300,000 b/d from recent highs of about 11.2 million b/d. He meets with OPEC and other non-OPEC producers in Vienna on December 10. Early next week, Novak will lead a 300-member delegation to Iran.

**Bleak Track Record**
Russia's track record of keeping promises to OPEC is bleak, but there are reasons to believe it may improve next year. President Vladimir Putin's own credibility is at stake this time. Although his interest in maintaining credibility depends on the situation, in this case it is high.

The Russian economy is more stressed by low prices than previously. In September, Putin held a key meeting with Saudi Deputy Crown Prince Mohammed bin Salman in Hangzhou, declaring that MBS was a "man of his word". Just prior to the OPEC meeting last month, he initiated a call to Iranian President Hassan Rouhani to discuss oil market cooperation. Novak's meetings with Saudi Energy Minister Khalid al-Falih have been much more intensive, extended, and numerous than previous limited and abbreviated meetings between Russian officials and their Saudi counterparts in 2001, 2008, or 2014.

**Naimi's Experience**
According to his own account, former Saudi Oil Minister Ali Naimi held a single meeting with Putin's then Deputy Prime Minister Igor Ivanovich Sechin on the sidelines of the Oran, Algeria OPEC meeting in late 2008. Sechin simply lied through his teeth during and after the meeting about being willing to cut by 300,000 b/d.

In November 2014, Naimi again held a single and quite short meeting with Sechin before the formal OPEC session. The burly Sechin, who had put on a lot of weight in the intervening six years, then said he was not prepared to cut by one barrel.

Novak was at that meeting, but although Sechin no longer held a government post (he was then just Rosneft's CEO, albeit with a commanding net worth), he overshadowed Novak. Two months later, he declared with obvious satisfaction that OPEC had "lost its teeth."

**Sechin Skips Meeting**

Sechin was the one boss who did not attend yesterday's meeting in Moscow. Rosneft instead was represented by Vice President Andrei Shishkin. Sechin last spoke out in public against cooperation with OPEC at an October energy meeting in Istanbul, after Putin gave a keynote speech endorsing cooperation. Putin spokesman Dmitry Peskov summarily dismissed Sechin's comments in an intentionally humiliating way for a man once considered to be Putin's right-hand man from his KGB days.

By early 2016, Novak had emerged as a proponent of cooperation with OPEC, a move which Putin fully backed.

**Putin's "Personal" Decision**

Commenting on yesterday's meeting, Peskov brushed off suggestions (from Lukoil) that Russian companies might be compensated for cutting production. "No, we did not discuss the issue," he told the press. "We have already said that the issue of lower production was coordinated with the President and all the major oil companies. The President…has personally decided on the basis of a consensus reached with heads of these oil companies. The question about any type of compensation has not been raised," he said.

Peskov said that both the government and the oil companies stood to benefit handsomely from higher prices. He added that Putin expected the government to receive about $11 billion in proceeds from a Rosneft stake sale by December 15. The sale of a 19.5% stake in the company to Glencore and the Qatar sovereign wealth fund closed yesterday.

**Details to Be Determined**

According to comments by the oil company heads, the schedule for lowering production is to be determined in a future meeting. One of those at yesterday's meeting, Transneft head Nikolai Tokarev, said on December 6 that he expected the reduction to begin in March but that annual production would be lowered by 15 million tonnes--or 300,000 b/d. He did not say from what.

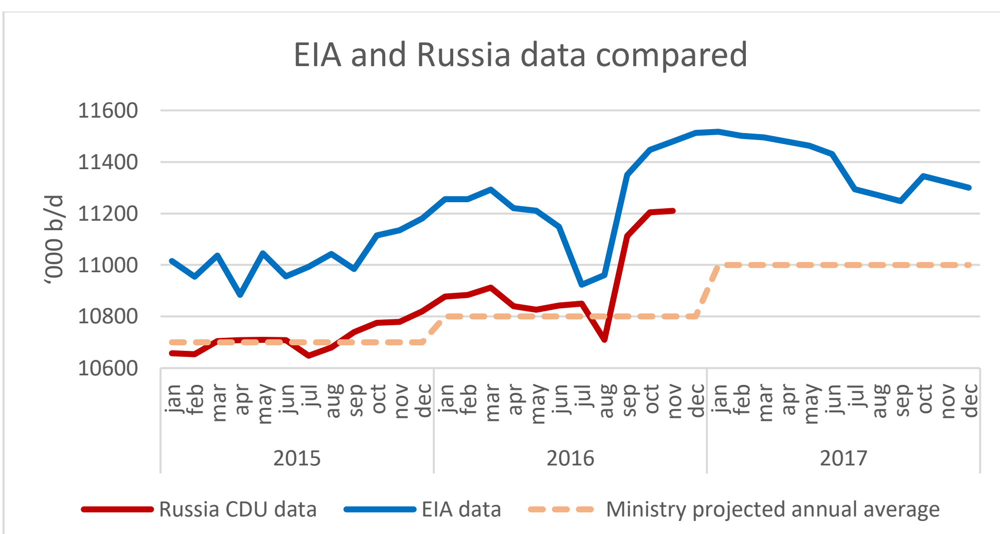
Transneft transports 90% of the oil produced in the country through its 70,000 km of pipelines. The government can use it to allocate pipeline capacity. The only long-haul export pipeline in Russian territory not wholly-owned by Transneft is the CPC export line from Kazakhstan to Russia's Black Sea port of Novorossiysk. Transneft owns 31% of CPC. Its power to determine the throughput of the distinct CPC-R section in Russia hasn't been tested.

**March Target and Transport Capacity**
"An agreement has been reached [to cut production] and it will begin working from March," Tokarev said. "We will probably be affected by the cut, but either way the cut could be 15 million tonnes per year. First and foremost, transport capacity will be affected," he said. Shutting down production wells during winter will probably be difficult, according to Tokarev. Doing so when the temperature is minus 50 degrees Celsius will result in the destruction of the well and knock the entire apparatus out of action, so it would make sense to wait until spring to reduce production, he added.

**Ministry Comments**
The director of the oil and gas production and transportation department at the Energy Ministry, Alexander Gladkov, told reporters that it is technically impossible to cut as of January 1: "If we reach an agreement with companies [at the next meeting] that we're drawing up some sort of schedule, then they will have to internally work out their own schedule, at which fields to reduce production, how, for how long. And apparently there will be another round of iterations so that companies tell us how they see this."

**EIA Projections**
Russia's announced plans have been met with skepticism so far and one obvious caveat is that Russia will have a chance to observe what OPEC producers do early next year before its own March preparations are set in stone. In its latest *Short-Term Energy Outlook*, published on December 6, the EIA projects that Russian production next year will average 135,000 b/d higher than this year's, but 90,000 b/d less than the recent November peak.

The EIA measures "total oil production" differently from the way the Russian Energy Ministry's Central Dispatch Unit reports total crude and condensate production, so the two data sets aren't comparable. Over the last two years, the EIA numbers have averaged about 300,000 b/d higher than the CDU numbers, but the difference has been as high as 380,000 b/d and as low as 75,000 b/d over CDU. Most everyone else uses the CDU numbers.



**No Quibble with Forecasts**

There is no point in quibbling with the EIA's forecasts given the resources and experienced talent it brings to bear. But it also has a duty to exercise proper skepticism over promises by other governments. Its projection, as shown in the chart above, forecasts a Russian decline of 217,000 b/d between January and December 2017.

The Russian Ministry's own projections for annual average volumes, also shown in the chart, clearly underestimated the industry's performance from September on. As of November, the CDU data indicates that average production so far this year has reached 10.93 million b/d--130,000 b/d more than the Ministry's initial projection. Last week, Deputy Energy Minister Kirill Molodtsov estimated this year's output at up to 545 million tonnes, or 10.95 million b/d, and next year's at 548 million tonnes, or 11.01 million b/d.

**Other Projections**

In a market outlook published last week, Lukoil estimated Russian liquids production would grow to 11.145 million b/d in 2017 and 2018, before starting to fall gradually to 11.125 million b/d in 2019 and 11.065 million b/d in 2020 as the effect of greenfields ceases to offset natural decline in West Siberia.

Some Russian analysts believe the cut Putin favors is most likely to be achieved by a reduction in drilling intensity in aging brownfields. These fields do not benefit from tax incentives granted to greenfields. "Natural decline at West Siberian brownfields is around 8% a year, even though oil producers are continuing intensive drilling there," *Platts* quoted a Moscow-based analyst at Raiffeisen Bank, Andrey Polischuk, today. "If they drill less intensively and implement multiple hydrofracking on a smaller scale--we're not talking about lost volumes but rather a delay to some volumes being produced."

*If Putin were to stick to his commitment to see production cut by 15 million tonnes next year* (300,000 b/d) from the peak level in November, then the EIA's projection may be 210,000 b/d too high. That admittedly is a big *if*, especially in case Russia doesn't intend to reach a 300,000 b/d cut until April. The EIA's latest forecast for non-OPEC production increases next year is 400,000 b/d. A change in the Russian outlook could cut that in half, with concomitant changes in projected inventory builds.

**Significant Margins of Error Are Normal**

Generally speaking, all of the best worldwide forecasts are subject to significant margins of error, which often offset each other at the end of the day. That is why quibbling over one item in a forecast or trying to parse differences between EIA, IEA or OPEC forecasts is a fool's errand.

Only hindsight can provide a measure of how good any forecast for non-OPEC production will turn out to be. For example, a year ago the EIA's December 2015 *STEO* projected non-OPEC production in 2016 at 57.73 million b/d. Its latest estimate for this year is 56.85 million b/d, lower by a small margin (-1.5%) but still off by 880,000 b/d.

Among the major changes over the year were higher than expected declines in China, Mexico and Colombia and better than expected output in Russia, Norway and the UK. The North American output forecast was off by a scant 0.2%.

**Putin's Test**

Russia's cooperation with OPEC will test Putin's credibility. If he lets other producers down, he will confirm Russia's hitherto bleak record and dispel the prospect that OPEC can expect wider collective action in the future. Arguably, that is more important than trying to anticipate margins of error in well-thought-out forecasts for next year's ultimate balances.