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Gas for roubles

Iwona Wiśniewska, Szymon Kardaś

On 23 March, Vladimir Putin decided to charge fees for Russian exports of natural gas to countries hostile to Russia (i.e. those countries which have introduced sanctions) in roubles in the near future. He ordered the withdrawal from the previous system of foreign currency settlements because, as he said, they had "compromised" themselves during recent weeks. In his interpretation, freezing Russian reserves in dollars or euros means the effective insolvency of the US and the EU due to their failure to meet their obligations towards Moscow. In this context, receiving payment for exports of goods in Western currencies is no longer justified.

At the same time, the president instructed Gazprom to introduce the necessary changes to gas contracts with customers. The government and the Central Bank of Russia (CBR) were also ordered to prepare a new, transparent mechanism for paying gas in roubles within a week. Putin emphasised that all gas importers should have a chance to purchase roubles on the domestic Russian market. He also maintained that the country would continue to supply gas to its customers in the amounts contracted. The first reactions from Russia's customers (in Germany, Austria and Italy) have been negative, and suggest that they will not consent to these unilateral changes in the trading rules.

According to data from the Russian Customs Service, the value of domestic gas exports via the pipeline system in 2021 amounted to US$55 billion, with the volume of supplies estimated at 203 bcm (at an average price of US$273 per 1000 m³). Exports outside the former USSR amounted to 188 bcm (no information about the value of this trade has been given). The vast majority of it – around 145 bcm – is allocated to EU states; the largest recipients from outside the EU include Turkey (26.7 bcm) and China (10 bcm).

In 2021, Russia also exported 30.3 million tonnes (about 41.8 bcm) of liquefied LNG, with a value of about US$7.3 billion.

Commentary

- President Putin's announcement raises a number of doubts as to the procedure and scope of the changes he has ordered. Firstly, it is unclear whether the modifications are intended only to apply to contracts concluded by Gazprom, i.e. those relating to the supply of gas via the pipeline system, or also to contracts for the export of LNG, where Novatek (the second largest gas producer in the country) is the other contracting party. Secondly, the issue of which currencies are used to settle accounts is regulated by the provisions of the specific contract, which in principle may only be changed with the mutual consent of the contracting parties. Although Putin's decision is intended as a kind

of counter-sanction against Western countries, it is unclear how the Russians intend to force their foreign partners to change their trade agreements, particularly within the extremely short time limit set by the president. The vast majority of payments for the supply of Russian gas to European consumers have so far been made in euros (58%) and dollars (39%). According to reports in the daily *Kommersant* newspaper, only the contracts for deliveries to Bulgaria, Moldova and Serbia provide for the possibility of paying for the gas in roubles.

- From the financial side, a possible transition to rouble settlements would not reduce the inflow of foreign currencies to Russia. The importers would most likely buy the necessary roubles on the spot for euros or dollars, but that would expose them to high exchange-rate risks and additional fees related to the operations. However, of key importance will be the mechanisms for these operations which the CBR and the Russian government prepare. The introduction of rouble fees for gas would primarily have negative consequences for Gazprom, which has the monopoly in the field of gas exports via the pipeline system. It would mean a further restriction of the company's access to Western currencies. The CBR's regulations introduced so far oblige exporters (including Gazprom) to resell 80% of their foreign currency revenues on the domestic market. The new change would mean that the company would lose access to all the foreign currency revenues they generate in the EU. As a result, it would have to buy foreign currencies on the internal market in order to meet its foreign obligations (servicing debts or importing goods & services). This would expose Gazprom to exchange-rate risks (having to take fluctuations in the value of the rouble into account), and leave it dependent on the Kremlin's consent to any such operations.
- Given the current very tense geopolitical situation, the introduction of changes in the settlement mechanisms would increase uncertainty on European gas markets. The mere announcement of the new solutions led to a significant (though temporary) increase in the value of gas in stock exchange transactions in Europe. On 23 March, the price of gas at the TTF hub rose by US$300, exceeding US$1500 per 1000 m³. Eventually it fell to around US$1200 by the end of the day. Switching to use of the rouble in settling accounts for gas supplies, even with just some of Moscow's major customers, would give it an additional instrument to influence gas prices on the gas hubs in Europe. As a consequence, this would also affect the final prices in long-term contracts (which are partially indexed to the value paid at the gas hubs).
- According to the president's statements, the gas fees in roubles are only the start of the planned changes. The Russian side's ambition is to export most of its raw materials for this currency. Thanks to this move, Moscow hopes to strengthen the rouble's exchange rate. The aforementioned announcement meant that by the afternoon of 23 March the dollar had fallen below 97 roubles, against 104 at the beginning of the day. Introducing rouble settlements would mean an additional benefit for the Kremlin in the form of greater control over foreign currencies within the country, and more power over export companies, whose access to hard currencies would be significantly limited, increasing their dependence on the authorities.
- However, it cannot be ruled out that Putin's decision will not ultimately be implemented, due to resistance from Russian gas importers – possibly even with Gazprom's support.

This has been confirmed by the first statements made by the company's European contractors. Alfred Stern, the CEO of the Austrian OMV, stated that the company intends to make its payments as usual, i.e. in euro; a similar statement came from Francesco Javazzi, an economic advisor to Italian Prime Minister Mario Draghi. The German economy minister Robert Habeck announced that Russia's decision was in breach of its contractual obligations. He also announced that Moscow's actions would be the subject of consultations with European partners. In turn, the Japanese government said that they did not understand the idea of switching to roubles in their settlements for gas supplies from Russia.

- The changes announced, then, could soon share the fate of the Russian leadership's earlier plans to limit hard-currency operations in relation with its Western partners. In this context, it should be recalled that on 5 March, Putin issued a decree banning payments in Western currencies to entities from hostile countries. However, these regulations have not yet been applied: both the companies (Gazprom, Rosneft) and the Russian government are continuing to transfer foreign currencies, and not roubles, to their creditors.
- It is possible that Moscow may want to use its foreign partners' reluctance to change the settlement mechanisms as a pretext to temporarily suspend or limit the supply of raw materials to selected countries. This could deter them from imposing restrictions on imports of oil, a key source of Russia's export earnings. However, such a scenario seems unlikely at present; this is evidenced not only by Putin's assurances that Russia remains ready to meet all its contractual obligations, but above all by the behaviour of domestic entities since the beginning of the invasion of Ukraine. Gazprom and other energy companies have been complying with the provisions of their agreements regarding both the supply and transit (via Ukraine) of their goods. For Russia, the export of raw materials is currently its main source of currency income.