The Russian oil industry

OPERATING RESULTS

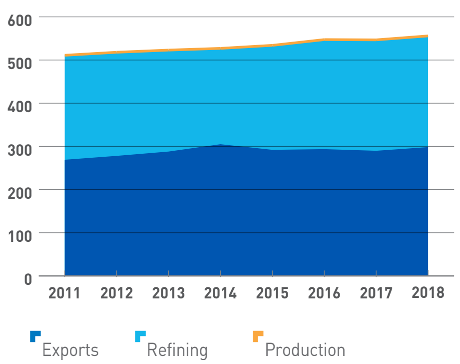
In 2018, the Russian oil industry effectively benefited from a positive market environment and the revised OPEC+ agreement. Russia produced 555.84 mt of oil and condensate, up 1.6% y-o-y, with strongest growth posted in 2H 2018 when OPEC+ countries decided to ramp up production to replace a decline in volumes from Iran and Venezuela. The situation changed in late 2018 urging Russia to cut production under the OPEC+ agreement by another 228 kbd relative to October 2018.

Despite rising production in 2018, oil exports from Russia remained flat at 258.2 mt while Russia was expanding East-bound shipments and scaling down European supplies. In 2018, Russia remained the largest oil exporter to China, well ahead of Saudi Arabia.

According to CDU TEK, Russia increased refining throughput by 2.5% to 286.99 mt in 2018 vs 279.98 mt in 2017 while heating oil production continued to decline (down 5.9% y-o-y), gasoline and diesel fuel output was marginally rising and jet kerosene supplies were soaring (up 11.2% y-o-y). Therefore, the Russian oil refining industry confirmed the effectiveness of ongoing refinery upgrades and its adaptability to market changes.

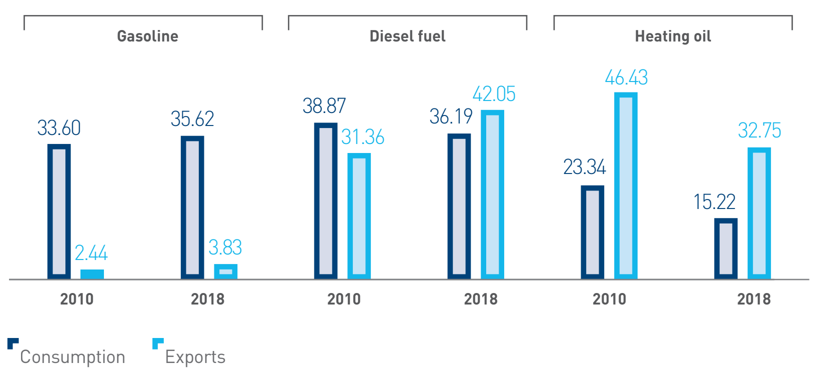
Oil production in Russia in 2011–2018 (split between domestic refining and exports) (mt)

Source: Ministry of Energy of Russia



Consumption and exports of key petroleum products in Russia in 2010–2018 (mt)

Source: Ministry of Energy of Russia



MACRO ENVIRONMENT

The Russian economy was steadily growing throughout the entire year. According to Rosstat, the national GDP grew 2.3% in 2018, delivering record-breaking performance since 2012, which was supported by similarly strong industrial output (up 2.9% y-o-y) largerly driven by the mining industry, with gas and condensate production rising by 16.5%.

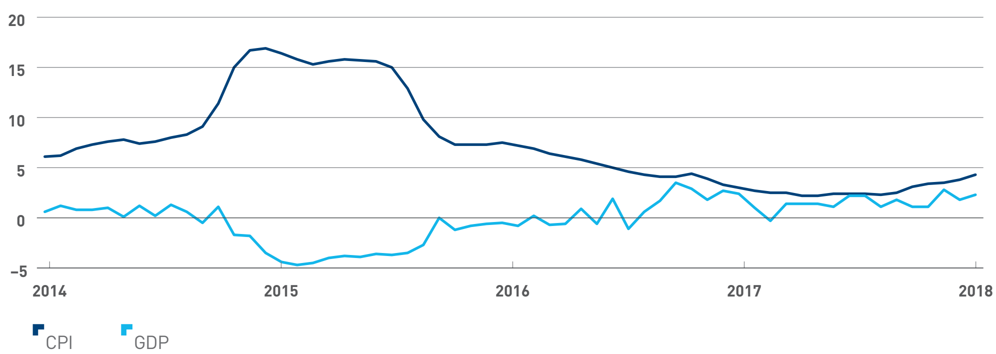
The manufacturing industry was also growing, though at a slower pace. The industrial growth was backed by rising retail sales (up 2.6% y-o-y) and other economic indicators. In 2018, the household disposable income returned into the positive territory (up 0.1% y-o-y) for the first time in several years.

The consumer inflation gained momentum following a trough in 2017. Consumer prices rose by 4.3%, which is slightly above the Russian Central Bank's target of 4%. In this context, the Central Bank which was still proceeding with interest rate cuts in early 2018 then opted for a more conservative monetary policy in 2H 2018. At the end of 2018, the key interest rate stood at 7.75%, exactly where it had been a year before. Given that the basic VAT rate hike to 20% is likely to affect the overall inflation in 2019, there is every reason to believe that the Central Bank will maintain a hawkish stance in 1H 2018.

GDP and Consumer Price Index (CPI) in Russia in 2014–2018

(% y-o-y)

Source: Rosstat



Should OPEC+ countries proceed with oil cuts, Gazprom Neft will still be able to grow

We want our projects to set the pace and standards for the global industry

The Russian economy is set to keep on growing in 2019 on the back of rising revenues from mineral resources coupled with recovering global prices for hydrocarbons, strong industrial output and other indicators.

The oil industry will benefit from its intrinsic drivers. In 2018, for instance, air transportation growth continued in Russia. The passenger turnover added 10.6% while the air cargo traffic remained virtually flat.

TAX POLICY AND REGULATION

2018 saw major changes to tax and customs regulations affecting the oil industry, including:

- Federal Law on Additional Income Tax (AIT) effective from January 2019, that will be tested during the next few years on specific fields, including those operated by Gazprom Neft. The new tax regime seeks to reduce the total amount of fiscal payments that depend on gross metrics (MET and oil export customs duty) with the AIT being levied on the income from hydrocarbon extraction at a subsurface site.
- A set of federal laws adopted to establish a regulatory framework for the completion of the tax manoeuvre. The tax manoeuvre provides for the export customs duties on crude oil and petroleum products to be phased out by 2024 along with the MET rates rising in parallel and a number of initiatives implemented to support those refineries that produce high-quality petrols. To prevent domestic petrol price hikes, the Government introduced a set of damping adjustments to the excise duty on petroleum feedstocks factoring in export netbacks and wholesale prices for Euro-5 petrol and diesel fuel.