

Russia's Oil Production Hits Record As Saudi Gambit Fails

"I Know Of No One Who Predicted This"

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In late October, [we noted](#) that for the second time this year, Russia overtook Saudi Arabia as the biggest exporter of crude to China.

Russia also [took the top spot](#) in May, marking the first time in history that Moscow beat out Riyadh when it comes to crude exports to Beijing. "Moscow is wrestling with crippling Western economic sanctions and building closer ties with Beijing is key to mitigating the pain," we said in October, on the way to explaining that closer ties between Russia and China as it relates to energy are part and parcel of a burgeoning relationship between the two countries who have voted together on the Security Council on matters of geopolitical significance. Here's a look at the longer-term trend:



You may also recall that Gazprom Neft (which is the number three oil producer in Russia) [began settling](#) all sales to China in yuan starting in January. This, we said, is yet another sign of the petrodollar's imminent demise.

On Monday, we learn that for the third time in 2015, Russia has once again bested the Saudis for the top spot on China's crude suppliers list. "Russia overtook Saudi Arabia for the third time this year in November as China's largest crude oil supplier," [Reuters writes](#), adding that "China brought in about 949,925 barrels per day (bpd) of Russian crude in November, compared with 886,950 bpd from Saudi Arabia."

This is an annoyance for Riyadh. China was the world's [second-largest oil consumer in 2014](#) and closer ties between Moscow and Beijing not only represent a threat in terms of crude revenue, but also in terms of geopolitics as the last thing the Saudis need is for Xi to begin poking around militarily in the Arabian Peninsula on behalf of Moscow and Tehran.



As we documented in "[Saudis Poke The Russian Bear, Start Oil War In Eastern Europe](#)," Riyadh has begun to encroach on Moscow's markets in Poland. Here's what [Bloomberg wrote](#) back in October:

"Poland has long been a client of Russian oil companies. Last year, about three-quarters of its fuel imports came from Russia, with the rest from Kazakhstan and European countries. Poland, however, is at the center of efforts to reduce the European Union's dependence on Russian energy.

"A new and reliable supplier is a godsend. As for the Saudis, they need to expand outside Asia where demand is falling.

"This could turn into a more active shoving match between the world's two biggest oil exporters, which already are at odds over the Syrian conflict.

Indeed, one could plausibly argue that one of the reasons the Saudis moved to artificially suppress prices last year was to squeeze Putin and ultimately force The Kremlin to give up its support for Assad. As The New York Times put it, a dramatic decline in crude prices has certain "[ancillary diplomatic benefits](#)."

Unfortunately for Riyadh, the strategy hasn't worked. In fact, it's backfired in more ways than one.

First, Saudi Arabia is facing a fiscal crisis as Riyadh's budget deficit balloons to 20% of GDP, forcing the kingdom to tap the debt market in order to offset the SAMA burn.

Second, Putin not only refused to give up his support for the government in Damascus, he actually doubled down by sending the Russian air force to Latakia. Meanwhile, Russia continued to pump even more oil, and as [Bloomberg reports](#), Moscow is now producing at "the fastest pace since the collapse of the Soviet Union."



"Russia's unexpected oil bounty this year is the result not of a new Kremlin campaign but of dozens of modest productivity improvements across the sprawling sector. Even pressured by plunging prices, as well as U.S. and European Union sanctions that cut access to much foreign financing and technology, Russian companies have managed to squeeze more crude out of some of the country's oldest fields," Bloomberg writes, before noting that

"Bashneft and other Russian companies working fields in the Volga River basin — some of the first to be discovered in Russia early in the last century — are benefiting from Soviet inefficiency as [the old motto was]: 'whatever we don't produce will be left for our children.'"

For analysts, Russia's resiliency has come as a surprise. "I know of no one who had predicted that Russian production would rise in 2015, let alone to new record levels," Edward Morse, Citigroup's global head of commodities research said.



As for what it would take to curtail production, Mikhail Stavskiy, head of upstream at Bashneft PJSC which has been "the biggest single contributor to increased crude output this year," says he doesn't know. "I don't know what the oil price would have to fall to for things to change dramatically. We've been through \$9 a barrel and production continued, so if something like that happens, we know what to do."

Indeed, thanks to the low cost of extracting crude from Russia's oil fields in West Siberia and the devaluation of the ruble, production costs are rock bottom:



But not everyone agrees that this is sustainable. Some say efforts to improve efficiency have run their course and with financing for exploration scarce, further gains may be hard to come by. Interestingly, Bloomberg also notes that because Moscow takes “nearly everything above \$30-\$40 a barrel” on exports, producers won’t feel the impact of low prices until crude falls substantially below those levels.

“Russia will maintain its current oil production levels within the bandwidth of 525 million to 533 million tons next year, as the federal government’s budget is set on such production levels,” Stratfor’s Lauren Goodrich says, presaging more of the same in 2016.

The takeaway here is that the Saudi gambit failed to wrench market share away from the Russians and between the conflict in Syria, Moscow’s closer ties with Beijing, and Riyadh’s move to antagonize The Kremlin by encroaching on Russia’s eastern European market share, one shouldn’t expect Putin to back down any time soon. In short, if John Kerry and Riyadh did in fact plan to bankrupt the Russians by tanking crude prices, the effort was a miserable failure that resulted not only in a 20% fiscal deficit for the Saudis, but also in the destruction of American jobs in the oil patch.

We close with a bit of humor from Deputy Energy Minister Kirill Molodtsov:

“I will tell you when Russian companies are for sure going to decrease production — when oil costs \$0.”

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