

Global Economic Policy Lab

Russia's Macro Resilience to Exogenous Oil Shocks

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- Russia is more insulated from external oil supply shocks than it has been in the past
- Saudi Arabia's current account deficit, low reserves, and high fiscal spending put them at a disadvantage against Russia in future oil price "wars"
- Global demand for Russian oil will continue to recover in the next few years
- In a future oil-price stand-off with Russia, Saudi Arabia would likely 'swerve' first by agreeing to oil production cuts

Overview

COVID-19, the Russian Petrostate, and the Oil Crisis of 2020

The fortunes of Putin's Russia are tied to its status as a petrostate. Russia is the third-largest producer of [oil worldwide](#), accounting for over 12 per cent of global crude production, and its economy is thus heavily reliant on oil export revenue. This dependence, however, has often left Russia exposed to the oil policies of Saudi Arabia and other OPEC member states. Saudi Arabia's ability to influence oil prices on the world market in particular has adversely impacted Russian revenues in the past, having even played a major role in the [collapse](#) of the USSR.

This was recently evidenced in the Russia-Saudi oil price war that crippled energy markets in March 2020. This standoff occurred against the backdrop of the COVID-19 pandemic, which has eroded global demand for oil significantly. During negotiations at OPEC headquarters in Vienna, Russia declined [OPEC proposals](#) to cut production by 1.5 million barrels per day (bpd). The subsequent collapse of OPEC+ talks in early March prompted Saudi Arabia to flood markets with cheap oil by announcing major [price discounts](#) of \$6-8 per barrel. This decision led to a rapid plunge in oil prices, with the value of Brent crude falling by 30 per cent (reaching \$25 a barrel by March 18) and global prices hitting [record lows](#) not seen since March 2001. Faced with collapsing markets worldwide, Russia and Saudi Arabia ultimately agreed to production cuts in late April under now highly unfavourable circumstances.

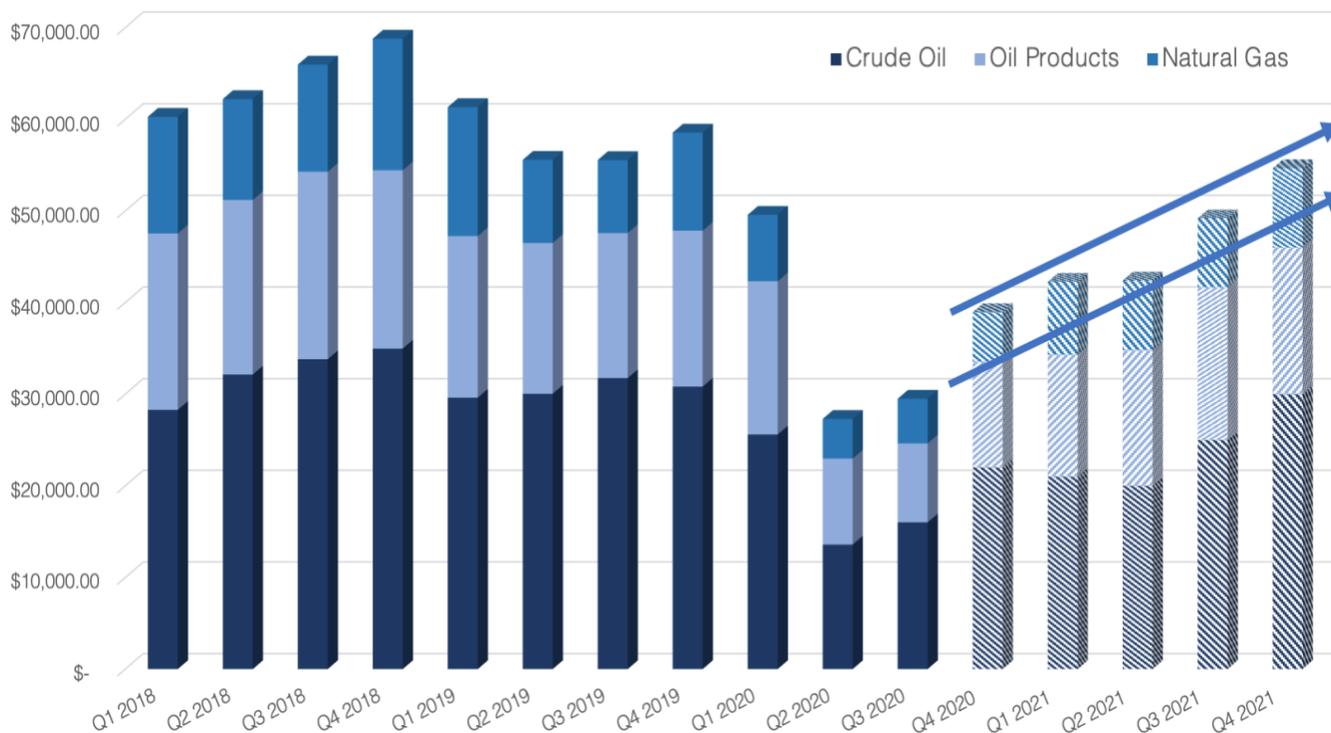
The oil price war imposed a heavy cost on Russia. For instance, low oil prices contributed to a sharp depreciation of Russia's currency, with the ruble (RUB) [falling](#) by 30 per cent against the dollar between January 1 and March 19. Real GDP [growth](#) is at negative four per cent for 2020. Facing economic contraction, the decision to spar with Saudi Arabia in March has proven to be a major strategic blunder on the part of Russia. Its leaders failed to anticipate the duration of the COVID-19 pandemic, as well as its devastating impact on the world economy, when they walked away from the OPEC talks. Holding the OPEC+ alliance together would have mitigated the pandemic's effect on the Russian economy and kept oil prices at a more moderate level.

That being said, the overall impact of last year's oil crisis on Russia's economic performance has been relatively muted compared to that of Saudi Arabia, and they look poised to rebound with more vigour in the short to medium run as oil demand recovers and prices stabilize.

The Macroeconomy of Russian Oil

The continued depression of oil prices has curbed Russia’s chief source of revenue. Russian crude oil, natural gas, and oil products have all suffered heavy revenue declines during Q2 and Q3 of 2020.

Reported Value of Energy Exports, Russian Federation (millions of \$USD)

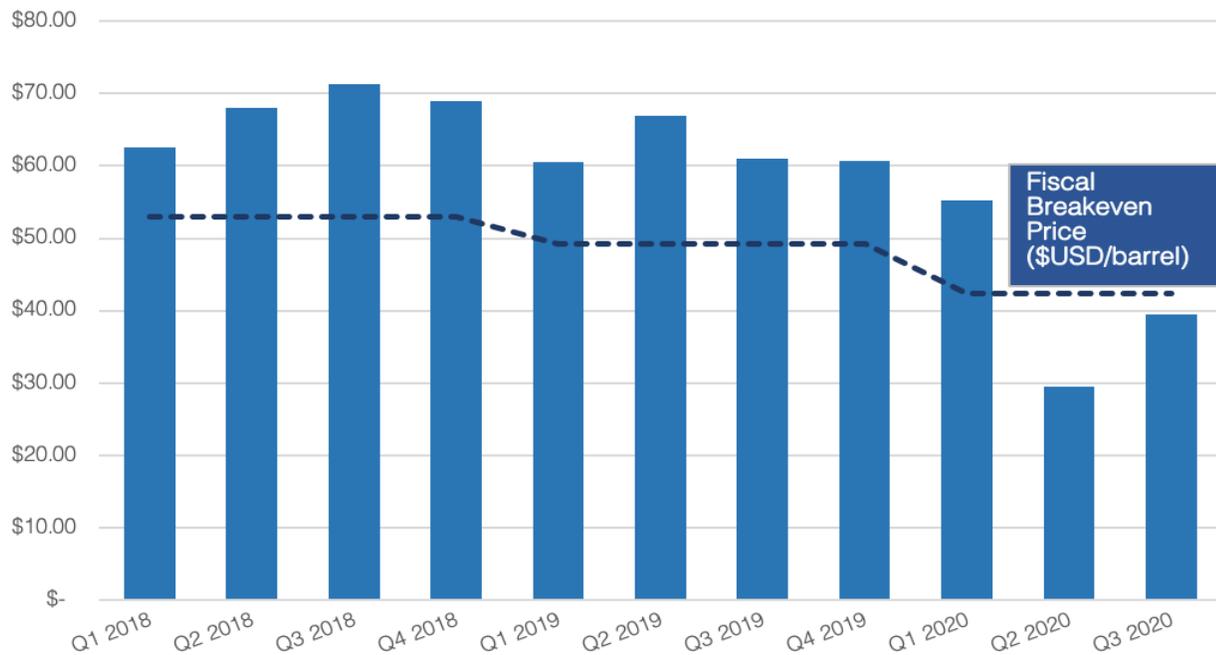


Source: [Bank of Russia](#), GEPL Calculations

Russia, despite these losses, appears to be more insulated from oil price shocks than Saudi Arabia. Its fiscal breakeven price (i.e. the oil price at which the government’s budget clears) and external breakeven price (i.e. the oil price at which the current account clears) were around \$56 and \$30 in 2020 respectively – considerably lower than the respective prices of \$76 and \$44 for Saudi Arabia. Importantly, thanks to their considerably lower production costs, Russia has exported its oil at a significantly higher profit margin than Saudi Arabia over the last two years and looks poised to break even again in Q4 of 2020 and beginning of 2021.

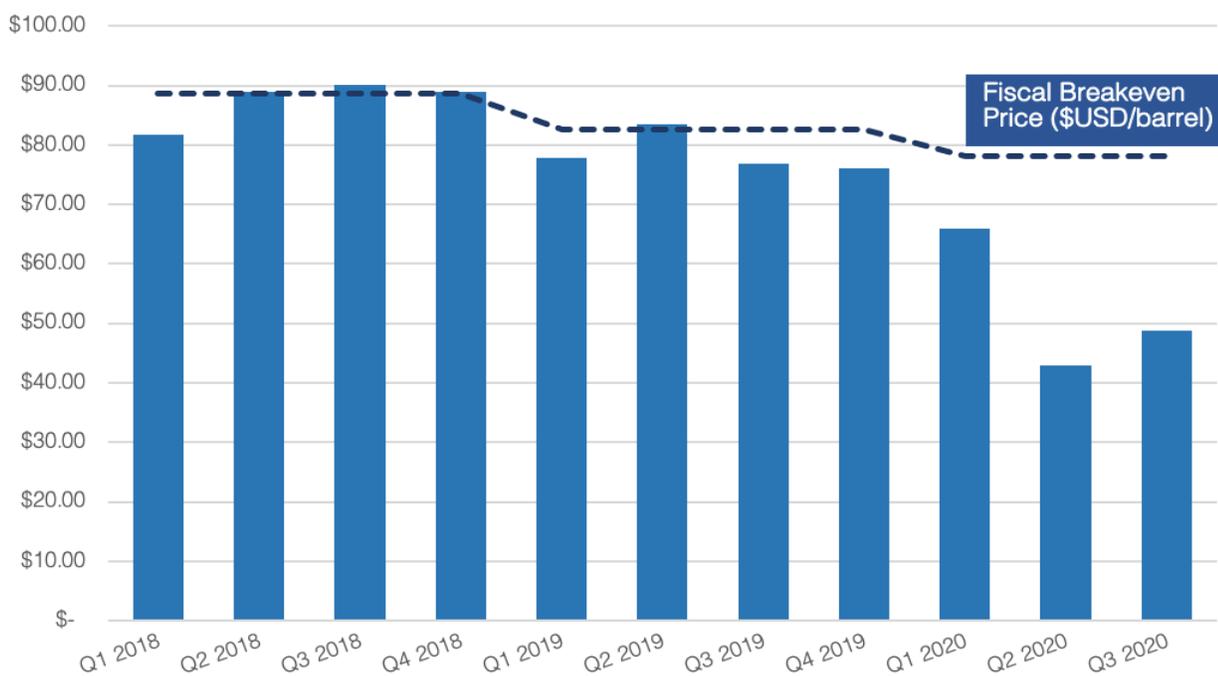
Moreover, Moscow was able to mitigate the impact of the crisis thanks to the prudent fiscal policy measures that have been in place since the global financial crisis and the 2014-2016 oil crisis. For instance, inflation as well as national and external debt have been kept relatively low in recent years. More importantly, Russia holds USD 586 billion in forex reserves and maintains a USD 160 billion National Wealth Fund, which act as powerful buffers during exogenous oil shocks.

Average Export Price, Russian Federation (\$USD/barrel)



Source: Bank of Russia, GEPL Calculations

Average Export Price, Saudi Arabia (\$USD/barrel)



Source: International Monetary Fund, GEPL Calculations

Saudi Arabia stands in stark contrast to Russia’s relative macroeconomic stability. While both countries had similar COVID-19 stimulus packages (less than 2.2% of GDP for the Kingdom versus 2.9% of GDP for Russia), Saudi Arabia’s foreign reserves have decreased by 42 per cent in the last 5 years. Within

the same time frame, the Kingdom's national debt has [grown](#) from 1.6 to 22.8 per cent of GDP, and it has announced public spending cuts to decrease their budget deficit. Despite [declining over 70 per cent in one year](#), from USD 65.34 billion in 2019 to 17.15 billion in 2020, Russia's current account was in a relatively strong surplus position at the end of 2020. This contraction, following a significant decline in fuel exports from USD 51 billion in Q1 to 28 billion in Q2 2020, is comparable to that of previous years where their oil exports have declined significantly, such as in 2019 during the [Druzhba Pipeline crisis](#). This outcome is in contrast to Saudi Arabia, which ended the year with a current account deficit, and reflects the resilience of Russia's current account to exogenous oil shocks. Saudi Arabia, as a result, is more exposed to oil shocks, and flooding the market with cheap oil will not be politically and financially sustainable for the Kingdom in the long run.

Current Account Balance (Billions of \$USD) — Russia — Saudi Arabia



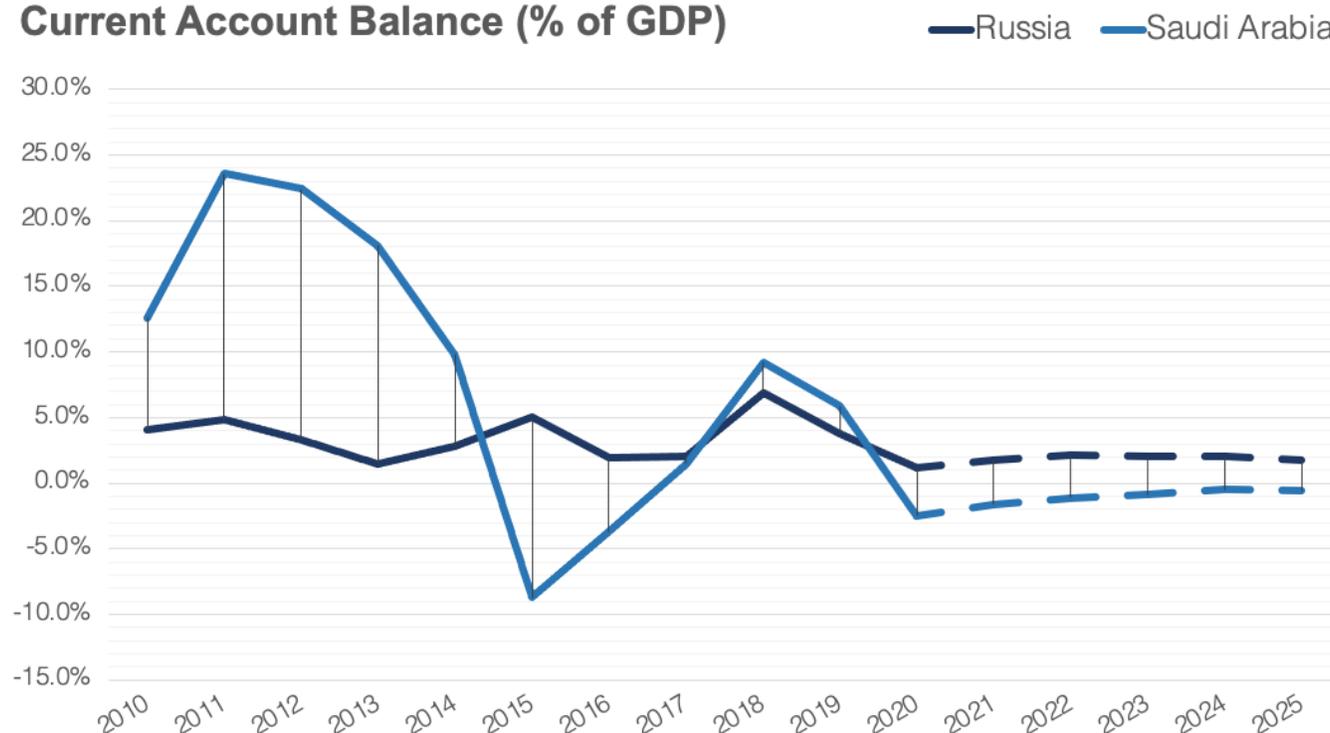
Source: [International Monetary Fund](#), GEPL Calculations

Russia's ability to sell its crude oil at a substantially higher price than its fiscal breakeven point has been reflected by the relative stability of Russia's current account balance, which has ranged from 0 to 6 per cent of GDP for most of the last decade. This is in stark contrast to Saudi Arabia's current account balance, which has been significantly more volatile in the past.

Russia's long-term prosperity as an "energy superpower," despite the recent rebound in oil prices and its higher resiliency to oil shocks, will depend on the prolonged stability of oil prices as well as the global demand for Russian oil – which are of course highly interconnected. In this regard, when considering the supply side of oil, it is clear that Russia believes the demand will continue to grow in the next few years. In fact, pipeline construction has recently [resumed](#) despite American sanctions to halt the Nord Stream 2 project (a gas pipeline that connects Russia and Germany through the Baltic Sea). Rosneft, Russia's energy giant, is similarly expected to complete a [USD 170 billion oil project](#) by 2024 that will allow Russia to meet rising global oil demand driven by post-pandemic recovery and population growth in energy-hungry developing countries. In addition, China is trying to reduce its dependency on Central Asian oil

and increase its economic interconnectedness with Moscow. This shift, demonstrated by the [newly built Power of Siberia-2 pipeline](#), is forecasted to replenish Russia’s coffers with USD 400 billion by 2050.

Current Account Balance (% of GDP)



Source: International Monetary Fund, GEPL Calculations

Moscow’s strategy in the short to medium term, given the aforementioned factors suggesting that Russia is less susceptible to oil price shocks than previously expected, will be to fill the vacuum that more “environmentally conscious” countries or concerned oil giants, such as Shell and BP, are leaving by [reducing](#) their fossil fuel investments. In the long run, however, this transition to renewable energy sources and eventual decline in the demand for oil will pose a challenge to Russia’s economic security and the continued viability of its petrostate model.

Predictions for a Future Saudi-Russia Oil Price War

In the event of another oil price war in the near future, Russia will continue to be far better equipped to weather a period of low oil prices than Saudi Arabia. In other words, a hypothetical price war between the two countries can be conceived of in game theory terms as a game of chicken, where both sides have incentives not to ‘swerve’ – i.e., agreeing on production cuts together – but where a ‘crash’ would be far more damaging to Saudi Arabia than Russia. Russia is unlikely to ‘swerve’ first as it would benefit from greater levels of oil production (i.e., lower prices), allowing it to maintain market share in places such as Europe and China by [pricing out US shale](#); meanwhile, Saudi Arabia is far more reliant on oil revenues for government spending, and would thus prefer lower levels of production (higher prices) – [the](#)

[IMF projects that oil prices need to reach roughly \\$80/barrel](#) for Saudi Arabia to balance its budget in 2021.

		Saudi Arabia	
		Swerve	Straight
Russia	Swerve	Tie, Tie (0, 0) Both sides arrive at an agreement to cut oil production, ending the price war.	Lose, Win (-1, 1) Russia ends the price war due to the domestic economic shock caused; Russia's credibility as an oil producer is greatly damaged.
	Straight	Win, Lose (1, -1) Saudi Arabia ends the price war due to the domestic economic shock caused; Saudi Arabia's credibility as an oil producer is greatly damaged.	Crash, Crash (-10, -15) The price war drags on for far longer than intended, destabilizing the economies of both--but with Saudi Arabia the clear loser

As seen previously, while Russia has consistently maintained current account surpluses for decades – likely owing to modest imports and adequate currency depreciation – Saudi Arabia has largely been in a current account deficit since the [2014 oil glut](#). The riyal's peg to the USD greatly limits Saudi Arabia's ability to balance its budget; Russia, meanwhile, enjoys a free-floating currency. This is noteworthy as it implies Saudi Arabia's domestic consumption would not be directly affected by declines in oil exports. When Russian oil exports fall on the other hand, the RUB depreciates and consumption will be depressed. However, Saudi Arabia's inability to exercise an independent monetary policy means that it must rely on its foreign currency reserves to finance its deficit and sustain its considerable imports. This vulnerability is further compounded by the [high-profile nature of public spending](#) on government projects and welfare in the country. To bolster fiscal revenues, especially in light of low oil prices and the pandemic-fueled recession of 2020, Saudi Arabia has even had to raise taxes such as the [VAT](#). In this regard, Saudi Arabia is believed to be far more exposed than Russia to domestic political sensitivity from oil price fluctuations.

Thus, Saudi Arabia, despite its formidable foreign reserves and (theoretically) lower costs of oil production, will be more likely to 'swerve' first by going for production cut agreements with Russia. This outcome is unlikely to change unless the Saudi economy undergoes major shifts – namely, a reduction in government spending or a large-scale economic transition.

Global recovery from the pandemic may lead to a broader commodity price boom as supply chain disruptions and transportation issues persist in the face of easing restrictions. Russia is likely to benefit

from such a boom given its more-faceted economy (e.g., in agricultural produce and natural gas in the long run). As essentially a one-commodity economy, Saudi Arabia will largely miss out on this rebound due to its greater relative dependence on oil revenue – thereby rendering it even more vulnerable to any continued depression in oil prices.

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