



## CURRENT DEVELOPMENTS IN KAZAKHSTAN'S OIL AND GAS SECTOR

Nowadays, Kazakhstan is among the world's fastest-growing primary energy source producers and exporters. The energy industry of Kazakhstan includes oil, gas and coal production, and electricity generation. Being at the heart of Kazakhstan's energy industry, the oil and gas sector traditionally generates a large percentage of the country's GDP. For instance, the oil and gas sector contributed around 20% to the country's GDP in 2017. Moreover, it is well known that over 90% of money that goes to the National Fund of Kazakhstan originate in taxes coming from oil export revenues. Taking into account the fact that these funds are allocated for both encouraging economic growth and financing budget deficits, there is a need to ensure that oil and gas are produced in a sustainable way for the decades to come.

Over the past years, the demand for the Kazakh oil around the world has been relatively stable. In 2017, Kazakhstan boosted oil production by 10.5% to 86.2 million tons, an increase of 8.2 million tons compared to 2016, which is the best result in the country's history. Such an increase is a result of an upward trend in the oil output of the Atyrau region, where a 21.4% growth was registered in the first 11 months of 2017, mostly due to the considerable increase in oil production at the Kashagan field that reached 8.3 million tons, which is 66% higher than the original annual plan of 5 million tons. This coupled with the steady oil output increase at the Tengiz and Karachaganak fields, namely, by 4.1% and 9.5% to 28.7 million tons and 12.5 million tons, respectively. These three largest oil fields in Kazakhstan account for over 57% of total oil output in 2017. Thus, despite the fact that the Kyzylorda and Mangystau regions continue to show negative dynamics with 3.9% and 0.4% decreases in oil production, respectively, Kazakhstan was able to increase the total oil output after four years of decline. To compare, the country's oil production decreased from 81.8 million tons in 2013 to 80.8 million tons in 2014, falling further to 79.4 million tons in 2015 and finally reaching 78 million tons in 2016.

However, by hitting its all-time high Kazakhstan exceeded the maximum oil output it had agreed to observe under the OPEC's production cut deal. Under the agreement, Kazakhstan committed to cut oil output by 20,000 barrels per day (bpd) from the baseline month level (October 2016) to average 1.7 million bpd starting in November 2016. As a result, in order to fulfill its commitment given to OPEC Kazakhstan was supposed to cut its oil production by 1 million ton in 2017. It must, however, be taken into consideration that if the country had continued to keep the October 2016 levels of production the total oil output would have reached over 86 million tons in 2017. Therefore, Astana doesn't see itself as a violator of the OPEC's oil cut deal given that the amount of the excess output

totaled only 40,000 bpd. However, since Kazakhstan has set its oil production forecast for 2018 at the level of 87 million tons it could be a cause for concern among the oil cut deal participants.

It is also worth mentioning that with the launch of the Kashagan project Kazakhstan managed to increase its oil shipments via the Russia-oriented pipelines, namely, the Tengiz-Novorossiysk, or Caspian Pipeline Consortium (CPC), and the Atyrau-Samara oil pipelines. For instance, in early January 2018 the CPC reported that the Kazakh hydrocarbons accounted for around 50 million tons out of 55.1 million tons of oil exported via the pipeline, which is a 10.8 million tons increase compared to 2016. Moreover, according to the KazTransOil report, the amount of oil transported through the Atyrau-Samara pipeline was 15 million tons, or 0.8 million tons more than in 2016. On the other hand, the volume of the Kazakh oil transshipped via the Atasu-Alashankou pipeline to China has continued its steady decline decreasing from 2.8 million tons in 2016 to 1.6 million tons in 2017. Considering the fact that the total oil exports of Kazakhstan reached 69.8 million tons registering a 12.4% increase, it becomes clear that the Russia-oriented oil pipelines remain key export routes for hydrocarbons produced in the country. However, although Kazakhstan's oil production is growing, and the oil price has stabilized, oil revenues to the National Fund will decrease in the coming year. The matter is that Kashagan, similar to Tengiz and Karachaganak, is developed under the production sharing agreement (PSA). As a result, the National Fund will start receiving oil revenues from the Kashagan PSA only after its operators will have real return on their investments. Despite the fact that state-owned KazMunaiGaz is among the shareholders of the project, in 2016 the company reached an agreement with Vitol, the international energy and commodity trader, on \$1 billion worth pre-export financing of oil supplies from the Kashagan field for five years, under a scheme similar to the one applied in the Tengiz field deal. Moreover, in August 2017 KazMunaiGaz received an additional prepayment for the amount of \$600 million. Therefore, the company has already received its oil revenues for the next few years.

One of the available options to raise the amount of revenues sent to the National Fund may be an increase of gas exports. Indeed, in 2017 gas production in Kazakhstan amounted to 59.9 billion cubic meters showing a 14% growth compared to 2016, while gas exports increased by 26.3% to 17.3 billion cubic meters. The bulk of the exported gas went to Russia, but in October 2017 Kazakhstan began, for the first time, to export gas to China. By the end of 2017, the volume of the exported gas totaled 1.1 billion cubic meters. Taking into account the plan to increase gas shipments to China

to 10 billion cubic meters and the total gas production to 53.4 billion cubic meters in 2018, there is a chance that the expected growth of gas exports could partly compensate the decline in government revenues from the depleting oil fields in the Kyzylorda and Mangystau regions.

In order to ensure a high growth in the country's oil and gas production, it is important not to lose momentum and continue investing in the energy resource exploration. Currently, 271 hydrocarbon sites are being developed in Kazakhstan, including production at 92 sites, exploration at 64 sites, and joint production and exploration at 115 sites. In fact, since 2003 there has been no substantial increase in the volumes of recoverable reserves of both oil and gas. Moreover, the growth of reserves registered over the past 10-15 years was mainly due to additional exploration of the previously known oil and gas fields. The lion's share of the geological exploration works, on the basis of which the major prospective reserves of Kazakhstan have been identified, were conducted during the Soviet era, namely, in 1970-1980s. Thus, the current geological exploration is based primarily on the 50-year-old research made by Soviet specialists. Therefore, despite the fact that there is some increase in Kazakhstan's oil and gas reserves, the increment rate is not sufficient to meet the projected growth in oil and gas production.

In fact, since the majority of Kazakhstan's natural resources is concentrated in the western part of the country, namely, in the Atyrau (72%) and Mangystau (12%) regions, while the country's prospective reserves of oil and gas are potentially located in the Kazakh sector of the Caspian Sea, it can be easily seen that the Pre-Caspian basin has the largest potential for the development of hydrocarbon deposits. Currently, a number of projects is underway in the Kazakh sector, including the North-Caspian project (Kashagan, Kalamkas-sea, Kayran, Aktoty), Zhemchuzhina (Khazar, Auezov), H-block, Kurmangazy, Satpayev, and Zhambyl, which are implemented by the national operator KazMunaiGaz in partnership with some transnational and foreign energy companies. However, due to the lack of developed infrastructure and high capital expenditures further development of the offshore projects faces a number of challenges. It appears that the government of Kazakhstan has recognized the problem of underfinanced exploration works and limited technological capabilities. Since Kazakhstan's oil and gas sector is heavily dependent on its mega-projects, such as Tengiz, Kashagan and Karachaganak, any uncertainty over their expansion plans, unexpected production delays, and possible industrial accidents could cause a significant decline in the country's total liquids output. Therefore, in order to both minimize the risks and stabilize the production outlook, Kazakhstan could gain more advantage from increasing exploration activities and developing medium-sized projects.

## Politics, Foreign Affairs and Security

- President of Uzbekistan Shavkat Mirziyoyev signed a decree approving the state program for the implementation of the action strategy on the five priority directions of the country's development in 2017-2021. The state program stipulates the drafting of 37 laws and 142 legal acts, and the implementation of 52 practical measures covering various areas.
- During the 12<sup>th</sup> meeting of senior officials of the Central Asia + Japan Dialogue held in Dushanbe, the sides discussed the ways to strengthen cooperation in transport, logistics, tourism, and regional security. It is also noted that the parties expect to intensify relations in the sphere of agriculture.
- During his official visit to Moscow, Prime Minister of Israel Benjamin Netanyahu met with President of Russia Vladimir Putin to discuss issues related to boosting the Russian-Israeli cooperation in trade, economy, cultural and humanitarian spheres along with pressing international and regional issues, including the situation in the Middle East and the Syrian crisis.
- During his official visit to Brussels, Minister for the EU Affairs of Turkey Omer Celik met with High Representative of the European Union for Foreign Affairs and Security Policy Federica Mogherini to discuss prospects of the EU-Turkey relations and the latest developments in the region, including the conflict in Syria and the Turkish military operation in Afrin.
- During his official visit to Moscow, President of Argentina Mauricio Macri met with his Russian counterpart Vladimir Putin to sign the joint statement on strategic foreign-policy dialogue. It is also noted that the parties discussed plans for a Russian nuclear power station in Argentina.
- During his official visit to Hanoi, the Defense Minister of Russia, Army General Sergei Shoigu, met with Defense Minister of Vietnam Ngo Xuan Lich to discuss the expansion of the Russia-Vietnam defense relationship. As a result of the meeting, the parties signed the 2018-2020 plan of joint military drills and military cooperation. The visit to Vietnam was part of Shoigu's broader Southeast Asian tour that also included trips to Myanmar and Laos.
- During his official visit to Tashkent, Deputy Minister for Emergency Situations of Belarus Alexander Khudoleev met with high-ranking officials of the Uzbek Ministry of Emergency Situations to discuss the action plan of cooperation between the ministries of the

two countries on emergency prevention and response for 2017-2018. Uzbekistan and Belarus are planning to hold joint drills in the territory of Tashkent and the Chimgan tract.

## Economy, Finance and Energy

- According to Kazakhstan's state-owned company Food Corporation, the country exported over 120,000 tons of grain and oilseeds in 2017. The volume of exports decreased by 70,400 tons compared to the previous year. In particular, more than 56,000 tons of barley were exported to Iran, while China, Azerbaijan, and Uzbekistan purchased over 40,000 tons, 15,000 tons and 5,000 tons of Kazakh wheat, respectively.
- According to the Energy Market Regulatory Authority of Turkey, Azerbaijan supplied almost 5.95 billion cubic meters (bcm) of gas to Turkey in January-November 2017, as compared to 5.89 bcm in the same period of last year. The share of Azerbaijan in the total volume of gas imported to Turkey for the reporting period was 12.1%.
- According to Azerbaijan's state oil company SOCAR, by the end of January 2018 the first delivery of about 100,000 tons of the Russian vacuum gas oil will be shipped to the country from the Black Sea port of Tuapse. SOCAR signed a deal with the Vienna-based Cetracore Energy oil trading company and its shareholder, Russia's Rosneft oil company, under which the company will act as an off-taker of oil products from Russia.
- The Russian state-owned railway company Russian Railways announced its plans to establish a transport and logistics center at the Kutum Station in the Astrakhan region, which would become a part of the International North-South Transport Corridor project. At the initial stage, it is planned to transport 6 million tons of cargo per year through the corridor, with further expansion to 15-20 million tons at later stages.
- According to the Central Bank of Uzbekistan, in September-December 2017 the country's commercial banks purchased cash hard currency worth \$854 million from individuals. At the same time, the banks sold hard currency worth \$56 million to the population. It is also noted that the share of the city of Tashkent in transactions with hard currency reached 32%, while the shares of the Samarkand, Andijan, and Ferghana regions totaled 10%, 8%, and 9%, respectively.
- According to the Ministry of Finance of Kyrgyzstan, the country's budget deficit in 2017 amounted to 17.3 billion soms (\$250 million). In the approved draft budget for 2018, it is expected that the

deficit would increase to the level of 21.4 billion soms (\$314 million), or 3.4% of GDP.

## Society and Culture

- The presidents of Azerbaijan, Kazakhstan, Kyrgyzstan, Turkey, Uzbekistan and other Eurasian countries conveyed their condolences to Afghan President Mohammad Ashraf Ghani following the deadly bomb attack claimed by the Taliban in Afghanistan's capital Kabul. The fierce attack in Kabul's secure zone, home to government offices and foreign embassies, left 103 dead and 158 injured. The police arrested four people in connection with the deadly attack.
- President of Uzbekistan Shavkat Mirziyoyev signed a decree on measures aimed at improving the system of general secondary, secondary special and vocational education. According to the decree, Uzbekistan will introduce mandatory 11-year general secondary education starting in the 2018-2019 academic year. From the 2019-2020 academic year, professional colleges will accept graduates of the 11<sup>th</sup> grade of general educational schools on a voluntary basis.
- The Latvian airline AirBaltic announced its plan to launch a new summer seasonal route between Riga and Almaty in April 2018. The new route will offer convenient travel options for travelers from the Baltics and Kazakhstan via the AirBaltic network spanning Europe, Scandinavia, Russia and the Middle East.
- According to Minister of Culture and Sports of Kazakhstan Arystanbek Mukhamediyev, the country intends to introduce a visa-free 72-hour transit regime for Indian citizens. It was noted that the similar regime introduced for citizens of China, which will be active until the end of 2018, has already shown its effectiveness in the pilot regime. In three months, Kazakhstan was visited by 4,500 Chinese, contributing over \$1.3 million to the economy of the country.
- The Iranian state-owned airline Iran Air resumed the Tehran-Baku flights after a three-year break. It is noted that the flights will take place two times a week.
- President of Turkmenistan Gurbanguly Berdimuhamedov approved limited volumes of water use by consumers in regions and districts of the country in 2018. The document was signed for the purpose of careful and rational use of the country's water resources in accordance with the Water Code of Turkmenistan.