Long Gazprom 4.95 07/19/22 Eurobond

Thesis: Gazprom dollar-denominated bonds are trading at deeply discounted levels (Appendix A) due to US sanctions and the threat of missed repayment from a lack of dollar supply and/or weakened operations. Current trends in European natgas imports (larger commodity markets) and Russian FX reserves indicate that the risks are lower than implied by the market, barring very unlikely harsher sanctions.

Natgas exports continue

Gazprom has announced that it is continuing its exports to Europe and that natgas is still flowing through Ukraine despite the conflict. While it is in the long-term interest of the EU and similar counterparties to move away from Russian natgas, this transition will take years - if it ever does occur. During the time-frame relevant to this bond, concerns about long-term shifts aren't very relevant. Further, I don't see much risk beyond that, especially in the next several months, even if the Ukraine conflict continues to escalate. The EU will be hammered by inflation and elevated prices as-is, and it is unlikely that they would want to worsen that further - especially considering the ECB's tightrope walk with rates and credit.

Accumulating FX from operations

While European natgas futures prices have moderated from their peaks, these prices are still elevated. Oil and gas exports, primarily to Europe, result in approximately $1bn a day with which Gazprom and Russia can bolster their FX reserves in preparation for future Eurobond payments. A similar trend can be seen with commodities as a whole. Windfalls from elevated commodity prices continue to flow to Russia despite American and EU sanctions and decreased exports to some regions. This can be seen through Russia's expanding dollar-denominated current account surplus (Appendix B).

The BoR has also set up facilities that will provide dollars and other foreign currencies in the event of payment issues. Concerns about the seizure of half of the BoR's FX reserves in the US and Europe are overblown. We have shown that despite this approx. $300bn loss, Russia continues to rebuild lost reserves via lucrative commodity exports in the context of the global supply shock.

Further sanctions risk

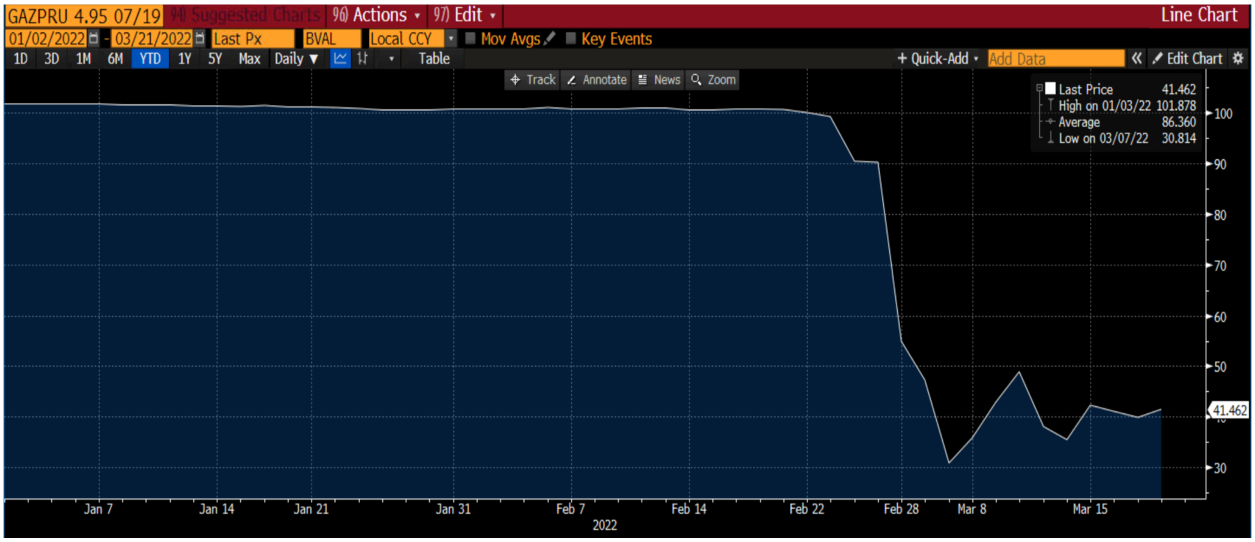
Given the uncertain geopolitical environment, the threat of further sanctions is non-negligible. However, I don't think that EU sanctions against Russia and Gazprom's key source of FX - oil and gas exports - can materialise in the short run. It will be very painful for both the EU and Russia if these product flows are suddenly halted - for reasons specified above. While further military assistance and some peripheral sanctions may be added on, the direct risk to the source of these new FX reserves is very minimal.

Trade expression

Because of strong export figures and FX revenues from these activities, I believe that most or all major Russian companies will make their Eurodollar payments and that the Russian government won't default on dollar- or FX-denominated payments - at least per bond's terms. There are more sanctions and liquidity risks when dealing with government bonds, so I think that corporate bonds are better-suited. Specifically, I chose Gazprom because it directly generates FX from its export operations in Europe.

Appendix

A. Gazprom 4.95 07/19/2022 Eurobond prices



B. Russian current account surplus expanding despite strict Western sanctions