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2014 OIES Brainstorming Meeting in Stockholm

Ken Koyama, PhD
Chief Economist, Managing Director
The Institute of Energy Economics, Japan

On June 12 and 13, the Oxford Institute for Energy Studies sponsored its 25th brainstorming meeting in the Swedish capital of Stockholm. Some 30 experts mainly from Western countries participated in the workshop, holding active discussions on a wide range of topics from the world economy and geopolitical risks to oil and gas markets and energy policy problems.

World economic developments are indispensable factors for shaping international energy market fundamentals. In the world economy for the immediate future, emerging economies are expected to decelerate growth after driving global economic growth in the last decade, while the U.S. economy is predicted to remain brisk. In the United States, steady consumption, unemployment drops and other favorable macroeconomic developments have continued, with stock prices breaking record highs. Factors behind the robust U.S. economy include the shale boom, lower energy costs and improved competitiveness. The United States is thus dominantly projected to continue steady economic growth. In China among emerging countries, however, economic growth is expected to decelerate as indicated by a decline in real estate sales and investment. Attention now focuses on whether Chinese economic growth will remain above 7% in 2014. Given that Chinese economic growth has so far driven resources and commodity demand in the world, future Chinese economic developments will be a key point for anticipating the future international energy market. But a common view at the meeting was that world energy demand next year is likely to post a certain increase (of about 1 million barrels per day in case of oil demand) from the previous year as the world economy as a whole grows at cruising speed with major countries' economic conditions remaining mixed.

Meanwhile, one feature of the meeting discussions was very great interest in geopolitical risks. Coming first was the Iraq situation over which tensions grew rapidly during the meeting. Sunni militants from the Islamic State in Iraq and the Levant, known as ISIL, expanded their dominance in northern Iraq and put the second largest Iraqi city of Mosul and the strategic city of Tikrit under their control, increasing pressure on the capital city of Baghdad in a manner to rapidly destabilize Iraq. In the North, the Kurd autonomous government's security forces took control of the oil city Kirkuk as central government forces withdrew. Iraq has thus indicated complicated destabilization. The destabilization is expected to affect Iraqi oil supply, boosting tensions in the international energy market. Then, the Brent crude oil price rose beyond $113 per barrel. The meeting discussions also covered the Middle East and North Africa including Libya and indicated that destabilization since the Arab Spring movements has worsened and deepened even further instead of fading away, exerting various impacts on oil supply.

Regarding geopolitical risks, meeting participants showed great interest in the Ukraine situation. Even after Petro Poroshenko was sworn in as the new Ukraine president, the Ukraine situation has failed to stabilize. Rather, Eastern Ukraine has plunged into a situation close to a civil war, as pointed out by some meeting participants. The confrontation that has emerged between Russia and Western countries due to the Ukraine problem has been very serious, causing deep mutual distrust and reactions, instead of going in the direction of settlement or improvement. Western economic sanctions have begun to affect Russia in various ways. Any tougher sanctions are expected to seriously hit the Russian economy. Such developments have driven Russia and China to rapidly deepen their relations, shaking Eurasian geopolitics. Asia has also seen growing geopolitical risks in the East and South China Seas. The meeting discussions thus led me to feel anew that rapidly growing geopolitical risks have become a key point for considering international energy problems.

As for the international oil market, meeting participants discussed factors behind crude oil prices remaining above $100 per barrel since 2011 without major fluctuations in particular recently. A key point about the market was that various supply/demand and geopolitical factors have offset each other, eventually working to keep a kind of balance. On the demand side, emerging countries' oil demand has slowed down after driving global demand, while U.S. demand has begun to increase. On the supply side, the United States has substantially expanded oil output in the shale boom, while Libya and Nigeria have reduced supply. Iranian oil supply has increased due to eased economic sanctions after declining under enhanced sanctions. In the meantime, Saudi Arabia has flexibly adjusted output in response to supply/demand changes. Ultimately, individual imbalances have been generally adjusted, allowing crude oil prices to remain stable at high levels.

Meeting participants also pointed out that overall costs were increasing amid the high crude oil prices. Material, personnel and other cost hikes have become a serious problem for the oil and gas industry. Oil-producing countries see increasing costs for their social stabilization. Amid such situation, many major players are comfortable with the present high crude oil prices, providing a sense of equilibrium. Oil prices have remained high as futures market players have also found a sense of equilibrium. Meeting participants broadly agreed that oil prices would stay at present high levels with the situation remaining unchanged for the immediate future. But there are upside risks resulting from deeper geopolitical risks as well as downside risks through the Chinese economy's further deceleration and the relaxation of economic sanctions on Iran. No optimism can be warranted for future developments.

As for the international gas market, meeting participants discussed challenges facing regional markets. Among them is the U.S. market where liquefied natural gas export plans are expanding with supply and demand restructured through shale gas output growth. The Asian market has seen expanding demand for natural gas or LNG and attracted global attention with China's recent agreement with Russia for gas imports through pipelines from Russia. The European market is the only major regional market with shrinking natural gas demand, while also having a gas supply security problem. A key controversial issue in the discussions was the Russian gas problem. Europe is considering reducing its dependence on Russian gas. Meeting participants noted that the reduction would not be easy as Russian gas has strong competitiveness. This means that Europe should be prepared to pay high costs for implementing any measures to reduce dependence on Russian gas. High costs would be required for enhancing energy security in Europe.

Russia for its part has attempted to reduce its dependence on the European market by expanding into the Asia market to diversify its gas export destinations. The attempt has produced the

Russia-China gas agreement. Behind the agreement might have been U.S. LNG's planned influx into the Asia market, as well as the Ukraine situation, and Russia's and China's hope to develop their strategic relationship. Russia's awareness not to miss any window of opportunity may be playing a key role in shaping its Asian strategy. The Russia-China gas agreement involves very interesting problems that we must consider, including its impact (downward pressure) on Chinese LNG demand in the future, the agreement's becoming a benchmark for future gas deals in the Asian market, its possible stimulation of Eastern Siberia development, and its possible promotion of gas hub development accompanying China's gas price reform. We must keep close watch on the United States, Europe and Asia as major gas markets, and major gas suppliers including Russia, the Middle East, Australia and Canada.

Contact: report@tky.ieej.or.jp
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