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Escalating U.S.-China Trade War Shaking International Energy Situation

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

The U.S.-China trade war has escalated to a new phase, shaking the world. Triggering the new phase was U.S. President Donald Trump's announcement to impose 10% additional tariffs on Chinese products worth about $300 billion from September 1 in the fourth round of tariff hikes on China. The U.S.-China trade war intensified in May as the United States decided to levy 25% additional tariffs on Chinese goods worth $200 billion in its third round of tariff hikes, inviting Chinese retaliation. At a U.S.-China summit on the occasion of the Group of 20 summit in Osaka on June 29, however, the two countries' top leaders agreed to resume trade talks and shelve tariff hikes, resulting in a pause in the trade war. Later, however, bilateral talks made for rough going. Even ministerial talks in late July failed to make any achievement. Frustrated by the absence of progress in trade talks, President Trump decided to implement the fourth round of tariff hikes at last.

The decision on the fourth round led market participants to shift their attention to a foreign exchange rate problem. China's renminbi (RMB) currency has tended to depreciate every time the United States decides on tariff hikes on Chinese products. Following the announcement on the fourth round of tariff hikes, the RMB slipped past 7 to the dollar on August 5, hitting an 11-year low. While additional U.S. tariffs raise costs of imports from China, the RMB depreciation lowers the import costs. The steep RMB depreciation led the United States to label China as a currency manipulator taking advantage of the RMB depreciation for avoiding the impact of tariff hikes. China was the first country to be labeled as such in 25 years, indicating a very tough U.S. stance against China. In response, China announced to suspend farm imports from the United States on August 6.

The U.S.-China trade war has thus expanded to include not only a tit-for-tat exchange of tariff hikes and a technological supremacy competition but also a currency war, growing fiercer and more complicated. The cut-throat economic war between the world's first and second largest economies led market participants to grow more conscious of global economic slowdown risks. The currency dispute could induce a currency devaluation race in which two parties to a bilateral trade war exchange currency devaluation measures to impoverish each other. Such a currency devaluation race is often viewed as a major factor behind the global economic confusion and depression in the 1930s. In this sense, the potential currency devaluation race has loomed as a new risk factor, leading market participants to grow concerned and cautious.

The Dow Jones average on the New York Stock Exchange accelerated its plunge in early August after hitting a record high of 27,359 on July 15 and remaining above 27,000 until late July, sinking to 25,717 with a heavy single-day loss of 767 points on August 5. It rallied to 26,029 on August 6 but expanded its loss to more than 500 points and slipped below 25,500 before rising back to 26,007 at its close on August 7, indicating stock market instability.

The International Monetary Fund in its "World Economic Outlook" released in July revised its 2019 global economic growth projection downward by 0.1 percentage points from the previous outlook announced in April to 3.2%. This growth rate still represents a cruising speed. However, if the U.S.-China trade war escalates further and is combined with the currency depreciation race, the future course of the global economy may grow even more uncertain. If concerns grow about the future course of the global economy to weaken confidence in future economic growth, a risk-off trend may be enhanced in the market. As a result, a capital outflow from risk assets may expand and affect emerging economies.

As the supply-demand balance in the international oil market has growingly been viewed as easing in such circumstances, oil prices have come under downward pressure. Growing tensions over Iran and risks regarding the passage through the Strait of Hormuz put an end to a downtrend of oil prices around mid-June, leading prices to seesaw around $65 per barrel for Brent and $60/bbl for West Texas Intermediate. Since early August, however, crude oil prices have plunged. By August 7, prices fell to $56.23/bbl for Brent and $51.09/bbl for WTI. From early July, Brent lost more than $10. The decline has come as what market participants see as abundant supply has been combined with their increased concerns about global economic slowdown risks amid the escalating U.S.-China trade war reaching a new phase and with a capital outflow from risk assets in such economic or financial situation. While tensions over Iran and the Strait of Hormuz have remained serious, market players have paid attention to downside risks rather than geopolitical risks.

The Institute of Energy Economics, Japan, in its energy outlook up to 2020 released in July projected that Brent would range from $60/bbl to $70/bbl in the immediate future in the reference scenario. It also predicted that the price range would be some $10/bbl lower in a lower price scenario in which the U.S.-China trade war would escalate. The market is seemingly going in the direction of the lower price scenario.

From the viewpoint of implications for the international energy market, we must pay attention to a potential fall in energy demand accompanying the global economic slowdown. The IEEJ outlook also indicates that if the global economy contracts by 0.8% on the escalation of the trade war, global primary energy consumption would decline by 0.7%. As coal has the largest share of the power mix in China where power consumption would decline on the economic slowdown, coal would post the largest consumption fall among energy sources of 1.1%, followed by a 0.7% fall each for oil and natural gas. The 0.7% decrease in oil amounts to about 0.7 million barrels per day. As the International Energy Agency in its latest analysis estimates global oil demand growth in 2020 at about 1.4 million bpd, the economic slowdown would halve the global oil demand growth. This would be the lowest growth since global oil demand declined in 2009 on the global financial crisis. The global economic slowdown would thus ease the global oil market supply-demand balance and push down oil prices, bringing about a new challenge for the Organization of the Petroleum Exporting Countries and some non-OPEC oil-producing countries including Russia in stabilizing the oil market and defending oil prices.

While natural gas demand is projected to decrease by 0.7% due to the economic slowdown, we must pay attention to various relevant possibilities. Although coal is expected to post the largest consumption decline among energy sources for the abovementioned reason according to the IEEJ

analysis, a general energy and power demand decline can be expected to seriously affect demand for the costliest energy sources. In this sense, we must carefully watch how demand for coal and natural gas, particularly liquefied natural gas, would be affected, based on market conditions. As the global oil and gas industry including international oil companies places hopes on robust gas/LNG demand in Asia and has included such Asian demand growth scenario into business strategies, the direction of natural gas/LNG demand in China and other Asian emerging countries and the U.S.-China trade war's impact on such demand must be closely watched.

Contact: report@tky.ieej.or.jp
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