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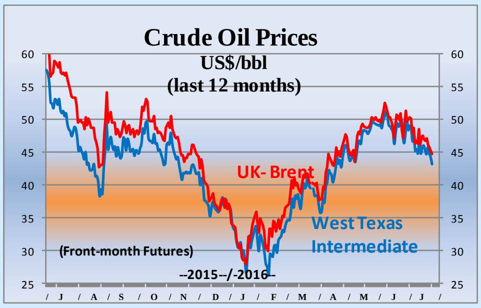
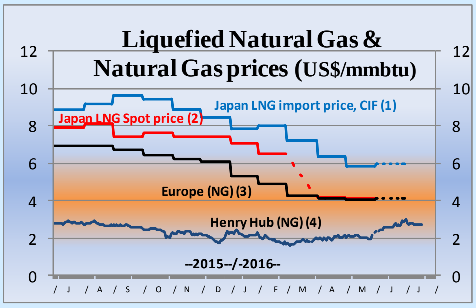
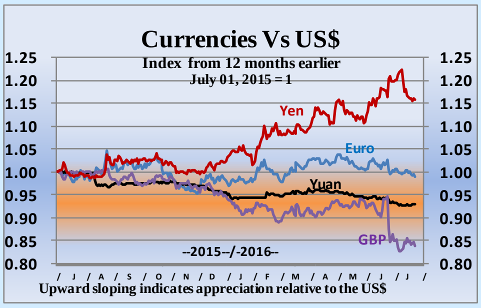


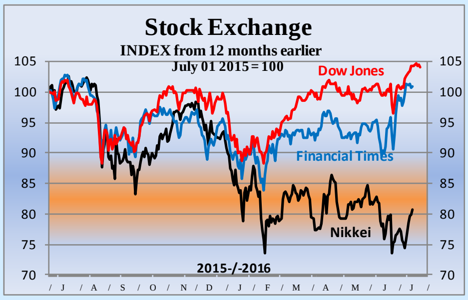
Source: DOE-EIA, Financial Times, NASDAQ



Sources:
(1) Ministry of Finance "Japan Trade Statistics"
(2) Ministry of Economy, Trade and Industry (contract month basis)
(3) Estimated by World Bank and World Gas Intelligence
(4) DOE-EIA, NYMEX (Front-month Futures)



Source: x-rates.com



Source: Financial Times

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Three Indian state-run companies reached an agreement with Rosneft on the transfer of interest in the Vankor oil field, but European and American companies remain hesitant to sign major deals. The EU has decided to extend the economic sanctions; Russia's economic isolation continues.

1. US: Republican Party Announces Alternative to Dodd–Frank Act

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On June 7, Republican members of the House Financial Services Committee published an alternative financial market regulation bill (the CHOICE Act) to the Dodd–Frank Wall Street Reform and Consumer Protection Act. The Dodd–Frank Act, established in July 2010, addresses a broad range of issues to prevent another financial crisis on the scale of Lehman Brothers' bankruptcy, through: (1) surveillance of systemic risks, (2) a more rigorous integrity regulation for major financial institutions to lower the risk of their failure, (3) reforms of the over-the-counter derivatives market, (4) new regulations on hedge funds, (5) enhanced regulations on rating firms, and (6) consumer and investor protection.

The Act is also related to the energy market. One reason for the surge in oil prices since 2005 is considered to be the influx of speculative funds into the commodity futures market. The Dodd–Frank Act: (1) requires all swap trading participants to register themselves, trade through an exchange, and carry out settlements at a clearing organization; and (2) prohibits financial institutions from spending their own funds on derivative trades (the Volcker rule). These measures were expected to curb the flow of speculative funds into the commodity derivatives market and help stabilize the market.

The CHOICE Act includes: (1) abolishing the functions of the Financial Stability Oversight Council, which monitors financial institutions that are important for the system and can liquidate them if they fail, (2) exempting major financial institutions from the regulations on condition that they increase their capital, (3) establishing bankruptcy procedures for major financial institutions, (4) limiting emergency lending by the Federal Reserve Bank and introducing external auditing of the FRB, (5) abolishing the Volcker rule, (6) enhancing Congress' surveillance on the regulations stipulated by the financial oversight organizations, (7) strengthening penalties for violation of rules by financial organizations. In other words, the CHOICE Act sees the Dodd–Frank Act as excessive control on the financial market and an impediment to economic growth, and suggests that it should be significantly eased. This does not specifically target energy futures, but is rather a request to ease financial regulations overall.

As already mentioned, the Dodd–Frank Act is expected to curb speculation and help stabilize the commodities markets. However, it is difficult to analyze the impact of the Act on energy trading, as the scale of fund inflows to the commodities market depends on differences in financial policy regulations among countries, and which financial market is outperforming the others. Republican lawmakers and the energy industry opposed the Dodd–Frank Act, arguing that it could hamper corporate financing, cause domestic resource development to stagnate, and compromise energy security. However, the impact of the Act is considered to be limited, since the key points in financing by energy companies are prices and supply and demand; financial regulation is rarely mentioned when discussing energy supply stability and securing investment. Thus, the potential impact of the CHOICE Act on the energy market is also difficult to forecast.

President Obama has commented on the CHOICE Act that he will not consider a bill that seems almost oblivious of the financial crisis of 2008, and that the bill has no chance of becoming law while he is in office. The bill, however, is in line with the House Republicans' economic policy plan announced by House Speaker Paul Ryan (Republican) on June 14. The bill is likely to be incorporated in the Republican Platform that will be released in July, and become a key policy of the Republicans in Congress from January 2017 and of the next administration, if Donald Trump wins in November. As the points of contention between the two major parties remain hard to identify in the view of the success of non-mainstream candidates such as Trump and Sanders, this is an area of sharp confrontation between the parties. This issue is a focal point of the conflict between the parties on government market intervention.

In Japan, a new nationwide symposium launched this month by NUMO, the Nuclear Waste Management Organization of Japan, to discuss geological disposal in earnest is receiving attention. The symposium is a joint effort by NUMO and the government based on the government’s goal of designating “scientifically suitable areas” within this year, and aims to provide accurate information to the public on the issues involved in the final disposal of high-level radioactive wastes, and to listen to their concerns. In the past, the nuclear PR activities of the government and the power companies have been criticized as “almost forcing people to understand”. Has the stance changed? It will be interesting to see the public’s honest reaction.

2. EU: UK's Exit from the EU Becomes a Reality

Kei Shimogori, Researcher
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On June 23, a referendum was held in the UK to decide whether to leave the EU. The referendum ended with a narrow majority for the Leave vote, with 51.9% voting to leave and 48.1% voting to remain. The contest remained close during the polls immediately before the referendum and even as the ballot count continued, and the result was too tight to call until the end. The Remain camp led the polls at one point, particularly after the tragic murder of the member of Parliament and Remain campaigner Jo Cox on June 16, but it was the Leave campaign that won in the end. As the result of the referendum became clear, the pound dropped to its lowest level since 1985 against the dollar. On the same day, Prime Minister Cameron, who had called for the UK to remain, announced that the will of the public must be respected and that he would step down. The news sent shockwaves through the global financial community, causing the stock markets in the UK, Europe, Asia and the US to plunge as investors sought to reduce risk. As the result threatens to affect the real economy, oil prices also fell on the 24th, with Brent falling 2.5 dollars from the previous day.

The UK must notify the European Council of its intent to leave the EU in accordance with Article 50 of the Treaty of Lisbon. The EU and the UK will then negotiate the terms of leaving in line with the principles set forth by the European Council that govern the arrangements for the withdrawal and outlining the country's future relationship with the Union. This negotiation period is two years in principle. Thus, even if the UK initiates steps to leave, it will remain subject to EU laws for two years after announcing its intention to leave.

In March 2016, the National Grid issued a report titled "The impact of Brexit on the UK energy sector". The report describes two possible options for leaving the EU: the Norwegian option (remaining in the Internal Energy Market (IEM)), and the Swiss option (leaving the IEM, too), and states that the cost of investing in the energy market will rise under either option. The report, however, indicates that the impact would be greater for the Swiss option, citing a possible decline of investment in the new international grid that the UK will need in order to adjust the supply-demand balance of its renewable energies, which are expected to expand. According to the report, if the UK leaves the IEM, consumers could face additional costs of up to 500 million pounds each year until the early 2020s.

Given the result of the referendum, Scotland, which was supporting Remain, is likely to press for another Scottish independence referendum. Also, the UK cannot ignore its Remain voters, who have lost but still account for nearly half the population. Further, with calls in the Netherlands and Sweden for a referendum in their own countries, the result of this referendum might encourage other EU members to leave the EU in a chain reaction. The repercussions of the Brexit shock must continue to be monitored.

3. China: Greater Efforts to Launch Full-Amount Purchase of Renewable Electricity

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On March 28, the National Development and Reform Commission (NDRC) issued the Guidelines for Full-Amount Purchase and Management of Renewable Generation (see the May 2016 issue of this Newsletter). Just two months later, on May 31, the NDRC issued jointly with the National Energy Administration (NEA) the operational procedures for the Guidelines, titled the Notice concerning the Steady Implementation of Full-Amount Purchase of Wind and Solar Generation ("the Notice"). This came unusually fast, considering that it took ten years and three months for the Guidelines to be published after the Renewable Energy Law was put into effect. Why so fast? According to the NEA, the average output curtailment rate for wind power for the first quarter of this year worsened by 7 points to 26%, with the amount of curtailed electricity output reaching 19.2 TWh. The authorities may have thought that unless actions are taken, renewable energy development could slow, and the international commitment to raise the percentage of non-fossil energy in primary energy consumption from 12% in 2015 to 15% in 2020 and 20% in 2030 may not be met. In other words, the government may have been driven by a strong sense of crisis and acted to protect the full-amount purchase system.

The Notice requires electricity exporting regions with surplus electricity that are subject to output curtailment to raise the annual purchase requirement, "guaranteed hours", per kW per region, for 29 wind power generating regions, to a minimum of 1,800 hours (Gansu Province, etc.) and a maximum of 2,000 hours (Zhangjiakou City, Hebei Province, etc.), and for 32 solar power generating regions, to a minimum of 1,300 hours (three Northeastern Provinces, etc.) and a maximum of 1,500 hours (Ningxia Hui Autonomous Region). The Notice states that grid operators must purchase the "guaranteed hours" of electricity generation at the standard price (FIT) set by the NDRC[1], and even if the required amount of purchase is not met, must compensate the electricity producers for the full amount. This will ensure an 8% internal rate of return for electricity producers.[2]

Meanwhile, for the regional governments that are promoting the construction of power plants as a means of investment to fight the downward pressure on local economies, if the amount of purchase by grid operators does not meet the guaranteed volume, the Notice prohibits the construction of any new wind and solar plants, including planned and licensed projects. Further, to enhance administrative oversight, the regional bureaus of the NEA will cooperate with the energy and economy administration departments of the regional governments to detect and punish any offenders, and report the result to the NDRC and NEA each time. Further, for regions without specific "guaranteed hours", grid operators must purchase the full amount at FIT, and must not set any "guaranteed hours" without the permission of the NDRC and NEA.

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[1] The purchase price for 2016 is 7.2-9.2 yen/kWh (1 yuan ≒15.4 yen) for wind, and 12.3-15.1 yen for mega solar.
[2] According to Qin Haiyan, General Secretary, Wind Energy Committee, Chinese Renewable Energy Society. http://www.escn.com.cn/news/show-320718.html

These rules are already proving to be effective. For example, on June 3, the NEA released its Solar Power Development Plan for 2016. The Plan sets the target capacity for newly constructed mega solar plants at least 18.1 GW, and allots capacity to provinces that comply with the rules, ranging from 1 GW (Hebei Province, etc.) to 200 MW (Fujian Province, etc.), but does not allot any capacity to offenders such as Gansu Province, the Xinjiang Uyghur Autonomous Region, and Yunnan Province. Meanwhile, the Plan does not set a limit on the construction of new capacity for the four government-ruled cities of Beijing, Shanghai, Tianjin and Chongqing, and Hainan Province and the Tibet Autonomous Region, on condition that output curtailment will not occur in future. Through a feasible institutional design and rigorous implementation as described here, the full-amount purchase of renewable energies will be steadily promoted. Attention must be paid to any developments in the situation.

4. Middle East: Holy Ramadan before the Storm

Koichiro Tanaka, Managing Director &
President of JIME Center

The Muslim fasting month of Ramadan for 2016 has passed relatively calmly, which is rare in recent years, as far as the situation in the Middle East is concerned, with the exception of Iraq where massive terrorist attacks continued. However, moves are surely being made behind the scenes that will lead to drastic developments in the next phase.

In Iraq, where two years have already passed since the establishment of an Islamic State by terrorist group ISIS/ISIL, political strife is intensifying daily, taking advantage of public frustration, and is significantly undermining the authority of the al-Abadi administration. The Iraqi army recaptured the city of Fallujah in the suburbs of the capital Baghdad from ISIS/ISIL, but the return of stable governance is still nowhere in sight. The capital continues to suffer random terrorist attacks, causing ongoing security concerns. The operation to recapture the strategic northern city of Mosul has still not begun, and is not expected to be easy.

In response to the delay in the lifting of sanctions following the nuclear agreement, the US Treasury updated the Frequently Asked Questions on the Iran sanctions, and provided additional information on lawful transactions with Iran by foreign banks. This updated document reflects what Secretary of State Kerry has said to major European banks as part of an effort to safeguard the nuclear deal. As the US primary sanctions continue to affect legal transactions with Iran, the effect of this update on major European banks, whom are cautious about starting to deal with Iran again, will not be great.

Increasingly distrustful of the US, Iran strongly condemned the US Supreme Court decision to allow Iranian frozen assets to be dispersed to compensate the families of US Marines victims of the Beirut suicide bombing in 1983. Iran appealed to the International Court of Justice (ICJ) to release the approximately 200 million dollars of assets of Iran's Central Bank currently frozen in the US. As the Iranian death toll continues to rise with its intervention in Syria's civil war, Ali Shamkhani, secretary of the Supreme National Security Council of Iran, was appointed as military coordinator with Syria and Russia, followed by a replacement of the deputy minister for foreign affairs in charge of Arab and Middle East affairs. This reshuffle is expected by some to affect Iran’s regional policy, which includes Syria.

In Bahrain, where intermittent clashes between the Shia population and the Sunni establishment have intensified since the Arab Spring, the government stripped an aged Shia cleric of his Bahraini nationality. He is also a spiritual leader of the opposition Wifaq party. This decision was supported by Saudi Arabia and other Arab countries that consider their Shia citizens, who could support Iran, as a threat. Reciprocally, conservative hardliners in Iran issued an "ultimatum" warning of an armed public uprising against the Bahraini royal family. The confrontation between the two coasts of the Persian Gulf is intensifying once again.

Angered by the UN report which held it responsible for the majority of deaths and injuries of women and children happening inside Yemen, Saudi Arabia allegedly threatened to withdraw funds from UN programs, in response to which UN Secretary General Ban Ki-moon expressed displeasure. Eventually, the UN reversed its earlier decision to blacklist Saudi Arabia. Saudi Arabia's Deputy Crown Prince Mohammad bin Salman visited the US to solicit investment in the Saudi national development program, and talked with President Obama while there. A divide in views has emerged between the senior officials of the UAE and Saudi Arabia over whether its troops should withdraw or remain in the Yemeni military operation.

5. Russia: Prolonged Economic Isolation

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From June 16 to 18, the Twentieth St. Petersburg International Economic Forum was held. According to the organizers, key persons from political and economic circles of 130 countries participated, and 332 official agreements worth over 15.4 billion dollars were signed during the period. In the energy sector, Gazprom and Shell signed an MoU on the Baltic LNG project, and Rosneft and BP signed the final agreement to establish a JV for exploring oil and gas resources in western Siberia. However, unlike in the previous Forums, there were no grand announcements of major deals between Russian companies and the countries of Europe and the US; the only highlight was an agreement on the transfer of interest in an oil field between Rosneft and three state-run Indian firms.

The Vankor oil field in Siberia is the major supply source for the Eastern Siberia - Pacific Ocean oil pipeline. The consortium of Indian state-run firms Oil India Limited, Indian Oil Corporation Limited (IOCL), and Bharat Petro Resources Limited (BPRL) is to purchase a 23.9% interest for 2.1 billion dollars from Rosneft. India's Oil and Natural Gas Corporation Limited (ONGC) has already purchased a 15% interest in the oil field for 1.27 billion dollars in May 2015. Meanwhile, China National Petroleum Corporation (CNPC) also reached a framework agreement with Rosneft on the purchase of a 10% interest in the same oil field in November 2014, but the parties have not reached a final agreement due to a dispute over the purchase price. As international oil prices remain low, and with slowing economic growth, China could be seeking to take advantage of Russia's impatience to secure new markets amid the current international supply glut, and negotiate a better deal. For instance, in early June, Wang Yilin, Chairman of CNPC, showed keen interest, expressing "interest in purchasing Rosneft's stocks if it ensures our participation in the company's management".

At the Forum, President Putin emphasized the recovery of Russia's domestic economy, commenting that "capital outflow from Russia (as of December 2015) has decreased to about one-ninth year-on-year, and money is starting to stay in Russia, which is becoming increasingly attractive economically". However, other indexes show that among Russia's foreign direct investment of 4.84 billion dollars for 2015 (net amount: 22 billion dollars for 2014), the top-three direct investments into Russia are from the Bahamas (5.23 billion dollars), the British Virgin Islands (2.5 billion dollars), and the British Bermuda Islands (1.9 billion dollars) (May 2016, Russian Central Bank). In other words, the figures do not necessarily suggest an increase in investment by foreign funds in Russia, but could be seen as the return of some of the assets of Russian companies that had been fleeing abroad. The Russian economic newspaper Vedomosti believes that this is caused by the Russian government pulling back capital that had fled abroad in the last two years, and not because the Russian economy has become attractive again.

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