# IEEJ e-NEWSLETTER

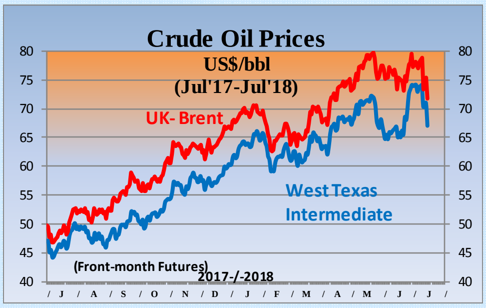
## No. 140

(Based on Japanese No. 178)

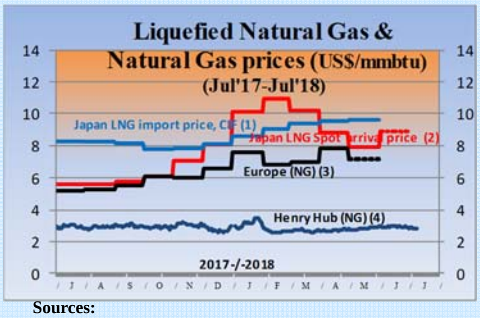
**Published: July 17, 2018**

**The Institute of Energy Economics, Japan**

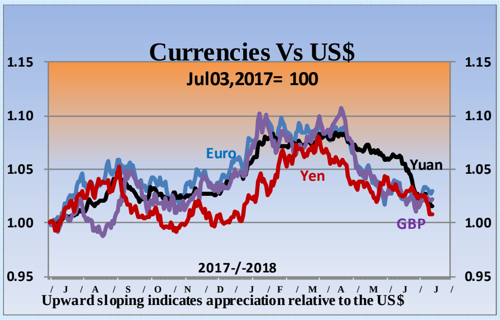
**(As of July 16, 2018)**




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)
(5) Investing.com




Source: x-rates.com


Source: Financial Times

## Contents

# Summary

**【World Monitoring】**

### 1. US: Risk of a Supply Shortage in the US Power Market

The summer reliability report of NERC indicated risks of a supply crunch in Texas and other areas that are becoming dependent on renewables and gas-fired thermal power. This may lead to renewed recognition of the importance of diversifying power sources.

### 2. EU: Countermeasures against the US and the Draft Revised Renewable Energy Directive

In response to the US tariffs imposed on steel and other products, the EU decided to impose tariffs on US products. Further, the EU revised the Renewable Energy Directive, raising the target share of renewables to 32%.

### 3. China: Tensions Rise as US-China Tariff Dispute Intensifies

The retaliatory war of tariffs due to US-China trade friction is intensifying. The Chinese government is refusing to back down in response to US action. If the two nations plunge into a trade war, US oil exports to China are likely to decrease considerably.

### 4. Russia: Responses to the Economic Sanctions and Joint Production Cut

Russia launched a new plan to counter the US economic sanctions. With the increase in oil prices, a decision was made to increase output from July partly due to Russia’s proposal to OPEC to ease the joint cut.

## 1. US: US: Risk of a Supply Shortage in the US Power Market

**Junichi Ogasawara**, Senior Economist, Group Manager
Electric Power Group
Electric Power Industry & New and Renewable Energy Unit

On May 30, North American Electric Reliability Corporation (NERC), the oversight and assessment organization for maintaining the reliability of North America's power systems, released their summer reliability report. The report expressed concern over a supply shortage in Texas this summer. The supply margin of 18.9% stated in the 2017 summer reliability report is expected to shrink to 10.9%, below the 13.75% margin required for a stable supply, as more coal-fired thermal power plants close, the start of new power plants is delayed, and more power plants stop operation. This, if combined with normal levels of unplanned outages of thermal power plants, very hot weather, or a reduction in wind power output, could result in a negative supply margin.

Further, the Midcontinent Independent Transmission System Operator (MISO), which is experiencing significant growth in wind power, says that it is often necessary to take emergency procedures due to frequent demand response and adjustment of BTMG (behind-the-meter-generation: on-site generation behind the meter) output. California's ISO also points out the possibility of a shortage of operation reserve capacity, with the risk rising particularly if the water level for hydropower and solar PV output drop concurrently. Supply risks in gas pipelines could also elevate the risk.

As all these regions have increased their levels of renewable electricity and are highly dependent on gas thermal power, problems emerge when the supply capacity of both energies comes under threat. Renewable energies have the risk of a simultaneous drop in output while gas thermal power may face a stoppage of gas supply facilities such as gas pipelines under abnormal weather conditions.

Coincidentally, according to media reports, President Trump has ordered the Department of Energy to consider measures to avoid closures of nuclear and coal power plants. While the order was issued to address any impact on employment, it may have also been caused by the mounting risk of supply disruptions due to an imbalance in supply capacity. So far, the reliability assessment for power has not been considering gas supply facilities. However, with the recent rise in dependency on gas in the US, information has begun to be gathered on the adequacy of gas procurement, and a method of evaluating the risk of gas supply disruptions is being studied. However, the method is yet to be fully established.

In 2017, President Trump ordered a study on a plan to subsidize nuclear power to make the power grid more reliable and resilient, but in January 2018, the Federal Energy Regulatory Commission declared the end of the study saying that it was not possible to ensure consistency with market procedures. Should a supply shortage emerge this summer due to the supply capacity imbalance, however, the importance of a diversified power mix could come under the spotlight again.

## 2. EU: Countermeasures against the US and the Draft Revised Renewable Energy Directive

**Kei Shimogori**, Researcher
Global Energy Group 1, Strategy Research Unit

The United States announced that it would impose additional tariffs of 25% and 10% from June 1 also on steel and aluminum exports from some of its allies including the EU, which were tentatively exempted in March due to national security considerations. In response, the EU instituted dispute settlement proceedings at the WTO on the same day.

It is interesting to note that the EU has ongoing legal proceedings in the WTO against China as well as the US. Chinese regulators require European companies to transfer the ownership and right to use their IP rights to Chinese companies, and the EU believes this is unreasonable. EU Commissioner for Trade Cecilia Malmstrom explained that challenging both the US and China at the WTO is a declaration that the EU does not intend to take sides.

On June 6, the European Commission decided to impose additional tariffs on all US products notified to the WTO to counter the US tariff measures. The WTO Safeguards Agreement allows for a rebalancing corresponding to the damage caused by the US measures, with EU exports worth €6.4 billion (2017) being affected. The EU announced that it will therefore exercise its rights immediately on US products worth up to €2.8 billion of trade.

As measures against US products valued at €2.8 billion, on June 20, the European Commission gave final approval to impose additional tariffs of 25% on agricultural products, bourbon whiskey, and jeans, as well as US steel and aluminum products. The measures will be implemented on June 22. Meanwhile, energy resources such as LNG are not included in the scope of additional tariffs on either side. The EU reportedly intends to withdraw the tariffs if the US does so, but the situation remains extremely volatile.

As another high-impact event for EU energy policy, on June 14, the negotiators of the European Commission, European Parliament, and EU Council agreed on the contents of the revised Renewable Energy Directive. The current target for 2030 of covering at least 27% of the EU’s final energy consumption was a non-binding target. In contrast, the newly agreed target set a binding renewable energy target of 32% and contains a clause for an upwards revision by 2023.

The new target shows the EU’s commitment to climate action and reducing its dependency on fossil fuels, including coal. Despite an 18-month negotiation to revise the Directive, however, not all EU member states have approved the new target. In particular, the four Visegrad countries (the Czech Republic, Hungary, Poland, and Slovakia) have shown certain openness to raising the target but have presented conditions for its implementation including maintaining the renewable target for the transport sector (14%) and the maximum blending ratio of biofuel (7%), arguing that escalating requirements on advanced biofuels is not realistic.

## 3. China: Tensions Rise as US-China Tariff Dispute Intensifies

**Li Zhidong**, Visiting Researcher
Professor at Graduate School, Nagaoka University of Technology

The second US-China trade talks on May 17-18 agreed on avoiding a trade war (see the June edition of this Newsletter). However, the 'ceasefire' ended in less than a month as the Trump Administration launched a new offensive in the ongoing tariff dispute.

The duel began on May 29 immediately before the third US-China trade talks (Beijing) when the US abruptly announced that it will release a list of items subject to additional tariffs by June 15. In response, on June 3 after the talks ended, the Chinese government mentioned in a statement that the two countries had made positive and concrete progress regarding increasing exports of US farm and energy products through good dialogue, while warning that the agreement should be "based on the premise that the two sides should meet each other halfway and not fight a trade war" and "any agreements reached on trade and business between the two countries will be void if Washington implements tariffs and other trade measures." Though not officially announced, China has agreed to purchase 70 billion dollars (approx. 7.7 trillion yen) of US farm and energy products per year according to the US Wall Street Journal (digital edition) dated June 5.

On June 15, despite China's warning, the United States announced additional tariffs of 25% on 50 billion dollars (approx. 5.5 trillion yen) of Chinese products. The tariffs will be imposed first on 34 billion dollars of products on July 6 and the timing of the remaining 16 billion dollars of products will be decided later. In response, China announced on the next day, June 16, that the same rate of additional tariffs will be imposed on the same amount of US products at a similar timing. Further, on June 18, President Trump warned of an additional 10% tariff on 200 billion dollars (approx. 22 trillion yen) of imports from China and on another 200 billion dollars of goods if China retaliates. China did not budge in the face of this threat: the next day, June 19, the Ministry of Commerce declared that "to respond strongly, China will have to adopt comprehensive measures in quantity and quality." According to US statistics, exports from China to the US were around 500 billion dollars in 2017 but only around 130 billion dollars in the other direction. Running out of goods on which to impose tariffs, China has to seek "qualitative measures" outside of trade. Experts consider that a voluntary public "boycott" of US products made in China as well as imports would be effective. For example, 21% of US Apple's sales came from the Chinese market in the first quarter.

China is making it clear that it will never bow to the United States. Meanwhile, on June 10, the Shanghai Cooperation Organization Summit of eight states including China, Russia and India met in Qingdao and released a leaders' declaration that the member states will "reject protectionism in any form." The State Council has released a notification on comprehensive measures including an easing of foreign direct investment regulations and enhanced protection of IP rights. Both are strategic messages directed at the US-initiated global trade friction.

So far, the US-China friction has not directly affected the energy area. However, American crude oil is included in the second set of retaliatory measures to be implemented by China. If the two countries plunge into a trade war as declared, US crude oil exports to China are likely to decrease considerably.

## 4. Russia: Responses to the Economic Sanctions and Joint Production Cut

**Sanae Kurita**, Senior Researcher
Global Energy Group 2, Strategy Research Unit

On June 4, President Putin signed the federal law on Countermeasures against Unfriendly Actions of the United States of America and Other Foreign States, which took effect immediately. Prime Minister Dmitry Medvedev had condemned the US sanctions imposed on Russia on April 6 as an illegal act of protectionism and had ordered the cabinet to take effective countermeasures and consider ways to support the Russian companies hit by the sanctions. Enactment of the law is part of the effort to put these measures into action.

The law applies to states and individuals who take hostile acts against Russia and enables the government to terminate international cooperation with the unfriendly state and limit exports and imports. The law stipulates that the industries, products and services to be prohibited or limited should be specifically determined by the federal government, not specified by laws. Views are divided as to why the scope of the sanctions is not clearly defined; some Russia experts point out that through the sanctions, Russia intends to sow doubt between the United States and its allies and maintain tension by not revealing who will be sanctioned next; some media reports interpret the lack of detail as a sign of ineffectiveness and remain optimistic.

New moves are emerging as international oil prices increase. On June 22, OPEC announced that the level of output reduction, which is now being exceeded, will return to initial levels from July, effectively increasing output. Before the OPEC decision, the Russian government had considered that the joint production cut had met its goal of correcting stock levels and had proposed a discussion to ease the reduction. Russian oil companies opposed the cut from the beginning and repeatedly emphasized the need to restore output levels. In particular, Rosneft had argued that the joint cut could hamper the development of oil fields in eastern Siberia that supplies oil to the Eastern Siberia–Pacific Ocean oil pipeline.

The rising oil prices are affecting the daily lives of Russian people. To stabilize the rise in domestic petroleum product prices since the start of the year, on June 1, the government lowered the commodity tax on gasoline and diesel by 48 US dollars and 31 US dollars per tonne, respectively, and a further tax cut of 11 US dollars is scheduled for July 1. According to First Deputy Prime Minister and Finance Minister Anton Siluanov, the series of tax breaks will reduce tax revenues by 2.2 billion US dollars, which will be offset by an increase in non-oil revenues and borrowings in amendments to the 2018 budget scheduled for autumn. The government is certain that this can be achieved as the Finance Ministry has revised the 2018 federal budget upward to 0.5% over GDP. In addition, Russia plans to abolish the oil export tax and mineral resource exploration tax toward 2024. Reforms of the oil tax system to accelerate oil exports and to switch from uniform volume-based oil and gas taxes to ones based on the difficulty of development of each field have been discussed repeatedly, but the policy has also been changed repeatedly and no consistent direction has been set. The reforms of the oil tax must be closely monitored as, depending on the situation, it could affect Russia's oil business in which Japanese companies are participating.

**Past IEEJ Events**

**Energy and Economy Indicators of Japan**

**IEEJ Homepage Top**

**Back Numbers of *IEEJ e-Newsletter***

**Back Numbers of *IEEJ Newsletter* (Original Japanese Version - Members Only)**

**IEEJ e-Newsletter Editor: Yukari Yamashita, Director**
**IEEJ Newsletter Editor: Ken Koyama, Managing Director**
**Inui Bldg. Kachidoki, 13-1 Kachidoki 1-chome, Chuo-ku, Tokyo 104-0054**
**Tel: +81-3-5547-0211 Fax: +81-3-5547-0223**