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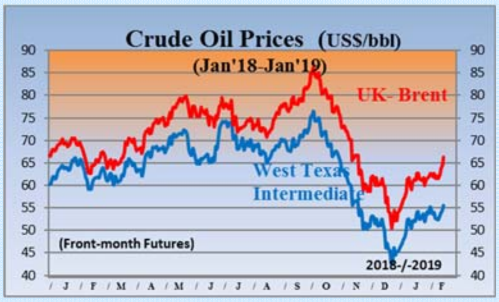
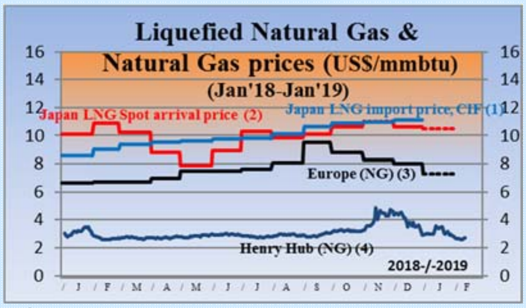


Source: DOE-EIA, Financial Times, NASDAQ



Sources:
(1) Ministry of Finance "Japan Trade Statistics"
(2) Ministry of Economy, Trade and Industry (arrival month basis)
(3) Estimated by World Bank (Netherland Title Transfer Facility)
(4) DOE-EIA, NYMEX (Front-month Futures)
(5) Investing.com and Finance.Yahoo.com

Source: x-rates.com

Source: Financial Times

Contents

Summary

【World Monitoring】

1. US: Developments in the Government Shutdown and US-China Trade Talks

As various uncertainties loom for the US economy, the prolonged government shutdown is worrying although a three-week reopening of government agencies was announced. The course of US-China trade talks held amid domestic political turmoil also requires close attention.

2. EU: Chaos in the UK Parliament and Stronger Ties between Germany and France

The UK parliament is in disarray over the EU withdrawal deal. Meanwhile, Germany and France signed a new treaty to strengthen the union of European countries. A revised regulation and directive for the electricity market was agreed on as an EU-wide initiative.

3. China: Course of the US-China Trade War and Prospects for a Truce

The events since the US-China summit last December suggest that the trade war is alleviating, but both sides need to compromise for a truce. All eyes are on the ministerial trade talks at the end of January.

4. Russia: US Congress Moves to Block the Lifting of Economic Sanctions on Russia

Some US government bodies are moving to end the economic sanctions on Russia while both chambers of Congress remain highly suspicious of the country. With reports of tougher sanctions being considered, developments must be closely watched.

1. US: Developments in the Government Shutdown and US-China Trade Talks

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The slowdown of the Chinese economy is in the news every day, and is caused mainly by the fall in exports triggered by the US-China conflict and the consequent cooling of the domestic economy. Meanwhile, according to US trade statistics as of October 2018, US exports to China fell by 26% while imports from China increased by 37% compared to March 2018 when steel and aluminum tariffs took effect, causing the US trade deficit with China to balloon by about 67%. This heightened concern over a slowdown of the US economy toward the end of last year.

This was followed by a sharp fall in share prices after Apple announced a downward revision of its earnings on January 3, but subsequent corporate earnings reports were "not as bad as expected" and share prices are showing no signs of serious weakness. However, as the Department of Commerce has stopped issuing statistics on trade, production, and consumer spending since November last year due to the partial shutdown of the federal government since December 22, it is difficult to grasp the impact of the additional tariffs based on Section 301 of the US Trade Act. Meanwhile, the jobs report by the Department of Labor, which is not on the list for shut-down, showed that jobs and wages continued to increase in December while consumer prices fell slightly, suggesting that the government shutdown, now in progress for over a month, may do more damage to the US economy than the confrontation with China.

The government shutdown, which was triggered initially by the Trump administration's demand for funds to build a wall on the border with Mexico to keep out illegal immigrants, has already affected the lives of the public in various ways: cutbacks in security control and the suspension of quarantine of agricultural produce and foods at some airports due to staff furloughs (hampering logistics), suspension of food stamps for the poor, and the halting of distribution of allowances to farms affected by the drop in exports of soy and other produce to China.

The Democrat-led House of Representatives had passed a stopgap budget ten times by January 24 to restart government agencies, only to be rejected by Senate Republican leaders. On January 20, the president's "compromise" that includes funding for the wall was rejected by the Democrats. The Senate vote on a draft budget that does not include funding for the wall was rejected as a result of opposition by a majority of Republicans, suggesting support for the president who insists on the wall. However, the president and his staff finally seem to sense their defeat in this game of endurance, as six GOP senators voted with the Democrats and polls show that the public considers the president responsible for the government shutdown. On January 25, President Trump agreed with Congress on a three-week stopgap budget that does not include funding for the wall and announced a temporary reopening of the government.

Amid the domestic political turmoil, US-China trade talks are due to be held at the end of January. On January 24, Commerce Secretary Wilbur Ross said that trade is complicated with many issues to be solved between the US and China, and that he would not be surprised if an agreement is not reached this time. These words are presumably intended to stop excessive expectations and to alleviate the frustration of the president, voters, and financial markets that "Made in China 2025" is yet to be cancelled. Congress is also closely watching the course of the talks. In 2018, bipartisan lawmakers submitted several bills to limit the president's authority to invoke punitive tariffs, arguing that President Trump is abusing the authority to impose taxes, which belongs to Congress. If the talks fail to achieve results, and if Congress decides to take the initiative on tax, the president may counter with a veto. However, this would endanger gaining Congressional approval for the revised NAFTA deal, one of the few achievements of the administration. Perhaps a compromise will be reached to suspend additional tariffs while discussions are under way, merely confirming China's commitment to further reforms, to allow President Trump to take the credit. (as of 1/28/2019)

2. EU: Chaos in the UK Parliament and Stronger Ties between Germany and France

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On January 15, the UK Parliament voted against the EU withdrawal agreement proposed by Prime Minister Theresa May by 432 votes to 202. While the rejection was generally expected, the historic scale of the defeat made headlines in the media. Prime Minister May survived the subsequent vote of no confidence submitted by Labour Leader Jeremy Corbyn to parliament, but that does not make the prime minister's problems any easier.

In the following week, on January 21, the Prime Minister proposed an alternative agreement to parliament, suggesting that she would consider revising the measures for the Irish border issue but would continue to reject the possibility of a second referendum, arguing that it would threaten the social cohesion of the country. Parliament is due to discuss and vote on the alternative agreements proposed by the Prime Minister and by members of parliament on January 29. Meanwhile, members of the European Parliament have indicated that they wish to start the ratification procedure for the withdrawal agreement, which is also required of the European Parliament. The start of ratification in the European Parliament would end all hopes for renegotiating the deal and thus send a clear signal to the UK. The current options for the UK are diverse: a no-deal Brexit, withdrawal based on a revised agreement, requesting an extension of the deadline from the UK, or retracting the withdrawal. The discussions in the UK's Parliament must be closely watched as the situation remains extremely volatile and unclear. .

Amid the chaos surrounding Brexit, German Chancellor Angela Merkel and French President Emanuel Macron signed a new treaty outlining collaboration to strengthen the union of Europe. The treaty renews the Elysee Treaty signed by West Germany and France in 1963 for reconciliation and friendship. The new treaty seeks to establish common diplomatic and national security policies and strengthen the economic and currency union of the two countries. No concrete references were made to energy. The first draft of the new treaty published in 2018 at the 55th anniversary of the Elysee Treaty included references to a new initiative on carbon pricing, but there were no such words in the new treaty. Though both leaders are facing waning popularity back home, they are expected to showcase the benefits of the union to other countries to prevent Eurosceptics gaining ground in the European Parliament election this year.

Although Eurosceptics are attracting attention, the EU is steadily moving ahead with initiatives to shift the entire EU to clean energy. In December 2018, the European Council, the European Parliament, and European Commission agreed on the revisions to the electricity market regulation and the electricity market directive (see Chapter 4. Update on Policies Related to Climate Change in this Newsletter). Meanwhile, based on the energy union governance regulation put into force as part of the Clean Energy for All Europeans package (to track the goals and status of the member states vis-à-vis the energy union), the member states are obligated to submit their National Energy and Climate Plans to the European Commission for assessment. Though seven member states reportedly have not submitted their plans, the efforts of the members deserve attention as a measure of the feasibility of the EU's ambitious targets.

(as of 1/28/2019)

3. China: Course of the US-China Trade War and Prospects for a Truce

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On December 1 last year, the leaders of the United States and China met for the first time in a year and agreed to halt any new mutual tariffs and start a 90-day truce to discuss "structural" trade issues. Accordingly, vice-ministerial trade talks were held in Beijing from January 7 through 9. On January 9, the United States Trade Representative announced that the meeting discussed issues such as increased purchases of US agricultural, energy, manufactured and other products by China and the need to continuously check and effectively implement China's structural issues and agreements. On the following day, the 10th, China's Ministry of Commerce announced that "the two sides conducted extensive, in-depth and meticulous exchanges on the trade and structural issues of common concern, enhanced mutual understanding, laid the foundation for resolving each other's concerns, and agreed to continue to communicate closely."

Further, on January 8, President Trump tweeted that "Talks in China are going very well!" and said to the press on January 14 that things are going well with China and a deal will hopefully be reached. Furthermore, on January 17, the Ministry of Commerce of China announced that Vice Premier Liu He will visit the US at the request of US Treasury Secretary Steven Mnuchin and US Trade Representative Robert Lighthizer for ministerial trade talks on January 30 and 31.

The events since the summit last December suggest that the trade war is softening. Why? Because it is now clear that the US administration's tactic of putting pressure on China with punitive tariffs only triggers retaliatory tariffs by China and that there are no winners in a war of tariffs. The three rounds of mutual tariffs imposed so far cover half of China's exports to the United States worth $250 billion of goods and about 85% of US exports to China worth $110 billion. The trade war served as one of the major factors resulting in the shrinking US-China trade, poor corporate performance, falling stock prices, and slowing economy. China's economic growth rate for 2018 fell by 0.2% year-on-year to 6.6%, the lowest in 28 years. In the United States, the Dow Jones Industrial Average fell by 8.7% in December 2018, causing great concerns for the future of the economy. In addition, with the start of the trade talks, China is also taking the initiative to accelerate the resolution of structural issues, including easing foreign investment regulations, strengthening the protection of IP rights, and lowering import tariffs. This has also helped turn the situation around.

Though recent developments do suggest positive momentum, both parties must ultimately make a compromise for the trade war to reach a truce. At the opening ceremony of China International Import Expo held last November, President Xi Jinping announced goals to expand foreign imports to $40 trillion in 15 years ($2.31 trillion in 2017). Further, at the 40th anniversary of China's reform and opening-up held at the end of last year, President Xi emphasized, regarding structural issues, that "We will make no change where there should not and cannot be any reform," while calling for continued reform and opening-up. China has a non-negotiable interest: maintaining the strategies for developing its technologies and industries essential for becoming a "great modern socialist country" by mid-century, a national goal stipulated in the constitution. In future trade talks, China is expected to be very open to expanding imports and opening up its market but to firmly reject any US technology blockade on China in order to maintain its technological hegemony or interfere in domestic policies concerning technological development and other areas. What action will the US take? The ministerial talks at the end of January will be monitored closely.

4. Russia: US Congress Moves to Block the Lifting of Economic Sanctions on Russia

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Strategy Research Unit

In 2018, Russia produced 555.84 million tonnes (11.16 mb/d) of oil, the highest since the collapse of the Soviet Union (Russian Ministry of Energy). However, Russia will be required to reduce its production by 0.23 mb/d from 11.41 mb/d recorded last October based on the joint production cut agreed by OPEC and non-OPEC producers last December to prop up plummeting oil prices (combined reduction of 1.2 mb/d from January 2019). Russia's reduction will be even larger as it produced 11.45 mb/d in December, and it is not clear whether this will be achieved.

The IMF's World Economic Outlook dated January 21 projects that Russia's GDP growth rate will generally remain flat at +1.7% in 2018, +1.6% in 2019, and +1.7% in 2020 (revised downward from the IMF projection as of October 2018). The projections have been lowered presumably due to weaker oil prices and problems in the fundamentals of the Russian economy.

Parts of the United States government are moving to lift the sanctions on Russia. On December 19, 2018, the Office of Foreign Assets Control (OFAC) of the US Department of the Treasury conveyed to Congress plans to lift the Ukraine-related economic sanctions within 30 days on Russian aluminum giant RUSAL, in which Russian oligarch Oleg Deripaska holds direct and indirect stakes, and its major shareholder and mega resource company En+ Group and its subsidiaries. This is because RUSAL swiftly responded to the requirements of the US Treasury Department, which the Department appreciated. Further, on January 4, Tass and others reported that the ambassadors of Austria, France, Germany, Italy, Sweden, the United Kingdom, and the EU to the United States had sent letters to US lawmakers requesting that the sanctions be lifted, noting that the sanctions on RUSAL, En+ and its subsidiaries affect jobs in the European aluminum industry.

However, there is persistent opposition to Russia within the US Congress and the future remains uncertain. The lifting of the sanctions had been deliberated in the Republican-led Senate in January, but the motion to end the deliberations was voted down on January 16, and so the deliberation on ending the sanctions could not proceed to a vote. Further, on January 17, the House of Representatives passed a bill blocking the lifting of the sanctions. Due to these circumstances, OFAC had extended the waiver of sanctions on RUSAL and the En+ Group and its subsidiaries by one week to January 21 and then to the 28th, but on January 27, announced the lifting of the sanctions on these companies. This marks the first time since the start of the sanctions in 2014 for world-renowned companies to be removed from the sanctions list.

Leading German business newspaper Handelsblatt reported that US sanctions may be imposed not on Nord Stream 2 AG, the project owner under Gazprom, but the European companies which lay the Nord Stream 2 gas pipeline that connects Russia and Germany via the Baltic Sea (Swiss Allseas Group and Italian Saipem). The US Congress is also deliberating a bill that would impose even tougher economic sanctions on Russia. Under such circumstances, Japan and Russia held the 25th summit between them on January 22 to discuss the signing of a peace treaty, bilateral cooperation, and the international situation. The course of US economic sanctions on Russia deserves attention as they could also impact Japan-Russia negotiations.

(as of 1/28/2019)

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)

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