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Geopolitics over Russian Energy Supply and Division of International Energy Market

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This week, I had opportunities to deepen discussions on the growing destabilization of the international energy situation under the Ukraine crisis and the fate of Russian energy supply holding the key to the destabilization through a webinar sponsored by the Institute of Energy Economics, Japan, and my talks with other experts. I also exchanged views with other energy experts on the geopolitical situation regarding the divide between the "China-Russia bloc" and Western countries and their relations with new "third pole countries", which may have great influence on the international energy order. In the following, I would like to make comments on some impressive points regarding these matters.

First, I felt that great destabilizing factors remain in the international energy situation towards the coming winter. Recently, crude oil and European natural gas prices have followed a downtrend. On September 7, the key crude oil futures price fell to $81.94 per barrel for West Texas Intermediate, the lowest since January, and to $88.00/bbl for Brent, the lowest since February. The benchmark European gas price sank to less than $70 per million British thermal units from a record high close to $100/MMBtu. The price was still very high, translating into some $400 per barrel of oil equivalent. However, the downtrend is clear. Nevertheless, future trends are difficult to predict.

Concern above global economic deceleration has exerted downside pressure on crude oil prices. Particularly, concern has grown about a Chinese economic slowdown. If Chinese oil demand weakens after driving up global demand, downside pressure on oil prices may increase. On the supply side, Iranian oil may come back to the international market, depending on progress in U.S.-Iran negotiations on a nuclear deal. This may work to push down oil prices. Considering these factors, the OPEC-plus group of oil-producing countries at its meeting on September 5 decided to cut oil production by 0.1 million barrels per day from October, offsetting a 0.1 million bpd increase agreed at the previous meeting. The group including Saudi Arabia apparently sent the market a message that it would not hesitate to cut production in response to oil price falls.

However, concern about Russian oil supply has become a destabilizing factor for the international oil market. On September 2, the Group of Seven industrial democracies at their online meeting decided to introduce a cap on Russian oil prices on December 5. The Russian oil price cap was proposed by the United States at a G7 summit in Germany in late June for the apparent purpose of preventing oil supply disruptions while suppressing Russian oil revenue. While the date for introducing the Russian oil price cap has been set, details of the cap are left for future negotiations. How China and India subject to the cap would react to the G7 action is still unknown. Russia's reaction is even more important regarding the stability of the international oil market. In an immediate warning, Russia has indicated plans to suspend oil supply to countries participating in the cap. If Russia implements such oil supply suspension, crude oil supply may decline substantially in a manner to push up crude oil prices. The international oil market may grow nervous about the Russian oil price cap towards the coming winter.

The Russian gas supply issue is more complicated and serious. The European gas market is plagued with Russia's reduction and suspension of gas supply through the Nordstream pipeline. Russian gas supply disruptions and subsequent gas and electricity price hikes and gas shortages may seriously affect the European economy and civic life. The gas issue has become the biggest geopolitical energy issue between Europe and Russia. A factor behind Russia's offensive using gas supply cuts and suspensions may be that oil export revenue, which is dominant in Russia's energy export revenue, is and will remain allowing Russia to exploit its gas supply for exerting pressure on Europe. This is an attention-attracting point. If Russian gas supply is disrupted, the benchmark European gas price may shoot up beyond the earlier record high. In the coming winter, Europe may consume all gas inventories, forcing the European gas market to remain structurally vulnerable in 2023. The fate of Russian gas and oil supply towards the coming winter will be a big destabilizing factor for the international energy market.

Second, I would like to point out an issue regarding the division of the international energy market. Russian energy embargo participants buy non-Russian energy sources at inflated market prices, while non-participating countries procure Russian energy sources at discount prices. In this way, the international energy market is divided into two over Russian energy supply. The division between Western countries and the "China-Russia bloc" has thus been apparent in the energy market. Other or "third pole countries" are positioned to to decide if they join either of the two poles or not. "China-Russia bloc" countries could exploit energy supply as leverage for enhancing or maintaining strategic cooperation. This could be combined with developing countries' discontent with developed countries over the escalation of the north-south confrontation involving the climate change issue, as well as various views and stances about democracy, freedom and other Western values, to deepen the division of the world and make the geopolitical environment severer for Western countries. Even Western countries could be divided. In the face of the potential energy crisis towards the coming winter, European countries could fail to keep in step in dealing with Russia. If European countries pursue "me-first policies" in securing stable energy supply, they may lose their solidarity. Russia for its part may take advantage of their loss of solidarity to shake the Western bloc. If the division of the world grows structural or deepens amid the difficult international energy and geopolitical situations, relevant issues may be complicated further and become more difficult to resolve.

Third, I would like to note that trends in China as the world's largest energy-consuming and -importing market will attract growing attention in the future. If grave disruptions to oil or gas/LNG supply come, the degree of destabilization in the energy market may depend on what actions China would take in procuring energy sources. How much Russian energy China would procure in the international energy market to be divided further may determine the energy volume available for other major energy-consuming countries including Western nations. Future economic growth in China that retains the so-called "zero-corona" policy may also attract attention. Along with China's initiatives to expand domestic fossil fuel production, the degree of its economic growth may exert influence on its energy imports and on the supply-demand balance in the international energy market. If Russia as China's strategic partner loses its power in the long run through Western economic sanctions amid the Ukraine crisis, such development may work to the disadvantage of China that faces competition with the United States. If the unity of Western countries including the United States and European countries is enhanced through their response to the Ukraine crisis, it may also affect China. What strategies China would adopt for Russia and "third pole countries" in dealing with the United States or Western countries may become a significant issue for the overall international situation and a factor to exert great influence on energy geopolitics.

While watching the international energy situation and geopolitical environment amid the Ukraine crisis, Japan will be required to develop its domestic and external strategies regarding the roles that it should or could play to protect its energy security and stabilize the world.

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