Tense Ukraine Situation and Its Impacts on Energy Market

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Rapidly growing tensions in Ukraine have attracted global attention. The Ukrainian government collapsed in late February as President Viktor Yanukovych left the country amid his government's escalating dispute with rebels. An interim government came into being in the capital city of Kiev, relieving pro-Russia Yanukovych of the presidency. While the pro-Western interim government is based in western Ukraine, people sympathetic to Russia are abundant and influential in the eastern and southern (Crimean peninsula) parts of the country. In this way, Ukraine is not united. Various destabilizing factors are mixed at political, economic and social levels.

Russia, which has positioned Ukraine as a cornerstone of its security, could not ignore the government change. Geographically, Ukraine borders Western Europe, sandwiched between the European Union and Russia. The Russian Black Sea Fleet is based in Sevastopol on the Crimean peninsula. Russia has thus had significant, special relations with Ukraine. In such a key country, the pro-Western government has replaced the pro-Russian president. Russia might have concluded that this development represented a grave threat to its security. As a result, Russian forces stationed on the Crimean peninsula have put local government, airport and other key facilities under control despite strong opposition and checks from the United States and Europe as well as the interim government, taking effective control of the peninsula by March 3, as has been reported.

The interim Ukraine government and Western countries raised strong opposition to the Russian military intervention. U.S. State Secretary John Kerry called Russia's troop movements into Ukraine an "incredible act of aggression." Russia for its part has described its action as required for protecting Russian residents, and, as requested by the (legitimate) Ukrainian (Yanukovych) government, maintaining a confrontational attitude against Western countries.

To counter the Russian action, Western countries have threatened to boycott a preparatory meeting for Group of Eight summit that Russia will host in Sochi in June and to impose economic sanctions on Russia. They have even indicated excluding Russia from the G8. The Ukraine situation has rapidly grown tense on Russia's military intervention, Western countries' opposition and an escalating exchange of accusations between them. Some observers now see U.S.-Russia relations as
the worst since the end of the Cold War and fear that the United States and Russia could revive the Cold War. Given that future Russian actions are very uncertain, the world is breathlessly watching the Ukrainian situation.

The Ukrainian crisis has shaken the international energy situation. As a revival of the Cold War is feared, the market has begun to respond to geopolitical risks. The Brent crude oil futures price rose from $109.02 on February 28 to $111.20 on March 3. While international oil market supply and Russian crude oil supply to East European countries via Ukraine have remained unaffected, a growing sense of risk has apparently exerted an impact on the market.

A problem that is likely to grow more significant in the energy market is related to Russian natural gas supply. Europe is the largest natural export market for Russia and depends on Russia for about a quarter of its natural gas imports. Some pipelines for Russian natural gas exports to Europe avoid Ukraine, including the Nord Stream pipeline opened in 2011. But most Russian natural exports to Europe go through Ukraine.

In January 2009, Russia actually suspended pipeline gas supply for a short period of time amid a gas dispute with Ukraine. As the Ukrainian situation has grown tense, energy market players have begun to pay attention again to how Russian gas exports via Ukraine will be affected. Since this winter has been rather warmer than in past years, no special problems have so far emerged with European gas supply and demand, with inventories remaining at high levels. As noted above, gas supply routes to Europe avoiding Ukraine have been developed. Given economic rationale and reputation risks, Russia is rather unlikely to suspend gas supply again. Nevertheless, concerns over Russian gas supply risks have attracted attention in the market due to the rapid developments in Ukraine and future uncertainties. In this respect, Russia has indicated a plan to cancel a discount for gas sales to Ukraine that had been agreed under the previous Ukrainian government, attracting attention from energy market players.

Another point to which we should pay attention is the impacts of the Ukrainian crisis on Russian energy trade and investment. Future developments are very uncertain with no optimism justified. If Western countries actually impose economic sanctions on Russia, various impacts may emerge on Russian energy trade and investment. Russia has exported energy resources primarily to Europe. Over recent years, however, it has expanded oil and LNG exports to the Asian market including Japan. As Russia is considering investment in various strategic energy projects for the Asian market, Japan will have to closely watch future developments regarding Ukraine and their impacts on the energy market.

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