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Discussions on Oil Price Decline, Ukraine Crisis and Energy Transition

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On November 17 to 19, I had an opportunity to exchange views with energy experts in Europe on a wide range of topics. I talked with various people at various locations on a variety of topics. Eventually, I and my discussion partners covered a host of topics according to their interests. I here would like to summarize discussions on four interesting topics for me: (1) recent oil price falls, (2) the Ukraine situation and energy security, (3) Europe's energy transition challenges and (4) futures prospects for the Asian liquefied natural gas market.

On the first topic of oil price falls, it was interesting for me to find that factors behind the recent price falls include not only the frequently cited loosening supply-demand balance but also an alleged "conspiracy" in which many of my discussion partners were deeply interested. The allegation includes the idea that the United States and Saudi Arabia have conspired to bring about an oversupply in the oil market for the purpose of lowering oil prices to economically affect specific countries (e.g. Russia) dependent on high oil prices. My view is that the crucial factor behind the falling oil prices is the loosening supply-demand balance that has resulted from the supply and demand sides' responses to high oil prices since 2011, including expanding non-OPEC oil supply as represented by, inter alia, growing U.S. shale oil output, as well as slackening demand. But the deep interest indicated by some of my discussion partners in the conspiracy theory demonstrates that major actors in the international oil market can influence international politics, the world economy and geopolitics. This means that energy problems are closely linked to political and economic problems in the present world.

In this respect, market players are paying attention to a general meeting of the Organization of the Petroleum Exporting Countries on November 27. What are the ideas or strategies of major OPEC members for the meeting? How will Saudi Arabia as a key OPEC member lead the meeting? While various remarks on the oil price falls and responses to the problem have been reported from Saudi Arabia, no clear direction for the oil kingdom has been indicated. The absence of any clear direction itself is unusual in a sense, attracting attention from market players. Saudi Arabia's oil policy decision will be a key point for anticipating crude oil prices in 2015.

As for the Ukraine situation as the second topic, I felt that European energy experts were heightening sensitivity to recently growing tensions. In eastern Ukraine where a ceasefire agreement in September has prevented the situation from deteriorating further, the recent escalation of fighting and concern about Russian forces' involvement into the region have indicated signs of destabilization again. The recent Group of 20 Summit in Australia highlighted the Ukraine problem. Some of my discussion partners believe that no optimism can be warranted about the future situation as a recent agreement on Russian gas supply to Ukraine has fallen short of providing any ultimate solution. The European Union's stress tests to simulate a disruption in Russian gas supply have provided a message that European countries could manage the relevant problems through EU-wide cooperation. Through the discussions, however, I felt that the stress tests led by the European Commission have not necessarily cleared concern about the degree or seriousness of the possibility of the real impact of a gas supply disruption. One of my discussion partners noted that energy security has apparently become a top priority challenge for Europe.

On the third topic of Europe's energy transition, I felt that expectations and problems are mixed concerning the transition from the present energy supply system through the promotion of renewable energy to a new system that would be low carbon and resilient in energy security. The EU's recently announced climate and energy targets for 2030 include a 40% cut in greenhouse gas emissions from 1990, an increase in renewable energy's share of final energy consumption to 27% and a 27% primary energy consumption cut through enhanced energy conservation, emphasizing again the need for the energy transition. In each European country, political groups promoting renewable energy are still present and firm, forming a strong backbone for the energy transition. But steep electricity cost hikes and rising economic costs through the diffusion of renewable energy in Germany and Spain have led Europe to pay attention to energy and economic competiveness as well as energy security based on the concerns over Ukraine crisis. In the actual European market, coal consumption has expanded thanks to its economic competitiveness in a manner running counter to the transition, indicating a chaotic situation regarding the transition. At the same time, however, an interesting view presented at the discussions was that given the U.S.-China agreement on GHG emission reduction targets at the recent annual Asia-Pacific Economic Cooperation summit, the transition could be driven again depending on international agreements and discussions at the 21st Conference of Parties to the U.N. Framework Convention on Climate Change.

The last topic was the Asian LNG issue. Although the issue might have been seen as a topic to which Europeans would be rather indifferent, my discussion partners in Europe were deeply interested in the issue. Particularly, they gave various arguments about the recent China-Russia gas agreement and its impact on the Asian LNG market. Russia has recently agreed to provide gas to China from western Siberia in addition to eastern Siberia. Russia's expansion of gas supply to China is a matter of concern to Europe that depends on Russian gas supply. My discussion partners noted that the expansion of Russian gas supply to China would ease the supply-demand balance in the Asian LNG market and that their gas price agreement and U.S. LNG prices could become "reference prices" for the Asian market. Their view is that despite various uncertainties, the supply-demand balance is likely to ease through 2020, opening a large window of opportunity for Asian LNG consuming or importing counties. They also pointed out that the recent crude oil price falls, while benefitting LNG consuming and importing countries by lowering LNG import prices linked to crude oil prices (though with some time lag), could delay LNG project launches and affect advantages of a plan to introduce an LNG pricing system linked to U.S. Henry Hub prices. It was also interesting for me to hear a concern that the windfall benefit of LNG price drops emerging from crude oil price falls may discourage market players from trying to make LNG procurement more competitive. The international energy situation is continuing to change. It has grown even more important for us to analyze the background and implications of such change and enhance our foresight for future developments.

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