

## **Discussion at the Sakhalin Oil & Gas 2015**

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On September 28 and 29, I had an opportunity to participate in a conference titled Sakhalin Oil & Gas 2015 in Yuzhno-Sakhalinsk (the conference lasted from September 28 to October 1). Attending the 19th conference on Sakhalin oil and gas issues were senior Sakhalin state government officials, energy officials from the Russian federal government, Russian oil and gas industry representatives such as those from Gazprom and Rosneft, delegates from international oil companies such as Royal Dutch Shell and ExxonMobil, and energy experts from Japan, China and other countries (there were more than 600 registered participants, according to the conference organizer). As indicated by the title of the conference, major topics included the present situation of and outlook for oil and gas development in Sakhalin and the roles of Sakhalin oil and gas resources in the Asia-Pacific market. I returned home when the conference was still ongoing, failing to cover some part of the conference. But I would like to summarize impressive points of discussions made during my participation in the conference.

The most impressive point was that bullishness and bearishness as well as hopefulness and fearfulness were mixed about the future outlook of Sakhalin oil and gas development among Russian stakeholders. The bullishness and hopefulness side is based on the past results and achievements. In the past 20 years since full-fledged Sakhalin oil and gas development started, Sakhalin has realized Russia's first liquefied natural gas exports, substantially expanded crude oil exports and contributed much to increasing Russia's presence in East Asia including Japan, China and South Korea. Sakhalin oil and gas development has brought about massive tax revenues for the Russian federation and Sakhalin State, making great achievements regarding the vitalization of the local economy and social contributions.

The presence of rich, competitive oil and gas resources for the achievements are a key factor behind the bullishness of Russian stakeholders. Sakhalin is expected to take advantage of its existing presence in the Asian market for its further development and has become a front window for the Asian market set to drive global oil and gas/LNG demand growth. So, it is not unnatural for Sakhalin to be bullish. The key factor of Sakhalin's proximity to the Asian market, as frequently noted by Russian stakeholders, gives Sakhalin a great advantage over major competing oil and gas exporters. At a time when Japan and other major Asian oil and gas consuming countries are trying to diversify supply sources, reduce their dependence on the Middle East and increase the flexibility of supply amid uncertainties about future demand, Sakhalin's geographical proximity to the Asian market is an advantage that is potentially great.

In this sense, Russia is hopeful and bullish about its future oil and gas development and expansion into the Asian market. But the conference gave me an opportunity to feel the Russian side's bearishness and fearfulness as well. Behind the bearishness and fearfulness are the following three factors:

The first factor is the impact of Western countries' economic sanctions. While some Russian participants noted the economic sanctions would have little effect on Gazprom that procures 90% of its materials and equipment from domestic producers, an Internet poll of conference participants at the venue interestingly found that more than 90% of them expected the sanctions to have negative effects on Sakhalin oil and gas development. The poll might have reflected a concern that the sanctions could affect offshore oil and gas development equipment and technology supplies that are the key to the development while accounting for a small portion of overall procurement. The impact of the sanctions on long-term strategic projects including LNG development may be difficult to foresee, making Russian stakeholders uneasy.

The second factor is the oil price weakness. The oil price slump, the loose supply-demand balance in the international oil market as its cause and the subsequent slackness of Asian LNG market prices have very great negative impacts on overall oil and gas development projects including those in Sakhalin. At a time when major oil and gas companies are required to reduce capital spending and modify their projects, the present market environment is surely unfavorable for stakeholders in Sakhalin oil and gas development projects. Growing U.S. LNG exports, new Australian LNG projects and other competitors against Russia may also be a matter of concern to Russia. At the same time, however, relatively efficient projects can exploit the current severe situation to acquire an advantage over various rivals. In this sense, I felt that brownfield projects, including expansion (third train) of Sakhalin 2, which can utilize existing infrastructure and facilities have attracted particularly great interests and expectations. Future developments involving this and other advantageous projects may attract attention.

The third factor is concern over uncertainty in future demand in major Asian countries. When seeing substantial growth in Japan's LNG demand after the 2011 Great East Japan Earthquake, Russia's expectations grew on the Japanese market. But the Russian side has begun to recognize the possibility of Japanese LNG demand slumping depending on the restart of nuclear power plants and the implementation of the just released energy mix for the future. But China may be more important than Japan for Russia now. Projects released last year for pipeline gas exports to China via eastern and western routes have made less progress than earlier expected, although pipeline construction has started for some part of the eastern route. In addition, China's economic growth slowdown, becoming clearer since early this year, has brought about concern over future developments for Russia that had placed great expectations on the Chinese market.

In a session where I participated, I strongly felt Russia's great expectations placed on the Asian market. But no one can deny that these expectations could become difficult to be realized depending on economic growth, developments involving competing energy sources such as nuclear and coal, and competing LNG projects. Therefore, Sakhalin oil and gas development project stakeholders must correctly understand how to enhance the competitiveness of their projects, what is

happening in sales destination markets and countries in Asia and what they should do and must take appropriate responses.

Sakhalin oil and gas resources are precious assets that could bring about win-win relations between Russia as a supplier and East Asian consumers or buyers. The effective use of the precious assets is a key challenge for all of them, while there are some difficult problems such as growing uncertainties about the world economy and international relations including economic sanctions. They will have to enhance efforts and initiatives to overcome these problems.

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