

Discussions in Europe on International Oil/Gas Situation Growing Uncertain

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From May 9 through 15, I visited the United Kingdom and the Netherlands where I had opportunities to discuss European political and economic conditions and the international energy situation including oil and gas conditions. On May 13, I attended the FLAME 2019 international conference on gas in Amsterdam, giving presentations at two sessions. In the following, I would like to introduce particularly impressive arguments on the oil and gas situation in those discussions.

First, I would like to note that the discussions came as the overall international energy situation grew uncertain on turbulent developments in the world from late April to May. Regarding the international oil situation, the United States announced the termination of waivers on its Iran oil embargo for eight economies in late April and launched the full Iran oil embargo on May 2, leading geopolitical risks to rapidly grow. While Saudi Arabia and some other oil producing countries are expected to increase oil production to cover a decline in Iranian oil exports and maintain an adequate supply-demand balance, tensions regarding Iran are growing to push up crude oil prices. Meanwhile, the U.S.-China trade war resurged suddenly, leading market players to grow concerned that the two countries' race to raise tariffs would seriously affect their economies and bring about global economic deceleration. As a matter of course, this development exerts downward pressure on crude oil prices.

An interesting view given in the discussions was that the present international oil market represents an equilibrium or a tug of war between upward and downward pressure factors. Upward and downward pressure factors for crude oil prices coexist now, with their future developments or effects remaining uncertain. As a result of their equilibrium, crude oil prices have remained in a narrow range. The benchmark Brent futures price has stayed in a \$70-72 per barrel range since late April. Despite the emergence of factors that can push the market upward or downward, the price has strangely been stable. This is seen as a result of the tug of war equilibrium.

However, there is no guarantee that the equilibrium will continue. If an upward or downward pressure factor grows or is expected to grow dominant for some reason, the equilibrium may rapidly collapse to trigger a steep rise or fall. In this sense, market players will closely watch how the abovementioned two factors will change. In the face of uncertain and widely different future scenarios, the Organization of the Petroleum Exporting Countries and some non-OPEC oil-producing countries, in particular Saudi Arabia, will be required to take a careful approach as a supply/demand coordinator in the international oil market. Topics and decisions at the next OPEC meeting on June 25 and the OPEC-Plus ministerial meeting on June 26 will depend on how crude oil prices and market conditions will change towards the meetings.

There were interesting arguments about gas as well in the discussions. First, great interest was indicated in the future course of China's gas demand that has attracted attention from gas market stakeholders in the world with its rapid increase after 2017. In discussions on Asia's liquefied natural

gas market, high interest was also indicated in China's future gas/LNG demand. Gas market stakeholders agree that China's demand for gas/LNG as a clean energy source will expand. However, there are various views about the speed and extent of the expansion.

Factors influencing the speed of the expansion include economic growth as a fundamental one. The deterioration of the U.S.-China trade war will affect not only the oil market and oil prices. If China's economic growth remarkably decelerates on the deterioration, China's overall energy demand will be greatly affected. If China's energy imports including oil, gas/LNG and coal slow down, the supply-demand balance and market sentiment regarding each energy source will be greatly affected. Given that China's LNG import expansion has remained the largest LNG market driver in the past few years, any sharp fall in China's LNG import growth may exert great influence on the LNG market. Last summer, the Institute of Energy Economics, Japan, released an analysis indicating that China's economic growth could fall by 2.9 percentage points from a reference level in the worst case for the escalation of the U.S.-China trade war. In such case, LNG and oil markets may be seriously affected.

U.S. goods subject to China's tariff hikes include LNG. U.S. LNG developers might have expected to export LNG to the expanding Chinese market. However, the tariff hikes may change the situation, affecting LNG flows. In such event, procurement and supply in the world's LNG market may be required to become even more flexible.

The uncertainties about China's gas/LNG market include not only the influence of the trade war but also how fast and much China would switch from coal to gas. Behind the rapid expansion in gas/LNG demand since winter 2017 has been the switching from coal to gas mainly in industry and household sectors. In this respect, some analysts view the switching as having a great enough potential to support rapid gas demand expansion. However, others say that it may be difficult to expect demand for such switching as much as seen in the past two years, as the switching has already ended in major consumption regions or regions where such switching is easy.

In regions where the switching is difficult, a problem is whether gas/LNG can be introduced into the market competitively. Regulations as well can influence the switching from coal to gas/LNG that is required in response to serious air pollution. However, the problem of affordability or whether consumers can pay for gas/LNG instead of coal must also be taken into account. The problem is not limited to China but is more important in lower-income emerging countries in Asia including India, other South Asian countries and Southeast Asian nations. The current Asian spot LNG price level (around \$6 per million British thermal units) may be acceptable for these emerging countries. Prices close to \$10/MMBtu are seen by many analysts as difficult to accept. Asian gas/LNG demand will depend on economic growth, environmental regulations, competition among fuels and affordability in China and the whole of Asia.

There were also interesting arguments about a gap emerging between spot LNG prices and long-term contract LNG prices indexed to crude oil prices. As crude oil prices move around \$70 per barrel, long-term contract LNG prices indexed to crude oil prices are \$10-11/MMBtu. Their gap with spot LNG prices reflecting supply and demand has widened to \$4-5/MMBtu. If the gap remains at the current levels or expands further, it may affect opinions and negotiations on LNG pricing, according to an argument raised in the discussions in Europe. This argument is an interesting one based on similar experiences or events in Europe. We will have to pay attention to future developments regarding the gap.

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