

IEEJ e-NEWSLETTER

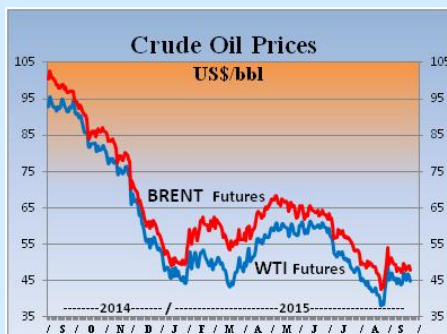
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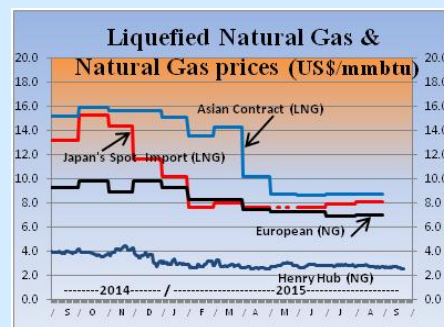
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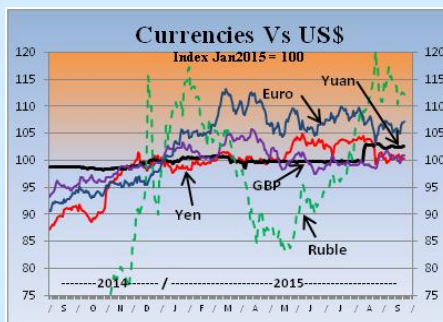
(As of September 23, 2015)



Source: Financial Times



Sources: Henry Hub NG/DOE-EIA, European NG/WB LNG spot/METI, LNG contract/WB



Source: x-rates.com



Source: Financial Times

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Summary

【World Monitoring】

1. US: Economic Policy Agenda under the Recent Market Environment

As concerns over the slowing of the Chinese economy mount, the US is seeing heated arguments over the economic policies between the Administration, the Democrats and the Republicans. Their developments must be closely monitored, particularly in view of the presidential election.

2. EU: North Sea Oil Development by the UK

North Sea oil production increased 2.5% year-on-year in the first half of 2015. Now that a major bid for oil field development is over, the question is whether the country can continue to increase output.

3. China: The "New Normal" for Energy Supply and Demand Becomes Prominent in the First Half of 2015

In the first six months of 2015, primary energy consumption increased by only 0.7% while energy consumption per unit of GDP dropped significantly by 5.9%. Decarbonization of the energy mix also advanced. The "New Normal" is becoming prominent also in the energy area.

4. Middle East: The Political Calendar for Autumn

Concerns are mounting over political stagnation until the re-election of the Turkish parliament. The US Congress remains divided over the Iran nuclear agreement. ISIS/ISIL is penetrating further into Saudi Arabia. Lebanon and Iraq are also becoming unstable.

5. Russia: Economy Worsens while the Country Stands Firm

As Russia maintains its tough stance against the West over Ukraine, the impact of the slowing Chinese economy, in addition to falling oil prices, on Moscow's overall diplomatic relations must be closely monitored.

1. US: Economic Policy Agenda under the Recent Market Environment

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The current market turmoil that began in China is also raising concerns about the outlook for the US economy, with differing views on economic policies emerging. For example, the recent US economic indexes such as consumer spending and unemployment are fairly good, but the Republican presidential candidates are attacking the Obama administration for economic mismanagement, citing the low labor force participation rate, namely the proportion of those either working or looking for work.

Conversely, while the global stock sell-off is attributed mainly to concerns about the Chinese economy, the White House is criticizing the Republican Party for destroying the policies that underpin the American economy and jobs. This criticism refers to the expiry of the Export-Import Bank charter that supports overseas investment by American companies and the failure of the Republican-majority Congress to pass the Highway Trust Fund Bill that supports public investment. Further, deliberations by Congress on the debt ceiling bill that expires at the end of October have not yet begun, raising the risk of a default by the Federal Government. These criticisms also reflect the will of the labor unions which are the traditional support base of the Democratic Party and which strongly focus on wages and jobs.

The labor unions also reacted sharply to the Chinese government's depreciation of the yuan. Lawmakers, mainly Democratic, have been urging Congress to include provisions in the TPP that ban currency manipulation by member governments. The currency depreciation by China and TPP member Vietnam has caused the unions to criticize the administration for its weak response to the currency manipulation and Democratic lawmakers to reportedly stiffen their attitude toward the TPP. The unions are also opposing the FRB interest rate hike expected within this year which could hurt both businesses and jobs, and wants it postponed. The unions are also strongly demanding a higher minimum wage, which has been the Administration's top priority since last year and which former State Secretary Clinton has included in her proposed policy.

Regarding economic policy, the Democrats advocate closing the wage gap by raising the minimum wage, public investment and subsidies, while the Republicans support the traditional approach of increasing jobs and wages by tax cuts, deregulation and economic growth. However, even the Republicans themselves are aware that this policy will not win the support of the middle class. In fact, anti-tax groups which demand Republican lawmakers to oppose all tax hikes and extreme liberals such as the Tea Party could actually be limiting the policy options of the lawmakers and restricting them.

What is the current dispute regarding the energy and environmental policy? First, the plethora of government environmental regulations that have been announced and the strong opposition against them, although the government has also been criticized by environmentalists for allowing oil development in the Arctic, making the situation complicated. Other conflicts include fossil fuels vs. non-fossil fuels, and coal vs. low-carbon fuels such as natural gas, in which winners and losers change quickly. In addition, in regions where shale and renewable electricity development has spawned a new energy industry and generated many jobs, changes have occurred in local politics. Such conflicts of interest between industries and regions have conventionally shown up in legislative activities in Congress. Recently, however, conflicts are becoming less visible due to the disruption in the deliberation of bills under the Obama Administration. With the conflicts and power balance becoming less visible even to those involved, it is understandably becoming harder for Congress to decide on an energy policy through negotiation and concession.

2. EU: North Sea Oil Development by the UK

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On August 3, Oil & Gas UK, the leading representative body of the British offshore oil and gas industry, announced that North Sea oil production increased 2.5% year-on-year in the first half of 2015. The increase is mainly thanks to the Golden Eagle field which began production in November 2014 and which added to the output of existing fields, marking the first increase in output from the North Sea oil fields in 15 years.

The UK is the EU's largest oil producer, and North Sea oil fields have supported the country's oil production. Output increased steadily since development started in the 1960s, but began to decline in the 2000s, and is currently down to a third of its peak. Despite the increase in the first half of 2015, how to maximize the reserves and production and slow the decline in production, and how to develop new deep-sea oil fields in the continental shelf, is a priority for the UK government.

With the main purpose of developing oil resources in the continental shelf, the Department of Energy and Climate Change established the Oil and Gas Authority (OGA) in April 2015. The OGA is currently part of the government body as an Executive Agency of the Department, and is in charge of issuing licenses for oil and natural gas fields both offshore and onshore, regulating the development of oil and gas fields and their production, and issuing CCS licenses.

Under the OGA, the 28th Offshore Licensing Round was held in January 2014, and in July 2015, additional winners of the round were announced. This added 41 new licenses to the 134 confirmed at the end of 2014. The licensing round comes after the Government announced a major support package in March 2015 to encourage 4 billion pounds of additional investment in the oil and gas industry, and is one of the largest rounds in the five decades since the first licensing round in 1964.

The recent fall in oil prices has put the British oil industry in a tough situation. In addition to the support package, the British government has announced a significant tax cut for North Sea oil and gas operators. The UK will reduce the petroleum revenue tax by 15% from its current level of 50% to 35%, and the supplementary rate of taxation from 30% to 20%. However, many oil companies operating in the North Sea say that a price of 60 dollars/barrel is necessary for sustainable production, and that an immediate major institutional response is necessary to encourage additional exploration in the already developed offshore areas. North Sea oil production has played a key role in raising the UK's energy self-sufficiency, but will it be re-energized by developing the new, harder-to-develop mining lots?

3. China: The "New Normal" for Energy Supply and Demand Becomes Prominent in the First Half of 2015

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On July 27, the National Energy Administration announced the supply and demand situation for energy for the first half of 2015. Together with the preliminary economic statistics report of China's National Bureau of Statistics and the electricity supply and demand report of the China Electricity Council (CEC) released earlier, it revealed the complete supply-demand situation of energy for the first half of the year.

In the first six months of 2015, primary energy consumption increased by only 0.7% year-on-year, remaining below 1% for the first time in 17 years. Electricity consumption increased by only 1.3%, the lowest since 1980. This was caused by a 0.4-point drop in the economic growth rate from the previous year to 7%, barely on track to meet the annual target¹, and a significant drop in energy consumption per unit GDP (energy-GDP intensity) of 5.9%.

How did energy-GDP intensity improve so dramatically? Let's look at energy prices. The natural gas price, which so far has been kept low by government policy, increased due to reforms, while the prices of coal, oil and electricity all dropped. For example, electricity tariffs for the industrial and commercial sector were reduced by 18 yuan per 1,000 kWh (1 yuan \doteq 18.8 yen; 1\$ \doteq 6.4 yuan) starting April 20. And yet why did energy-GDP intensity fall despite the price cut? The answer could be the fruit of Xi Jinping's economic development strategy that focuses on the "quality and efficiency of growth", which aims to shift to a value-added industrial structure, and to improve energy usage efficiency through technological innovation and better management. If we look at the industrial structure, tertiary industry, which consumes less energy per added value, has grown by 8.4%, up 2.6 points year-on-year to account for 49.5% of GDP. On the other hand, secondary industry, which consumes more energy per added value, grew by only 6.1%. According to the CEC, in addition to improved energy efficiency, pig iron and cement output decreased by 2.3% and 5.3% respectively while power consumption decreased in the electricity-intensive steel industry and in the ceramics, stone and clay industry by 6.5% and 6.4%. This helped cut the power consumption of heavy industry and overall secondary industry by 0.9% and 0.5%.

Decarbonization mainly by reducing coal consumption has also advanced significantly. In the first half of the year, coal output decreased by 5.8% year-on-year, while coal imports dropped by as much as 37.5%. As a result, coal consumption (production + net imports) is assumed to have decreased by 8.3%. In contrast, oil and natural gas consumption increased by 3.2% and 1.2%. Further, non-fossil electricity output soared by 16.0%, up 3.0 points to 22.9% of total power output. Meanwhile, thermal power output dropped for the twelfth consecutive month since July 2014.

All of the above reflect the "New Normal" for energy that was introduced in line with the "New Normal" for economic development. The Xi Administration previously pledged to its own people and other countries that it would promptly improve the atmospheric environment and reach peak CO₂ emissions. To achieve this, the New Normal must take root. The economy is exposed to more downward pressure, but the government must forge ahead with its energy policies without backtracking.

¹ Note that, based on power consumption and rail transportation indexes which were regarded as closer indicators to reflect the real economy, it is recently assumed that economic growth rate is in reality falling to lower levels.

4. Middle East: The Political Calendar for Autumn

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With the failure of all efforts by the ruling AKP to form a coalition with the opposition parties after losing a majority in the June general election, President Erdogan has called another election for November 1. The two-year ceasefire with the Kurdish rebel forces, PKK, has been broken, and terrorist attacks are occurring in many parts of Turkey. The AKP and President Erdogan's motive in calling the election is presumably to win back the seats that they have lost to the Kurdish party HDP by appealing to the mounting anti-Kurdish sentiment among Turkish citizens and thereby halting the momentum of the HDP. The election, however, is unlikely to give the AKP a two-thirds majority needed for a constitutional amendment to strengthen the president's authority, and there is concern about the possible political stagnation until the re-election.

Seizing the opportunity to improve bilateral relations brought about by the nuclear agreement, the British Embassy in Teheran reopened after four years, with UK Foreign Minister Hammond attending the opening ceremony. Americans remain divided over the nuclear agreement, but President Obama finally succeeded in preventing a rebellion by Democratic lawmakers. In Iran, the agreement is being heavily criticized in the parliament, and now, the deputies have called on IAEA Director General Amano to appear for deliberations, just like what he had done at Capitol Hill. There were rumors in the past that Israel was considering a controversial pre-emptive strike on Iran, and indeed, a recording of the former Defense Minister surfaced, revealing that strikes had been considered three times: in 2010, 2011 and 2012. The repercussions of the revelation of this story, however, are unclear. To catch up with Europe which is sending ministers to Iran, Japan sent METI Vice Minister Yamagiwa to the country to talk with the Petroleum Minister Bijan Namdar Zangeneh. Japan is now negotiating an investment agreement with the country.

In Yemen, Islamic State (ISIS/ISIL) and Al-Qaeda in the Arabian Peninsula (AQAP) are on the move, taking the civil war as an opportunity. ISIS/ISIL staged a suicide bombing attack on security forces in Asir Province in southwest Saudi Arabia, as well as destroying a temple in Syria's Palmyra Site. Meanwhile, the Saudi authorities captured a Shi'ite activist in Lebanon as the main perpetrator of the 1996 Khobar Towers bombing. where a legitimate president has been absent for over a year, the Salam Government has experienced tremendous pressure from the citizens stemming from a garbage collection crisis. In Iraq, Prime Minister Abadi is showing his readiness for political reforms following wide spread anti-corruption demonstrations. The decision to extend the presidential term of the Kurdistan Regional Government has intensified the conflict between the two main rival Kurdish parties, making the situation even more fragile for the Iraqis to deal with.

Concerns are mounting about the damage to the Middle East economies should oil prices fall further. Saudi Arabia, which is expecting a much bigger financial deficit than when the budget was drafted, plans to weather the crisis by issuing 20 billion riyal (660 billion yen) of government bonds in August. However, considering the need for domestic countermeasures against ISIS/ISIL, financial assistance to other countries, and the cost of military intervention in the civil war in Yemen, the country might eventually make a drastic change in policy to restore oil prices.

5. Russia: Economy Worsens while the Country Stands Firm

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Russia's economy continues to worsen. On August 10, the Russian Federal State Statistics announced that the country's GDP for Q2 of 2015 dropped 4.6% year-on-year, falling even further from minus 2.2% in Q1. The average wage and disposable income in July dropped by 9.2% and 2% year-on-year in real terms, respectively (preliminary figures). Since the beginning of August, the Russian crude oil (Urals) price fell to the 40 dollars/barrel range for the second time this year, and a further downward plunge of the economy is becoming likely. As of August 25, the ruble has fallen to around 70 to the dollar, down almost 50% from 36 rubles in March 2014 before the Ukraine crisis, and is approaching its lowest point for the year. Inflation for the first half of 2015 is running at 16%, and the impact of the economic slump is spreading to public life.

The oil and gas sector, which provides the foundation of the Russian economy, is also struggling. On August 12, the IEA announced that Russian oil output for July, including condensate, dropped by 75,000 barrels/day from the previous month to 10.65 million barrels/day, and forecasted that the pressure to cut production will become stronger toward 2016 due to falling oil prices and the West's sanctions. Further, due to declining domestic and overseas demand, Gazprom's natural gas output dropped to 205.2 billion m³ for the first half of 2015, falling 13% year-on-year and marking the lowest level in the company's history, according to the Ministry of Economic Development. Further, the falling oil prices are hurting the company's profits as its gas export price for the European market is still largely oil-indexed.

On July 29, the UN Security Council adopted a resolution to establish a special court to prosecute those responsible for the shooting down of Malaysia Airlines MH17 last July, only to be vetoed by Russia. Although Moscow has been insisting unilaterally that there is no evidence of involvement by pro-Russian forces in Ukraine's eastern regions, this veto shows that Russia has no intention of helping the West investigate the case. Meanwhile, the battle between the Ukrainian government and the pro-Russian forces has been intensifying in the area since early August, making it increasingly unlikely that the Second Minsk Agreement, requiring the resumption of the Ukrainian government's control of the national border between eastern Ukraine and Russia, to be implemented by the end of 2015 .

President Putin has maintained his uncompromising stance against the West, and is attempting to warn the West by strengthening ties with China. However, the slowing Chinese economy may hamper his plan in unforeseen ways. The "Asia Shift" advocated by the President cannot be achieved without huge investment in the Russian Far East, including the energy sector. However, due to the slowdown, the Chinese government and companies might lower the priority of Russian projects in the near future. Indeed, the agreement to build a gas pipeline connecting the Russian Far East and China, which attracted global attention in May 2014, has ground to a halt and gas exports by the pipeline may not even start within this decade. We must closely monitor not only how falling oil prices but also the change in economic relationship between China and Russia may affect the Ukrainian question as well as Russia's overall diplomatic relations.

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