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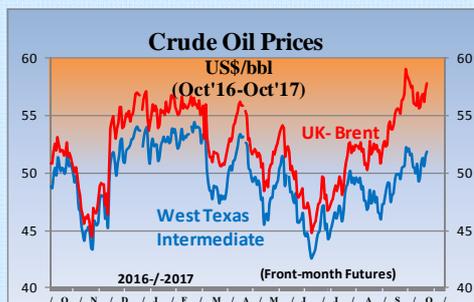
No. 121

(Based on Japanese No. 169)

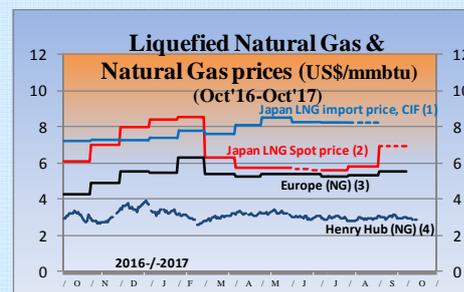
Published: October 18, 2017

The Institute of Energy Economics, Japan

(As of October 16, 2017)

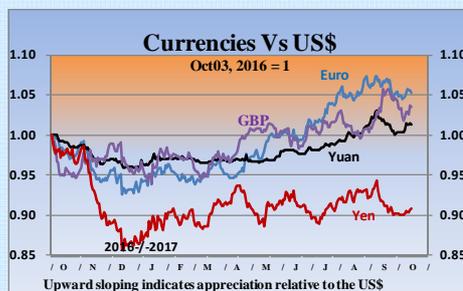


Source: DOE-EIA, NASDAQ



Sources:

- (1) Ministry of Finance "Japan Trade Statistics"
- (2) Ministry of Economy, Trade and Industry (contract month basis)
- (3) Estimated by World Bank and World Gas Intelligence
- (4) DOE-EIA, NYMEX (Front-month Futures)
- (5) Investing.com



Source: x-rates.com



Source: Financial Times

Contents

【World Monitoring】

1. US: DOE Releases a Report on the Electricity Market
2. EU: State of the Union Address of the EU, and the German Election
3. China: BRICS Xiamen Summit and Response to North Korea Issue
4. ME: Further Regional Tension Resulting from the Kurdish Independence Referendum
5. Russia: Russia under a Spotlight amid the North Korean Crisis



Summary

【World Monitoring】

1. US: DOE Releases a Report on the Electricity Market

The United States Department of Energy released a report on the electricity market and supply reliability. Attention must be paid to the direction of policy discussions, including the design of the system for maintaining baseload power sources in the future.

2. EU: State of the Union Address of the EU, and the German Election

The State of the Union Address of the EU highlighted the importance of completing the Energy Union and fighting climate change in the energy area. In the German general election, the ruling CDU/CSU became the dominant party, but is expected to struggle to form a coalition.

3. China: BRICS Xiamen Summit and Response to North Korea Issue

The BRICS Summit in Xiamen was a success. China voted in favor of additional sanctions on North Korea, but is calling for resolution through dialogue. Meanwhile, experts have begun to express the need to prepare for a military emergency in North Korea.

4. ME: Further Regional Tension Resulting from the Kurdish Independence Referendum

The Kurdish independence referendum threatens to destabilize the region. The hardline US policy against Iran will draw a sharp reaction from the country. ISIS/ISIL is weakening, but still has a bridgehead in Libya.

5. Russia: Russia under a Spotlight amid the North Korean Crisis

Russia and China have taken a careful approach toward the UN sanctions against North Korea, but have conflict of interests addressing national security environments. Russia's diplomatic attitudes must be closely monitored.



1. US: DOE Releases a Report on the Electricity Market

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At the end of August, the Department of Energy (DOE) released the Staff Report to the Secretary on Electricity Markets and Reliability. The report was written based on Secretary Perry's instructions to analyze the impact of the closure of baseload power sources on power supply stability. The report initially raised concerns that it will be used as a basis for accusing environmental regulations of blocking investment in power facilities and demanding their abolishment, or contain extreme policy proposals such as demanding the abolition of measures to accelerate the introduction of renewable energies. However, after its release, the report was welcomed for being well-balanced according to the American Petroleum Institute, as an objective analysis based on comprehensive information, though without new findings. Although the US and Japanese electricity markets differ in many ways, the report contains interesting insights for Japan, where institutional reforms are underway.

Regarding changes in the market environment that were not foreseen in the 1990s and the early 2000s when markets were liberalized, the report named: (1) the expansion of natural gas-fired generation prompted by low-cost and abundant domestic supplies and environmental friendliness, (2) the growth of renewable electricity supported by subsidies and falling costs, (3) slower growth in electricity demand associated with changes in industrial structure and progress in energy conservation, and (4) the consequent drop in wholesale electricity prices and the resulting difficulty in recouping investments faced by electricity producers.

Regarding the growing percentage of gas-fired generation, Northeast-based independent grid operator PJM has pointed out the risk of relying too heavily on certain energy sources. On the other hand, the report points out that policy-led diversification of power sources will not necessarily result in a stable power supply unless it is carried out integrally with fuel assurance. For instance, gas-fired generation plants, which are becoming increasingly important as a back-up for renewable generation, usually obtain gas supplies on demand from the gas mains network to which they are connected. However, there have been several cases where plants could not get hold of the required amount due to gas shortages in the market during extremely cold weather or gas mains accidents despite having supply contracts, resulting in power shortages. Thus, the report points out the need for contractual guarantees for procuring fuel in accordance with power demand fluctuations, a scheme for adequate compensation for on-site fuel storage by wholesale energy markets, and further coordination between the power grid and the mains network.

The report further points out, regarding federal and state subsidies and purchase programs for certain fuels, that such policies distort the relative pricing of fuels and generation technologies and negatively impact plant investment and consequently the generation mix, as already discussed in the technical conference of the Federal Energy Regulatory Commission



(FERC). To resolve the difficulty of making plant investments, capacity markets have been introduced in several liberalized regions to allow retailers to trade supply capacity while meeting supply assurance obligations. However, the report states that capacity markets have not earned enough revenues to ensure the construction of facilities necessary for supply assurance.

The report points out that many issues including the above have been known for several years, suggesting a delay in response, but does not offer actual advice. However, now that President Trump has filled its vacancies, the FERC has reportedly begun to make institutional adjustments since September so that baseload power sources will be priced sustainably in the wholesale market. The US has used wide-ranging options to deal with changes in market conditions, including a freeze and withdrawal of liberalization. The process of revising liberalized electricity and gas market systems must be closely monitored as a precedent for others.



2. EU: State of the Union Address of the EU, and the German Election

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On September 13, European Commission President Jean-Claude Juncker delivered his annual speech on the State of the Union for 2017, and outlined high-priority policies for the coming year and his prospects for a deeper union of the EU by 2025. Regarding energy, he referred to the completion of the Energy Union in the context of completing the initiatives implemented so far. Further, as one of the five proposals of particular significance, he mentioned the fight against climate change, commented that "Set against the collapse of ambition in the United States, Europe will ensure we make our planet great again," and said that a proposal for reducing carbon dioxide in the transport area will be released soon. In his address, President Juncker indicated an agenda for "a more united, a stronger, a more democratic Europe". This lists all the European Council and unofficial meetings and their agendas from now up to the end of March 2019 when Britain will officially leave the EU. Future energy and climate policies, including the future of the EURATOM (European Atomic Energy Community) Treaty, are planned to be discussed in the European parliament in around June 2018.

The cornerstones of the EU's future are without question Germany and France. In Germany, a federal election, which is held in principle just once every four years, was held on September 24. The election campaign focused on the center-right Christian Democratic Union (CDU)/Christian Social Union (CSU) and the center-left Social Democratic Party of Germany (SPD) which have taken turns in power in post-war Germany and which, being part of a grand coalition, could not present clear policy differences. The election was won by the ruling party led by Chancellor Merkel, with CDU/CSU winning 33% of the votes and SPD 20.5%, but the percentage of votes for the former was the lowest since 1949. In 2017, the focus of national elections in European countries has been the rise of ultra-right parties with anti-immigration and anti-EU policies. The equivalent party in Germany is Alternative for Germany (AfD), which so far has won seats in State Parliaments but not in the Bundestag, as elections had not been held. In this election, AfD won 12.6% of the votes and thus leapt to become the third-ranking party. With SPD reluctant to form a grand coalition with CDU/CSU, the negotiations for coalition will focus on smaller parties. However, as the smaller parties have very different policies from those of CDU/CSU, the coalition negotiations are expected to face difficulties.

However, the energy policy of Germany may not be affected so strongly by the election results. Germany is already pursuing an energy transition policy, and its policy to phase out nuclear power is set in law (the 13th Act to Amend the Atomic Energy Act). With all parties excluding AfD advocating increasing renewable energy and moving away from nuclear power, a great shift in energy policy is unlikely. One of the criticisms against Chancellor Merkel is not working hard enough on preventing air pollution due to her strong ties with the auto



industry. Accordingly, the Chancellor established a 500 million-euro air pollution prevention fund on September 4, and also revealed plans to double the exhaust reduction budget in urban areas to 1 billion euros to avoid a ban on diesel vehicles in those areas. If Chancellor Merkel wins another term, it will be interesting to see how she demonstrates Germany's presence in the environment and climate areas in comparison with France.



3. China: BRICS Xiamen Summit and Response to North Korea Issue

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On September 4, a summit meeting of five emerging economies, namely Brazil, Russia, India, China, and South Africa (the BRICS), was held in Xiamen in Fujian Province, China. On the next day, the 5th, a meeting of "BRICS Plus" was held, joined by the BRICS leaders plus the leaders of Mexico, Egypt, Tajikistan, Guinea and Thailand. This BRICS summit marked the ninth, with the member countries taking turns in hosting it, but the meeting of "BRICS Plus" was the first, and came about at China's initiative.

In both meetings, President Xi Jinping stressed the importance of a deeper BRICS partnership and stronger ties between the BRICS and developing countries in global governance. In both the BRICS Leaders Xiamen Declaration adopted on the 4th and the presidential statement on the "BRICS Plus" dialogue issued by the host country on the 5th, the leaders emphasized the importance of an open global economy and a free trade regime, and clearly opposed protectionism. Regarding the prevention of global warming, positioning climate change as a common challenge for the international community, the leaders called on countries to adhere to the principle of equity, common but differentiated responsibilities, and respective capabilities, and to fully implement the Paris Agreement. The leaders also stated that developed countries need to ramp up financial assistance and technological and capacity building support for developing countries. All these messages strongly reflect China's stance toward global governance.

The BRICS Xiamen conference thus closed successfully for China, but for the Xi leadership which is heading into the five-yearly National Congress of the Communist Party of China (the 19th) in October, a foreign affairs problem remains, namely the issue regarding the development of nuclear and missile technology in North Korea.

China's stance on North Korea has three principles: (1) Denuclearization of the Korean Peninsula, (2) maintaining peace and stability, and (3) peaceful resolution through dialogue and discussion. To achieve these, China is calling for a "double suspension," demanding that North Korea suspend its nuclear and missile activities in exchange for the suspension of US-South Korea military exercises, while also pursuing a "dual-track" approach of denuclearizing the peninsula on the one hand and establishing a mechanism for peace and stability on the other. However, North Korea conducted a nuclear experiment on the 3rd, the day before the Xiamen Summit. China immediately released a Foreign Ministry statement expressing resolute opposition and strong condemnation, and voted in support of additional sanctions against North Korea at the UN Security Council. By supporting the strict additional sanctions, which are likely to slash petroleum product exports to North Korea by 30% and ban textile imports from the country which, combined with existing sanctions, will cut imports from the country by more than 90%, China expressed its firm resolve to denuclearize the



peninsula. In a speech at the UN General Assembly and a meeting with the Foreign Minister of South Korea, Foreign Minister Wang Yi stated that China will take all measures, including reinforced control of smuggling between China and North Korea, to fully implement the UN resolution. China also called on both the US and North Korea to exercise self-restraint, again emphasizing the need to stick to dialogue and negotiation to solve this issue.

As a result, the government's efforts for denuclearizing the Korean Peninsula are welcome, while some think that China should prepare itself for a military emergency on the Korean Peninsula. For example, Jia Qingguo, Professor of the School of International Studies of Peking University, argues that China should prepare for a possible armed conflict in the Peninsula and start talks with the US, South Korea, and others on the management of North Korea's nuclear weapons, immigration measures, and reestablishment of a political system after the current regime collapses, as well as the removal of the Terminal High Altitude Area Defense (THAAD) missile system from South Korea.¹

¹ For instance, see <http://www.zaobao.com.sg/realtime/china/story20170912-794718>



4. ME: Further Regional Tension Resulting from the Kurdish Independence Referendum

Koichiro Tanaka
President of JIME Center

Despite the concern of the international community including the UN, on September 25, the Kurdistan Regional Government (KRG) held a referendum on the Kurdish region's independence from Iraq, resulting in an overwhelming vote in favor of "independence." Nervous that the referendum might spur Kurdish independence movements in their own countries, Iran and Turkey stood by the Iraqi government in raising concerns that the referendum would undermine the unity and territorial integrity of Iraq and in turn cause damage to coordinated operations against ISIS/ISIL, but this argument was ignored. Turkey is enraged by the KRG which forced through the referendum, and is threatening penalties including shutting down the border with Iraq and imposing economic sanctions. The favorable relationship between Turkey and the KRG going back to the 1990s is now lost. Iran has also suspended the operation of civil aircraft to and from the KRG's region, and the regional government is under increasing pressure from neighboring countries.

Calling the Iran nuclear deal an embarrassment to US diplomacy, President Donald Trump took hardline stance against Iran at the UN General Assembly. Despite the IAEA's repeated confirmation of Iran's compliance with the nuclear agreement, the president tried to attract the international community's attention by likening the issue with the North Korea crisis. President Trump has been ordering various officials to review the nuclear agreement, and is rumored to be intentionally not reporting to Congress in mid-October whether he thinks Iran is complying with the agreement, raising fears that the currently suspended sanctions may be re-imposed by this act. However, the international community is generally skeptical of the US's tough posturing, as shown by the 800 million Euro investment in an Iranian solar PV project by a British company and the announcement to establish a 10 billion US Dollar equivalent credit line by China. Meanwhile, in Iran, President Hassan Rouhani dismissed President Trump's speech at the UN General Assembly as "ignorant words," and announced the successful test launch of a new 2000km-range ballistic missile, Khorramshahr, which was later found to be untrue. As provocation escalates on both sides, President Trump released a new executive order banning designated nationals including Iranians from entering the US.

ISIS/ISIL is close to losing a stronghold in Syria following the one in northern Iraq. The Syrian Democratic Forces (SDF) mainly consisting of the Kurdish militia YPG is pushing ahead with an offensive from Raqqah in the north toward Deir ez-Zur in the east. Meanwhile, alleged air-raids by Russian military aircraft on a position of the US-backed SDF have emerged, which could trigger a confrontation among the countries concerned. With Turkish President Recep Tayyip Erdogan sending in Turkish troops to Idlib in northern Syria based on an "accord" with Russia and Iran, the situation remains unforeseeable. The UN Security Council unanimously adopted a new resolution that approves investigations into ISIS/ISIL's



"war crimes." With its back against the wall, ISIS/ISIL is apparently focusing again on Libya.

Despite speculations that King Salman of Saudi Arabia will abdicate the throne to Crown Prince Muhammad bin Salman after the Eid al-Adha holidays, the king remained in his throne, at least for the time being. Iraq had once been secretly developing nuclear weapons, and in a speech at the UN General Assembly, Iraqi Foreign Minister Ibrahim al-Jaafari reaffirmed the country's interest in nuclear power, this time, for peaceful purposes. Middle Eastern countries began to provide humanitarian aid to Rohingya refugees from Myanmar. Britain agreed to provide Typhoon fighter aircraft to Qatar while the country remains under boycott from its Arab neighbors. Kuwait and Qatar began to stop renewing visas for North Korean laborers.



5. Russia: Russia under a Spotlight amid the North Korean Crisis

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After North Korea conducted its sixth and largest nuclear test on September 3, on the 11th, the UN Security Council unanimously adopted a resolution to impose additional sanctions on the country. The draft resolution submitted by the United States to the Council included an oil embargo and a freeze of Chairman Kim Jong-Un's assets, but the sanctions were eventually eased to setting a cap on oil exports. The United States made a compromise with China and Russia, which were reluctant to impose additional sanctions, reportedly to expedite the adoption to demonstrate the international community's united approach.

While China and Russia have apparently taken concerted actions regarding the North Korean crisis in the United Nations, however, they have gradually encountered conflict of interests. First, while China and the United States agree not to allow North Korea to possess nuclear weapons, Russian policymakers, including President Putin, are starting to acknowledge North Korea's possession of nuclear weapons as reasonable, citing the cases of Iraq and Libya. Whereas China views North Korea's nuclear development as a possible threat to its own national security, Moscow does not see it as a "threat" to Russia itself. Besides, unlike China, Russia is not worried about the possible influx of refugees in the event of a military emergency on the Korean Peninsula.

Second, China is deeply concerned that an arms race, including conceivable nuclearization of the other nations, in Northeast Asia should North Korea be allowed to possess nuclear weapons, whereas such argument is rarely seen in Russia. Notwithstanding that China and Russia have both expressed concerns over the plans of deploying the THAAD (Terminal High Altitude Area Defense) system by the United States Forces Korea, however, in reality, Russia does not view it as a threat to itself.

Third, Russia has increasingly regarded the escalation of the North Korean crisis as a "strategic opportunity". Since Russia's priority is centered on the European front rather than Asia, some argue that the North Korean crisis should be used as a bargaining chip to make the United States and the other countries back down over Ukraine, and that Russia should engage in brinkmanship by coming out strongly against the United States and gaining ground.

On September 6 and 7, the Third Eastern Economic Forum was hosted by President Putin in Vladivostok, attended by 350 people from the public and private sectors of Japan including Prime Minister Abe. At the Japan-Russia Summit on the 7th, in keeping with the leaders' agreement last December, five candidate priority projects were selected for joint economic



activities in the Northern Territories, and they agreed to continue the discussion. Prime Minister Abe has reportedly asked for President Putin's understanding on the need for stronger sanctions against North Korea by the international community, but virtually in vain. The world is watching Russia's diplomatic attitudes in the North Korea crisis.



Past IEEJ Events

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IEEJ Homepage Top

Back Numbers of *IEEJ e-Newsletter*

Back Numbers of *IEEJ Newsletter* (Original Japanese Version - Members Only)



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