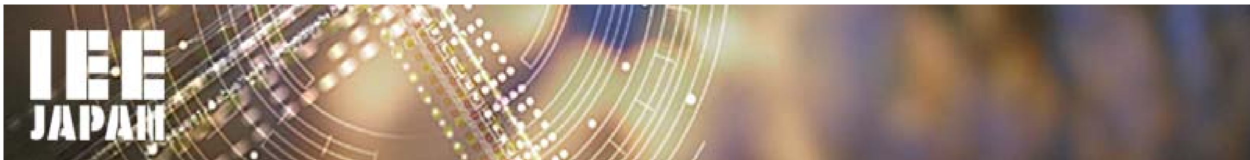

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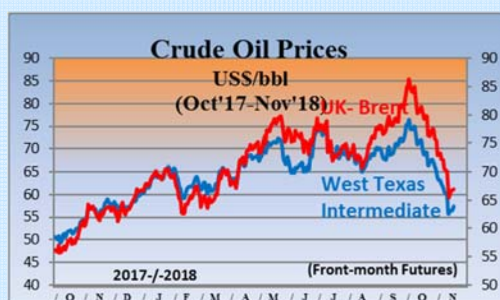
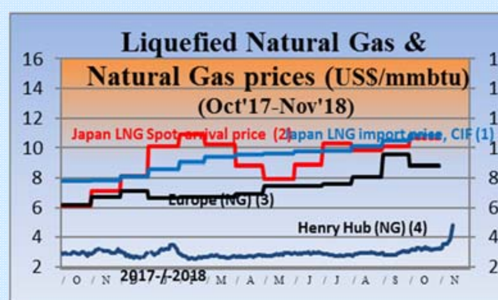


Source: DOE-EIA, Financial Times, NASDAQ



Sources:
(1) Ministry of Finance "Japan Trade Statistics"
(2) Ministry of Economy, Trade and Industry (arrival month basis)
(3) Estimated by World Bank (Netherland Title Transfer Facility)
(4) DOE-EIA, NYMEX (Front-month Futures)
(5) Investing.com

Source: x-rates.com

Source: Financial Times

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Summary

【Global Monitoring】

1. US: Repercussions of Eliminating NAFTA's Proportionality Clause

The proportionality clause that has been restraining Canada's oil exports under NAFTA was eliminated in the renegotiations, correcting the distorted market but ironically giving China access to Canadian crude at exceptionally low prices.

2. EU: Recent Moves in the Brexit Negotiations

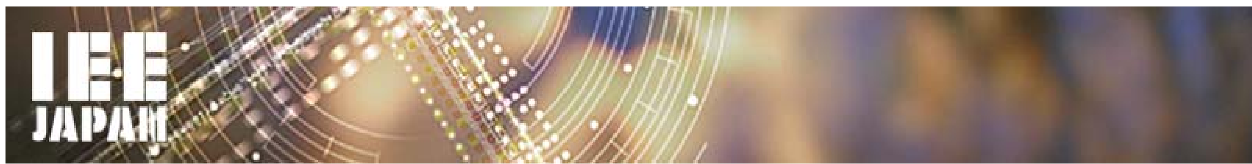
Whether the UK and the EU will agree on the terms of withdrawal remains uncertain. While a deal is expected to be reached in November 2018, all sectors including energy must prepare for a no-deal Brexit.

3. China: Raising Tariffs on American LNG: Impacts on China

China imposed an additional 10% tariff on American LNG in September. China is diversifying its supply sources and believes that it can comfortably secure a stable supply of natural gas without relying on America.

4. Russia: Economic Prospects and Investment in the Energy Department under the Economic Sanctions

The Russian government expects expanding exports to drive economic growth, offsetting slowing domestic demand. The country seeks to cooperate with foreign companies in gas, refining, chemicals and other areas not subject to the sanctions and in new LNG businesses including Arctic 2.



1. US: Repercussions of Eliminating NAFTA's Proportionality Clause

Ayako Sugino, Senior Researcher
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Ahead of the anticipated US-China summit in November to resolve the escalating trade war, on October 1, the United States, Mexico, and Canada announced the conclusion of a deal on the NAFTA renegotiations. The new agreement, titled the United States-Mexico-Canada Agreement (USMCA), is now being reviewed by Congress and its details are still undisclosed. However, in the energy area, the proportionality clause, which has been applied to both the US and Canada, is reportedly no longer in the new agreement.

The proportionality clause forbids a NAFTA oil or natural gas exporter seeking to reduce exports to another NAFTA member from changing the proportion of the exports relative to the domestic supply or changing the proportions among the exported goods based on their quality. This means that Canada, for example, cannot reduce just its oil sand production to cut its CO_2 emissions without affecting its domestic oil supply due to the quality-based constraints. Meanwhile, as these constraints do not apply to the United States which has long been a net importer of oil and natural gas, the clause has been recognized effectively as having forced Canada to prioritize its US exports before its own energy security and policy flexibility.

To circumvent the proportionality clause, Canada has been developing a pipeline connecting the eastern and western parts of the country, which has been delayed due to geographical reasons: oil is produced primarily in the western part of Canada while it is imported from the US, the Middle East, and the North Sea on the east coast. Once the east-west pipeline opens, Canada will be able to reduce its domestic supply, defined as the sum of its domestic output and imports, and in turn slash its heavy oil output which is currently maintained to meet its supply obligation to the US.

The elimination of this clause from the USMCA, a sign of US confidence in the long-term expansion of its domestic oil and gas production, will allow Canadian producers to divert their entire US-bound oil exports (3.45 mb/d as of 2017, including 2.65 mb/d of heavy oil) to other regions with better pricing conditions. China is naturally a promising destination. A plan to expand the Trans Mountain pipeline, which was built in the 1950s and has been transporting Canadian oil to the west coast Port of Vancouver in British Columbia, was announced in 2004. The plan was opposed by the provincial government in 2018 for environmental reasons, but the federal government temporarily nationalized the project to firmly support the plan.

The expansion of the pipeline and the elimination of the proportionality clause would also allow China to secure an alternative source of valuable heavy oil, which is an essential raw material for asphalt used for infrastructure construction as well as as a fuel. Canadian crude exports to China have already been soaring since July 2018 to make up for the drop in heavy oil imports from Venezuela whose output has plunged due to political unrest. Its most recent price is reportedly around $50 lower than WTI.

The proportionality clause of NAFTA, which was signed under Democrat rule in the past (but whose negotiation started under a Republican administration), may have been distorting the market in the US' favor. It is ironic that its elimination by the Trump administration corrects the market distortion and restores the natural flow of trade, providing China with exceptionally cheap and abundant crude oil supplies as a result.

2. EU: Recent Moves in the Brexit Negotiations

Kei Shimogori, Senior Researcher
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The negotiations regarding the United Kingdom's exit from the EU are struggling. The EU initially planned to call an extraordinary European Council meeting in November 2018 to make the final decision on the UK's withdrawal deal. However, at a working dinner on the UK's terms of withdrawal from the Treaty on European Union, the leaders declared their readiness to convene a European Council meeting only if and when the European Union Chief Negotiator Michel Barnier reports that decisive progress has been made. The leaders of EU member states have reconfirmed their determination to stand united on the issue of the UK's withdrawal, noting that not enough progress has been made in the discussions with the UK. This comment, together with the European Council's request to the Chief Negotiator to continue his efforts to reach an agreement in accordance with the previously agreed European Council guidelines, shows that the EU is not ready to cede ground to the UK.

Agreement apparently has been reached on a significant proportion of the withdrawal deal, with UK Prime Minister Theresa May saying 95% and the EU Chief Negotiator saying 90% of the agreement is settled. Meanwhile, both sides recognize the immense complexity of how to control the border between Ireland, an EU member, and Northern Ireland, a UK territory, which are connected by land. While the UK and the EU agree that the free movement of people and goods on the Island of Ireland should not be disrupted, the EU plans to have Northern Ireland remain in the Customs Union of the European Union while the UK thinks that this would compromise the integrity of the UK and argues that the entire UK should temporarily remain in the Customs Union. Both sides have mentioned the possibility of not reaching an agreement.

While stressing that the risk of a no-deal Brexit is small, the UK government has released guidance for many areas in case of such a situation. In the energy area, guidance has been released for civil nuclear regulation, the support scheme for low-carbon electricity generation, nuclear research, licensing and stockpiling policies for fossil fuels, and the regulatory regimes for gas and electricity trading. For instance, regarding fossil fuel-related licenses and environmental protection, the UK's existing domestic legal framework which is in line with the relevant EU Directives will be maintained. Regarding obligations on holding oil stocks, the UK will be released from its obligation under the EU Directive and will only have such an obligation under the IEA. Meanwhile, to ensure efficient electricity trading, the UK government is negotiating with Ireland and the EU to keep Ireland and Northern Ireland in the Single Electricity Market after the UK withdraws from the EU. However, it is also preparing a separate Northern Ireland market as a contingency plan in the event that the Single Electricity Market cannot be maintained.

On October 24, Prime Minister May attended the 1922 Committee of Conservative backbencher MPs and delivered a speech. The meeting reportedly proceeded peacefully and was supportive of the Prime Minister despite predictions of severe criticism. EU Chief Negotiator Barnier notified the UK that December will be the final deadline to reach a deal in order to prepare a treaty before the UK's withdrawal. Close attention must be paid to the next few months of negotiations.

3. China: Raising Tariffs on American LNG: Impacts on China

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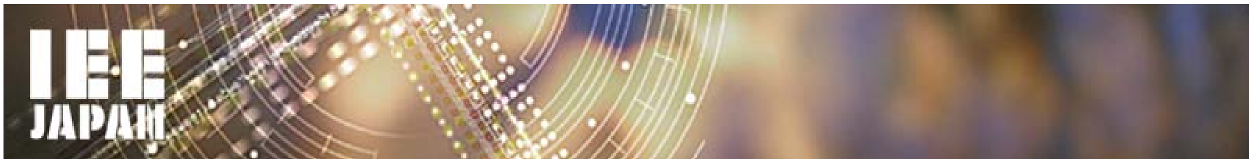
Increasing American LNG exports to China has been considered as one of the key approaches for resolving the US trade deficit with China. This is because it matches the intentions of both the Trump administration, which is determined to expand LNG exports to the global market, and China, which seeks to secure a stable supply of natural gas as domestic demand soars. However, plans have been derailed by the US-China trade war which erupted on July 6 and entered the third phase on September 24. The United States imposed a 10% additional tariff on $200 billion worth of Chinese goods, in response to which China imposed a 5 to 10% additional tariff on $60 billion worth of American goods, including an additional 10% tariff on American LNG. China was able to take this bold step because it has now almost finished securing a stable supply of natural gas.

On September 5, the State Council released "Several Opinions on Promoting the Coordinated and Stable Development of Natural Gas." The document pledges to expand domestic production, diversify the sources and modes of import and contract types, develop a pipeline network, enhance storage and emergency response capabilities, and rationalize the consumption structure. It specifies that domestic production will be expanded from 148.7 billion m^3 in 2017 to at least $200 billion in 2020. All these measures had already been included in the 13th Five-Year Plan for the Development of Natural Gas released by the National Development and Reform Commission in 2016; however, the State Council's opinions in the circular declare China's determination to achieve a stable supply of natural gas without American LNG.

According to the National Bureau of Statistics and others, China consumed 237.3 billion m^3 of natural gas and imported 92 billion m^3 (or 68.72 million tonnes, including 38.29 million tonnes of LNG) of natural gas in 2017, giving an import dependency rate of 39%. LNG imports from the US were 1.53 million tonnes, accounting for 4% of China's LNG imports and 2.2% of its natural gas imports. China's natural gas consumption (domestic output + imports) up to September this year stands at 205.6 billion m^3, up 16.7% year-on-year, while its output is 116.2 billion m^3, up 6.2%, and imports stand at 89.4 billion m^3 (64.78 million tonnes), up 34%. Meanwhile, Reuters reports that China imported 2.2 million tonnes of American LNG, accounting for 3.4% of its natural gas imports during the same period. This means that as a result of the increased tariffs, more than 2 million tonnes of American LNG imports could diminish to zero as the energy loses competitiveness and Chinese importers voluntarily withhold their purchases. Whether alternative sources can be secured merits close attention.

According to media reports, Chinese companies have signed new agreements for importing 0.45 million tonnes of LNG per year from Papua New Guinea and 3.4 million tonnes per year from Qatar. They are also accelerating talks with Russia on extending the Sakhalin-Khabarovsk-Vladivostok pipeline to China and exporting gas via the Western Siberia pipeline, as well as on expanding LNG imports from Yamal and putting the East Siberia pipeline into operation in 2019. Further, Canada's LNG Canada, in which China has a stake, made the final investment decision (FID) on export infrastructure development, and US oil major ExxonMobil has decided to export non-American LNG to China. While many of these measures will take time to boost actual supply, Chinese experts believe that China can comfortably secure a stable supply of natural gas without American LNG.



4. Russia: Economic Prospects and Investment in the Energy Department under the Economic Sanctions

Sanae Kurita, Senior Researcher
Global Energy Group 2, Strategy Research Unit

According to the forecast for the socioeconomic development of the Russian Federation to 2024 released by the Economic Development Ministry on October 1, Russia's economic growth rate will decelerate to 1.8% in 2018 and to 1.3% in 2019. Causes of the slowdown are believed to include the hike in the value added tax planned for January 2019 and tight monetary policy. However, starting from 2020, the economic growth rate will remain robust at above 2% and rise to as high as 3.3% in 2024. The Ministry predicts that while domestic demand will slow, exports of foods and chemicals will increase backed by the cheap ruble, driving growth. Meanwhile, the IMF's World Economic Outlook released on October 9 projects that the Russian economy will grow by 1.7% in 2018 (same as the July outlook) and 1.8% in 2019 (a 0.3 point upward revision from July). The IMF projects that the high oil prices and recovering domestic demand will contribute to economic growth, while structural reforms are needed to grow in the medium term. It is interesting that the IMF's projections are more optimistic than those of the cautious Economic Development Ministry.

On October 12, the US Office of Foreign Assets Control (OFAC) announced another extension of the wind-down period under Ukraine-related economic sanctions for Russian energy conglomerate En+, major aluminum company Rusal under it, and their respective subsidiaries. On the 18th, the wind-down period for Russian automaker Gaz was also extended to December 12. There are no visible moves to tighten economic sanctions against Russia now, but the US Congress is discussing further sanctions from November.

International oil and gas majors are exploring possibilities for cooperation even under the current economic sanctions in energy areas of Russia that are not subject to the sanctions. On October 19, Bloomberg cited a Russian government official as saying that ExxonMobil is considering extending the scope of an ongoing project agreement with Rosneft, which includes new cooperation in areas outside the scope of the current sanctions (natural gas, refining, chemicals, etc.).

On October 23, CEO Kirill Dmitriev of the Russian Direct Investment Fund (RDIF) said at the Saudi Arabia investment forum that Saudi Arabia is prepared to invest around $5 billion in Russia's Arctic 2 project. Arctic 2 is an LNG development project led by private gas company Novatek on the Gydan Peninsula in Northern Russia. It will have a liquefaction capacity of around 19.8 million tonnes/year, and is scheduled for the final investment decision in the latter half of 2019 and to start operating its first train by the end of 2023. In May, France's Total revealed plans to acquire a 10% stake in the business (worth $2.55 billion), and China's CNPC, the Korea Gas Corporation, and Japanese companies also have a keen interest.

Russia appears very eager to expand its LNG exports, with President Putin himself ordering the government to formulate a strategy for LNG industry development in December 2017. Meanwhile, in February 2017 Russia's Ministry of Energy released a revision to the Energy Strategy of the Russian Federation until 2035, which remains on hold, yet to gain government approval. As Russia remains without a medium- to long-term energy strategy, attention must be paid to the country's energy policies going forward.

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