



# IEEJ e-NEWSLETTER

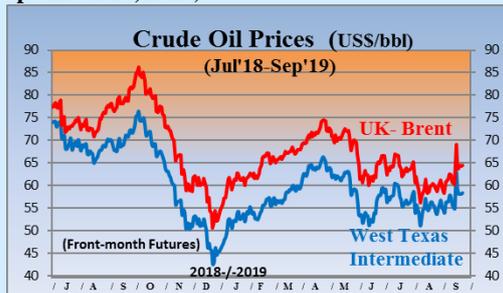
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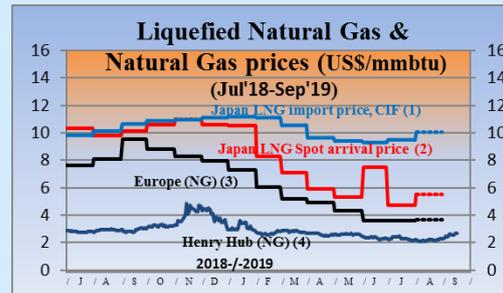
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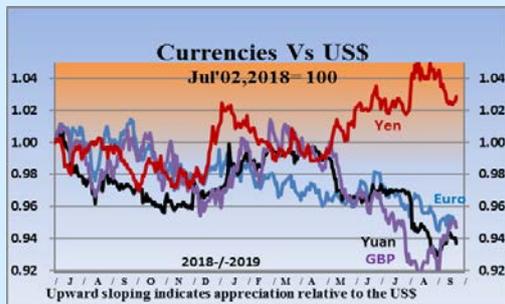
(As of September 23, 2019)



Sources:  
 (1) DOE-EIA  
 (2) Investing.com



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 and Finance.Yahoo.com



Source: x-rates.com



Source: Investing.com and Finance.Yahoo.com

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## Summary

### 【Global Monitoring】

#### 1. US: Spikes in Electricity Prices in Texas

In August, wholesale electricity prices of Texas' ERCOT spiked to abnormal levels, reaching \$9,000/MWh. Analyzing the causes and examining countermeasures will provide valuable input to the discussions on designing the electricity market in Japan.

#### 2. EU: Recent Developments Regarding No-Deal Brexit

UK Prime Minister Boris Johnson is maintaining that a no-deal Brexit is a serious option, while urging the EU to renegotiate the draft withdrawal agreement. The EU is showing no sign of coming to the table and thus the possibility of leaving without a deal is rising.

#### 3. China: New Phase in the US-China Trade War and Response to the Japan-South Korea Row

The US-China trade war entered a new phase in August as the Trump administration began to impose additional tariffs and other measures. China has signaled it is ready for a full-scale confrontation with the US, while urging Japan and South Korea to mend their worsening relations.

#### 4. Russia: US Steps Up Sanctions against Russia

The US State Department announced the tightening of economic sanctions against Russia for using biochemical weapons. US Congress has received several bills on strengthening the sanctions against Russia, including via Nord Stream 2 and Turk Stream.



## 1. US: Spikes in Electricity Prices in Texas

**Ayako Sugino**, Senior Researcher  
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The wholesale electricity price of Texas independent grid operator Electric Reliability Council of Texas (ERCOT) rose to \$9,000/MWh (approx. 950 yen/kWh) in all areas under its control (about 90% of the state's electricity demand) for 45 minutes on August 13, and again on August 15. When reserve capacity falls to a certain level, ERCOT's wholesale price rises based on the Operating Reserve Demand Curve (ORDC). This mechanism is designed to warn the market of high wholesale prices, urging consumers to curb electricity consumption and power producers to boost supply. A price cap exists to prevent an abnormal surge in wholesale prices, called the System Wide Offer Cap (SWOC), which was raised from \$3,000 to \$4,500 in August 2012, and to \$9,000 in 2015. This means that a supply crunch severe enough to cause prices to reach this cap happened twice in mid-August.

The supply crunch was caused by an abnormal heat wave which triggered a sharp rise in electricity demand amid a shortage of power supply which occurred, as predicted, due to the closure of coal-fired thermal power plants in Texas in 2018-2019, and which unfortunately coincided with a three-day period of low wind power output. ERCOT issued an energy emergency alert for the first time since January 2014 and called on residential and other consumers to cut back on electricity. However, this failed to ease the supply-demand balance and resulted in the price rise as several thermal power plants stopped operation.

SWOC is set higher than the price caps of other ISOs/RTOs which range from \$1,000 to \$2,500. This is because ERCOT does not have a capacity market to underpin its long-term supply capacity, relies entirely on price signals, and thinks that certain levels of price hikes are necessary to get new investments in power generation. However, out of the 451 hours between August 1 through 19, wholesale prices were extremely high at above \$5,000 for just four hours in total and were at \$30 on average for 400 hours, including one hour in which prices were negative. Such wild price fluctuations, and relatively low electricity prices in Texas compared with the nation owing to its cheap natural gas supply and rapid increase in renewables, suggest a lack of progress in securing supply capacity due to uncertainty in recouping investment in power generation. This lack of progress is manifesting in the form of closures of coal thermal power plants and delays in gas power plant and wind power projects.

ERCOT's wholesale prices surpassed \$9,000 in January 2018 and May 2019, but the one in May 2019 was due to a glitch in the transaction order system of a major power company, eventually leading to a lawsuit demanding that ERCOT compensate for losses caused by unreasonably high prices.

Discussions are currently under way in Japan regarding the design of an imbalance tariff system primarily for short-term adjustment of supply and demand. The market situation and experiences in Texas provide valuable lessons for both the price calculation for sending appropriate price signals and the scheme for preventing wrong information and market manipulation. Furthermore, in terms of securing long-term supply capacity, precedents in Europe and the US have shown that the capacity market, which will be launched in Japan in fiscal 2020, alone will not be sufficient for securing investment in power generation, and the imbalance market is becoming a promising incentive to invest in electricity to complement the capacity market. The experiences in Texas provide valuable lessons in this regard as well. (as of August 28)



## 2. EU: Recent Developments Regarding No-Deal Brexit

**Kei Shimogori**, Senior Researcher  
Global Energy Group 1  
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There are only two months left till October 31, on which the United Kingdom plans to leave the EU. UK Prime Minister Boris Johnson has been clear since taking office on July 24 that a no-deal Brexit is a serious option, while urging the EU to renegotiate the draft withdrawal agreement. Prime Minister Johnson sent a letter to the European Council President Donald Tusk requesting the removal of the Irish border backstop from the draft agreement and proposing an alternative to be implemented during the transition after leaving the EU. However, the EU has not softened its position that it will not renegotiate.

President Tusk stated, “The backstop is insurance to avoid a hard (physical) border on the island of Ireland unless and until an alternative is found,” criticizing the UK for not presenting realistic alternatives. According to the media, this is the consensus among all 27 EU member countries.

European Commission President Ursula von der Leyen, who will take office in November, has said that the EU should consider extending the current Brexit deadline if there were good reasons to do so, but has not shown signs of agreeing to a renegotiation itself. At the UK-Germany summit on August 21, German Chancellor Angela Merkel said the EU would consider “practical” solutions for the Irish border after Brexit, but this does not mean reopening the withdrawal agreement, which some media reports considered a positive sign for a possible renegotiation. At this stage, however, there appears to be very little prospect of a renegotiation, and it seems increasingly likely that the UK will crash out of the EU without a deal. According to media reports, the UK government will launch a PR campaign to prepare the public for a no-deal Brexit in September.

On August 18, a leaked confidential government paper revealed that the UK will almost certainly face shortages of food, fuel, and medicine in the case of a no-deal Brexit. At the start of the year, the UK government published plans to remove almost all import tariffs, including for fuel, in the case of a no-deal Brexit. Meanwhile, fuel exports from the UK would be subject to a 4.7% export tariff if it leaves without a deal and adheres to the WTO rules. The UK Petroleum Industry Association warns that such a gap between import and export tariffs would hurt the competitiveness of British refiners. Meanwhile, a Wood Mackenzie analyst considers it unlikely that domestic refineries will have to close, as Britain can divert part of its fuel exports to domestic consumption and can switch its existing Europe-bound exports to the United States. As a no-deal Brexit could cause major pain and confusion in Europe, particularly the UK, developments over Brexit must be closely watched, as well as the progress of discussions on a US-UK free trade agreement. (as of August 28)



### **3. China: New Phase in the US-China Trade War and Response to the Japan-South Korea Row**

**Li Zhidong**, Visiting Researcher  
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At the US-China summit held on June 29 during the G20 Osaka Summit, the two countries agreed to restart trade talks and not to impose additional trade tariffs. President Donald Trump had even mentioned lifting the import ban on Chinese telecom giant Huawei in the post-summit press conference. Ministerial-level talks were indeed restarted at the end of July, but with no substantial progress. After the talks, the Trump administration restarted various measures to China's disadvantage and the US-China trade war entered a new phase.

On August 1, President Trump announced that the US would impose an additional 10% tariff on about \$300 billion worth of Chinese goods as the "fourth" round of sanction tariffs starting September 1. On August 13, however, US trade representatives announced a postponement of the tariffs until December 15 for cell phones and laptops considering the impact on year-end shopping, and took some products off the list for health and security reasons. Regarding Huawei, President Trump said on the 18th that he wants "no business at all" with the company, after which the US Department of Commerce added 46 affiliated companies to a sanctions list called the Entity List (EL). Further, the US designated China a "currency manipulator," linked the Hong Kong issue with the trade talks, and agreed to a weapons sale to Taiwan, applying pressure on China in unprecedented areas.

In response to the aggressive stance of the US, China has made it clear that it is ready for a full-scale confrontation. On August 3, the Customs Tariff Commission of the State Council decided to suspend imports of American agricultural products by China-related companies. On the 15th, China denounced the US tariffs as violating the summit agreement and announced that it would be forced to take retaliatory measures. The People's Bank of China dismissed the US' designation of China as a "currency manipulator" as unfounded, and stated that China has not used the exchange rate as a tool for resolving trade friction, and never will. The Ministry of Foreign Affairs strongly protested against US intervention in Hong Kong, seeing it as interference in internal affairs, demanded that the weapons sale to Taiwan be stopped, and declared it would take whatever countermeasures were needed, including imposing sanctions on relevant US companies.

Regarding the course of the trade war, Global Times, an affiliate of the Communist Party's official newspaper, the People's Daily, considers that in contrast to the US which has run out of Chinese goods on which to impose tariffs and can no longer exert pressure, China is in no hurry to sign a trade agreement with the US and most of the population is mentally prepared for an extended period without a deal. Further, the newspaper suggested that China should strike back by launching retaliatory tariffs on some \$40 billion worth of US goods, banning the export of rare earths, and introducing a Chinese version of the EL and a "national technological security management list" which would enable high-tech exports to be regulated, and then wait for the Trump administration to lay down its arms. This is presumably similar to the government's intentions.

Meanwhile, the Japan-South Korea dispute, which originated in the wartime labor issue and has now escalated to economic matters, is receiving attention in China as well. China is keen to agree on the Regional Comprehensive Economic Partnership (RCEP) within this year and to accelerate talks on the Japan-China-ROK FTA to soften the blow of the US-China trade war. To this end, the government expressed hopes that "the two countries can handle relevant issues properly through dialogues and consultations on the basis of mutual respect, equality and mutual benefits," urging the two countries to mend relations. China continues to wait and see how the bilateral dispute spreads into the national security area.



#### **4. Russia: US Steps Up Sanctions against Russia**

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

On August 2, the US Department of State announced a new set of sanctions against Russia over the attempted assassination of a former Russian intelligence officer in the United Kingdom in March 2018 using the military nerve agent Novichok. This is the second round of sanctions associated with the incident following the ban on the export of national security-related goods and technologies imposed in August 2018. Under the Chemical and Biological Weapons Control and Warfare Elimination Act of 1991 (CBW Act), the sanctions will prohibit US banks from participating in the primary market for non-ruble denominated bonds to prevent the World Bank and other international financial institutions from extending loans to Russia, and will reinforce export regulations on goods that could be used to develop chemical and biological weapons. Some consider that the sanctions were introduced at this timing to forestall and contain even tougher action, as hardliners in Congress had submitted a bill that would impose even stronger sanctions against Russia, particularly in the financial area.

Bills to strengthen the sanctions against Russia continue to be brought before Congress in 2019. In the area of energy, particularly noteworthy is the Energy Security Cooperation with Allied Partners in Europe bill of 2019 (ESCAPE) submitted to the Senate in June. The bill strongly opposes Nord Stream 2 and proposes revising the US Natural Gas Act to automatically approve the export of US natural gas to NATO allies including European countries and Japan for the energy security of those countries. It would further obligate the president to impose sanctions on individuals (including non-US persons) or companies involved in the Nord Stream 2 international gas pipeline project connecting Russia and Germany.

Meanwhile, on July 31, Protecting Europe's Energy Security Act of 2019 (PEES) was submitted to the Senate following approval by the Senate Foreign Relations Committee, and is due to be deliberated. The bill would impose sanctions on all companies involved in laying the pipelines for the Nord Stream 2 project and the Turk Stream project connecting Russia and Turkey, specifically by prohibiting the laying of pipelines lower than 100 feet (approx. 30.5 meters) below the seabed, prohibiting the issuance of visas and the import and export of certain products, and increasing the difficulty of dollar-denominated financial transactions.

Among European companies, Germany's Allseas and Italy's Saipem are involved in laying the pipe for the two projects and concern is rising over the potential impact should the bill become law. As of the end of July, 1,700 kilometers (over 70%) of the pipe have been laid for Nord Stream 2, which is scheduled for completion within 2019. The outcome of deliberations on ESCAPE, PEES and similar bills, and the timing of their possible adoption, may determine the economic viability of the Nord Stream 2 project, alongside the delay in approving the construction of Nord Stream 2 by the Danish government. Attention must be paid to any developments regarding these bills, which will need to pass the plenary sessions of both houses of Congress and be signed by President Trump to become law. (as of August 28)



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