

APEC Oil and Gas Security Newsletter

Southeast Asia Is to Be a Net Gas Importer

by *Yoshikazu Kobayashi*

Southeast Asia, a traditional natural gas supplying region, will turn to be a net natural gas importer in the mid-2020 according to the latest regional energy outlook published by the International Energy Agency in October. In the region, Singapore and Thailand have already been a net natural gas importer. The Philippines and Viet Nam are currently self-sufficient in natural gas supply, but they are planning to introduce LNG to make up for their declining domestic production and to meet the growing energy demand. Even Indonesia, Malaysia, and Myanmar, a major net exporter in the region, will increase its gross natural gas imports as their home demand expands. This change of trade position brings significant implications to the gas security in Southeast Asia.

The primary concern in the region’s gas security discussions so far has been placed in the enhanced natural gas transportation capability, particularly the development of the region-wide pipeline network. This was on the premise that the region has abundant natural gas resources particularly in Indonesia and Malaysia, and the region is basically self-sufficient in natural gas supply. Becoming a net importer means that the region will have to have more interactions with international LNG market and thus, have multiple challenges.

First, the region will have to adapt and absorb the fluctuations of international LNG prices. In many Southeast Asian countries, gas and power prices are regulated. Current LNG prices are at a low level from historical standard and the countries may be able to accommodate such price movements for the moment. The market, however, can go up easily depending on the international crude oil price and demand –supply balance at the spot market. Second, the development of supply infrastructure becomes even more important. Extensive pipeline (*next page*)

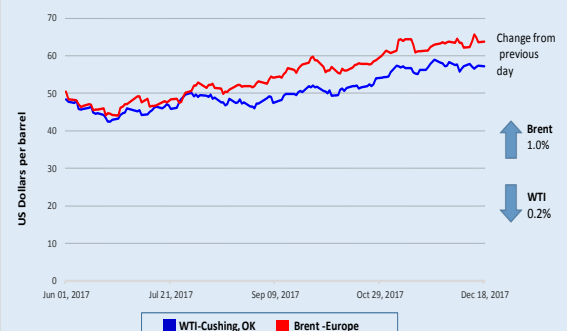
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CRUDE OIL SPOT PRICES



WTI—USD 57.17 (Dec. 22)

Source : US Energy Information Administration

“This change of trade position brings significant implications to the gas security in Southeast Asia.”

Southeast Asia.....

network across the region will enable the countries to secure various import points as well as enhancing resilience, in case of unexpected supply outage. Because there are a number of depleted natural gas fields in the region, development of storage capacity may worth considering. Finally, the LNG supplier has to enhance its supply flexibility. Because LNG is mainly utilized to meet the “residual demand” after coal, renewable and domestic natural gas is used. The demand pattern in the region is therefore very unstable by nature, and they will need a more liquid LNG market to secure a sufficient volume of LNG at any time.

Indeed, becoming a net natural gas importer, Southeast Asian countries will have to overcome these challenges to ensure their gas security in the coming years.

The Extension of Joint Production Cut by OPEC and Non-OPEC Countries

by Tetsuo Morikawa

OPEC member countries decided to keep the current production cut (1.2 mb/d) till the end of 2018 at the 173rd meeting in Vienna on November 30. On the same day, ten non-OPEC countries, namely Azerbaijan, Bahrain, Brunei Darussalam, Kazakhstan, Malaysia, Mexico, Oman, Russia, Sudan, and South Sudan, agreed to maintain the current cut (0.56 mb/d) also till the end of 2018. These agreements were widely expected by the market, and oil prices hardly fluctuated with the news.

Maintaining production cut will surely solidify the rebalancing process of the oil market that has been evident especially since the summer 2017. According to IEA, world oil demand already exceeds supply by 0.2 mb/d in 2Q 2017. OPEC is said to target to reduce the stock level down to the five-year average to support the price. OECD stock level was 8% higher than the five-year average when production cut was initiated in January 2017, now it is 3% higher than the average. It is likely that the stock level will finally decrease to the five-year average in 2018.

However, there are uncertainties about the prospect. The biggest one is how much more the US will produce in the coming year. Shale oil production, which was the driver of the US production expansion, struggles to grow at the moment. Nevertheless, it is important to note that production efficiency of shale oil still has the potential (*next page*)

“Maintaining production cut will surely solidify the rebalancing process of the oil market that has been evident.....”

The Extension.....

to improve that will drive down the production cost. Price recovery since the summer incentivizes shale producers to increase investment. The number of drilled-but-uncompleted (DUC) wells is growing steadily in 2017, which clearly shows the potential of production increase especially with price recovery. The next uncertainty is the unity within OPEC and its allies. The history shows that the longer the production cut continues the lower the compliance rate is.

To sum up, the tug of war between shale producers and OPEC with its allies will continue next year. Without major contingencies such as financial market crash or oil supply disruption, the market will be in balance in 2017, and Brent price will average \$65/bbl in 2018.

“These evoke memories of the oil crises in the 1970s. “

Energy Security Viewpoint of the “Powering Past Coal Alliance”

by Ichiro Kutani

During the COP23 in Bonn, Germany in October, the “Powering Past Coal Alliance” was launched. The alliance consisting of 25 countries and state governments as of 16 November, aims at phasing out traditional coal power generation in respective countries. It also expressed its goal to increase the number of partner countries to 50 before COP24. The movement recognizes the fact that the energy sector, in particular coal consumption is the largest contributor of CO2 emission. However, the author would like to make a point of view on energy security implication of the Alliance.

In the 1970s, the economies of oil importing countries suffered much from two oil crises due to physical supply shortage and price surge of oil. This was because of very high dependency on oil in their energy supply. From these experiences, those countries learned the importance of energy security, or more precisely the need for diversification of energy mix. This is to mitigate security risk by avoiding excessive dependence on single source of energy, particularly imported energy. And this principle is still an effective basis in formulating energy security policy.

Then the question is; what if, phasing out of coal power generation creates excessive dependence on imported natural gas? On the one hand that phasing out of coal reduces environmental risk, on the other hand, it may possibly pose a risk to energy security and even on energy economics, i.e. increase of energy price.

The declaration also encourages to replace coal with renewable energy, which is another good alternative. But, in short- to mid-term at the least, the reality is different. Current technology doesn't allow renewable energy alone to replace coal, except maybe for some blessed country where there's abundant hydro power. Natural gas then might be the more realistic choice to replace coal in many countries, but then again it might pose a risk on energy security in some countries.

These evoke memories of the oil crises in the 1970s.

Every economy has the responsibility to address climate issue. Phasing out of coal is an effective option and may be pursued in countries, where possible. However, we should also be reminded that climate is nothing more than just one of the many issues of national policy. It is indeed important to formulate practical transition or pathway to low carbon society but we should also take into consideration the unique conditions of each country.



Mr Koichiro Tanaka

Mr Koichiro Tanaka rose from the ranks. Starting his career as a Special Assistant for Political Affairs in the Embassy of Japan in Iran in the early 90s, he became a researcher and analyst in the most part of 2000s focusing mainly on Middle east situation, then finally assuming the Directorship position in 2005 of Japanese Institute of Middle Eastern Economies (JIME) Center of the Institute of Energy Economics Japan (IEEJ). Since then, Mr Tanaka headed JIME, while serving concurrently as one of IEEJ's Board Members.

Mr Tanaka's field of expertise is on International relations in West Asia (Middle East) region, with a strong focus on Iran and Afghanistan. His observations and views were frequently sought after, whenever a situation relating to the Middle East is occurring.

In 2017, Mr Tanaka reprises his career as a professor and now teaching the Graduate School of Media and Governance at Keio University .

He has this message to his students.

"The world we live in never has been an ideal place for peace and stability. Today states and non-state actors alike threaten our security. The eventuality is that there will be outbreaks of civil wars and prolonged conflicts. Once stability is lost, then restoring order and governing institutions will likely become futile tasks. Throughout my own career, I have come to hold a strong conviction to this kind of reality.

(next page)

Interview with Mr Koichiro Tanaka

Mr Tanaka concurrently served as IEEJ's board member and head of JIME Center since 2006. In this issue of OGS Newsletter, APERC is honoured to have him for the Interview with the Expert, sharing some of his more than 20 years of experience in analysing the geopolitical, economic and other developments in the Middle East.

APERC—After assuming the head of JIME center of IEEJ, you have witnessed and analysed how changes in Middle East Region which is the major oil and gas producing area in the world, affect the global energy situation. Up to now, which changes in Middle East affected mostly the oil and gas supply security in the world?

Mr Tanaka—Historically, the two oil shocks during the 1970s were explicit examples of possible supply disruptions. Apart from this, both the Gulf War of 1991 and Iraq War of 2003 could have led to serious supply crises, but ended without the battlegrounds expanding to neighboring oil producers and causing irreversible damage. I am of a belief that none of the recent events, except for one, have come close to these incidents from the past.

Since the day I assumed responsibility as president of JIME Center at IEEJ, which dates back to early 2006, I cannot forget the one incident when al-Qa'eda targeted Biqaiq oil facilities in Saudi Arabia. The attack was thwarted, fortunately, but could have led to a disastrous situation if the penetration was extensive enough. This was a major wakeup call for both producers and consumers of Middle East oil. The message was clear: We are no longer immune from attacks against key infrastructural sites by terrorists. In general, all are obliged to beef up security for infrastructure, including oil and gas facilities.

APERC—At this moment, there are various incidents in Middle East. Which incident will affect the oil and gas supply security in near future?

Mr Tanaka—Now, for the past seven years, geopolitical factors have somehow played a lesser role in determining oil and gas prices. But, there is no doubt that sources of instability in the region, represented by civil wars in Syria, Yemen, and Libya, contention between Saudi Arabia and Iran, Iran's ballistic missile capabilities, boycott of Qatar, Kurdish separatism, and succession issues in kingdoms and sheikhdoms, is on the rise. We should always bear in mind that there is no guarantee that physical threats from terrorist *(next page)*

Interview.....

activities could always be neutralized before it causes actual harm. Eventually, a crisis may happen if necessary and effective measures are not put in place and the economies are not resilient enough.

I would like to draw the attention of the readers of this interview that a paradigm shift is quietly, but undoubtedly, taking place in MENA. Concerns over expansion of Iranian sphere of influence have brought Israel and Saudi Arabia close together. For the past 70 years, this kind of alignment has never happened before. Along with the U.S., a coordinated approach by these states against Iran could spark another regional conflict, either through proxies, or directly between concerned states.

Areas where security breach could occur is not confined to the actual world. Today, we are required to follow developments in cyber space as well. Although it may not only be targets in or threats emanating from the Middle East, we should be prepared of cyberattacks that target oil or gas facilities, and ready to repel and counter them.

One additional issue that I would like to draw the attention is about the rapid political, economic, and social changes the region is embracing. The emerging millennials among the leadership of key MENA states, followed by a new wave of industrialization of their own design, is likely to have impact on energy policies of these oil and gas producers as well. At this moment, it is unclear whether this will benefit consumers to its east or not, but at least, we should be vigilant all the time.

APERC—Though Middle East is far from APEC members, what kind of interchange and cooperation can be expected between them?

Mr Tanaka—As a fact, most Asian members of APEC lack indigenous resources for natural gas. Here, Middle East remains to be a potential major supplier of gas for APEC economies, although fossil fuels, especially oil, may turn into ‘stranded assets’ in the not so distant future, if there are no means to ‘liberate’ them once again. In the Middle East, where most states are aspiring to economic structural reform today, it is well known that the region, in general, faces

Mr Tanaka (continued)

During your academic training, apart from dwelling on theories and ideologies, I would suggest you to explore ways to obtain optimal solutions for threats and challenges by pursuing comprehensive and multi-facet analyses of today’s actual events. “

Following are some of some his selected publications:

—“Ostracizing Qatar: Regional complication and its implications for Japan” at the Foreign Correspondent’s Club of Japan (FCCJ), July 2017;

—“Iran in Transition: Elections, Trump, and the Nuclear Deal” The Edgerton Series on Iran & Turkey at the Pacific Council on International Policy, June 2017 .

Ways to Build a Strong One” at the 17th Doha Forum, May 2017

—“Chatham House Gulf Geopolitics Forum” at Chatham House (Royal Institute for International Affairs), November 2016 .

Source: IEEJ ad KEIO University websites

deficits in infrastructure, industrial platforms, and adequate human resources for development, while Asia and Pacific region, on the contrary, has established advantages and surplus in this field. Definitely, there is ample room for the two regions to collaborate and compensate each other.

APERC—This year you become a professor at Keio University and increased you activities in academia. What kind of role can academia play in interregional cooperation, especially those between Middle East and APEC Region?

Mr Tanaka—I consider it a privilege for myself to teach at a university where a relatively large number of international students, mostly from Asia and Pacific, are present and pursuing their academic interests. Taking advantage of this opportunity to teach and give guidance to those undergraduate and graduate students, I am planning to expose those generation to think comprehensively of energy and security, and raise the awareness of them especially towards the volatile conditions of the MENA region.

Hopefully, one day, part of them will become policy makers and planners for their respective countries and make meaningful contribution in coordinating energy policies among APEC economies, as well as collaborating with MENA states.



Middle East Update •

Current Political Upheaval in Saudi Arabia: Risk or Not?

by Amane Kobayashi

The current political upheaval in Saudi Arabia, particularly the move of young crown prince to consolidate power is not expected to change the kingdom's oil market strategy, but it does raise new questions about its political stability.

On November 4th, the authority of Saudi Arabia arrested a number of royal family members, senior officials and prominent businessmen including at least 11 princes, and four current ministers in an investigation by an anti-corruption committee. Prince Alwaleed bin Talal, a billionaire businessman who owns the investment firm Kingdom Holding; Prince Mi-taab bin Abdullah, the head of the National Guard; and Adel Faqih, the economy minister were among those held.

The very public dismissal and arrest of opponents and rivals, including members of the royal family, by the Crown Prince Mohammad bin Salman is unprecedented in the country's history. The shake-up of the Saudi government comes just months after King Salman replaced his nephew Mohammed bin Nayef with his son Mohammad bin Salman as the kingdom's crown prince. Crown Prince Mohammad has then been responsible for pushing through a number of radical political and economic changes both at home and abroad since he became the first in line to the throne.

Regarding the disputes in the Gulf region, the tension between Saudi Arabia and Iran has been increasing since Mohammad bin Salman was nominated as the Crown Prince and made the country's foreign policy more aggressive. If Crown Prince Mohammad and Saudi emerging leaders feel they have American support and even encouragement for taking action, they can dare to escalate tensions with Iran and its proxies in the region. The Straits of Hormuz are still a potential choke point for the global flow of oil, some 17m B/D—almost a quarter of world traded oil—goes through the straits. Any radical action or policy would seriously risk the global energy stability in the region.

It is difficult to judge at this moment how current political changes would influence Saudi's political stability and global energy security. In any case, there still seems little threat in Saudi Arabia, which would seriously risk global oil prices and energy security in short term. But that doesn't mean these risks can be under control for a longer term, considering its drastic changes in the domestic power balance and their effects to the foreign policy.

“...The very public dismissal and arrest of opponents and rivals,is unprecedented in the country's history..”

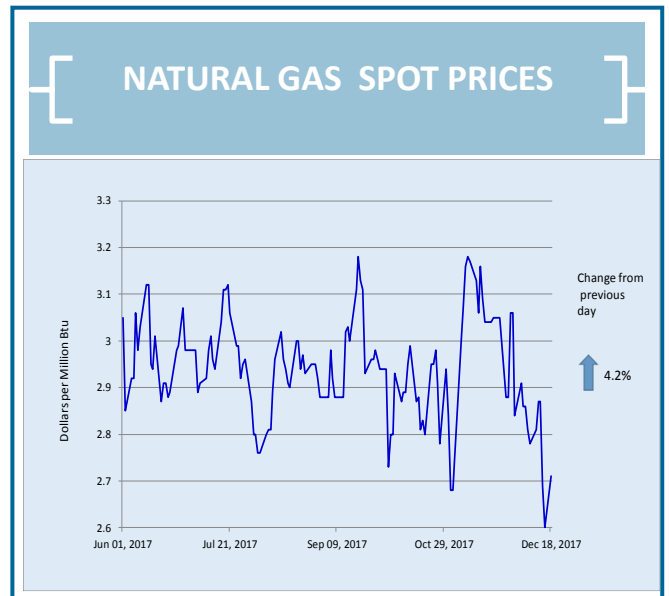
Upcoming Event ●

4th Oil and Gas Security Network Forum

The Oil and Gas Security Network (OGSN) Forum is back in Japan and the preparations are underway. The 4th OGSN Forum will be tentatively held in Tokyo in March, 2018.

As in the previous, the forum will serve as a venue to form a network of working level officials in the APEC economies and experts from international/regional organizations.

Details of the 4th OGSN Forum will be discussed in the succeeding issues of the OGS Newsletter.



Henry Hub—USD 2.71 (Dec. 22)

Source : US Energy Information Administration



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