No 380 | FEBRUARY 2023

SEE ENERGY BRIEF

Monthly Analysis

The Global Energy Crisis Helps Redraw the Geopolitical Map

Introduction

Global energy geopolitics were transformed in 2022 following Russia's invasion of Ukraine, which will continue to cause major reverberations this year and beyond. In Ukraine itself, an extended conflict looks most likely, but escalation is always looming within the country and in the broader region. Seen at global level, the crisis has forced a geopolitical inflection point that has heightened concerns around Taiwan, raised the potential for escalation in the Middle East and in the Gulf area and accelerated global realignments. Oil and gas will remain deeply politicized, too, as energy and security dynamics in European, Asia-Pacific, Mideast and Asian theaters are reshaped.

As the energy industry navigates through a complex and tumultuous environment in 2023, it will have to keep its eye on multiple geopolitical arenas that will shape both hard realities such as oil and gas trade flows, and the broader environment in which it must operate. First will be the course of the war in Ukraine. However, the impact of that conflict has extended far beyond its borders, influencing developments in Europe, China, Taiwan, Venezuela and more. Other conflict areas now look more intractable - not least Iran, given its military aid for Russia's war in Ukraine - or unpredictable, with Russia's grip in the Caucasus weakening.

The conflict has seen the West find new depths of unity and resolve, but also exposed the limits of its reach as an increasingly multipolar world pushes back. India has made clear that buying heavily discounted Russian crude **(1)** - that is, sourcing affordable energy - is in its national interest, and that this will remain the case, no matter what Europe or the US thinks.

Saudi Arabia, similarly, has made clear that it views its OPEC+ partnership with Russia **(2)** as critical to market management and therefore to its national interest. This has thrown up new pressures in producer-consumer relations, especially as Western sanctions and controls on Russia's oil trade expand. The Mideast Gulf's longer-term shift in focus from West to East has also accelerated, as evidenced in the very different atmosphere, which prevailed during visits to Saudi Arabia by the Chinese and US leaders last year.

Frozen Conflict

Ukraine's outlook will depend partly on the military course and partly on the sustainability of international support. During a Washington trip last month by Ukrainian President Volodymyr Zelenskiy, President Joe Biden said the US "will stay with you as long as it takes". However, this support is not open-ended. When asked about the US's refusal to send advanced weaponry like long-range missiles, Biden stressed that NATO allies are "not looking to go to war with Russia". A Republican-controlled House of Representatives raises the prospect of a lessening commitment **(3)**. As the war drags on, frustration with the economic fallout could also mount in Europe.

But even if the US or Europe pushed for negotiations, it is hard to see either Russia or Ukraine making serious compromises. Clear military limits challenge the idea of either a Ukrainian or Russian triumph on the battlefield. Improved Russian defenses, supported by conscription, could make any further Ukrainian inroads harder and more costly. That leaves an extended or frozen conflict as the most likely trajectory for the year ahead, with Russia fighting a war of attention in the battlefield.

Escalation, however, is still possible. Signs that Russia is leaning harder on Belarus to support its war effort in Ukraine cannot be ignored. Some reports also suggest that Moscow may be planning a fresh offensive in Eastern Ukraine or beyond early this year. Any escalation has clear potential to spread beyond Ukraine. Unclaimed attacks on critical infrastructure in Europe could increase, with cyberattacks a known strategy for Moscow. More energy supply disruptions could also figure - with remaining Russian piped gas the more likely target, making it even more difficult for Europe to replenish gas stocks for winter 2023-2024. Some oil market response, like slashing production, by Moscow could also be expected.

China on Edge

Beyond Europe, the Ukraine crisis has pushed Russia and China closer together, while shifting geopolitical dynamics over a key Asian flash point, Taiwan. Whatever Beijing's discomfort with Moscow's invasion, it will see a loss for Russia in Ukraine and as a win for the US, its biggest geopolitical rival. That makes any break in China-Russia ties in the year ahead hard to envisage.

Regionally, Russia's invasion of Ukraine has been a wake-up call: A warning that an attempt by China to annex Taiwan by force and a US-Chinese conflict in the Asia-Pacific axis should be treated as real possibilities. Japan, for one, last month tore up its postwar security stance, announcing major new military spending plans **(4)** in what Prime Minister Fumio Kishida called a historic "turning point."

In the year ahead, many Chinese experts believe Beijing may opt for relative caution and steady pressure on Taiwan, drawing lessons from Russia's difficulties in Ukraine and the wide-ranging sanctions against it, and focusing instead on the economy and Covid-19. However, tighter ties between Taiwan and its allies - viewed by Beijing as provocative - could yet spark tensions, and accidental conflict amid a ramp-up of Chinese incursions in Taiwan's air defense zone cannot be ruled out.

Mideast Escalation?

In the Middle East-Gulf area, the Ukraine war served to inflame producer-consumer tensions — with the US in October accusing OPEC+ of aligning with Russia, while Gulf producers viewed Western sanctions and strategic stock releases as challenging their market management. The war has also shifted the dynamics on nuclear negotiations with Iran. Tehran's crackdown on protesters and its supply of drones and other arms to Russia have put nuclear talks into a deep freeze, but continued advances in Iran's nuclear program will still be seen as a threat. While Washington will not want to trigger a major conflict in the Mideast, Israel, under a new right-wing government led by Benjamin Netanyahu, could take covert action against Iran's nuclear program. This risks putting the region on a fresh escalatory path, with Iran potentially retaliating by targeting tankers and energy infrastructure in the Arabian Peninsula and in the Gulf area, including war via proxies in Yemen, as seen in 2019.

Meanwhile, the longer Russia's war in Ukraine drags on, the less influence Moscow may wield in its near abroad. That could see border skirmishes spill over into bigger conflicts, particularly between Armenia and Azerbaijan. Kazakhstan and Azerbaijan are angling for closer ties to Europe, including on energy trade. But none will want to antagonize Moscow, given reliance on Russia as a transit route for their export of oil and gas and other goods. It is useful to remember that in 2022, Kazakh exports were repeatedly disrupted as Russia halted operations at its CPC terminal, a scenario that could replay in 2023. **(5)**

Politics and Energy

The full-scale Russian invasion of Ukraine in February 2022 led to major reverberations in energy markets around the world. In an attempt to pursue alternatives to newly sanctioned Russian hydrocarbons, some European countries lowered their limits on coal-fired power plants, while others pushed back the proposed retirement dates of existing coal and nuclear power plants. In spite of the sudden proliferation of coal, however, reduced demand due to high oil and gas prices and continued growth in renewable energy generation limited overall greenhouse gas emissions throughout the year.

The fluctuations in the oil market in 2022 suggest that both geopolitical events and the growth of the global economy will continue to shape the oil market in 2023. Brent crude oil prices were rising at the start of 2022 as the pandemic-induced slowdown in the global economy eased, hitting $130 a barrel in March in the early days of the Russian invasion. The IEA and other organizations predict that demand will grow slower than in the pre-pandemic era. While demand increased at a rate of 2 million barrels per day in 2019, it is expected to rise by 1.7 million barrels per day in 2023, with roughly half of this projected demand from China's economic recovery. Oil and European gas prices have dropped from early 2022 highs, but concerns over demand remain.

In 2022, OPEC pursued oil production cuts in order to stabilize the market and preempt stockpiles, drawing the ire of the United States. OPEC justified its decision by claiming that it was reducing carbon production and redefining its equipment in line with climate change plans. OPEC's long-term goal has usually remained the preservation of “price stability”, ensuring the continued operation of existing oil fields without decreasing global prices. Facility shutdowns can cause physical damage to oil equipment and even the fields themselves. Shutting down ocean drilling is difficult and costly, so keeping global prices steady is in OPEC’s interest.

The oil market by early 2023 may behave quite differently as the world awaits the outcome of events that could potentially shift supply and demand in the coming days and weeks. Oil exports play a particularly important role in Saudi Arabia’s economy, as the country’s economic diversification efforts have fallen behind their benchmarks under the “Vision 2030” reform plan. Riyadh’s actions suggest that despite the turmoil in the oil market and the fear of market stagnation, there is confidence in the country’s revenues. The country’s authorities expect the budget surplus for 2023 to reach SAR 16 billion (USD $4.3 billion).

According to the IMF, Saudi Arabia can break even at a price of $66.80 this year **(6)**. Independent analysts have suggested that Riyadh’s 2023 budget assumes an oil price ranging from $70 to $80 per barrel, and Mazen al-Sudairi, head of research at Al Rajhi Capital, suggests it is based on a figure of $78 a barrel **(7)**. At the same time, the UAE, as reported by Bloomberg **(8)**, will return to its energy routes and is reportedly looking to increase both oil and gas production - a step that could provoke tensions with OPEC, which has sought to keep prices high throughout the year. Abu Dhabi National Oil Co. plans to invest $150 billion, rather than the $127 billion initially proposed, in the run-up to 2027.

While the UAE’s oil exports have reached about 3.7 million barrels per day and Iraq’s have reached about 4.5 million barrels per day, Iran’s daily oil exports are estimated to remain at only 1 to 1.5 million barrels per day in 2023. Iranian oil, subject to extensive international sanctions since 2018, is traded at a huge discount in informal markets. The troubles of Iran’s oil market do not end there, and now the Group of Seven and Australia have set a price ceiling of $60 for Russian oil - effectively keeping prices low for Iranian supplies as well. According to the G7 plan, if Russia sells its oil at $60 or less, it can use the exemption from sanctions on oil tankers and insurance companies, and this situation has driven oil prices down and made Iranian exports less competitive. Following the war in Ukraine and the embargo on its oil, Russia has also shifted its market sphere from Europe to Asia, particularly China, further reducing Tehran’s market share in these regions.

If the war in Ukraine continues, sanctions against Russia are likely to persist, with concerning implications for the future of Iran’s oil market **(9)**. In the meantime, the potential of a nuclear agreement in Iran is lessening as Western anger grows over the Iranian government’s crackdown on its domestic protest movement and its sale of drones to Russia for use in Ukraine. When it comes to China, the United States may not pursue financial sanctions and will maintain export controls while establishing a system to control China-bound investment, especially technology items.

In 2023, global oil refineries will likely continue to enjoy high profit margins (10), which remained stable throughout 2022 and are expected to persist in 2023, although slower demand growth and growing competition from new refinery startups could affect these trends. Geopolitical policy shifts - sanctions on Russia, nuclear negotiations with Iran, an American rapprochement with Venezuela, and OPEC production quota policies - could also play a role.

EU Dilemmas on Energy Security

Russia's war in Ukraine and the expected decoupling from Russia's energy supply chains have dramatically exposed the limits and flaws of the EU's approach to energy security, as well as the major failures in the implementation of the EU's Energy Union. This includes both the issue of overreliance on Russia and the creation of a coherent, coordinated and effective foreign-energy security framework in the face of a dramatically changing geopolitical landscape and a rapidly transforming global energy system. (11)

As the EU embarks on redesigning its energy security strategy, it faces five major dilemmas. First and foremost, the EU faces lasting tension between different levels of energy governance (national, regional and supranational) and the Energy Union Package has not fundamentally solved this tension. Today's dilemma is the difficult reconciliation of different national priorities with the urgency to coordinate an external response to secure present and future energy supply.

Second, the EU faces a dilemma between market and economic rationality and the return of state intervention and geopolitical competition. The current dilemma is how to preserve Europe's model of open and liberalised energy markets while adapting to a world where energy markets will be disrupted, energy becomes scarce and flows are reoriented. Geopolitics, states, and security considerations, more than economic rationality, cost efficiency, and market design, dominate both fossil fuel and renewable value and supply chains. (12)

Third, the EU faces a dilemma between long-term climate goals and short-term fossil-fuel supply security, while gas remains an essential bridging technology in the midterm. While high gas and electricity prices increase the business case for renewables, securing fossil-fuel supply in the short term will be costly, putting further pressure on the cost-intensive green transformation processes in the hard-to-abate industrial sectors and increasing the risk of lock-in effects. This could jeopardise EU emissions reduction targets and slow down global climate goals.

Fourth, the EU faces a short-term dilemma between securing gas supply and volatile global (LNG) markets: the issue is not only the complicated substitution of Russian gas supplies in the short-term but also the growing dependence on volatile and tight global markets in the mid-term. The reality is that while diversification is needed more than ever, more diversification does not necessarily mean a secure, affordable and stable gas supply.

Fifth, the EU faces a long-term dilemma between energy independence aspirations and new supply dependencies and risks: the task facing the EU is not only reducing “old” fossil-fuel energy security risks by strongly reprioritising supply diversification. It is much more about securing greater energy independence in the future amidst growing external dependencies and competition along the entire green value and supply chains, including critical infrastructure.

Discussion

We are currently living through a “global energy crisis of unprecedented depth and complexity”, according to the International Energy Agency’s World Energy Outlook 2022 **(13)**, which warns that “there is no going back to the way things were” before Covid-19 and Russia’s war in Ukraine rocked the globe. Together, these events have already reconfigured energy trade worldwide, but the shockwaves to the global economy and geopolitics in general are just getting started. Lately, the IEA, through its Executive Director, repeated the warning that we have not yet seen the end of the current crisis. **(14)**

Everyone seems to agree that we are living through a large-scale reconfiguration of global geopolitics, but there is less consensus as to what is in store for world trade once the dust has settled. Some experts are saying that the global south is increasingly gaining influence in geopolitics on the world stage as climate change is rewriting the rules of trade and consumption, while others argue that reactionary protectionist practices in the developed world will only further marginalize and alienate less developed nations.

For decades, geopolitical risks to energy have largely centered on the availability of sufficient oil and gas at affordable prices, whether it is the Arab oil embargo of 1973 or the controversial Nordstream 2 pipeline. These “traditional” threats to energy security will be greatly diminished in a world of clean energy. Yet new risks will emerge - both from new clean energy sources and from the multi-decade process of transition during which the old geopolitics of oil and gas will coexist alongside the new geopolitics of clean energy.

The risks of a disorderly energy transition were apparent even before Russia invaded Ukraine. Indeed, Europe faced an energy crisis last winter that led to soaring electricity prices and utility bankruptcies as it struggled to cope not only with initial cuts to the Russian gas supply but with a steep rise in post pandemic demand and also with more intermittent electricity sources and fewer buffers to handle unexpected shocks.

Eventually, the old geopolitics of oil and gas will fade, but the new world of clean energy will also present many of its own geopolitical risks, several of which were already evident in 2022. A clean energy future, for instance, will require a vast increase in materials such as lithium, cobalt and copper that are needed for batteries, solar panels, and other clean energy components. If all governments follow through on their current pledges, demand for these materials will more than double by 2030 **(15)**. Today, the vast majority of these minerals are refined and processed in China and many are mined by Chinese firms around the world. Western governments have taken steps to diversify the supply chains for critical minerals, but face challenges such as the long timelines for mine development, difficulty in permitting such projects, and the geographic concentration of certain minerals.

References

1. Sharma, R. (2022), “India's Russia Moment”, https://www.energyintel.com/00000184-5c4e-dc1b-a9a4-dc6e3a160000
2. Klaus, O. and Meredith, E. (2023), “Another Year, Another Set of Challenges for Producer Group”, https://www.energyintel.com/00000185-7cb1-d6b5-a9cd-fefdbc260000
3. Meredith, E. (2022), “US Looks to Lock In Ukraine Funding”, https://www.energyintel.com/00000184-8295-d0fe-abc5-d3f536e20000
4. Demongeot, M., Tan, C. and Sharma, R. (2022), “Asia’s New Security Dynamics”, https://www.energyintel.com/00000185-38ba-d571-adcd-38fbffdf0000
5. Junnola, J. and Pike, D. (2023), “Energy Geopolitics Transformed”, https://www.energyintel.com/00000185-aa68-de58-a3ef-fbfb5fea0004
6. Uppal, R., Yaakoubi, A. E. and Saba, Y. (2022), “Saudi Arabia expects narrower 2023 surplus as uncertainty clouds oil outlook”, https://www.reuters.com/world/middle-east/saudi-arabia-expects-narrower-2023-surplus-uncertainty-clouds-oil-outlook-2022-12-07/#:~:text=The%20International%20Monetary%20Fund%20(IMF,Rajhi%20Capital%2C%20estimates%20around%20%2478
7. Uppal, R., Yaakoubi, A. E. and Saba, Y. (2022), “Saudi Arabia expects narrower 2023 surplus as uncertainty clouds oil outlook”, https://www.reuters.com/world/middle-east/saudi-arabia-expects-narrower-2023-surplus-uncertainty-clouds-oil-outlook-2022-12-07/#:~:text=ADCB's%20Malik%20estimates%20the%202023,Rajhi%20Capital%2C%20estimates%20around%20%2478.
8. Magdy, M., Martin, M. and Omar, A. A. (2022), “Saudi Arabia Sees 2023 Budget Surplus Bump Despite Oil-Market Jitters”, https://www.bloomberg.com/news/articles/2022-12-07/saudi-arabia-unfazed-by-oil-angst-sees-2023-budget-surplus-bump?leadSource=uverify%20wall#xj4y7vzkg
9. Lichfield, C., Nikoladze, M. and AI, C. (2022), “Global Sanctions Dashboard: What’s coming in

2023?", https://www.atlanticcouncil.org/blogs/econographics/global-sanctions-dashboard-whats-coming-in-2023/

10. Turner, E. and Hickin, P. (2022), "Commodities 2023: Oil refining landscape to resume transformation in 2023 after hiatus", https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/petrochemicals/121922-oil-refining-landscape-to-resume-transformation-in-2023-after-hiatus
11. IENE (2022a), "SE Europe Energy Outlook 2021/2022", https://www.iene.eu/en/congress/47/iene-study-see-energy-outlook-2021-2022
12. IENE (2022b), "The Current Energy Crisis, Energy Security Implications and the Impact on SE Europe", *Monthly Analysis No358 (March-April 2022)*
13. IEA (2022), "World Energy Outlook 2022", https://iea.blob.core.windows.net/assets/830fe099-5530-48f2-a7c1-11f35d510983/WorldEnergyOutlook2022.pdf
14. Sheppard, D. (2023), "Europe's energy war with Russia is not over, warns IEA chief", https://www.ft.com/content/a3649a57-122b-4418-a44e-f306c194ad74
15. Bordoff, J. and O'Sullivan, M. (2023), "Why we need to rethink energy security in the transition to net-zero", https://www.weforum.org/agenda/2023/01/davos23-rethink-energy-security-transition-net-zero/

IENE SEE ENERGY BRIEF MONTHLY ANALYSIS - Issue No. 380 – ISSN:179-9163
Contributed by IENE's Research Team
Monthly Analysis is published by the INSTITUTE OF ENERGY FOR SOUTH-EAST EUROPE (IENE)
3, Alex. Soutsou st. 106 71 Athens, Greece, T: +30-210 3628457, 3640278, F: +30 210 3646144, marketing@iene.gr, www.iene.eu