



2019 Global
Energy Outlook

Energy security and political rhetoric influence energy markets

The intersection of Politics and Energy Policy is a busy one. Unfortunately, not everyone agrees on the traffic signals and, as a result, there's a lot of gridlock. Even as scientists warn that world leaders are running out of time to take comprehensive action on climate change, some politicians are still debating the existence of the problem. Across the globe, the carbon-free-future campaigners are in a tug of war with the fossil-fuel advocates. Bold plans set in motion by one administration are postponed or cancelled by the next.



In the **United States**, the Trump administration is opening up protected public land and offshore waters for gas and oil drilling. At the same time, market forces are tipping in favor of renewables. According to a Reuters analysis, more coal plants closed during President Trump's first two years in office than during the first five years of the Obama administration. Utility executives have realized they can generate more revenue from a new wind farm than a new coal plant, with or without federal subsidies.



In **Australia**, the Liberal and National parties want to guarantee coal's future with a \$5 billion fund for power plant construction. The Labor Party, meanwhile, wants to set even more ambitious targets for reducing emissions than the ones set by the Paris Agreement.



Even in the **European Union** – where politicians are taking steps to address climate change – progress has been slow. In England, coal-fired power production may spike in the first quarter of 2019 as the country tries to find a clear path to leave the European Union. There is regulatory uncertainty in France and Germany, as well, in regard to long-term energy plans. Leaders say they want to phase out coal, but there is uncertainty about the speed and specifics of the transition. At the start of the year, French President Emmanuel Macron paused a planned tax increase on fossil fuel to allow a national debate on energy policy.

Changing political winds and the associated uncertainty complicate short- and long-term planning for corporations. Government energy policies – those simply debated and those haltingly implemented – affect global energy prices, as well. This slow, sometimes contradictory, process makes it a challenge to build an energy strategy.

In 2019, energy buyers must remain alert in tracking political developments, as well as traditional concerns about energy security, and trade policies and sanctions, for example, to understand the impact on energy markets.

Trump and Trade: The Impact on the Energy Sector



In the U.S., Congress is divided, with Democrats controlling the House of Representatives and Republicans in charge of the Senate. There is no one policy or piece of legislation influencing the energy markets. There are some incentives for renewables, but these are offered at the state, not federal, level and vary from program to program.

The most important dynamic for American consumers is trade policy. President Trump has more latitude to act in this area without involving Congress and oftentimes his rhetoric has as much influence as his policy actions.

For oil producers, Saudi Arabia and Iran are the countries to watch in 2019. Trump's Twitter tactics have put Saudi Arabia in an uncomfortable spot. He thanked the kingdom in November 2018 for a "tax cut for all Americans" delivered by lower oil prices. In an earlier tweet, he said, "Hopefully, Saudi Arabia and OPEC will not be cutting oil production. Oil prices should be much lower based on supply!" OPEC colleagues want higher prices, but Saudi Arabia will want to balance a desire to preserve its relationship with the U.S.

Trump has further influenced the supply and demand of oil by re-imposing sanctions on Iran after unwinding the terms of the Joint Comprehensive Plan of Action nuclear agreement. Restrictions on sales of oil and petrochemicals from Iran technically took effect on November 4 last year, though the administration offered a six-month waiver that allows the largest consumers of Iranian oil to reduce purchases gradually. This includes the European Union, Turkey, China, Japan, India and South Korea. Subtracting that supply from the global market would have reduced supply by ~2.5 million barrels a day. There is no way to predict whether sales of Iranian oil will taper off gradually or stop abruptly; however, Trump's Iran policy may contribute to higher prices as a result. As of early 2019, exports have already dropped well over 1 million barrels per day and should continue to about 2 million barrels per day based on current estimates.

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For natural gas suppliers, the issue is access to Asian markets. Producers and liquefied natural gas (LNG) companies in the U.S. have been expanding export capabilities for LNG for an increase of 60 to 70 percent in capacity. Demand is strong in Asia for liquefied natural gas. The unresolved tariff war between the U.S. and China has the potential to curtail access to these new markets and limit new investment.



Economics vs. Energy Security in Europe

New energy export infrastructure in Europe is also causing tension. The Nord Stream 2 pipeline would double the capacity of an existing pipeline to 110 billion cubic meters per year – more than 25 percent of the European Union's (EU) gas consumption. Western European country leaders generally support the project, while central and eastern countries do not.

Since it was first proposed, Germany has framed the project in economic terms. The new pipeline will make Russian gas cheaper for German consumers. Other European leaders have said that building the pipeline sends a signal that Europe is back to business as usual with Russia, despite the alleged election interference, support of Bashar al-Assad in Syria, and ongoing hostilities in eastern Ukraine.

A strictly economic analysis of the benefits of the pipeline quickly gives the obvious economic answer: build it. Russian pipeline gas is cheaper than imported LNG from the U.S. (or anywhere else for that matter). However, when energy security takes on greater importance, the calculus changes. Supply diversity becomes an important defense against Russia using its increasingly powerful leverage granted by Europe's reliance on Russian gas supplies.

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Gazprom – Russia's state-owned gas company – is leading the project, which would replace volume that currently goes through Ukraine, where transit fees contribute between \$2-3 billion dollars to the Ukrainian economy every year. In addition to Ukraine's financial loss, eastern European countries would also lose leverage with Russia if their land no longer hosted a vital pipeline.

At a NATO summit in July 2018, President Trump accused Germany of being held captive by Russia because of this pipeline. In January, the Trump administration threatened to sanction Russia and construction companies building the pipeline, but construction continues. Russian leaders promised to complete construction even under sanctions and President Vladimir Putin claimed Gazprom could complete the pipeline without external funding, if necessary. Collectively, Shell, Germany's Wintershall and Uniper, France's Engie, and Austria's OMV are paying half of the construction costs.

In addition to making threats, the Trump administration has taken diplomatic steps to protect the market for U.S. gas in Europe through a partnership with Poland on a Joint Declaration of Energy Security. In parallel – and to further reduce its dependence on Russian pipeline gas – Poland plans to increase imports of LNG from Qatar and the U.S. In October, Polish Oil & Gas finalized two contracts to purchase approximately 1 million tons of LNG annually for the next 20 years from an American supplier.

The Trans Adriatic Pipeline (TAP) is another hedge against Europe's complete reliance on Russian gas. TAP is the last leg in a pipeline that will transport natural gas from Central Asia to Western Europe. Project leaders closed the last round of financing in December 2018 and expect the first delivery of gas in 2020. TAP represents 3.9 billion euros in the total budget of 40 billion euros for the Southern Gas Corridor.

Connecting with the Trans Anatolian Pipeline (TANAP) at the Greek-Turkish border, TAP will cross Northern Greece, Albania and the Adriatic Sea before coming ashore in southern Italy. According to Reuters, TAP will be the first non-Russian gas pipeline to supply Europe since the Medgaz link connected Algeria to Spain in 2011.

Brexit and More Regulatory Uncertainty

For EU and U.K. leaders, the challenge is figuring out new regulations to guide a similarly difficult transition: *Brexit*. For energy markets, one of the top issues is the EU's Emissions Trading System (ETS). If Britain leaves the EU with no plan in place, the most likely options are the creation of its own carbon trading system or the implementation of a new carbon tax. In contrast to the moving ETS price, a carbon tax would be reportedly fixed at between 16 and 18 pounds per tonne.

Before these decisions are made, generators will be in a temporary regulation-free zone during the first quarter of 2019. As with everything connected to Brexit, it's complicated. The current fee scheme will be retired before the new one goes into effect, boosting the margins for coal-powered generation. If generators know before April that the U.K. is leaving the ETS, generators could expect lower emission costs. This is only a temporary reprieve, however, as the U.K. has laws that make carbon much more expensive than other EU countries. This is why the country has been able to eliminate coal-fired power almost entirely.

In the longer term, limits on energy trade between the U.K. and the EU – whether through regulatory barriers or decreased physical interconnectivity – will increase overall price volatility. The U.K. government will still have the triple challenge of securing energy supplies, cutting carbon emissions and providing affordable energy. U.K. leaders likely will face higher transportation costs and decreased EU investment in the U.K.'s energy infrastructure. And, the ongoing uncertainty around Brexit and its impact will discourage outside investments in general.



The Brexit challenge for EU leaders will be filling a 13.45-percent revenue gap created by Britain's departure. In February 2018, a group of former EU officials recommended the implementation of new carbon taxes to address this shortfall. An annual fee of 5 euros per ton of CO₂ generated from burning fossil fuels would generate 17 billion euros per year. The group also suggested raising or adding fees on diesel fuel, kerosene and airline tickets. This push toward higher energy taxes got an additional push from the Organisation for Economic Co-operation and Development report on taxes on fossil fuels. Researchers found that current worldwide tax rates on energy use are inadequate to compensate for the toll pollution from energy production takes on the environment and on human health.

Vehicle Fuel Tax Fuels Unrest in France

The French government also got a painful reminder of the public backlash that new fees related to energy and fuel use often provoke. Earlier, President Macron's government planned a January 1 increase in vehicle fuel taxes to support emissions reduction. (Increases in gas and electricity prices this winter and stricter rules for vehicle emissions tests were planned, as well.) Macron was forced to delay all the measures after several days of riots, vandalism and four deaths.

This public protest in France mirrors a similar reaction to a 90s-era gas tax increase scheme in Britain. The fuel duty escalator increased taxes on gasoline from 1993 through 1997, until the fee reached 75 percent of the total cost of one liter. Britons went from paying some of the lowest fuel prices in Europe to among the highest. The increases stopped at that point, until 2006, when additional taxes pushed the tax portion of a liter of fuel over 80 percent. Politicians abandoned the scheme after 2011 due to its unpopularity. The increase planned for 2017 was cancelled, reflecting the persistent challenge of increasing fuel prices to balance the impact of rising carbon dioxide levels.

Australia: More Coal or No Coal?

In Australia, the debate centers around the fuel source that has long been a cornerstone of Australian energy policy: *coal*. The Liberal Party wants to stick with coal despite renewable generation cost falling below the cost of new coal-fired generation. The Labor Party wants to accelerate coal's retirement. A staggering 70 percent of Australia's electricity is generated from coal, though that figure is down from 80 percent only a few years ago. Between 2019 and 2035, many coal-fired power plants in Australia will reach 50 years of age, and it's likely that over half will be retired.



However, the right wing of Australia's Liberal Party wants to build new coal-fired power stations as a means to pressure power prices, while the more center-left Labor Party wants to increase efforts to meet the Paris emissions targets and argues that renewable energy is cheaper than new coal-fired generation. The current target calls for a 27 percent reduction of carbon dioxide (CO₂) emissions by 2030. Labor's proposed target is a 45 percent reduction by 2030, but it is unclear whether they can implement any of their policies. There are suggestions that the Labor Party may take a majority of seats in the upcoming 2019 election, which would only help its cause.

These radically different potential futures are restraining investment and creating price uncertainty in a country where declining reliability of aging coal-fired generation and increasingly extreme weather events are pushing prices up, while the current wave of new renewable energy generation would be well-served by additional flexible generation.

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Former Prime Minister Tony Abbott was elected in 2013 on a promise to repeal Australia's carbon tax before a sharp drop in popularity saw him replaced. Malcolm Turnbull, his more centrist successor, committed Australia to the 27 percent Paris agreement target. To meet the target, he proposed the "national energy guarantee," or "NEG" in 2017. The NEG sounds like a fair compromise: It requires energy retailers to provide a sufficient and reliable source of power while lowering emissions at the same time.

Generally, business leaders still favor the plan, while both the right wing of the Liberal Party and environmentalists are against it. The right because it may reduce coal output, while environmentalists object to the lack of ambition in the target set by Turnbull. Australia is set to largely meet the Paris target for the electricity sector on the back of renewable generation currently under construction. However, a further increase in the target may push more coal-fired generation out of the market, which could increase prices and reduce reliability without investment in new balancing capacity. No one can agree on how to manage prices in conjunction with emissions and reliability or what the right path forward is. The central question is whether it's viable for Australia to keep swimming against global initiatives to reduce carbon emissions.

Strategies for Tracking and Understanding Political Changes Worldwide

Tracking the economics behind the energy market is a significant and ongoing challenge. Buyers must take a comprehensive view of all the factors that affect the market. Monitoring political changes makes it easier to respond to regulatory and economic shifts.

It's tempting to leave the work of negotiating regulations in the hands of local, state and federal politicians, but that runs counter to an **Active Energy Management** strategy. Often, network operators, generators and retailers will lobby against new competition and in favor of additional market regulations that discourage competition. Without the consumer's point of view to influence the conversation, generators are able to maintain outsized influence on the market and end users end up picking up the tab for any extra costs that influence creates.

It's crucial for end users to engage governmental decision-makers as part of the regulatory process. Energy consumers should know how regulatory changes will affect their organization, then act proactively and plan accordingly.



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