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Asia's energy security trumps green push

Russia's invasion of Ukraine has rattled energy markets and led to governments in Asia fretting about energy security. The importance placed on energy security has meant that the green push from governments could be derailed, at least in the short term



Emission allowance prices fell in February to the lowest level since July 2021

Russia-Ukraine war pushes fossil fuel prices higher

The Russia-Ukraine war has upended global energy markets, and the impact of this has been felt most by Europe, which is heavily dependent on Russian natural gas, oil and coal. However, given the nature of energy markets, the impact is being felt across the globe, including in Asia. Reduced Russian pipeline gas flows to Europe have meant that Europe is having to rely more on liquefied natural gas (LNG) supplies, and in doing so is competing against Asia for this supply. This has tightened LNG supply and pushed up LNG prices in Asia. In addition, the sanctioning of Russian oil and coal by Europe has meant that European buyers are looking elsewhere for supply. While some Asian buyers, such as China and India, may be willing to take advantage of the large discounts available for Russian fossil fuels, this is not true for all Asian countries. For example, Japan and South Korea appear to be moving away from Russian fossil fuels.

What has made matters worse for a number of key importers is that not only are we seeing higher fossil fuel prices, but the strength in the US dollar has meant that the pain from higher prices is even more acute.

One would expect that the high fossil fuel price environment would speed up the green push from governments across Asia, particularly given that a number of these economies are large net importers of energy. However, clearly, the deployment of renewables takes time and will not ease security concerns in the short term. Therefore, we are likely to see more of a push to boost the supply of fossil fuels and therefore the reliance on these dirtier fuels.

More coal please

Admittedly, we were seeing growth in coal output prior to Russia's invasion of Ukraine. China boosted domestic coal output in the second half of 2021 due to its own domestic energy crisis, which saw electricity rationing. China's coal output in 2021 hit a record 4.07bn tonnes, up almost 6% year-on-year. This growth has continued this year, with output over the first six months of the year up 12.6% year-on-year. In addition, there are suggestions that China is potentially looking to end its unofficial ban on Australian coal imports.

India has also had to deal with its own power crisis, not helped by hotter than usual weather boosting power demand. India has also tried to increase domestic coal output. According to numbers from the Ministry of Coal, output over the first three months of the fiscal year starting in April totalled almost 205mt, up around 31% year-on-year. India initially wanted to grow domestic production in order to be less reliant on imports. However, given the tightness in the domestic coal market, the government is now pushing for a boost in imports, along with higher domestic output.

The other factor which will be supporting coal demand in Asia is the strength of the LNG market. Tighter LNG supplies and higher prices mean that some countries will have to rely on relatively cheaper and dirtier fuels, so turning increasingly to coal and even oil for power generation needs. Looking at relative prices for LNG, thermal coal and fuel oil, the cheapest fuels are fuel oil and coal. Given that European demand for LNG is likely to remain robust for the foreseeable future in what is already a tight market, LNG prices will remain elevated.

Furthermore, inflation concerns have seen a number of countries increasing subsidies or cutting taxes on fossil fuels, although this move is not isolated to Asia and we are seeing a number of governments around the world going down this route. However, this goes against pledges made at COP26 in Glasgow to work towards phasing out fossil fuel subsidies. While not a great image for the energy transition, it also does little to help solve tightness in these markets, given it delays the demand destruction that some of these markets need to see.

It is not all bad news, however. While a number of countries will be looking to fossil fuels to shore up their energy supply, there are some that are looking for other alternatives. Japan

recently announced that it wants nine of its nuclear plants up and running by this winter, up from the five which are currently operating. This would help with energy security concerns during these uncertain times. And while this is a low emission alternative, there will be some concern when it comes to safety, given the Fukushima incident is still in the back of people's minds. There are also other countries in the region that are looking more favourably at nuclear power. South Korea is restarting the construction of two reactors, the Philippines is looking to include nuclear power in its energy mix, and Singapore is exploring the potential for nuclear as well.

Short term pain, long term gain?

It is concerning the degree to which we have seen governments going back on pledges to phase out fossil fuel subsidies and reduce coal output. This action will do little to help reduce carbon emissions in the short term. However, the longer elevated fossil fuel prices remain, the more pressure there will be on governments to tackle the issue and look for alternatives, including renewables, nuclear and other low emission solutions. This suggests that we could see a quicker deployment of renewables capacity, at least for those Asian nations which are heavily dependent on energy imports. China stands out on this point, with yet another record deployment of solar and wind capacity expected this year. In fact, estimates of solar and wind deployments in China over 2022 are equivalent to around 54% of total installed wind and solar capacity at the end of 2021 in Asia (ex-China).

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