

## Session 2: Cooperation in the Oil Sector

### Keynote Report

# *Japan's Need for Russian Oil: A shift in energy flows to the Far East*

MOTOMURA, Masumi

Senior Advisor and Chief Researcher, Japan Oil, Gas and Metals National Corporation (JOGMEC)

To date the energy flows from Russia have been aimed at Europe. Over the last few years a large-scale new flow of crude oil of approximately one million barrels per day has come into being, directed toward Asian markets from the Russian Far East. The flow of natural gas has also taken up this trend, and is taking aim at Asian markets.

Following that, I would like to see what kind of impact Russian oil has had on the Japanese market. At Sakhalin I they commenced production in 2005, and oil exports commenced in October 2006. Currently a daily volume of 160,000 barrels is produced, and is exported from De-Kastri.

At Sakhalin II the Trans-Sakhalin Pipeline was completed in 2008, and oil and gas are able to be transported to Prigorodnoye on the southern edge of Sakhalin. The year-round production of oil has become possible, and currently a daily volume of 84,000 barrels is being produced. As for LNG, production commenced in March 2009, and capacity is an annual production of 9.6 million tonnes.

For the ESPO (Eastern Siberia-Pacific Ocean) pipeline, the stretch from Tayshet to Skovorodino is ESPO-1 and that from Skovorodino to Kozmino is ESPO-2; commencing operation at the end of 2009 the first stage (ESPO-1) has a daily volume of 300,000 barrels, and at the end of 2012 they aim for export of a daily volume of 600,000 barrels

with the second stage (ESPO-2). The spur to Daqing began operation at the beginning of 2011 and a daily volume of 300,000 barrels is flowing to China.

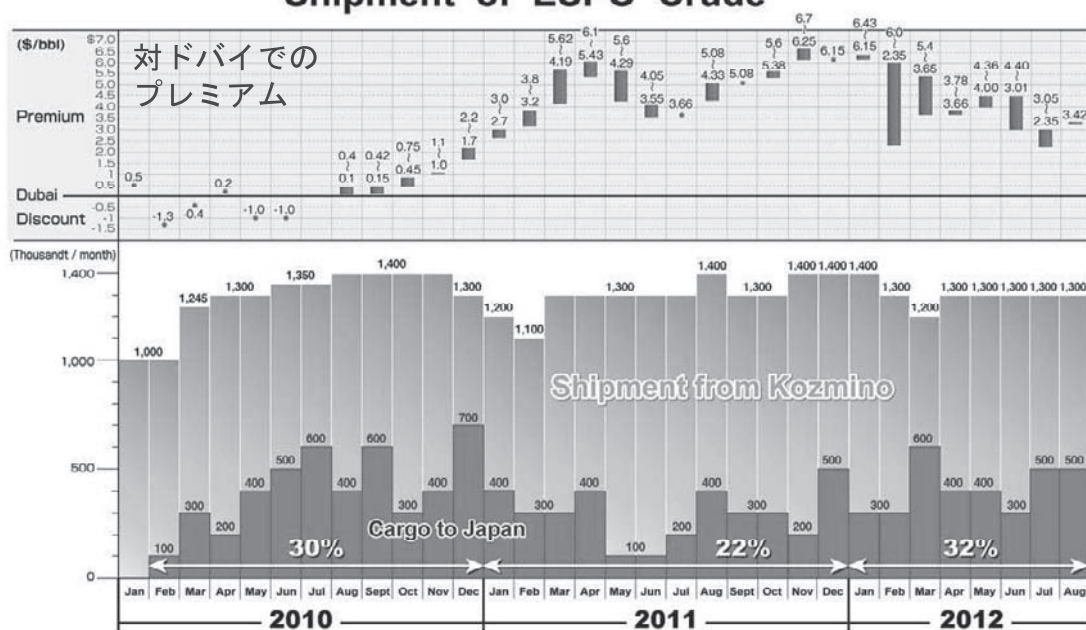
The export results for each month for ESPO crude oil since January 2010 are an average of 1.3 million tonnes, and have been exported in 13 cargoes on 100,000-tonne tankers. In 2010, 30% of the total export volume went to Japan. That year exports to Japan were the largest.

In 2011, with the fall in demand due to the earthquake disaster, Japan's imports also dropped greatly to 22% of the total. Japan's demand for crude oil that year saw an 8% decrease. The ESPO decreased on a scale greater than this. That is something that is due to the situation, with a large amount of other sources of crude oil being in long-term contracts, of imports being curtailed in advance from ESPO crude, which is spot traded. For 2012, Japan's economy has practically recovered, and as of August Japan's import volume was 32% of the total, and is showing that there is prime demand. It is based on preliminary reports, but it is held that for October Japan imported close to 60% of the total. Looking through to the end of the year it will probably be a value close to 40%.

Looking at the premium (US\$ per barrel) for ESPO crude oil as against Dubai Crude, for the first half of 2010 it wasn't a premium, but became a discount, and it was rather unpopular. This, as the announcements of the properties,



## Shipment of ESPO Crude



etc., of ESPO crude were insufficient, is why the market reaction was weak. As the situation for ESPO crude has become clear, it has become extremely popular. When high it is US\$6, and recently, with a high premium attached of US\$3, it is popular.

The highness of Japan's degree of dependence on Middle East crude oil has become a problem, and how to diversify it has been a long-time policy issue. In 2006, when Russian crude oil from Sakhalin-I began being imported, it was 1% of the total, but in 2010, when ESPO crude oil was added, it became 7%. On the other hand, the degree of dependence on the Middle East was 89% in 2006, and went down to 86% in 2010. After ESPO-2 commences operation, in 2013 or 2014, Russian-produced crude oil will have a share of close to 10%, and it is expected that Middle East crude oil will be around 80%. Such changes, with Japanese investment in Sakhalin having borne fruit and crude oil exports to Japan having increased, are due to the results of Japan's active investment efforts.

Looking at the properties of the world's main crude oils, there are reports that for ESPO crude oil the API gravity is a medium 35 degrees, and the sulfur content is 0.6% and has recently fallen to 0.55%, and it is of extremely good quality. At the same time as ESPO crude oil being popular, the crude oil price is also high.

Why is Russian-produced crude oil welcomed? The three factors for energy security are security, flexibility and economics. ESPO crude oil is of good quality and expensive, and in economic terms is somewhat problematic, but the reason it is accepted widely in Northeast Asian markets, including Japan, is because it excels in the factors other than economics. The seas around Japan are extremely safe ones, and don't have the choke points of the Hormuz and Malacca Straits. In addition the crude oil from the Middle East takes 20 days for transportation, but from Sakhalin and Kozmino it arrives in 2 or 3 days. Moreover, Russian-produced crude oil differs from that produced in

the Middle East and has no "destination clause". With the resale of crude oil possible it is possible to also purchase it from intermediaries. In this fashion, it can be said that ESPO crude oil has an excellent quality that outweighs its high price, and that it is very popular.

In 2011, in contrast to the import of ESPO crude oil having greatly decreased, Japan's LNG imports increased 11% with the halting of nuclear power generation owing to the earthquake disaster. Qatar's share also increased, by 4.3 million tonnes from 11% to 15%. For Russia also it increased 1.1 million tonnes, but its share remained at 9%. On Russia's part, in the future, through pushing forward the LNG projects such as a Vladivostok or Sakhalin II third train, it will be a policy line for increasing the LNG supply to the Asian region. As the increase in LNG supply to Japan was due to a direct order by (then) Prime Minister Putin immediately after the earthquake, the position of emphasis on the Japanese market is strongly apparent.

Japan-Russia energy cooperation has a long history, beginning with the development of Sakhalin in 1974. As a recent intergovernmental agreement there is the "Japan-Russia Action Plan" which was concluded between Prime Minister Koizumi when he visited Russia in January 2003, and President Putin. There, along with cooperation by both countries on Sakhalin, etc., it was declared that: "both sides support the development of cooperation among corporations from both sides in the oil and gas field development sector in the Russian Far East and the Siberian region".

The next agreement is the "Initiative for the Strengthening of Japan-Russia Cooperation in the Far East of Russia and Eastern Siberia" which was concluded between then Prime Minister Abe and President Putin on the occasion of the 2007 Heiligendamm summit. On the matters relating to energy "secure stable energy supply for the mid- and long-term energy security of the countries of the Asia-Pacific and the development of the Russian Far

East and East Siberia" was declared.

JOGMEC, based on such bilateral intergovernmental cooperative relations, has been dedicating itself to promoting collaborative projects with Russia in East Siberia. Recently the private-sector Irkutsk Oil Company (INK), which has its base in Irkutsk Oblast, and JOGMEC, in collaboration developed oil development projects in three blocks of Irkutsk Oblast, and discovered oil and gas in each. The target blocks are Severo-Mogdinsky, Zapadno-Yaraktinsky, and Bolshetirsky. Those results will be explained in detail in the following address. Subsequently, in June 2012 JOGMEC reached agreement with Gazprom Neft on conducting joint exploration in the Ignyalinsky block of Irkutsk Oblast. Work on the ground is planned to develop next financial year.

As to why Russian energy is important, I present the following conclusions:

- 1) In order for Japan to attempt to diversify and alleviate its excessive dependence on the Middle East, it is

necessary to secure new energy supply sources.

- 2) Via new crude oil from Russia entering into the Asian market, competition is being facilitated, and it is expected to lead to the weakening of the price of crude oil from the Middle East.
- 3) Russia, due to its proximity, safety and flexibility regarding Japan, can be called the most appropriate energy supplier, and will strengthen the counteracting of traditional Middle East oil-producing countries, which supply under long-term contracts and destination clauses.
- 4) Regarding gas, Russia in its current situation is a minor supplier, but in terms of resources there are ample reserves in Sakhalin and East Siberia, and in addition, due to their proximity to Japan, it is expected that they will become important supplier regions in the mid- to long-term.

[Translated by ERINA]