

Beijing signs for Russian gas supplies – a boost for both partners over U.S. interests

The business deal is massive. The long-term implications for the geopolitics in East Asia are much greater with the signing in Shanghai Wednesday by Russia's Vladimir Putin and China's Xi Jinping which will see, from 2018, Russia's Gazprom sell 38 billion cubic metres of gas a year to China National Petroleum Corp. ✖

A very telling point is made in today's *The Financial Times*: that there exists a strategic triangle encompassing Washington, Moscow and Beijing, and that if two of those players forge a strong relationship then it freezes out the third. Thus Nixon's opening to China left Moscow out in the cold, and on its own, and helped lead to the the weakening of the former U.S.S.R. Now Moscow has, with the new gas deal, forged a strong tie with Beijing. A victory for both, or so it would seem.

Or maybe not. China is going to be the main beneficiary. The triangle analogy is not quite sustained by the fact that Russia actually comes in second place. Yes, it will earn \$400 billion from piping gas to China, but as the *FT* also notes that is only one-quarter of the gas it sells to Europe, and the future of that business (sanctions in the short term, LNG from the Middle East and the U.S. in the longer term) are in question.

If however, Moscow can now build on this deal to get into other Asian markets, then that will be another matter. As I reported here on Investor Intel just a month ago, the Russians forgave almost all of North Korea's debts in April as a trade-off under which Pyongyang will allow the Russians to build a

pipeline across the DPRK to supply South Korea, a huge importer of gas. The pipeline that will be laid to supply China from Russia will allow development of gasfields in eastern Siberia – and once those fields are in business, Russia has plans to build a liquefied natural gas plant at Vladivostok to supply LNG to South Korea, Taiwan, Japan and China. There is already an LNG facility on Sakhalin Island, which could also be expanded to supply Asian markets.

There is little doubt that the U.S. is the one out in the cold. Apart from the geopolitical relationship with China as signified by the agreement signed in Shanghai, the Russian gas coup has tremendous implications for the big shale gas plans harboured by the Americans. It was these Asian markets – China along with three staunch U.S. allies in Taipei, Tokyo and Seoul – that are being targeted by American energy companies and the potential of these markets as an export market was the main impetus for the U.S. investment in LNG.

China is certainly a big winner. It has apparently driven a hard bargain on price secure in the knowledge that the Russians are clearly anxious about their European markets, and revenue from which is an important pillar of the Russian economy.

A note from Deutsche Bank's London analyst Michael Hsueh says the East Siberia fields were too far from Europe to justify developing them for that market, and gaining a large customer in the form of China is a substantial economic victory. "It also gives Russia an opportunity to access an Asian market which is increasing in demand as opposed to the European market which is generally shrinking," he wrote.

Of the top 10 countries by GDP, China has the smallest share of natural gas as part of its energy mix – just 4.7%. Russia has more than 50% of its domestic energy needs supplied by gas, the U.S. 30% and even India and Brazil have integrated natural gas into their economies more than has China, the

country with the worst air pollution of all 10.

Hsueh deduces from the wording of the agreement that China has decided to take the fast from East Siberia rather than earlier plans to tap the West Siberia fields and pipe the bags to Xinjiang province in China's west. He points out that, while Russia will be cheered by the prospect of finally tapping the East Siberia gas, the choice of the western route would have strengthened Gazprom's hand in negotiating terms with European customers.

Clearly, American energy strategists and companies will be looking at their own plans in light of this development (although it is hardly a surprise: discussions had been under way, on and off, for 10 years). Perhaps it might lead to their taking more interest in Western Europe LNG markets, After all, the Europeans want to free themselves of Russia's gas grip.