MACRO TOPICS

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POLICY: RUSSIAN FAR EAST CLOSER TO DEVELOPMENT

Neighbours are expressing interest to further support the process, but looking for good returns.

Russia's eastern territory now seems to be the next big thing for the country's government. After decades (or maybe centuries) of being overlooked, the area's potential is now more appealing than ever before, leading Mr. Putin to prioritise the local development process, as stated at the Eastern Economic Forum held in Vladivostok earlier this month. Opportunities in the Russian Far East could attract the interest of neighbouring East Asian countries, whose support would be essential to speed up developing high-technology production facilities, financing infrastructure projects and advancing the economy.

The South Korean President, Park Geun-hye, and the Japanese Prime Minister, Shinzo Abe, attended the forum in Vladivostok, just two-and-a-half hours away both from Seoul and Tokyo by plane, to meet Mr. Putin. All three leaders were keen to discuss the co-operation, looking for synergies between the resources and low costs available in Russia's Far East, and the developed know-how and markets of East Asia. The result was rather impressive, with several agreements and investment deals immediately finalised during the forum.

Japan's interest has so far been focusing on the Russian Far East's greenfield projects, with USD 4.2 Bn invested since 2003. China followed with USD 1.7 Bn and South Korea with USD 992 Mn. But diversifying away from primary sectors could prove to be a steep challenge. Inward investment mainly targeted the resources sectors, with metals accounting for USD 7.1 Bn of the USD 17 Bn invested in the region's greenfield in total since 2003, with coal, oil and natural gas capturing USD 4.3 Bn. Only automotives among all non-resources have broken the billion-dollar mark during the same period, with investments of USD 1.1 Bn.

Energy supply and relevant infrastructure required are important to attract investment in productive sectors, but they also provide further opportunities for investors if they are less developed. A Far East Development Fund was created to offer cheap financing, while land is given away for free for development and some of its subsidies will focus on the construction of infrastructure.

But of greatest importance is manpower. Only 12 out of the 66 cities within the Far Eastern Federal District have a population of over 75,000. As stated by former Australian Prime Minister Kevin Rudd, the region has the size of Australia in terms of land mass but the population of Singapore.

The other key to success or failure is without doubt politics. After emphasizing the benefits of the constantly improving relations between Japan and Russia, Mr. Abe mentioned the need for a final peace agreement between the two countries, lacking since the end of the second world war, and a resolution of territorial disputes over the Kuril Islands. Mr. Putin, however, said that he would only view either issue focusing on national interests, and was not willing to trade territory for economic deals.

DRY CARGO: LOSING THE BATTLE?

Is the Chinese effort to reduce overcapacity in its steel sector working, and what will the impact be for the Capesize market?

On Tuesday 20 September, news broke that two of the China's largest steel producers are to be joined. The companies in question are Baosteel and Wuhan Iron and Steel, two state owned behemoths which when combined is estimated to have over USD 100 Bn in assets, producing as much as 60 Mn T of steel per year. This would make it the second largest steel producer in the world, second only to ArceolMittal.

While Baosteel, a company that brings in about three times as much revenue as Wuhan, might not appreciate the merger, the lossmaking nature of Wuhan, and indeed much of the Chinese steel industry is what necessitates such a move. Last year the sector lost as much as USD 10 Bn, 90 per cent of which coming from state-owned companies.

The build up towards this merger has lasted a few months, and now that the restructuring approaches its final stages, the merger sets the precedent for a range of other high profile consolidations. Examples of candidates include Bengang Steel Plates and Angang Steel as well as the Hebei Iron & Steel Group and Shougang Group. However, the viability of these mergers, all of them would create behemoths, is questionable. While it is true that the companies will be able to better exploit the economies of scale, there is a risk that the absorption of loss-making mills, as opposed to shuttering them, will create bigger, weaker and overall unprofitable entities.

Despite markets recovering over the summer, largely a result of increased Chinese investment set to curb the effects of the slowing Chinese economy, very real concerns remain as to the state of supply in the steel sector. While China has vowed to take care of the major supply gluts in its industrial sectors, saying in February that it would close 100-150 Mn T of steel capacity over the next 3-5 years, 45 Mn of them this year, there is the occasional slip of information suggesting that the efforts may not be all that effective. In May, a senior Chinese official said that there had been "no improvement in overcapacity", a fact that production volumes seem to confirm.

For the seaborne iron ore market, these developments are key. The big miners are looking to ramp up their production over the next couple of years, with Brazil and Australia being, according to a recent report from Citigroup Inc., set to add about 100 Mn T of supply each towards the end of the decade. Considering Brazil's Vale being about to start a four year ramp up of its S11D project, this may well come to pass. While likely to contribute to further price weakness for iron ore, it is also a bet that demand will grow to justify the investment. With the ongoing consolidation in the steel sector, and the prospect of future mega-mergers, the shuttering of capacity may well progress far slower than the international steel market would wish, while simultaneously lending continued support to the demand for iron ore, and by extension, shipping.

If the above indeed comes to pass, there is a possibility for some much needed relief for the capesize sector. However, it would be imprudent to forget the added seaborne capacity the introduction of 30 new Valemaxes in 2018-19 will bring. On long term COAs, these ships are set to make life more difficult for the capesize market, despite the recent uptick in rates.

Sources: Affinity Research, Business Times, The Economist, Reuters

CONTAINERS: NEXT BIG PORT FOR PHILIPPINES?

Mega Harbour to start work on the Davao project by early 2017 – cost estimated at PHP 39 Bn.

Mega Harbour Port Development, leading the coastline development project in Davao, expects to get the nod of the Philippine Reclamation Authority for its proposal and plans to start construction within the first six months of 2017.

"We are in the process of getting all permits from the national government. The target is to start construction before middle of next year, maybe during the first quarter. Once the Philippine Reclamation Authority issues a notice to proceed then we can start with the project," the President of Mega Harbour, Victor S. Songco, said on Friday at the 8th Davao Agri Trade Expo 2016.

The 200-hectare Davao Coastline and Port Development Project, a joint venture with the Davao City government, will cover the area from the Sta. Ana Port to Bucana, where the Davao River flows out into the gulf.

After the PRA, the project will have to be approved by the National Economic and Development Authority and then be subjected to a Swiss challenge according to Philippine law. Third parties could submit competing offers, and the original proponent will be allowed to match them. The current four-island plan includes commercial, industrial, tenement housing, and government components and an international port.

Mega Harbour officials confirmed almost all requirements have been submitted, such as traffic and financial plans, feasibility studies, and hydrologic and coastal engineering.

Mr. Manalili, Mega Harbour spokesperson and marketing head, said the project's port will not directly compete with the existing Davao Int. Container Terminal in Panabo City.

"DICT primarily services bananas and other fruits. If you look at the Davao Gulf, DICT can service the northern portion while ours can service the (Davao) city and the southern portion of Davao Region," he said.

Moreover, the proposed expansion of the Sasa Port, pending under the government's public-private partnership scheme, could meet the expected growth in cargo in the region. But the expansion of the Sasa port could prove problematic, due to limited expansion possibilities, offering an opportunity for Davao to have a port that could handle its needs for the long term. The Mega Harbour project also considers setting up a passenger terminal.

Mindanao will continue to be a premier food source and agribusiness producer, accounting for at least 60 per cent of the Philippines' exports. Relevant statistics suggest that the USD 3 Bn worth of Mindanao's agricultural exports grew by 16.7 per cent year-on-year, outpacing the national rate of only 7-8 per cent.

This will be the country's closest link to the Association of Southeast Asian Nations, currently comprising of nations within the sub-region of Singapore, Brunei, Malaysia and Indonesia.

Source: BusinessWeekly

TANKER: OPEC INDECISION NOT BAD NEWS FOR TANKERS

The larger tanker segments will be hoping that the latest attack in Nigeria was a one-off – the more cargoes the better.

Opec is due to hold their informal meeting in just two days' time during the International Energy Forum in Algiers, and it is becoming increasingly likely that the meeting and its conclusion will have little bearing on oil markets. Too many of the members are still keen to raise production, notably Iran and Iraq, and so a deal is unlikely to be agreed. Moreover, Opec has its next formal meeting scheduled officially for 30 November; there are slim hopes that an emergency official meeting will be called in the wake of the meeting on Wednesday, this that is unlikely. As it stands, the group is unlikely to agree on anything concrete before the end of November. From an industry point of view, this would be the preferred outcome.

Besides, the meeting has come at a bad time as far as Nigeria is concerned. The Niger Delta Avengers, the militant group with which the government has enjoyed an unsteady ceasefire since last month, have claimed responsibility for a new attack on Friday, damaging a Bonny export pipeline operated by Shell. The reason for this attack is thought to be comments made by President Muhammadu Buhari when meeting President Obama last week, which are believed to have suggested that a military push in the Niger Delta was necessary. The Nigerian government had been hoping to bolster its production, which fell to less than 1.4 Mn bpd, following the wave of militant attacks.

Nigeria will be hoping that any deal to freeze or cut production will fail to materialise while it once again tries to recover. On the positive side, the Forcados oil terminal is scheduled to be reopened at the end of this month, with a loading programme issued for October. The terminal has been closed since February, when Shell's Nigerian subsidy issued *force majeure* following a pipeline leak. The Forcados terminal has a capacity of 400,000 bpd; exports are estimated to be around 230,000 in October. The news will likely lift VLCCs and, in particular, Suezmaxes, which has undergone somewhat of a resurgence as of late, in no small part due to the recent rise of West African cargoes.

Comments made by Russian Energy Minister Alexander Novak have further dimmed the picture. He has been quoted as saying that reaching an agreement is "non-critical" for Russia, although it would still be "beneficial for all". Russian crude oil production has just recently broken through the 11 Mn bpd level for the first time.

Elsewhere, the port of Fujairah, the Middle East's largest commercial storage hub of refined oil products, has announced that it will publish weekly inventory data. The port is determined to establish itself as a global energy trading hub; its own oil products benchmark is expected to follow. The port handled 56 Mn T of oil products in 2015 and, just last week, it opened the United Arab Emirates' first VLCC jetty. Construction of a second is already underway.

Sources: Reuters, Bloomberg, Vanguard

GAS: NATURAL GAS STILL HIDES A DARK SIDE

It may be considered greener than coal, but natural gas still has its drawbacks.

Coal may still have some life in it yet, but it's still dirty, polluting and being legislated against on a global scale. Natural gas is the fuel most widely expected to be seizing most of its market share but just how credible are its green credentials?

Well, for a start, it produces nearly half as much CO_2 per unit of energy by comparison, and it also produces negligible amounts of sulphur, mercury and particulates. Fewer greenhouse gases, so far, so good, but you need to start looking further up the chain to see where natural gas possibly falters. Methane leakage is a huge issue and is far more damaging to the environment than CO_2. It is 34 times more potent than CO_2 at trapping heat over a 100-year period and 86 times stronger over 20 years. Therefore, any benefit of natural gas should include total life cycle emissions when compared to that of coal. A report in Nature by J Tollefson concluded that current methane losses need to be kept under 2-3 per cent for natural gas to have lower life cycle emissions than coal when burned in power plants. Right now methane emission estimates in the US associated with its natural gas network range from an unhelpful 1-9 per cent! It is likely, therefore, that in the US there are no current benefits from switching to natural gas from coal as far as greenhouse gas emissions are concerned.

As a whole around 1 Mn T of methane is leaked for every 14 Mn T produced in the US. Whilst two-thirds of all natural gas in the US comes from fracking, the amount of methane which leaks from this extraction method is relatively small, and the biggest source of the methane leaks are associated with the distribution systems and abandoned oil and gas wells. Whilst improvements are being made, other countries seeking to bolster their shale reserves, such as Argentina and China, should look particularly hard into developing more stringent technology and regulations to try and offset this before it becomes problematic. This will be especially hard for China, which would have large distribution channels as the shale basins are far from the surrounding cities and demand centres.

The "easy" switch to natural gas could potentially delay the onset of renewables as these are typically seen as costlier and harder to implement. At the end of the day, natural gas is still a fossil fuel and has its downsides, but if captured correctly can help lower emission levels to those less than coal. It will also result in many benefits not just for the environment but for air quality for large swathes of the population, especially in India and China. Rather than being seen as the final solution, however, natural gas is considered to be a bridging solution. While an improvement on coal, natural gas is still less environmentally friendly than renewable sources, which are the real end game.

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