

# ENERGY COMPASS<sup>®</sup>

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## THE BIG PICTURE

### US and Saudi Arabia Edge Toward New Understanding

- A high-profile meeting between US President Joe Biden and Saudi Crown Prince Mohammed bin Salman is on the table.
- Oil — a key component of politically fraught inflation — is a motivator to ease tension on the US side.
- For Riyadh, a better relationship looks like more action on security concerns and more high-profile recognition of Prince Mohammed as de facto leader.

After 18 months of keeping Riyadh at arm's length, the White House appears open to change: Biden reportedly could meet in the coming weeks with Prince Mohammed, the de facto head of the Saudi government. Persistent high energy prices in the run-up to US midterm elections in November appear to be affecting the Biden administration's calculation. There's no guarantee, however, that such diplomatic outreach will bring relief: Opec kingpin Saudi Arabia has its own wants and needs — and those include holding Russia close in the Opec-plus alliance, with an eye on the energy transition.

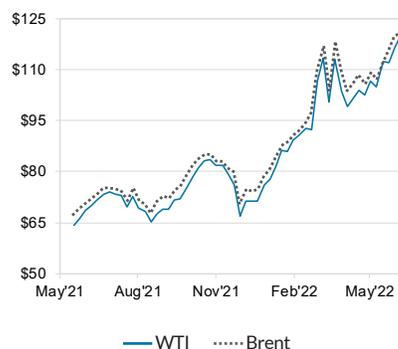
For Biden, "The politics are: High gas prices are really bad for him politically. Anything that brings those prices down help him quite a lot," said Brian Katulis at the Middle East Institute. Those high prices are a much greater political risk than the criticisms Biden faces from progressives critical of the crown prince, Katulis added.

The news of Biden's possible visit followed a late May trip by White House Middle East Adviser Brett McGurk and Energy Envoy Amos Hochstein to Riyadh. Opec-plus' Jun. 2 decision to increase planned supply additions by 50% for the next two months, accelerating the wind-down of the group's pandemic-induced production cuts, was described by US officials as "very positive." The extra barrels may be marginal for now but might lay the groundwork for further increases in production from September, a month ahead of schedule.

More broadly, the administration has "come to an understanding that this desire to peripheralize [Prince Mohammed], who is likely going to be king of Saudi Arabia for the next 40 years or so, it's not working," said David Schenker, the State Department's assistant secretary for Near Eastern Affairs during the administration of former President Donald Trump.

To that end, White House spokesperson Karine Jean-Pierre on Tuesday framed a potential meeting between Biden and Prince Mohammed as routine. "Every president since FDR has met with Saudi leaders, and the president considers Saudi Arabia an important partner in a host of regional and global strategies, including other efforts to end the war in Yemen, contain Iran and counterterrorism." Those comments are a marked change from Biden describing Saudi Arabia as a "pariah" on the campaign trail and the White House insisting that the crown prince and president were not diplomatic counterparts.

BRENT, WTI PRICES 2021-22 (\$/bbl)



Source: CME, ICE

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## No Automatic Relief

That's not to say that a smoother relationship with Riyadh will rapidly ease pricing pressure at the pump. While crude prices remain the largest factor in determining the price of gasoline, products markets remain tight: The world lost some 4 million barrels per day of refining capacity during the pandemic, and prices of jet fuel, diesel and gasoline are all high. The priority Saudi Arabia attaches to preserving the Opec-plus alliance with Russia, whose production is being hit by sanctions over the Ukraine war, could also mitigate against any major supply shifts. Mideast Gulf Opec-plus delegates reiterate that market conditions will drive output decisions when they next meet on Jun. 30, and they still see a global crude surplus by the end of the year.

## Signs of Progress

The political pressure related to high energy prices may be a motivator, but changes in two irritants in the bilateral relationship also make progress easier. The chances of achieving a nuclear deal with Iran now look narrower than at any point since Biden came to office pledging to renew the 2015 agreement strongly opposed by Gulf states. And a cease-fire in Yemen was extended last week (p4).

The prospect of negotiations over Iran's nuclear program ending also crystalizes the need for better exchange. "This effort to restore ties between Saudi and the US is partly driven by pre-emptive diplomacy. You want to be on better terms in case the region faces more turmoil soon," says Matt Reed at consultancy Foreign Reports.

At a more basic level, Gulf countries have been worried about the US commitment to the energy-for-military security exchange that has underpinned Washington's involvement in the region for decades. The perception is that the Biden administration has been slow to react to attacks and threats posed by Yemen's Iran-backed Houthis.

Key to assuaging those concerns is finding a "stronger agreement that buffers them from the vicissitudes of US politics," Katulis said, a difficult feat when the US is not inclined to a Nato-style agreement for the region. One way of doing that is adding US troops to the country as a signal Washington would be primed to retaliate if a key base were attacked, observers say. Integrating regional drone systems is another step the US could take to bolster regional security without a large troop commitment, Schenker said.

As officials work toward a high-profile meeting in the coming weeks, observers expect a focus on common ground, particularly with the planned visits of Saudi Commerce Minister Majid bin Abdullah al-Qasabi and Investment Minister Khalid al-Faleh to

Washington this month. Those could include announcements around investments or economic issues that concern leaders in both countries, such as regional food security.

"There's still so much to be gained by a strong relationship with the US that the Saudis can't forfeit it," Reed says, pointing in particular to technology investment.

## Grander Bargain?

Still, closer ties to Riyadh are clearly sensitive for Biden, who last week seemed to suggest broader regional issues were on the table when asked about a visit with Prince Mohammed. "Look, I'm not going to change my view on human rights but as president of the United States, my job is to bring peace if I can," Biden told reporters last week, saying he was focused on putting an end to "some of the senseless wars between Israel and the Arab nations."

The framing echoes the Abraham accords brokered by the Trump administration that triggered the normalization of relations between Israel and the United Arab Emirates. But observers so far seem skeptical of a similar formal normalization of Saudi-Israel relations, particularly under King Salman, even if some tentative steps toward that end are being made.

Biden's half-hearted return to an old formula — US as peacemaker — reflects the struggle to get to grips with the changed dynamics. Conventional US-Saudi ties started fading during the former Barack Obama administration, while Trump engaged in a very transactional relationship. Biden now finds himself needing to find some way to craft an effective US Saudi policy — but is treading on uncertain ground.

*Emily Meredith, Washington*

## POLICY

# EU Oil Embargo Plays the Long Game

*EU sanctions could start driving down Russian oil export levels in the coming months, as Brussel prepares to phase out most imports of Russian crude by a Dec. 5 deadline, and also eliminate its intake of Russian oil products by Feb. 5. Much has been made of Brussels' struggle to agree an oil embargo, amid protracted negotiations and exemptions granted to Hungary, Slovakia, the Czech Republic and Bulgaria. But these do not alter the likelihood that Russian oil will be shut out of most of Europe for years, possibly for good — even if, in the near term, higher prices mean the Kremlin is netting higher revenues than it was a year ago.*

• **The EU crude embargo is another five months away, so its short-term impact on Russia's economy will be minimal.**

In the medium to long term, however, the damage will be huge, especially if the war with Ukraine drags on and Russian President Vladimir Putin remains in power. For decades, the EU has been the dominant overseas market for Russian oil, with total imports of crude and products last year well in excess of 3 million barrels per day. Sanctions exemptions that will allow Bulgaria to bring in products via the Black Sea, and Hungary, Slovakia and the Czech Republic to continue importing Russian crude along the Druzhba (Friendship) pipeline, are the exception and not the rule. Such flows also account for a fraction of Russia's EU oil sales.

By contrast, Germany and Poland, which for over 30 years had been prolific importers of Russian crude via Druzhba, have slashed their Russian intake by tapping into alternative crude supplies brought in by sea, including from the US and Middle East. As far as they are concerned, there is no turning back.

Likewise, EU sanctions allowing only "strictly necessary" transactions with Russian state-backed oil giants Rosneft and GazpromNeft, pipeline operator Transneft and shipping firm, Sovcomflot came into force in mid-May, prompting the big Western oil traders Trafigura and Vitol to slash their Russian offtake and Western insurers and shipbrokers to steer clear of Russian-owned tankers.

Another knock-on effect of the EU embargo is that it will, almost certainly, force Russian oil companies that own refineries in Europe to give them up. This could soon happen in Germany, where regulators are looking to take over management of the 230,000 b/d PCK Schwedt refinery, in which Rosneft is a major shareholder, while Lukoil's three plants in Bulgaria, Italy and Romania are under serious threat. "Europe is closing its doors to Russian companies, that's the sad truth of the matter," a Russian oil executive now based in Europe says. "I don't think there's any way back."

• **European banks and insurers are also distancing themselves from Russia, and under the EU embargo they will be barred from handling any Russian oil delivered to "third countries," with the same deadlines applying.**

It has already become much harder to finance shipments of Russian oil, as fewer Western banks are willing to provide exporters with letters of credit. "This is why so much of the business has moved to Dubai," another Russian industry source says. "Banks in Switzerland don't want to touch Russian trade any more, it's too dangerous." He says Middle Eastern and Asian banks are happy to finance Russian oil purchases, as there is nothing to stop them

doing so, making Dubai an ideal base for Russian traders. Over a month ago, Lukoil's Geneva-based trading arm Litasco, shifted most of its trading to its Dubai office, a trading source familiar with the company says, while smaller traders dealing with Russia have also set up shop in the emirate, he says.

Insurers are also giving Russian oil a wide berth: Sovcomflot, which owns a fleet of tankers that were previously handling large crude shipments from the likes of Rosneft and Gazpromneft, is much less active than before, traders say. At the same time, more vessels owned by Chinese and Turkish firms have started to appear on shipping lists. "Russia has become very toxic, everything is now moving away from Europe, including insurance, and this is just the start of it," a veteran ship charterer says. This week, former Russian president and close Putin ally Dmitry Medvedev said Russia was prepared to send its own tankers without insurance, if necessary, but with the government's full backing.

• **Russia is banking on China and India, and a lesser extent Turkey, to fill the gap that will be left by the EU.**

Since the war started, Chinese and Indian refiners have upped their imports of Russian crude — largely for economic reasons, as the barrels are heavily discounted, sometimes as high as \$30-\$35 per barrel. Rosneft, for example, has started selling crude directly to India's largest refinery, Indian Oil Corp., and it continues to supply the 400,000 b/d Nayara Energy (formerly Essar) in which it owns a 49% stake. China remains the dominant buyer of Espo blend crude shipped out of the Kozmino terminal in the Far East, and is also taking barrels that come from Baltic and Black Sea ports, port data show. Turkey has also upped its Russian crude imports in recent months, some of which is supplied by a Dubai-based trader Coral Energy.

How much more Russian crude India and China are willing to buy once the EU embargo comes into force is an open question, although Moscow is now looking at upgrading existing infrastructure in the east. India is likely to come under strong US and European pressure to reduce its Russian imports, although government officials have pointed out that most EU countries are swelling the Kremlin's coffers by importing large amounts of Russian gas. And for India, continued discounts are a must.

Assessing Russia's actual exports will become increasingly tough, as more ships "go dark" by turning off their transponders and also transferring some of their cargo to other smaller vessels under ship-to-ship transfers. And new obscure offtakers of Russian crude are cropping up that have no previous track record of doing business with Russia.

*Paul Sampson, London*

## COUNTRY RISK

# Yemen Truce Extension Signals New Phase of De-Escalation

- Hours before its Jun. 2 expiry, Yemen's cease-fire received the kiss of life in the form of a two-month extension.
- The UN is now targeting new security and economic arrangements aimed at a more durable de-escalation of Saudi Arabia's bloody seven-year war.
- This cease-fire is the result a major realignment of Yemen's political stars, namely: conflict fatigue on all sides, re-energized UN mediation, closer Saudi-UAE coordination and strong US support.

### The Issue

The big question is whether this extended cease-fire can be transformed into a sustainable agreement on security and revenue sharing. An end to Yemen's carnage would yield a serious potential energy dividend by ending the cross-border attacks that destabilized oil trade and hit energy targets as far as Jeddah and the United Arab Emirates; enabling a ramp-up of operations of Saudi Arabia's new 400,000 barrel per day Jizan refinery; and eventually allowing for a restart of operations at the TotalEnergies-led 6.7 million ton per year Yemen LNG facility.

### Shuttle Diplomacy

It took a major diplomatic effort to get the cease-fire extended, requiring last-ditch UN efforts and strong US backing to get it over the line. The original truce, which took effect in April, was by no means perfect, and key elements of agreement are yet to be implemented. But enough has been delivered for it to be viewed as a success, and a shining one compared to previous de-escalation initiatives. A slide back to heavy fighting is certainly possible, but the weight of evidence points toward further de-escalation.

"Civilian casualties have dropped significantly, fuel deliveries through Hodeidah port have increased considerably, and commercial flights resumed to and from Sanaa International Airport after almost six years of closure," noted UN Special Envoy for Yemen Hans Grundberg, who spearheaded the mediation.

The original agreement called for civilian flights from Sanaa to both Amman and Cairo. Flights to Jordan got going relatively smoothly, but it took some "extreme diplomatic pressure" for the first Cairo flight to finally take off on Jun. 1, notes a UN source. The focus now is on an earlier commitment to ease travel in and around the besieged central city of Taiz, with Grundberg hosting talks in Amman between the Saudi-backed government and Houthi rebels on the issue this week.

The UN is hoping to leverage recent gains to "start making durable, sustainable arrangements on two tracks: the security and the economy," says the UN source. A deal on the economy would involve management and sharing of revenues and salaries. An initial deal would probably not cover arrangements to restart Yemen LNG, but this could be on the cards once confidence-building measures build up sufficient momentum — eventually offering some relief to tight gas markets as Europe turns its back on Russian imports.

### Inflection Point

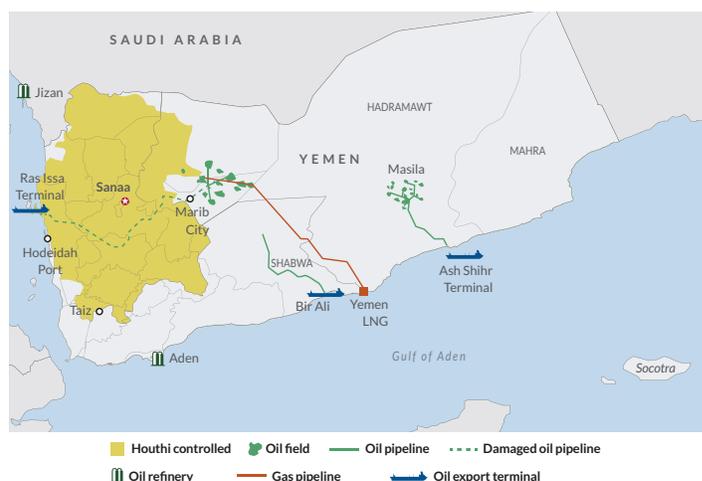
That an exit ramp from continued carnage and regional destabilization now appears viable represents a quantum leap in conflict dynamics compared to a few months ago. The serious threat to regional stability and economies posed by Houthi cross-border attacks was very likely a wake-up call for both Riyadh and Abu Dhabi, forcing them to put aside their differences and work together.

While Saudi Arabia and the UAE have been formal allies, in practice they have worked against each other in Yemen for much of the past seven years. In 2020, major clashes broke out between UAE-backed southern separatists and Saudi-backed government forces. Such disunity only worked to the Houthis' advantage.

The benefits of the new Saudi-UAE coordination have been dramatic. A combination of Gulf unity and increased military backing for their respective Yemeni allies have helped leach hope out of Houthi determination to prevail by force of arms. Perhaps more significant has been Riyadh's ditching of its protégé, President Abed Rabbu Mansour Hadi, widely seen as corrupt and lacking in legitimacy, and the appointment of a new Presidential Leadership Council that has both credibility in Yemen and good relations with Saudi Arabia and the UAE.

However, beyond these factors, a constellation of new peace drivers has transformed the conflict in recent months.

### YEMEN'S ENERGY INFRASTRUCTURE



Source: European Council on Foreign Relations, Yemen Ministry of Oil and Minerals, Energy Intelligence

Grundberg, who took over last August, has created momentum. Conflict exhaustion has also been critical. The international context in which the war is playing out has also changed, with Ukraine sucking the oxygen out of international relief efforts and attention. Warnings of donor shortcomings are likely increasingly playing on protagonists' minds.

The Yemen war had also emerged as a stumbling block in Saudi-US relations (p1). US President Joe Biden's public welcoming of the cease-fire extension was notable in that context, with progress in Yemen possibly helping to facilitate an expected meeting between Biden and Saudi Crown Prince Mohammed bin Salman later this month or next.

## No Quick Peace

Rising tensions between the Houthis' ally, Iran, and the West could emerge to frustrate Yemeni peace efforts, as a revived Iran nuclear deal drifts increasingly out of reach. But on balance the evidence points to sustained de-escalation, although this doesn't mean the conflict will end anytime soon. For a start, tensions and contradictions on the government side, while eased, remain formidable.

The UAE-backed separatist Southern Transitional Council (STC) is represented on the new Presidential Leadership Council. An independent South Yemen, as advocated in the past by the STC, is not realistic, says Abd al-Ghani al-Iryani of the Sanaa Center for Strategic Studies. Such an Aden-led entity would "be challenged by other components of the south, [such as the governorates of] Hadhramaut, Mahra, Shabwa [and] Abyan," he argues. In the end, the only way a future Yemeni state can work is with "a highly decentralized state, with the governorate the main building block," he explains. There are sound reasons for championing such a devolved governance model. Yemen has rarely been united, and while there is no doubt widespread identification with a greater Yemeni nation, this has always co-existed with vigorous local loyalties.

*Rafiq Latta, Nicosia*

## POLICY

# High Oil Prices Meet Transition Efforts in Mideast Gulf

With crude prices hovering around \$120 per barrel, Mideast Gulf states are in for their biggest windfall oil revenues in almost 10 years in 2022. The surging income supports countries' strategies to boost upstream investments as they seek to speed up the monetization of their reserves and meet global demand. But countries are also using the newly generated funds to support wide-ranging economic diversification and energy transition

initiatives to position themselves as clean energy players in a world that's inevitably moving toward decarbonization.

• **Windfall oil revenues are not seen derailing regional energy transition plans led by the United Arab Emirates and Saudi Arabia, but rather supporting them.**

Mideast Gulf states have made important progress on their path toward decarbonization. Last year, the UAE became the first regional country to announce a net-zero emissions target for 2050, followed soon after by Saudi Arabia and Bahrain announcing 2060 pledges. Renewable energy projects, carbon capture and storage (CCS) schemes and both blue and green hydrogen initiatives are gathering further momentum. The question is, will those plans stay on track despite the latest bumper oil revenues and a broader fossil fuel resurgence?

In the past, windfall oil income was commonly allocated to trophy investments, vanity projects and social spending on a variety of subsidies, while reform initiatives often moved to the back burner. This time, it's different. The six Gulf Cooperation Council states are expected to stick with their more stringent fiscal policies adopted in the wake of low energy prices from late 2014 onward and the economic fallout from the coronavirus pandemic in 2020. Gulf countries' commitments to pursuing economic diversification strategies aimed at reducing their dependence on hydrocarbons while working toward climate targets also don't appear to be in doubt.

At the same time, Gulf producers argue that global demand for fossil fuels won't go away for decades while transition efforts will require more time. Sultan al-Jaber, the CEO of Abu Dhabi National Oil Co. (Adnoc) and the UAE's special climate envoy, earlier this year warned that global leaders must "inject a dose of realism" into their planning for the energy transition — or risk a damaging supply crunch. A global energy crisis is already in full swing, with oil and gas prices at historical highs and questions around energy security looming large as a result of Russia's war in Ukraine.

This trend is prompting Opec producers such as the UAE and Saudi Arabia to boost production capacity to meet global demand. Indeed, with crude markets facing a supply crunch and the long-term health of Russia's oil sector increasingly in doubt, Gulf states' upstream investments could put them in an even stronger position as suppliers: Their low-cost, low-carbon output gives them a competitive advantage over most rivals in the long term, even in a world in which demand is eventually constrained by the energy transition.

• **Gulf states, and the UAE in particular, will want tangible results to show for when world climate stakeholders gather in Abu Dhabi for COP28 in late 2023.**

The next two UN climate conferences in Egypt in 2022 and the UAE in 2023 will put the wider Middle East at the center stage

of global climate efforts. Flush with cash from oil sales, the UAE is expected to move swiftly — and possibly double down — on projects and initiatives aimed at presenting the country as a responsible climate player while also seeking to shape the global climate debate as an oil producer. “COP28 next year is a turning point and for the region an opportunity to come out in the climate leadership,” Jessica Robinson, senior adviser for environmental, social and governance and sustainable finance at Deloitte, said at last month’s World Utilities Congress in Abu Dhabi.

Implementation will be key going forward. Abu Dhabi, the UAE’s largest and richest emirate, and which is targeting 44% of electricity to come from renewables by 2050, has announced a string of new initiatives in recent months. Already home to the world’s presently largest single-site solar power plant — the 1,200 megawatt Noor PV facility — new schemes include the 1,500 megawatt Al-Ajban Solar PV project, for which investors have been invited to bid for a 40% stake. Low-emission nuclear power is now providing electricity to almost all of Adnoc’s onshore operations. The neighboring emirate of Sharjah meanwhile hopes to become the first zero-waste city in the Middle East.

CCS and hydrogen projects are also on the region’s drawing boards, but will now need to be scaled up from study or pilot levels, industry experts say. Countries like the UAE and Oman have announced numerous hydrogen-related schemes, but it is Saudi Arabia’s Neom project — the world’s largest integrated green hydrogen plant — which is most advanced. The large-scale development also has the advantage of the offtake being built in by Air Products, an equity partner in the project. QatarEnergy this year announced an updated sustainability strategy that includes plans to reduce carbon intensity at its domestic LNG facilities by 35%.

“Gulf adapters — led by the likes of the UAE, Saudi Arabia and Qatar — are set to remain well ahead of their peers in this area given their more established transition initiatives, low-carbon energy investments and more success in attracting foreign investors,” says Andrew Zoeller, risk research manager at Energy Intelligence.

• **Oil production capacity expansions aren’t just being talked about, but are moving forward and even being scaled up.**

At a time of sky-high oil prices and supply concerns, global production capacity has come under ever-closer scrutiny. This has put the focus on the Opec-plus alliance’s undershooting of targeted supply levels, with most members unable to pump at capacity. Western sanctions on Russian oil exports, which have impacted output, have compounded the capacity issue.

But as oil revenues bolster Gulf producers’ coffers, companies such as Adnoc and Saudi Aramco are pressing ahead with, and stepping up, investments in their upstream sectors. Aramco is

advancing plans to raise production capacity by 1 million barrels per day to 13 million b/d by 2027. The UAE is meanwhile exploring the possibility of further upsizing its expansion program and taking production capacity to 6 million b/d by 2030, about 1 million b/d higher than previously planned. It may also accelerate the program to complete it two or three years earlier, depending on the outcome of the feasibility studies Energy Intelligence understands Adnoc is presently conducting.

*Oliver Klaus, Dubai*

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## COUNTRY RISK

### Erdogan’s Curveball Ukraine War Policies

- *Ankara has leveraged the Ukraine crisis in ways that have simultaneously infuriated, bamboozled and heartened partners on both sides of the war.*
- *This chameleon-like ability to play multiple roles underlines Turkey’s unique ability to project influence in any Eurasian conflict.*
- *There are already hints that domestic concerns, notably over 2023 elections, are shaping President Recep Tayyip Erdogan’s crisis response.*

#### The Issue

Russia’s invasion of Ukraine found Erdogan at a political low point. Inflation has hit 70%, and both his popularity and that of the ruling AK Party are at historic lows. The war brings with it massive risks for Ankara, given Turkey’s economic and energy exposure to Russian and Ukrainian supplies, its long-standing ties with both protagonists, and its Nato commitments. True to form, Erdogan has embraced the crisis as a major opportunity to both bolster Turkey’s geopolitical standing and burnish his nationalist credentials ahead of June 2023 elections. But major risks, notably to the economy, abound.

#### Maverick Moves

Turkey’s role in the crisis is riven with paradox. Erdogan has been a key weapons supplier for Kyiv, with Turkey’s TB2 Bayraktar drone, produced by a company run by his son-in-law, gaining legendary status for Ukrainian defenders. At the same time, Turkey’s veteran president, through his opposition to the accession of Sweden and Finland to Nato, is seen as seriously undermining the Western response to Russia’s invasion.

The Ukraine crisis has intensified the oscillation between conflict and coordination that has characterized Erdogan’s dealings with Moscow of late. In addition to arming Ukraine, Ankara in

late February invoked the 1936 Montreux Convention and closed the Turkish Straits (the Bosphorus and the Dardanelles) to Russian warships. “That is something that was most welcomed in Washington and in other capitals,” notes former US diplomat Ed Stafford.

Further, by supporting Azeri moves to bolster its position in the disputed enclave of Nagorno-Karabakh, Turkey has undermined Russia’s position as Armenia’s security guarantor. But potentially of greatest importance is Erdogan’s pledged security operation in northern Syria, driven in part by a desire to resettle refugees in the territory as domestic political pressure over immigration mounts. A push to create a buffer zone there threatens to put Turkish troops in the direct firing line of both Moscow’s proxies and US-backed Kurdish forces.

On the flip side, Russian President Vladimir Putin is also seeing some major benefits from his Turkey relationship. Erdogan’s desire to play a pivotal mediator role, first in cease-fire talks and most recently in discussions aimed at freeing Ukrainian grain supplies, has given Moscow a platform as a legitimate protagonist in the conflict.

## Energy Vulnerability

Economically, Turkey has stepped up its purchases of Russian oil since the invasion (see table). It is by no means unique here, with India spearheading efforts by a number of nations to insulate themselves from the impact of eye-wateringly high prices by buying discounted Russian crude. Even some EU states have indulged. Turkish imports of Russian gas in March, the most recent month for which there is data, rose to 2.7 billion cubic meters. This compares to a 2021 monthly average of 2.2 Bcm, equating to some 44% of Turkey’s gas import mix. Further, Turkey’s strategic construction industry is already seeing a big post-conflict reconstruction opportunity, notes consultant Mustafa Oguz.

Turkey remains one of the few countries that still welcomes Russian nationals and is easy to get flights to. Russia’s middle class and oligarchs alike “love going to Turkey,” says Stafford, who argues Ankara’s open-door tourism policy provides a political service to Putin by undermining the sense of isolation that sanctions aim to generate, certainly as applies to Russia’s urban elites. It “is a safety valve for Putin,” he explains. For Ankara,

Russian and Ukrainian visitors are an increasingly important source of revenue in these times of austerity.

Erdogan’s controversial refusal to approve Sweden and Finland’s bids to join Nato, while rooted in Turkish

national security concerns, arises too from a domestic political agenda to be seen as a defender of Turkish nationalism. He is insisting Stockholm and Helsinki take action against Kurdish activists, or what Turkey slams as support for “terrorism,” in addition to lifting related bans against weapons sales to Turkey. Some form of a compromise will likely be found, but the move has angered Nato partners already alienated by Turkey’s human rights record and its close Russian ties.

## Countdown to the Polls

The state of the economy is emerging as the dominant political issue in Turkey ahead of the elections. That concern helped drive rapprochement with Mideast Gulf states, first with the United Arab Emirates, and more recently with Saudi Arabia. Erdogan’s fixation on growth has had some impact, with first-quarter GDP up 7% on the same period last year. But any good news here has been completely eclipsed by concerns over inflation, which is currently topping 70%. It “is the No. 1 enemy of Erdogan,” notes Oguz.

Unsurprisingly, Erdogan’s popularity has taken a hammering. Polls show support for the AK party sinking below 30% for the first time since it came to power in 2002. Already, Erdogan “is pulling out all the stops to undermine opposition leaders who have the best chance to unseat him in a long time,” notes Stafford. In March, he changed the electoral law, lowering the threshold needed to get parliamentary seats from 10% of the vote to 7% as a clear aid to his nationalist coalition partners, the MHP, who are currently sitting just above 7% in the polls. The law changes also make it harder for smaller parties in a coalition to win parliamentary seats, in a move aimed against a new grouping led by the opposition CHP, which has yet to come forward with a candidate for president.

Rafiq Latta, Nicosia

### TURKISH IMPORTS OF RUSSIAN OIL

('000 b/d)	Urals Crude	Products	Total
May '22	254	106	360
Apr '22	306	123	429
Mar '22	57	169	226
Feb '22	110	102	212
Jan '22	100	146	246
2021	74	141	215

Note: Does not include Russian crude from CPC Terminal. Source: Kpler

## CLOSING ARGUMENTS

## Japan Eyes Nato, China's Pacific Pursuit

## Japan: Closer Nato Ties to Reshape Pacific Geopolitics

Japanese Prime Minister Fumio Kishida is reportedly planning on attending the Nato summit, currently scheduled for Jun. 29–30, in Madrid. While Kishida is on record condemning the Russian invasion of Ukraine, his presence at the Nato summit would represent a diplomatic escalation at a time when Japan and Russia have been at odds over territorial disputes involving the Kuril Islands, claimed by Japan but occupied by Russia. Nato is expected to discuss expanding its involvement in the Indo-Pacific region during the Madrid summit, and Kishida's attendance would send a clear signal to Russia that the geopolitical consequences of its decision to invade Ukraine extend beyond Europe into the Pacific.

Nato has extended an invitation to Kishida and other Nato partners in the Pacific region, including Australia, New Zealand and South Korea, to discuss a unified response to Russia's invasion of Ukraine. Kishida's planned involvement in the Nato summit comes as Japanese Defense Minister Nobuo Kishi is conducting meetings with Nato Military Committee Chair Admiral Rob Bauer over a plan for Japan to strengthen its military ties with Nato — to include increased military cooperation and joint exercises. Japan's commitments in this regard are real — Kishida's cabinet passed a five-year plan calling for the strengthening of defense capabilities that would see Japan's

annual defense expenditure rise from the current level of just over 1% of GDP to the Nato standard of 2% of GDP.

Formal cooperation between Nato and Japan dates to 1990, when Japan was designated an official Nato partner. Recently, Japan has been working with Nato and other pro-Western nations in the Asia-Pacific region on how to deal with the growing threat from China, including how best to respond to any Chinese military attack on Taiwan. Japan sent a delegation to the Nato summit in Brussels in 2021 and Japanese naval forces have regularly participated in Nato naval exercises in the Mediterranean Sea and Gulf of Aden. And Japan's Treaty of Mutual Cooperation and Security with the US provides Japan with assurances similar to those contained in Article 5 of the Nato Charter, in that the US is committed to come to the aid of Japan if it is attacked by another country.

As the military and political ties between Japan and Nato expand, so too does the possibility of a farther-reaching Nato becoming entangled in crises that have the potential to turn into war, whether in the Kuril Islands, Taiwan or the South Pacific. Japan's expanding relationship with Nato represents a remarkable deviation from past policy that will shape the geopolitical picture in the Pacific for decades to come.

## China: Pacific Island Tour Produces Mixed Results

Chinese Foreign Minister Wang Yi's ambitious 10-day tour of eight Pacific island nations, starting in the Solomon Islands on May 26 and ending in East Timor on Jun. 4, fell short of achieving the comprehensive strategic economic and security agreement Beijing sought. While that's seen as a setback for Chinese policy objectives, Wang also inked broad agreements promising increased economic cooperation, which could further enhance China's Maritime Silk Route project, part of its overall Belt and Road Initiative. Agreements were also struck on areas like health care, disaster response and technology.

Wang's trip came on the heels of US President Joe Biden's debut tour of Asia, during which time the US sought to rally long-standing regional allies such as Japan, South Korea and Australia in the cause of pushing back against aggressive Chinese expansionism. Seen in this context, Wang's tour was deemed problematic by the US, Australia and New Zealand, who viewed the Chinese diplomatic foray as infringing on their traditional sphere of influence. Indeed, one of China's primary goals during this tour was to gain support for a wide-ranging regional economic and security agreement to counter the existing Australia-UK-US pact and Quad security dialogue comprised of the US, India, Australia and Japan.

Wang started his tour in the Solomon Islands, where he inked a controversial security deal that gave China the ability to establish a limited military presence in the island nation. China was hoping that similar agreements could be struck with other Pacific Island nations, such as Papua New Guinea, Kiribati, Samoa and Tonga. Each carry long-term Chinese debt, which Wang hoped to be able to use as leverage for his security package. However, during a virtual meeting in Fiji on May 30 with the other Oceania nations, Wang's security proposals were met with a cold shoulder by most of the attendees.

Samoan Prime Minister Fiame Naomi Mata'afa labeled China's multilateral economic and security deal "abnormal," describing it as premature given the fact that the "region has not met to discuss it." Her rejection of the pact was echoed by others, with the president of the Federated States of Micronesia, David W. Panuelo, noting that it could trigger a new "Cold War" between the West and China in the Pacific that would be detrimental to all parties. China's diplomatic forte, however, has been to push economic development over military posture — and the limited economic deals it struck could yet end up serving it well.