

Emissions rules and electric shift to spur car engines M&A



Mergers and acquisitions have been stuck in a rut since Volkswagen (VOWG_p.DE) was caught cheating pollution tests in 2015, triggering a global tightening of emissions regulations that depressed the value of petrol and diesel technologies. But the market is beginning to separate companies capable of meeting new emissions standards from those struggling to do so, which could close the gap in price expectations between buyers and sellers over the next 12-24 months, industry experts say. The auto industry has all but stopped developing next-generation combustion engines as limited resources are directed towards building electric and self-driving cars. However, electric vehicles are still a niche product, accounting for only 1.26 million – or 1.5 percent – of the 86 million cars sold worldwide last year, and analysts forecast it will be the middle of the next decade before a tipping

point comes when electric cars overtake combustion-engined variants. That means there will still be demand for emissions-compliant combustion engines and so manufacturers and suppliers able to offer that are likely to see valuations recover, said Reinhard Kuehn, co-head of European Automotive at Deutsche Bank. "At the same time, suppliers that struggle with this will remain a hard sell," Kuehn said. Meanwhile, as production capacity of petrol and diesel engines is cut back, the impetus for mergers among suppliers should increase, bankers believe. Germany's Volkswagen, one of the largest manufacturers of petrol and diesel engines, has said it will develop its final generation of combustion engines by 2026, while U.S. rival Ford (F.N) last month said it would close two engine factories in Europe. "The profit pool of companies with combustion engine-related technology – once the envy of the industry – is shrinking with the rise of electric vehicles and the digitization of the industry," Goldman Sachs managing director Axel Hoefler said. "You would expect someone to come in and consolidate to benefit from economies of scale." Volkswagen is now warning its suppliers to prepare industry-wide solutions for winding down combustion-engine manufacturing as it ramps up mass production of electric vehicles. The company is retooling 16 factories to build electric vehicles and plans to start producing 33 different electric cars under the Skoda, Audi, VW and Seat brands by mid-2023, transforming the industry's supply chain. "It makes no sense to have factories running at only 40% capacity," Stefan Sommer, Volkswagen's procurement head, told Reuters. "The auto industry is obliged to develop structures to consolidate combustion engine assets, to decide where to bundle certain activities." "If we end up with uncontrolled insolvencies, it will be a problem for the industry," he said.

MISMATCH

There are more than 120 plants making combustion engine components in Europe, according to consulting firm

AlixPartners. German auto industry association VDA says 436,000 jobs are tied to building petrol and diesel engines in Germany alone. Demand for compliant combustion engine assets has already triggered consolidation among carmakers themselves – PSA Group's (PEUP.PA) takeover of General Motors' (GM.N) Opel business in 2017 was driven by that issue. "With emissions regulation getting more stringent, particularly in Europe, some manufacturers are getting left behind in terms of their ability to develop compliant engines," Franciscus van Meel, BMW's (BMWG.DE) head of vehicle development, told Reuters. Until recently, deals have still proved difficult to do because of lingering disagreements over valuations. U.S. group Dana (DAN.N) late in 2018 launched the sale of its European head gasket business, a key component for combustion engines, people close to the matter said. With the help of Bank of America it invited suitors to bid, but pulled the auction several weeks later due to muted interest. The sale of Germany's closely-held Ifa Group, a maker of shafts mainly used in combustion engine-powered cars, was announced a year ago, but never got over the finishing line. Among the few suitors was China's Wanxiang, but differences on pricing proved insurmountable, people close to the talks said. "The main problem is that buyers' and sellers' price expectations don't match," KPMG partner Juergen Schlangenotto said. "A seller typically says: I have a robust order book and good margins so I want a valuation of 6 times EBITDA (annual core earnings), while a buyer says there's no long-term growth so I am paying 4 times." A fresh test of interest in combustion engine assets will be the sale of engine parts and gear box parts maker Tekfor. Private equity owner KKR is in talks with a Chinese buyer, according to people close to the matter. James Kamsickas, CEO of U.S. drivetrain supplier Dana, believes internal combustion engine (ICE) demand could persist for many years. "People are overbaking a little bit on how much the internal combustion engine is just going to go away," he told Reuters. "If anything, I'm a very strong advocate that it's going to be a world of hybridization for the next 15

years. Last time I checked, that still requires an ICE.”

Editing by Georgina Prodhan and Mark Potter

China refiners curb fuel output after massive new plants stoke glut



Reuters/Singapore/Beijing

China's fuel producers are making extended curbs to their output in the third quarter after supply from mammoth new refineries stoked an already-sizeable glut, potentially dragging on crude oil demand from the world's biggest importer of the commodity. Private refiner Hengli Petrochemical ramped up its 400,000-barrels per day (bpd) plant in northeast China to full capacity in May, while Zhejiang Petrochemical began trial runs around the same time at a similar-sized refinery on the east coast. In the wake of that wave of fresh supply and

amid slowing local demand for fuels such as gasoline and diesel, refiners are cutting their crude processing, or throughput, industry sources and analysts said. That drop should sap their appetite for crude imports, pulling down on international oil prices that have already been hit by fears over a slowing global economy. The swollen surplus of fuel products could also send China's fuel exports surging to new highs and further pinch Asian refining profits. "For markets that are already consumed with fears about a global recession...headline numbers of oil demand growth slowing alongside talk of run cuts seem to reinforce a bearish narrative," said Michal Meidan, a London-based analyst at Energy Aspects. Small-scale refiners known as 'teapots', mainly located in Shandong province, are coming under most pressure to make fresh output cuts, analysts said, extending curbs many of them made in May and June. Teapots have been seen as a bellwether for China's oil demand since 2015 when they became first-time crude oil importers. They now make up a fifth of the nation's total crude imports. Dongming Petrochemical Group, the province's largest independent refinery, is closing its 240,000-bpd plant this week for two months of maintenance in the wake of "poor margins", according to a company source. That comes after plants were losing 300-350 yuan (\$44-\$51) on each tonne of crude oil they processed in June, their largest such loss in nearly four years, said Shi Linlin, an analyst at consultancy JLC, and analyst Wang Zhao at Sublime China Information, another consultancy in the province. Seven plants in Shandong – including Dongming – with total crude processing capacity of 470,000 bpd will be offline in July for overhauls, JLC estimates. That's equivalent to a throughput cut of 14mn barrels of crude in July alone, or nearly 4% of the country's processing levels in May. Meanwhile, two major coastal plants run by Sinopec Corp, Asia's largest refiner, are planning to trim throughput by nearly 2%, or roughly 10,400 barrels per day, in July-September from the second quarter, plant sources said. That comes after these two plants were hit by refining

losses in June for the first time this year. Sinopec did not respond to a request for comment. All refinery sources declined to be named as they were not authorised to speak to the media. The losses at small refiners come a month after behemoth Hengli cranked up operations at its plant in the northeastern port of Dalian. Hengli, traditionally a polyester maker, shipped its first gasoline cargo in early June. That was 80,000 tonnes sold to Sinopec at 5,300 yuan (\$769.48) a tonne at an ex-plant rate, which is 700 yuan, or 12%, below prices offered by Shandong teapots, said two sources with direct knowledge of the transaction. The refiner in June placed a total of over 500,000 tonnes of gasoline at 300 to 500 yuan a tonne below market rates on average and sold a similar amount of off-specification diesel fuel with smaller discounts as its fuel quality has yet to stabilise, the sources said. "We were indeed marketing at promotional rates to build our customer base. But this is a temporary marketing strategy as we are new to the market," said a Hengli spokesman, without elaborating. The Hengli and Zhejiang plants are together expected to account for about 6.4% of total Chinese crude oil throughput.

The ECB Needs to Explain Itself



Ambiguity is hampering effective policymaking by the European Central Bank and leaving market participants wondering what to expect. A review of the ECB's policy framework would help to eliminate such ambiguity – and place the Bank on much sounder footing for a new era of leadership.

ZURICH – Finland's central bank governor, Olli Rehn, has reiterated his call for the European Central Bank to conduct a long-overdue review of its policy framework. The upcoming change of leadership at the institution – with Christine Lagarde, the International Monetary Fund's managing director since 2011, likely to succeed Mario Draghi as president – offers an important opportunity to heed that call.

When the ECB was established 20 years ago, central banks were generally not too clear about the details of their policy frameworks. At that time, some ambiguity may have been helpful, because of the flexibility it offered when the ECB started operating. Furthermore, it allowed central bankers with different experiences and perspectives to agree on a framework, even though they may not have agreed on its precise details.

But the world has changed considerably since then, and the public is now demanding far more clarity. How can the ECB offer that, 16 years after the last review of its monetary-policy framework?

Since that review, conducted in 2003, the global financial crisis, and the ensuing European debt crisis, prompted the ECB to adopt a plethora of new policy instruments. These crisis measures – which have been deeply unpopular, particularly in Germany – can be justified only to the extent that they have been effective, and this must be evaluated. Moreover, as Rehn, who sits on the ECB's governing council, has noted, long-run structural trends – such as population aging, lower long-term interest rates, and climate change – must be considered.

The effectiveness of ECB policy requires the members of the governing council to be singing from the same song sheet. They need a shared understanding of Europe's long-term goals and the strengths and weaknesses of various policy instruments. And, in order to strengthen accountability and support smart decision-making, they need to be able to spell out the details of their monetary-policy strategies in ways that the public can understand.

As it stands, such clarity is at times hard to find, even when it comes to some of the most fundamental elements of the ECB's policy strategy. Price stability – the ECB's primary objective – is currently expressed as “inflation below, but close to, 2%.” Does 1% inflation meet that condition, or is it too low, demanding more monetary-policy accommodation? Different members of the ECB's governing council may well have different answers to this question, and thus support different policies.

The same goes for the questions of whether the ECB's inflation target is symmetric – with the authorities intervening as vigorously when inflation is too low as they do when inflation is too high – and whether inflation should be measured over time or at a given moment. If, over some period, the inflation rate ranges from 0% to 4%, but averages to “below, but close to, 2%,” has the objective been achieved?

The answer has major policy implications. If inflation is measured over time, the ECB could accept, or perhaps even aim

for, a somewhat higher inflation rate in the medium term, to compensate for the excessively low inflation of recent years. If the public came to believe that a period of above-target inflation was likely, the expected real interest rate would fall, giving a jolt to the economy.

Of course, Draghi has established in speeches and press conferences that, in his view, the inflation target is symmetric; 1% inflation is too low; and the inflation rate should be measured over the “medium term.” But it is not clear whether this view is broadly shared within the ECB’s governing council.

Inflation targeting is hardly the only area where ambiguity is hampering effective policymaking and leaving market participants wondering what to expect. The ECB’s outright monetary transactions (OMT) scheme – whereby the ECB promises to purchase bonds issued by eurozone member states on secondary sovereign-bond markets – is also generating significant uncertainty.

OMT, Draghi’s chosen tool for fulfilling his 2012 vow to do “whatever it takes to preserve the euro,” was controversial from the moment it was announced, with Bundesbank President Jens Weidmann – one of Lagarde’s main rivals for the ECB presidency – arguing fiercely against it in public. But that was seven years ago, and OMT has never actually been used. Is the governing council still committed to it? Or have the events – and council membership changes – of the last few years rendered that commitment obsolete?

With public debt in Greece and Italy still far too high, the eurozone still at risk of slipping into a recession that would significantly worsen both countries’ fiscal positions, and Italian politics as volatile as ever, it would pay to know. A review of the kind Rehn demands would provide the needed answers – and put the ECB on much sounder footing for a new era of leadership.



STEFAN GERLACH

Writing for PS since **2016** Stefan Gerlach is Chief Economist at EFG Bank in Zurich and a former deputy governor of the Central Bank of Ireland. He is also a former Executive Director and Chief Economist of the Hong Kong Monetary Authority and Secretary to the Committee on the Global Financial System at the BIS.

EU ministers collide over timid eurozone reforms



Agence France Presse

LUXEMBOURG: EU finance ministers wrangled over watered-down economic reforms Thursday with France hoping the eurozone

budget it has long been pushing for was finally within reach. Almost a decade after the debt crisis, French President Emmanuel Macron wants his partners to implement the changes in order to make the single currency area more resilient to shocks and to tackle the global dominance of the United States and China. But resistance to overhauling the eurozone has deepened, amid a budget row with populist-led Italy, and as richer northern countries grow reluctant to indulge the budget-busters to the south. This distrust and hesitance has plagued the eurozone since it was launched in 2002, a disunity that economists say limits growth and invites crisis.

Ministers are discussing France's flagship reform of a eurozone budget that has been scaled back by opponents led by the Netherlands that fear a transfer of wealth to Italy, Greece or Spain.

"We are not far from a consensus," French Finance Minister Bruno Le Maire said on Thursday as he arrived for talks that were expected to last late into the night.

Such a step would be "a major breakthrough in strengthening the eurozone," he said.

"We are close," said German Finance Minister Olaf Scholz who added that approval was widespread for a Franco-German compromise on the delicate matter.

Not a budget The EU ministers are officially not negotiating a budget – which would be too politically sensitive – but something called the Budgetary Instrument for Competitiveness and Convergence, a fund with limited firepower to be used to back reforms.

The cumbersome renaming comes at the demand of the Dutch, who have only accepted the instrument on condition that it remains an extremely modest affair.

The skeleton of Macron's plan on the table comes after months

of negotiating the broad elements, including spending priorities, source of revenues, and who should ultimately wield control over its decisions

A European source said it was the last element that would keep ministers up late with the Netherlands and others insisting the budget remains under the auspices of the EU budget. As such, the budget's firepower would remain at a modest 17 billion euros over seven years with no chance of expansion and under the authority of the EU's 27 member states (after the exit of Britain).

Macron had originally demanded an amount of several hundred billion euros to be used to stabilize economically weak countries, but this was swiftly slapped down.

The young French leader also wanted the creation of a eurozone finance minister, an idea that was fast cast aside under pressure from Germany, which prefers that power over the economy remains national.

'Impasse' Ignored for now is a Europe-wide deposit insurance scheme, which is supposed to be the last pillar of an EU banking union set up after a series of bank failures during the worst of the crisis.

"Regrettably, the impasse on this project is still there. No tangible progress has been made," said EU commission vice president Valdis Dombrovskis on Wednesday.

The deposit scheme is resisted by Germany, Finland and other northern European countries that fear being put on the hook for deposits in fragile countries such as Italy or Greece. Ministers also discussed Italy with Rome in infraction of EU budget rules and in danger of major fines inflicted by its currency zone partners.

Gushing European energy IPO pipeline faces muted investor appetite



Norway's Okea, Britain's Neptune, Chrysaor, Siccar Point and Spirit Energy are all either actively preparing or expected to plan an initial public offering (IPO) in the short term, as are recently merged German-Russian Wintershall Dea and Israeli-owned Ithaca Energy.

Oil and gas companies with a combined value of around \$41 billion are seen as candidates for listing in the coming years, according to estimates by energy consultancy Wood Mackenzie.

Shares of oil and gas companies historically rise after a

crash in oil prices as investors bet on a recovery in prices.

But the recovery following the 2014 downturn, the worst in decades, has been slow and bumpy amid surging U.S. shale production and wider uncertainty over long-term oil demand as the world transitions to cleaner energy.

“IPOs tend to come when markets are sizzling hot and valuations are high – that is not the case for the energy sector currently,” said Bertrand Born, portfolio manager for global equities at German asset manager DWS.

Listed oil and gas companies have struggled in recent years, underperforming in many cases oil prices and other sectors, and offering a tough backdrop for any company contemplating a public listing.

In a sign of the challenging conditions, Okea on Thursday lowered its offered price per share and delayed its listing on the Oslo stock exchange.

Sam Laidlaw, executive chairman of Neptune, backed by private equity firms Carlyle Group and CVC Capital Partners, said he saw no time pressure for his company’s IPO.

“Lower returns at \$100 a barrel than at \$60 raised concerns among capital markets. There is less appetite from generalist investors. We don’t see anything that’s IPO ready yet,” he told Reuters this month.

“Some will consolidate, some will never make it to market, some will take longer. If we wanted to be first, there’s plenty of time still.”

Many of the IPO candidates, including Neptune, were set up in the wake of the 2014 crash by private-equity funds seeking to buy cheap and sell high when the oil price recovers.

But nearly five years on, the going is still tough for the sector.

In the first quarter of 2019, European IPOs slumped to their lowest since the aftermath of the 2008 financial crisis, as uncertainty over Brexit and the U.S.-China trade dispute left companies not wanting to take their chances.

UNIQUE STORY

To succeed, companies will have to offer investors something unique, says Jon Clark, regional transaction leader at EY.

“The European oil and gas IPO landscape looks like it will shift from famine to feast and the potential IPO candidates need to think how they will best position themselves,” Clark said.

Wintershall-Dea is the largest producer of the group, aiming to boost its output by around 30% to at least 750,000 barrels of oil equivalent per day by 2023, in a portfolio stretching from Brazil to Europe and Russia and the Middle East.

Chrysaor, backed by Harbour and EIG, is the largest oil and gas producer in the North Sea after acquiring large portfolios from Royal Dutch Shell and ConocoPhillips.

Neptune has assets in a number of regions and is focused on gas, seen as the least-polluting fossil fuel.

In addition to returns, environmental, social and governance (ESG) issues are an ever-growing concern for fund managers and their clients.

Unlike any other time, investors are likely to question a company seeking to list on its role in the transition to a lower carbon economy following the 2015 Paris climate agreement to limit global warming.

“Sentiment in the market is not necessarily as strong as it used to be for oil and gas assets... we’re moving towards a lower carbon economy,” said Les Thomas, chief executive of

Ithaca, owned by Israel's Delek Group, which last month acquired most of Chevron's North Sea assets for \$2 billion.

Greek group Energean was one of a handful of energy companies to list in London in recent years, betting on Israeli gas production and long-term offtake agreements. Its shares have risen over 90% since listing last year.

"Oil price upside is not enough anymore. You have to offer investors at least partial, if not complete, security of a return on their investment regardless of commodity prices," Energean Chief Executive Mathios Rigas said.

"It's not enough to say I have this amazing geologist or knowledge of a basin or promise to find oil in frontier areas. To continue investing as an energy company only in oil, from an ESG perspective, is suicidal."

OPEC warns that trade tensions are hurting global oil demand



LONDON (Bloomberg) – OPEC said that international trade tensions are hurting demand for oil, slashing its estimates for consumption earlier in the year and predicting further challenges ahead.

The organization, due to meet in the coming weeks to set production levels for the second half, said demand increased by less than 1 MMbpd in the first quarter after cutting its assessment by more than 20%. The world economy is headed for its weakest growth in a decade, buffeted by a prolonged tariff battle between the U.S. and China.

“Throughout the first half of this year, ongoing global trade tensions have escalated,” resulting in “weaker growth in global oil demand,” the cartel’s Vienna-based secretariat said in its monthly report. “The observed slowdown in the global economy in the first half will be further challenged in the second half.”

Oil prices slumped into a bear market last week, sinking below \$60/bbl in London for the first time since January, on concerns that faltering demand would lead to a crude surplus

even as the Organization of Petroleum Exporting Countries and its allies keep supply in check. Prices surged 3% today on suspected attacks on oil tankers in the Persian Gulf.

Although OPEC reduced demand estimates for the first quarter, it kept forecasts for 2019 as a whole mostly unchanged and projects that consumption growth will accelerate during the rest of the year. World demand will rise by 1.14 MMbpd, or 1.2%, on average this year, down from an estimate of 1.21 MMbpd in last month's report.

As a result, the report signaled that if OPEC maintains production at current levels then global markets should tighten significantly during the third quarter, by about 1.3 MMbpd. Output from its 14 members fell by 236,000 bpd to 29.9 MMbpd last month as the U.S. tightened its squeeze on Iranian exports, it said.

Nonetheless, as OPEC and its partners prepare to meet in Vienna, its members appear focused on continuing to restrict supplies.

Saudi Arabian Energy Minister Khalid Al-Falih said in St. Petersburg last week that the organization is aligned on maintaining its output curbs during the rest of 2019, and awaits only a similar commitment from its ally, Russia.

As the booming American shale industry propels U.S. production to new records, United Arab Emirates Energy Minister Suhail Al Mazrouei even indicated that OPEC may also need to constrain supply in 2020. The cartel pumps about 40% of the world's oil.

Although the policy decision looks straightforward when OPEC and its partners convene, the producers are still struggling with one issue. As the tensions between Saudi Arabia and Iran continue to heat up, members are bickering over exactly which date to meet.

Higher gas prices, North Field production boost Qatar account surplus: World Bank



Qatar's current account surplus increased to 8.7% in third quarter of 2018, from less than 4% in 2017 due to higher gas prices and production from the North Field, the country's biggest gas repository, according to the World Bank.

Qatar, the largest LNG exporter globally, had seen its goods export earnings rise by 25% in 2018, World Bank has said in its recent "Economic Update."

The country's public finances have improved, supported by the recovery in energy prices, and Qatar is expected to post a small fiscal surplus in 2018, the first since 2014. A large public investment programme for 2014-2024 has been pared back, with FIFA 2022 projects given priority.

Qatar's withdrawal from the Organisation of the Petroleum Exporting Countries (Opec) in January 2019, after six decades of membership, has not had a major impact since Qatar was one of the smallest members of the group, making up less than 2% of Opec's total oil production, World Bank noted.

The World Bank said Qatar's "outlook remains positive" with growth expected to rise to 3.4% by 2021 driven by higher service sector growth as the FIFA World Cup draws nearer. In addition, higher infrastructure spending on the Qatar National Vision 2030 projects aimed at diversifying the economy should help offset falling investment spending on FIFA projects.

The hydrocarbon sector growth is also expected to pick up as the Barzan natural gas facility comes online in 2020, and as the expansion of the North Field gas projects is completed by 2024. Monetary policy is expected to gradually tighten as the Qatar Central Bank resumes raising interest rates to restore the spread versus US policy rates, and to attract FX inflows into the banking system. Public finances are expected to remain in small surplus, supported by recent tax reforms and the introduction of a VAT over the medium term, the World Bank said.

A recovery in imports, driven by capital goods related to infrastructure spending, should keep the current account surplus in single-digits (in contrast to surpluses of over 30% prior to 2014).

Qatar's economy has largely overcome the constraints posed by the "continuing diplomatic rift" with GCC (Gulf Co-operation Council) neighbours, the report noted.

"Nevertheless, a resolution of this situation would help boost investor confidence. Key external risks include risks of volatility in global energy prices, regional instability risks, and global financial volatility that affects capital flows and costs of funding although these are mitigated by the

return to fiscal and current account surpluses,” the World Bank said.

Turkey drafts law to help banks restructure debt



(Reuters) – A draft law submitted to Turkey’s parliament introduces tax exemptions to loan restructurings and legal protection for bankers as Ankara tries to make it easier for banks to restructure bad debt.

Following last year’s sharp fall in the lira, Turkish banks and the government have been in talks on how to restructure billions of dollars of loans and remove them from banks’ books – an important step toward pulling the economy out of recession.

The draft law seen by Reuters contains some of the demands banks put to the government during the talks, such as tax

exemptions on restructurings and amendments to protect bankers involved in restructuring.

Under an existing legal technicality bankers involved in debt write-downs or decreasing the value of loan collateral could potentially be liable to embezzlement charges.

The government pledged in April to repackage problem loans to energy companies, estimated at more than \$12 billion, into funds which can then be sold to investors. It aims to do the same with construction loans.

The plan is seen as one of the ways to free up banking resources as well as supporting industries that are burdened by the slowing economy.

“Banks seems to have got most of their demands from the government. I think perhaps this may help with the most troubled types of restructurings, but I’m cautious on a broader take up by banks” a restructuring consultant said on condition of anonymity.

The draft law, submitted to parliament on Monday, exempts at least 50% of the profits banks make on problem asset sales from corporate tax. Asset transfers from borrowers to creditor institutions will also not be subject to value added tax.

The types of restructurings that fall under the scope range from amend and extend agreements, to debt to equity swaps and transfer of problem loans and assets to special purpose funds.

The changes will be in effect for two years and can be extended for two more.

The Lessons of the EU Leadership Fight



The haggling may have been unedifying, but the candidates nominated by the European Council to lead the European Union's governing institutions are undoubtedly impressive. If approved by the European Parliament, German Minister of Defense Ursula von der Leyen and Belgian Prime Minister Charles Michel will become president of the European Commission and Council, respectively, and Spanish Minister of Foreign Affairs Josep Borrell will serve as High Representative of the Union for Foreign Affairs and Security Policy. Then, in November, Christine Lagarde is set to succeed Mario Draghi as president of the European Central Bank.

The good news is that each of these candidates would strengthen the EU at a time of global insecurity. The bad news is that the EU itself will continue to face significant challenges from within. The struggle to fill the top leadership positions resulted in the elimination of the *Spitzenkandidaten* process – whereby the largest party grouping in the European Parliament selects the Commission president – and the return of backroom deal-making, which many

see as undemocratic. The justification for that change needs to be explained, or the EU's credibility may suffer. After all, the *Spitzenkandidaten* process was introduced in 2014 to counter the perception that the EU suffers from a democratic deficit.

The leadership struggle has also intensified a clash of perspectives within – and about – the EU's sources of legitimacy. Whereas member states with a strong parliamentary culture think the top personnel should be selected based on the results of May's European Parliament election, others (like France) consider executive experience far more important than the link to those results. It is naturally a long process to devise a broadly accepted system for selecting EU leaders. Despite this year's setback, the principle of the *Spitzenkandidaten* system should be preserved and combined in the next elections, with additional transnational lists of candidates backed by stronger trans-European party structures. Beyond that, the EU also needs to strengthen the role of the European Parliament.

A number of MEPs are deeply frustrated by the Council's failure to nominate any of the *Spitzenkandidats* on offer, and they could make their sense of betrayal known by voting against von der Leyen's appointment. Should her candidacy be rejected, months of institutional gridlock would likely follow. As a show of good faith, von der Leyen should announce early that she will work toward empowering MEPs *de facto* to initiate legislation. With an inter-institutional agreement with the European Commission, such a change would not require an amendment to any founding treaties. Moreover, if confirmed, von der Leyen and the new European Parliament president, David Maria Sassoli of Italy's Democratic Party, should establish a working relationship as close as that of their respective predecessors, Jean-Claude Juncker and Martin Schulz. But, given the new composition of the European Parliament, they should strongly involve the chairs of all parliamentary groups

that wish to work toward a stronger Europe.

The fact that MEPs elected Sassoli instead of the Council's own candidate, former Bulgarian Prime Minister Sergei Stanishev, suggests that the European Parliament election in May has led to a renewed desire for institutional self-assertion. And yet the election left the body more fragmented than ever. The number of seats held in the 751-member parliament by the two main party groups, the European People's Party (EPP) and the Progressive Alliance of Socialists and Democrats (S&D), fell from 404 to 336, owing to gains by the Greens, right-wing nationalists, and liberal centrists.

The fall of Europe's grand coalitions and the emergence of new, smaller parties will impede decision-making, as already demonstrated by the Parliament's failure to agree on its own *Spitzenkandidaten*. Divisions among the parliamentary groups are not just political, but also geographic. The EPP has almost no MEPs from France or Italy, and large delegations from Germany and Northern Europe. The S&D draws far more support from the Iberian Peninsula and Italy, with relatively few MEPs from the Visegrád group (the Czech Republic, Hungary, Poland, Slovakia) or France.

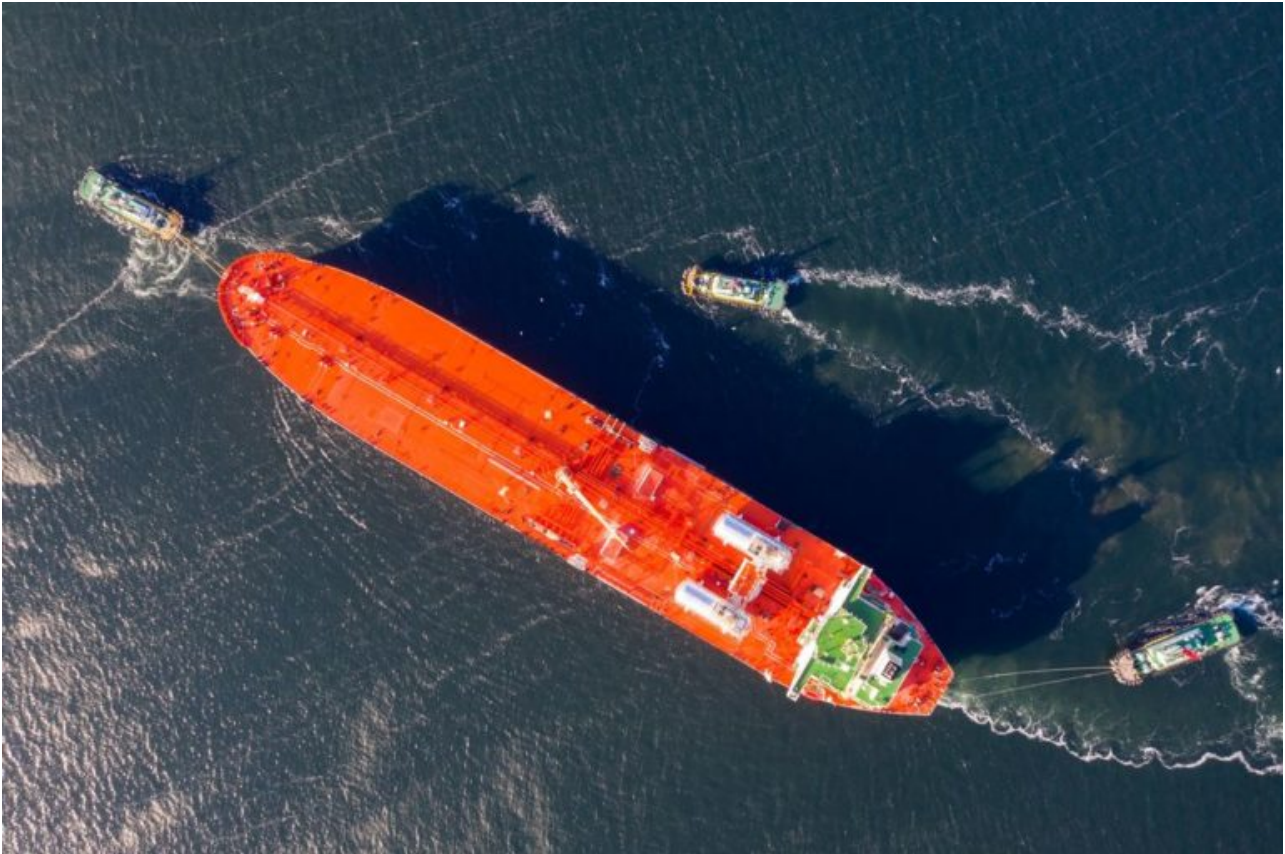
The increased fragmentation in the European Parliament goes hand in hand with changing relationships between EU member states. France and Germany's days of working hand in glove are gone; and even if they do come together on a particular issue, blocking minorities can stand in their way at the Council. The latest round of EU leadership negotiations shows just how hard it has become to reach a majority, let alone unanimity. On the contrary, national governments fight increasingly recklessly for their interests. As a result, individual member states will face a strong temptation to pursue specific objectives in smaller, likeminded groups. The challenge, then, is to ensure that such initiatives follow official EU processes, rather than being decided through intergovernmental backroom deals.

The strong turnout in the European Parliament election indicates that the EU has not lost public support. The political center was strengthened at a time when Euroskeptic and nationalist parties are on the rise in member states. Overall, public trust in the EU is as high as it was in the 1980s, when European integration served as a defense against the Soviet Union. For most Europeans, being a part of the EU still means something.

But the outcome of the election also signaled a desire for change. Many citizens abandoned traditional parties, and a significant share of them did so out of fear. Like politicians at the national level, the EU's new leaders will have to answer to voters who harbor deep uncertainties about their and their children's future. Europeans are understandably anxious about great-power competition, new security threats, and a technological revolution that threatens to upend entire economic systems and societies.

The EU, working with member-state governments, will need to respond to these challenges with ambition and resolve. The European Council has already devised a strategic agenda for 2019-2024, and now the ball is in the European Parliament's court. Since the elections in May, MEPs from the four moderate party groups have been negotiating a shared program of policy priorities. In other words, they are putting substance over personnel; regardless of who fills the top leadership positions, the European Parliament will already have a shared platform in place. Despite the circumvention of the *Spitzenkandidaten* process, this effort, like the slate of promising candidates selected by the Council, suggests that the EU is slowly and steadily maturing.

LNG Ships Are Turning Away From Europe's Gloomy Gas Market



A tanker traveling from the Arctic region to Belgium with a cargo of Russian liquefied natural gas was instead sent to Israel at the last moment.

The British Diamond changed destination just before arriving, indicating how quickly natural gas traders need to act in a market where healthy inventories and supply have sapped prices to near their lowest in almost a decade. It may well be a sign of things to come for the rest of the summer, as the Asian benchmark Japan-Korea marker widens its premium to its European Title Transfer Facility counterpart and Middle East demand for cooling increases.

“You can see room for more diversions. It’s hard to believe JKM will strengthen any time soon, but TTF could weaken

further as European stocks are full,” said Jean-Christian Heintz, head of LNG broking at SCB Brokers SA in Nyon, Switzerland. “It might rapidly become more attractive for cargoes to go to India and southeast Asia – they could be good opportunistic buyers in coming weeks.”

Two other tankers with gas from Russia’s Yamal LNG project have gone on month-long journeys to China rather than stop in Europe in recent weeks. That’s not surprising as even a heatwave last week was unable to prevent the rapid refilling of storage sites, which are 74% full, about 17 percentage points above their five-year average.

“If the demand-side response is not enough, prices will then need to fall to the point where either more power demand appears, or supply starts to be choked off,” Energy Aspects said in a note. “Either way, that would mean prices moving downwards from current levels.”

As European inventories are filling rapidly, traders may start looking at filling underground storage in the U.S. or choose to float cargoes on the water, according to Energy Aspects. The latter is looking attractive as prices for months later in the year are higher than for next month, known as a contango.

And the demand for power generation may also be limited. Even with natural gas becoming cheaper in the region than lignite for the first time ever, increased generation from renewables will probably curb the extra European demand, according to BloombergNE.

U.S. LNG cargoes may also prefer to go to Asia, supported by a wider inter-basin freight differential. With increasing volumes from new plants in the U.S. and Russia and a premium required to return empty ships after unloading in Asia, west of Suez shipping rates are higher.

One Yamal cargo is taking this season’s first voyage from Siberia via the Northern Sea Route to Asia, while

transshipments of the project's cargoes in northwestern European ports are also on the rise.

The question remains whether a few cargoes being sent to Asia rather than unloaded in the oversupplied European market will relieve the glut. Record LNG deliveries flooded liquid northwestern European markets in March and April, and while the wave has since subsided, shipments remain strong.

"At a certain point the market should regulate itself, if you see some supply going to Asia, it should help rebalance," Heintz said. "Storages are so full that just a few cargoes less may not be enough to change the picture."