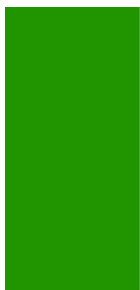


# Headache for ECB as populists take power in debt-laden Italy



EUROPEAN CENTRAL BANK

FRANKFURT AM MAIN (AFP) –

The arrival of an anti-austerity, populist government in Italy has revived concerns about the country's massive debt pile, underscoring the pitfalls ahead for the European Central Bank as it tries to wean the eurozone off its massive monetary support.

"It's the elephant in the room, because the problem was never resolved," said Pictet Wealth Management economist Frederik Ducrozet, noting that Italy was the only "highly indebted"

euro nation not to embark on a structural reforms programme.

After a political rollercoaster ride that sent markets into a spin this week, a coalition government between the far-right League party and the anti-establishment Five Star Movement is to be sworn in Friday.

While immediate fears that the eurosceptic parties could yank Italy out of the single currency have been calmed with their pick of a pro-euro economy minister, the drama in the eurozone's third largest economy is far from over.

Both parties came to power promising tax cuts and higher spending – in a country already saddled with 2.3 trillion euros (\$2.7 trillion) of debt and plagued by low growth.

At 132 percent of gross domestic product (GDP), Italy's debt burden is second only to bailed-out Greece, and more than double the European Union's 60-percent ceiling.

The near-collapse of the two populist parties' efforts to form a government and the prospect of snap elections sent Italian bond yields spiking in recent days, making it more expensive for the government to borrow money.

The bond market turbulence spread to Spain and Portugal, prompting the Frankfurter Allgemeine Zeitung to warn of "contagion danger" that could send Italy's debt woes spiralling out of control, dwarfing the Greek debt crises and posing a threat to the single currency in the long run.

That doomsday scenario appears to have been averted for now, and Italian yields fell on Friday as investors heaved a sigh of relief over the deal clinched in Rome – a welcome birthday present for the ECB on the day the Frankfurt institution celebrates its 20th anniversary.

– Balancing act –

The markets' anxiety about Italy comes at a sensitive time for the ECB, the eurozone's chief firefighter in a financial crisis.

After years of ultra-loose monetary policy aimed at bolstering growth and pushing up inflation to the bank's target of just under 2.0 percent, the ECB is inching towards turning off the easy money taps as the eurozone recovery has gathered strength.

Although it is still buying 30 billion euros in bonds each month, including Italian debt, it is widely expected to phase out the so-called "quantitative easing" programme this year, before raising its record-low interest rates in the second half of next year.

But the bank's slow-motion stimulus exit has been complicated by the euro area's shaky first-quarter growth figures, leaving observers to debate whether the region has hit a mere soft patch or if a downswing is in sight.

For now, most expect the ECB to stay on the sidelines of the Italian turmoil and continue carefully preparing markets for its stimulus wind-down at the next governing council meeting on June 14.

Already holding some 22 to 25 percent of Italian public debt, the independent ECB "doesn't want to and can't be perceived as aiding any specific country," said Ducrozet.

– 'No easy option' –

In the short-term, the Italian woes could paradoxically even boost the ECB's efforts by weakening the euro against the dollar. A weaker euro makes imports more expensive, driving up eurozone inflation.

Provisional inflation data released this week also seemed to support the ECB's plan to begin phasing out QE, with inflation

hitting 1.9 percent in the eurozone, 2.0 percent in France 2.2 percent in Germany – well past the ECB's target.

But as calls mount for the central bank to withdraw its crisis-era medicine, particularly in Germany, a return to higher interest rates will make it harder for heavily indebted nations like Italy and Spain to service their debt.

And if the populists in Rome stick to their spendthrift campaign pledges – including a universal basic income for Italy's poorest and rolling back pensions reforms – Italy's deficit could climb to between “five and seven percent” of GDP, according to analysts at M.M. Warburg bank, putting the country on “a collision course” with European partners.

The Warburg economists predicted that Italy may eventually need some kind of European aid or debt relief to prevent a full-blown crisis.

“There's no easy option if Italy needed help tomorrow,” said Pictet's Ducrozet. “And that's why the ECB will be very cautious about when to raise interest rates.”

by Coralie FEBVRE

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## **Russia to boost presence on global LNG market, helped by lower costs**



FILE PHOTO: Russian Deputy Energy Minister Pavel Sorokin speaks during an interview with Reuters in St. Petersburg, Russia May 26, 2018. REUTERS/Sergei Karpukhin/File Photo

- \* Russia plans to produce up to 120 mln T LNG per year by 2035
- \* To compete with Australia, U.S. on global LNG market

By Oksana Kobzeva and Olesya Astakhova

ST PETERSBURG, June 1 (Reuters) – Russia plans to raise its annual production of seaborne liquefied natural gas (LNG) to as much as 120 million tonnes by 2035 and take market share from Australia and the United States by capitalising on low costs, a deputy energy minister said.

In December, Russia's No.2 gas producer Novatek and its partners including France's Total launched the Yamal LNG plant in the Arctic, with capacity of 17.4 million tonnes per year seen reachable by the end of 2019.

The project highlights Russia's ability to produce LNG in

harsh climates and further strengthens its foothold in the global energy market.

“Russia may set a goal of producing 100-120 million tonnes (of LNG) per year by 2035,” Deputy Energy Minister Pavel Sorokin said in an interview.

“We understand this from our discussions with the companies about their potential, which they can add to their previously announced projects.”

Yamal LNG aims to help Russia double the country’s share of the global LNG market by 2020 from about 4 percent now. Qatar, aided by production costs that are among the world’s lowest, is the biggest LNG exporter with a 30 percent market share.

Novatek also plans to launch LNG production at the neighbouring Gydan peninsula.

Russia’s Gazprom, jointly with partners including Shell, launched the country’s first LNG plant in 2009 on the Pacific island of Sakhalin with a capacity of more than 10 million tonnes per year.

Yamal LNG has produced around 2 million tonnes since its launch in December.

So far, Russia has been the dominant player in pipeline gas supplies to Europe, with Gazprom supplying around a third of the continent’s needs.

Demand for seaborne LNG has taken off in recent years as it is cleaner than oil or coal, and can reach markets worldwide because it does not depend on pipeline networks. LNG is typically more expensive than pipeline gas, however.

Sorokin said he expects global LNG demand almost to double in the next 20 years to exceed 500 million tonnes per year.

U.S. export capacity has shot up from less than 2 million tonnes per year in 2015 to 18 million tonnes in 2017, and is

projected to top 77 million by 2022. That would see the United States leapfrog Australia to become the world's No. 2 exporter.

“What will trigger the rivalry are the additional volumes that the U.S. or Australia could supply,” Sorokin said, adding that Russian companies are highly competitive due to their low costs for production and transportation.

According to the Moscow-based Skolkovo think tank, average production and transportation costs at Yamal LNG for exports to Shanghai are seen at just above \$8 per million British thermal units (mBtu) by 2025.

That is roughly the same as the cost for LNG projects in Western Australia and less than the approximately \$9 for LNG exports from the southeastern United States.

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## **Big Utilities Back Proposed EU Deal with Gazprom**

## EU imports of Russian gas

Brussels wants to reduce reliance on Russian gas export monopoly Gazprom, which supplies around a third of the EU's gas. In 2011, it launched an antitrust probe into the Russian firm's abuse of market power in eastern Europe—markets with few alternatives to buying from Gazprom.

**IMPORTS OF RUSSIAN NATURAL GAS**  
as a percentage of total natural gas imports,  
2015 data.



Some big utilities in eastern Europe are backing a proposed EU antitrust settlement with Russian state gas exporter Gazprom, increasing the chances of a deal that is opposed by countries striving to loosen the Kremlin's grip over their energy sectors.

The provisional agreement, announced last month, would see Gazprom avoid a fine of up to 10% of its global turnover over EU charges it abused its dominant market position and overcharged clients in eight eastern European nations. In return the Kremlin's gas giant, which denies the charges, has offered concessions on contract terms and pricing to settle one of the EU's largest, longest-running antitrust cases.

However, the deal is subject to feedback from EU states and market players in the region and could still be amended or even abandoned.

Many of the countries involved – once in the orbit of Moscow and reliant on Gazprom for the bulk of their gas supplies – are disappointed at the EU's deal-making.

They believe Russia has been exploiting their dependence in a region where gas prices can make or break governments and want to see Gazprom punished, EU diplomats said.



“Russia uses the full arsenal of tools to deploy influence: military, economic, political and even cultural,” an EU diplomat said. “Is there a country that doesn’t want this case solved? Probably not...but there is a lot of anger.”

EU antitrust authorities say the case is not political and that the market response will take priority.

A settlement would smooth business ties with Russia, which supplies around a third of its gas, despite tensions over Ukraine and Syria.

The agreement has drawn a positive response from some big utilities and network operators which said it would allow them to strike better deals with Gazprom, increasing the likelihood the EU will accept the Russian company’s concessions.

Bowing to EU conditions, Gazprom’s offer would see it do away with contract terms that bar clients from exporting its gas to other countries and tie deals to investments in pipelines.

The company would also link its prices to benchmarks such as European gas market hub prices, rather than oil, and allow clients to renegotiate the prices every two years.

“It (the deal) is a very welcome step if it is made a reality,” the head of Latvia’s public utilities commission, Rolands Irklis, told Reuters. “It would give Latvia a direct access to the European markets even if (it) is not directly connected to the infrastructure,” he said.

Aigars Kalvitis, head of gas utility Latvijas Gaze, which is partly owned by Gazprom, said the settlement could help it negotiate more favourable terms for its long-term Russian gas contracts, which expire in 2030.

Slovakian gas utility SPP said Gazprom had already scrapped curbs on cross-border trade and shown more flexibility on pricing in recent years.

The pledges could further boost integration on gas markets, a spokesman said, leading to “higher energy security”. The EU member states where Gazprom has allegedly engaged in anti-competitive behaviour are Poland, Estonia, Latvia, Lithuania, Bulgaria, Hungary, Slovakia and the Czech Republic. The eight

governments and industry players have until May 4 to lodge objections to the proposal in the final chapter of a case which began with raids on offices in 10 countries in 2011.

A spokeswoman for the European Commission declined to comment ahead of the EU executive's final assessment, saying there "no formal deadline" for its decision.

Its complex, politically-charged investigation has played out against the backdrop of tense relations since the EU imposed sanctions on Russia over the annexation of Crimea in 2014 and the subsequent conflict in east Ukraine, as well as deep disagreements over the Syrian civil war.

Brussels officials have repeatedly said they want to reduce the EU's reliance on Russian gas.

Moscow argues the antitrust case is politically motivated – something denied by Brussels.

With a settlement, however, Russia would accept EU authority in applying competition law – something it has long balked at. If it fails to abide, the EU could still impose fines.

In the five years since the EU began its antitrust probe, Gazprom has shifted its strategy under pressure from increased competition from LNG imports, price arbitration cases brought by Western customers and more liquidity on Europe's energy markets.

It abandoned some of its most contentious practices and sold stakes in some gas pipelines in response to new EU energy rules.

Gazprom "is offering new trade tools, adapting and perfecting the contract model in accordance with our clients' needs," Elena Burmistrova, who heads its export arm, wrote in an industry publication earlier this year.

Some EU diplomats have questioned the Commission's decision to pursue a case against US tech giant Google that will likely lead to hefty fines while settling with Russia's gas exporter. Poland has threatened to take the European Commission to court if it settles on a deal that its state-run energy company

PGNiG called “far from enough”. PGNiG estimates it has been losing almost \$1bn per year from buying Russian gas at oil-linked prices but reselling it at hub-linked prices.

Others say the settlement is too little, too late – particularly in the Baltic states and Czech Republic, which have taken their own steps to break Gazprom’s supply monopoly. The Czech Republic, for example, has been buying Norwegian gas for several years.

“We have done the homework,” Czech energy security ambassador Vaclav Bartuska told Reuters. “You can only force your supplier to behave if he knows you have alternatives...fines and investigations can alleviate the situation for some time but are not a permanent solution.”

After Lithuania broke Gazprom’s supply monopoly by opening a Liquefied Natural Gas terminal in 2014, it won a 20% discount on Russian gas supplies.

Since 2015, it has been trading gas with Estonia and plans to include Latvia this year.

“Gazprom no longer has meaningful levers for influence in the Baltic states,” the head of its state-owned gas network operator Dalius Misiunas said.

Latvia, meanwhile, regards Gazprom’s settlement pledges as simply agreeing to abide by existing EU energy rules rather than making meaningful concessions, said Olga Bogdanova, head of energy at the economics ministry.

Despite the cautious optimism from bigger market players, traders and smaller clients said Gazprom’s concessions came with too many strings attached, such as restrictions on time, volume, location and fees for gas swapping.

“What kind of commitment is this, if I have to walk through fire to use them?” one executive in the Baltics said. “These commitments do not cost Gazprom anything...Gazprom should be punished.”

For Bulgaria, almost wholly dependent on buying Russian gas under a contract that runs until 2022, the stakes are high and

the clock's ticking.

A speedy deal is the priority for the EU's poorest nation.

The country's independent energy regulator said it hoped a settlement would allow to renegotiate contracts pegged to oil prices before next winter.

If not, it said hot water and heating bills would rise by up to 35%, squeezing households and industries.

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## Lebanon Starts Offshore Energy Exploration, Defying Israel





**Lebanon has started exploration of oil and gas at its offshore energy reserves in the Mediterranean waters disputed by the Israeli regime.**

Lebanon's Energy and Water Minister Cesar Abi Khalil said in a televised statement that the exploration project for the country's first oil and gas reserves began on Tuesday after Lebanese officials approved a plan submitted by a consortium of France's Total, Italy's Eni and Russia's Novatek.

Khalil expressed hope that Lebanon would launch the second phase of offshore licensing by the end of 2018 or early 2019.

The announcement came after months of tensions between Lebanon and Israel over the disputed energy reserves.

No immediate reaction has been observed on the part of Israeli officials.

In December 2017, the Lebanese government granted licenses to a consortium of three international companies to carry out exploratory drilling in Lebanon's Block 4 and Block 9 territorial waters and determine whether they contain oil and gas reserves.

Israel lashed out at the three international firms for making "a grave error" by accepting the offer. Israeli minister of military affairs Avigdor Lieberman warned that Lebanon would "pay the full price" should another war erupt between the two sides.

Lebanon, however, was quick to respond to the blatant threat, with Energy Minister Abi Khalil pledging that Beirut was going to push ahead with its exploration plans.

Lebanese President Michel Aoun also vowed to use all the diplomatic powers vested in him to resolve the dispute, saying the country had a right to "defend its sovereignty and territorial integrity by all means available."

The territorial dispute between Israel and Lebanon runs over 776 square kilometers (300 square miles) of waters claimed by both sides.

The underlying Levant basin of the Eastern Mediterranean has been proven to contain large natural gas reserves and maybe even crude oil.

Israel itself has long been developing a number of offshore gas deposits in the Mediterranean Sea, with the Tamar gas field, with proven reserves of 200 billion cubic meters, already producing gas, while the larger Leviathan field is expected to go online in the coming months.

A source close to Israeli Prime Minister Benjamin Netanyahu said in 2012 that Israel's natural gas reserves were worth around \$130 billion. A Businessweek estimate later that year put the reserves' value at \$240 billion.

Israel relies heavily on gas. According to estimates by the Israel Natural Gas Lines, the Israeli-occupied Palestinian territories consumed around 9.5 Billion Cubic Meters (BCM) in 2016. The number is expected to reach 10.1 BCM in 2018.