LNG traders line up for Asian hub

It might take at least a decade, but industry insiders believe Singapore is positioning itself to take the lead in the region's gas trade. But will the country be a physical trading location or a price-reference point? Damon Evans reports

Thinking big: Singapore has ambitious LNG plans

THE hype surrounding the plans for an Asian liquefied natural gas (LNG) trading hub remains wildly premature. But global traders are positioning themselves to take advantage of the potential opportunities.

It's hard not to feel overwhelmed by the rhetoric at any given gas conference in Asia, particularly in Singapore, where plans are afoot to win the race for an Asian gas trading hub.

However "Singapore may not straight away be a pricing hub, but many companies are shifting their business here, which creates opportunities, even if it's not a hub," Jonathan Westby, head of global LNG trading at BP, told CWC's Asia Pacific LNG summit.

Whether a hub will be created – the word often used to describe its arrival – as opposed to emerge, is an interesting debate in itself.

Still, it's not clear if the hype is about a price reference point or a physical trading location. Asia desperately needs both. As Singapore opens its doors to LNG flows, its aspirations to become Asia's trading hub – whatever that means – are starting to take shape.

Its 3.5 million tonne per year (t/y) LNG import terminal, opened earlier this year, will be expanded to handle 6 million t/y by the end of 2013. By 2017 it should have a processing capacity of 15 million t/y.

This far exceeds BG Group's unique aggregator deal that will see it supply up to 3 million t/y as part of its franchise. Of that, the UK-based gas player has already contracted 2.6 million t/y.

The Energy Market Authority is considering appointing a second aggregator to import up to 1.5 million t/y until 2017. After that, the exclusivity for both aggregators will cease, allowing multiple suppliers to compete for growth within Singapore.

Initially, the suppliers will be allowed to compete for short-term or spot cargoes into Singapore outside of their contractual supplies. BG is already doing this.

Singapore's model envisages up to four aggregators, but it will stick with two if they provide sufficient competition.

While the island nation will host the first terminal in Asia offering import, storage and reload options to traders, it's unlikely that a credible trading hub with ample liquidity will emerge in the region over the next 10 years.

While BG does not envisage a dramatic move into the commoditisation of LNG it will have a reasonable amount of flexibility built into its portfolio. By 2017, its LNG supply volumes will double to around 25 million t/y - 30% of those volumes are flexible.

Taking the lead

Given its role as Asia's leading oil trading hub, Singapore is keen to get a head start on aspiring marketplaces such as Shanghai, Tokyo or Hong Kong to establish Asia's first legitimate hub.

In China, which has launched two traded markets in an attempt to create a hub, there has been little interest from financial parties. The small amount of trade that has taken place is purely physical. Tight capital controls and the dominance of state-owned oil companies in both the upstream and downstream present major challenges.

Japan, the world's biggest LNG importer, has signalled that it is prepared to start a futures market, but it is far from developing a trading hub. While it imports huge volumes of LNG, the majority is tied up on long-term point-to-point deals. Limited third-party access to LNG import terminals limits competition too.

The International Energy Agency reckons the cards are stacked in Singapore's favour. With its more relaxed market approach and availability of financial services to cater to the natural gas trading industry. But Singapore is a small market

Reality bites Asian buyers

Damon Evans, SINGAPORE: Buyers of liquefied natural gas (LNG) in Asia are slowly waking up to the fact that new supplies from North America will not be cheap – and nor will they flood the market anytime soon.

Over the past two years, the debate among buyers in Asia has shifted from an assumption that access to North American gas is cheap to a realisation that it's a means of developing a portfolio of pricing exposure, Dr Anthony Barker, BG Group's general manager in Singapore, told *Petroleum Economist*.

"Rather than search for lower prices, it's now an informed approach to diversify exposure to particular indices, which we think is healthy," says Barker.

Buyers in Asia have been overwhelmed with projections for US exports based on relatively low Henry Hub gas prices. The latest numbers suggest potential exports of 300 million tonnes per year (t/y). But in reality only 18 million t/y is actually being built now.

Even if the market factors in the estimated 50 million to 60 million t/y predicted to be exported from the US by 2025, new projects in Canada and East Africa still need approval to help narrow the supply-demand gap, but they will not eliminate it, adds Barker.

Energy research firm Wood Mackenzie says high spot prices and tight LNG supplies could persist in Asia-Pacific beyond 2020. Producers, including BG, expect the market to remain tight until 2025. Beyond 2025, there is the possibility that the successful development of China shale will influence a major portion of the supply/demand balance. But while Barker does not expect to see large-scale Chinese shale-gas development before 2025, it still remains a wild card.

Roger Bounds, global head of LNG at Shell told the CWC Asia Pacific LNG summit that "to avoid a tight market we need more confidence in long-term pricing behavior to enable investment".

Another challenge is that buyers perceive the market will be over-supplied. The general consensus is that prices and supplies will ease around 2018 as new production comes online.

But the industry's track record at delivering projects on time is notoriously bad. And with the highly capital intensive nature of LNG developments, particularly those mooted in Canada and East Africa, a high degree of off-take needs to be committed before they can push forward.

"Ultimately it's the pace at which buyers contract that will dictate the flows coming in," says Barker.

However, policy and regulatory uncertainty in Japan and South Korea – the world's biggest importers of LNG – could delay buying decisions, says Wood Mackenzie.

With capital-intensive projects predominantly requiring oil-based pricing structures to proceed, BG expects oil indexation to prevail within the Asian market.

"And that's understood by the customer," adds Barker. Interestingly, traditional buyers are working their way further up the energy chain.

"We're pleased to see that appetite and are seeking more partnerships at an earlier stage, particularly for our pre-[final investment decision] North American and Tanzania projects, as well as potentially a third train in Australia," says Barker.

But Philip Olivier, president of GDF Suez LNG, cautioned delegates at the summit that as more buyers enter the upstream there would be greater pressure on their balance sheets, but not the deep liquidity in the markets if they were forced to sell..

– equivalent to 15 million t/y based on its net gas take" and does not have deep volumes nor the logistical flexibility to emerge as a successful pricing hub yet.

In theory, a reasonable-sized market could emerge, as the Southeast Asian island state is inter-connected to neighbouring Malaysia and Indonesia – both major LNG producers – by pipeline.

Subsidies

The challenge, though, is that both those nations subsidise gas consumption. Although subsidies are starting to be tackled as both countries have been forced to begin importing LNG to help meet domestic demand.

"If they were to achieve full liberalisation, presumably it would open up the ability to contemplate flows of LNG into Singapore, back out to Malaysia and Indonesia, and vice versa. This would generate a much deeper market that would lend itself to developing some of the financial instruments," Anthony Barker, BG Group's general manager in Singapore, told *Petroleum Economist*.

"Once you put the demand of Singapore, Malaysia and Indonesia together, coupled with a truly transparent pricing mechanism, as well as third-party access to pipelines, you reach a point where there is sufficient depth and liquidity for a pricing indicator to evolve," he added.

But the removal of pricing subsidies is a politically tricky process to unwind.

Both Indonesia and Malaysia are taking steps to peel back subsidies but it may take five to 10 years to bring gas prices up to market levels, Tony Regan, a gas specialist at Singapore-based consultancy Tri-Zen told *Petroleum Economist*.

"Before you can start thinking about the genuine criteria for an LNG hub, you need to ask how long will it take to deregulate cross-border trade in Asia," Roger Bounds, global head of LNG at Shell told the CWC Asia Pacific LNG summit.

But the prospects for gas market deregulation look slim. "Don't think we are really going to see open access or an end to supporting local champions, which hold monopoly positions. All Asian gas markets are regulated and whilst policy may be to encourage competition, new supply and market responsive pricing, I don't think we are going to see real deregulation in the near future," says Regan.

Certainly there is the political will in Asia to create a hub, but today there is not enough inter-connectivity, Philip Olivier, president of GDF Suez LNG said.

Nevertheless, Singapore has made a strategic investment to build an LNG terminal that has the spare capacity to promote regional trading activity.

"It has the beginnings of a regional business. Whether that eventually evolves into a trading hub and pricing index depends on a myriad of factors that are open to debate, but it's certainly a very important building block," says Barker.

Still, without a crystal ball it's hard to predict the future. Olivier likens the LNG market to a "rollercoaster" as supply hits the market in waves.

The next waves of LNG from Australia and the US will be washing up in Asia by 2017. By which time Singapore will be positioned to aggregate any excess into a rapidly expanding regional market – by 2020 the number of markets in Asia will likely double from six last year to 12. But they are unlikely to be homogenous and Singapore is betting the expanding number of buyers will have different needs and approaches towards procuring LNG.

Of course, it will take decades for a true trading hub to develop in Asia, just like it did in Europe, but if the rhetoric holds true Singapore seems primed to kick-start the regional trading game.