China rediscovers its appetite for LNG

Doubts over a Chinese shale-gas revolution have made the country a key market, Damon Evans reports

Back in the red: China is looking to LNG to increase energy reserves

CHINESE companies are rediscovering their appetite for liquefied natural gas (LNG) as import capacity surges. But it's not just the existing buyers that are upping their game, as new non-national oil companies emerge as potential contenders in the world's fastest-growing major LNG market.

But the coming year or two will probably mark the most active period for the Chinese market yet, Gavin Thompson, an Asian gas specialist at research firm Wood Mackenzie, said.

The trend is largely driven by two themes: the expectation of rising gas prices that support LNG demand; and smaller players' desire to control their own supplies rather than rely on third-party sources, particularly from the big national oil companies.

Perceived market tightness in the longer run as the rate of gas demand growth supersedes production is also a major factor. While the extreme levels of pollution across eastern China has accelerated the shift from coal to gas at a greater pace than most expected.

"Realistically, I don't think anyone is expecting a shale revolution in China by 2020, which has raised concerns over supplies and this is driving the attractiveness of LNG," said Thompson.

China is looking to increase gas supply from 4-5% to 8% of total energy demand by 2015 and 10% by 2020.

Ping Lee, president of BG Group in China, told *Petroleum Economist* that all types of gas development, including pipeline, LNG and shale, are needed to meet the nation's enormous gas ambitions.

As a result, China's major cities and fast-growing coastal regions will continue to rely on LNG for the foreseeable future.

But shale-gas development remains constrained by infrastructure and capacity limitations, which will take time to build.

"Taking into account the challenges facing shale production in China it looks unlikely to take off by 2020, but you might not want to bet against 2025," says Thompson.

Beijing has earmarked a shale-gas production target of 100 billion cubic metres (cm) by 2020, widely thought to be overly optimistic. But many industry observers believe that number could be hit by 2025.

In 2025, 100 billion cm of supply would roughly equal 16-20% of China's total gas demand – forecast at around 500 billion to 600 billion cm.

Still, most of China's shale resources do not lie near the energy-hungry coastal markets. And Wood Mackenzie's analysis shows that potential output from shale gas will not flood the eastern demand centres, a point that is often overlooked.

Indeed, the idea that rising shale-gas volumes could knock out LNG is realistic only if you have a fully liquid market like the US. But this is not the case in China.

Close to home

Consequently, Thompson expects much of the gas to be consumed close to where it will be produced, primarily because provincial governments do not take any revenue from production.

"If you have a shale boom in Sichuan province, other than job creation, there is not a huge amount of upside because the commodity – which is attractive as it's low-cost and clean – will leave your province".

Instead regional governments in provinces such as Sichuan, Chongqing and Guizhou are more likely to want to build industrial and power sectors around shale gas, rather than allowing production to be piped east to coastal markets.

Therefore provincial governments, such as Guangdong or Shanghai on the eastern seaboard, industrial off-takers, power generators, or city gas distributors, will probably feel more comfortable securing gas through the international market, rather than crossing their fingers that firstly shale-gas happens and secondly that they will be able to access it, adds Thompson.

As a result smaller players, such as independent distributors ENN, Guanghui and Jovo, as well as power companies such as Huadian, are voicing their interest in developing their own terminals and contracting LNG imports.

But the challenge for big LNG suppliers is figuring out which companies are credible and what sort of volumes they will be taking in 2020.

By the end of 2011, China had built six LNG import terminals. Three more terminals were commissioned in the final quarter 2013, bringing the tally to nine. The country's current regasification capacity of 35 million tonnes a year (t/y) is expected to reach 85 million t/y by 2020.

It is no surprise then that LNG imports were up significantly year-on-year. Singapore-based consultancy Tri-Zen estimates volumes rose around 20% to 17.5 million tonnes in 2013.

With the latest three terminals coming online towards the end of last year, it's fairly certain that Chinese demand shows no sign of slowing.

Tony Regan, a gas specialist at Tri-Zen, expects import volumes to double within the next five years with contracted demand already projected at around 50 million t/y by 2020. ●